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Dear Mr Yeowart and Ms Gilliland

### **Application for access to the West Coast Main Line (WCML)**

1. We have carefully considered your application for approval of a track access contract between Network Rail Infrastructure Limited (Network Rail) and Great North Western Railway Company Limited (GNWR). This was submitted to us under section 18 of the Railways Act 1993 (the Act) in May 2015. ORR has decided to approve the application. This letter explains the reasons for our decision.

2. We will now work up the detailed access contract that we will direct Network Rail to enter into. This will be in line with the draft contract submitted with the application. However, we will include additional requirements relating to the investments GNWR will make (that justify the 10-year contract duration), calling pattern requirements and rolling stock commitments, including the time by which the rolling stock must be secured and the services introduced. We will discuss the drafting of these terms with you.

### **Background**

3. The application is for firm rights for 6 Monday to Saturday (5 on a Sunday) off-peak return services between Queen's Park in London and Blackpool North with contingent rights between Queen's Park and London Euston. Although it is GNWR's intention to run into and out of Euston, and it believes this will be achievable in practice, Network Rail is not prepared to sell new firm rights now due to uncertainty around capacity available at the station during HS2 works.

4. The calling pattern includes firm rights to call at Crewe, Preston and Poulton-le-Fylde with contingent rights to call at Milton Keynes, Nuneaton, Tamworth, Lichfield Trent



Valley and Kirkham & Wesham. The different rights reflect the conclusions of earlier work by Network Rail; GNWR intends to call at each of these stations.

5. The application is for rights starting during the December 2017 timetable year for 10 years. Since submitting the application GNWR has told us that, realistically, it is likely their services would not be able to start until early 2018 due to the length of time it will take to procure and ready the rolling stock. GNWR proposes to use 4 new six-car Pendolinos, built for GNWR. Each Pendolino will hold around 330 passengers, and GNWR will offer both standard and first-class seating with a range of tickets.

6. The proposal will increase direct services between London and Blackpool from the current 1 to 6 or 7 each way per day and will create new direct services between London and Poulton-le-Fylde and Kirkham & Wesham. There will be an increase in direct travel options from some other stations and some journey times will be improved including London to Tamworth and Lichfield Trent Valley.

7. In December 2014 we rejected a previous application from GNWR to access the WCML. Our reasons included uncertainty around capacity constraints (especially at the South end of the WCML and in Euston during HS2 works), performance impacts and the interaction with the Northern Hub enhancements. We also considered the absolute impact on the funds available to the Secretary of State.

8. This application is for half the number of services in the previous application and it focuses on providing a regular off-peak service between Blackpool and London only. The services now proposed broadly replicate the Blackpool rights sought in GNWR's last application but with the addition of calls at Kirkham & Wesham (which does not currently have a direct London service) and the removal of calls at Warrington that would likely be very abstractive of revenue from current operators.

9. Overall, we are satisfied this application deals with those earlier concerns.

### **ORR's role and approach**

10. Under the Act we have an approval function in relation to track access contracts between Network Rail and train operators and amendments to them. If Network Rail and a train operator reach agreement, they jointly submit the proposed contract for our approval, under section 18 of the Act.

11. When we consider track access applications we do so in the manner we consider best calculated to achieve our statutory duties, which are set out mainly in section 4 of the Act. The weight we place on each duty is a matter for us depending on the

circumstances of each case. Where the duties point in different directions, we balance them against each other to help us reach a decision.

12. Although our duties are wide ranging, our experience generally is that a subset tend to be especially relevant to access decisions with the others not pointing strongly one way or the other. In this case we considered all our duties; these were the most relevant:

- promote improvements in railway service performance;
- protect the interests of users of railway services;
- promote the use of the network for passengers and goods;
- promote competition for the benefit of rail users;
- have regard to the funds available to the Secretary of State [for Transport] for the purposes of his functions in relation to railways and railway services;
- have regard to any general guidance given to ORR by the Secretary of State about railway services or other matters relating to railways;
- have regard to the interests in securing value for money of various stakeholders; and
- enable operators to plan their businesses with a reasonable degree of assurance.

13. ORR is supportive in principle of open access, by which we mean passenger services provided outside of a franchise or concession. This reflects our duty to promote competition for the benefit of rail users and our recognition that competition can make a significant contribution to innovation in terms of the routes served, ticketing practices and service quality improvements, by both the new operator and through the competitive response of existing operators.

14. But we must also consider our other duties when making access decisions. These include duties to have regard to the funds available to the Secretary of State in relation to railways and to protect the interests of users of railway services, both passengers and freight customers. These require us to consider the impact of new open access services not just on the passengers benefitting directly from those services but all users of railway services.

15. With those issues in mind, our approach is to test whether new services such as these would be “not primarily abstractive” (NPA) as explained in our published criteria and

procedures for the approval of track access contracts. In essence, the NPA test aims to limit cherry-picking and help us balance our duties, in particular those to promote competition for the benefit of users and to have regard to the funds available to the Secretary of State. The extent to which we value the potential benefits competition can bring is reflected in the threshold for the test that we expect new services to reach – we would not expect to approve applications that did not generate at least 30p of new revenue for every £1 abstracted from existing operators (i.e. achieve a ratio of 0.3).

16. In addition to the NPA test, our criteria and procedures explain the range of other issues we expect to look at, including capacity and performance. We also consider the absolute impact on the funds available to the Secretary of State. We discuss these later.

### **Industry consultation and engagement with GNWR**

17. In advance of submitting the application to ORR, and in line with our criteria and procedures, Network Rail carried out an industry consultation in April 2015. Several train operators and other stakeholders responded.

18. Virgin Trains West Coast (VTWC) felt there was insufficient evidence to assess the impact of these services, and raised concerns on both capacity and performance grounds.

19. London Midland objected to the new service, questioning whether it would pass the NPA test and its impact on future franchises, and raising performance concerns.

20. DB Schenker felt it had insufficient information to assess the impacts with any degree of certainty, and raised concerns over future capacity for freight on the route. Freightliner raised similar capacity concerns.

21. The Department for Transport (DfT) welcomed in principle the benefits such as wider competition that open access services can provide. But it had concerns about the potential implications of this particular application for the funds available to the Secretary of State.

22. Network Rail responded to all these issues in May 2015, stating its belief that the proposed services could be accommodated if more efficient use were made of existing capacity, not least through a reworking of the timetable.

23. VTWC repeated some of its original concerns plus others relating to fair treatment and rolling stock clearance processes in a letter to Network Rail on 20 July 2015. The Secretary of State sent a further letter to ORR on 16 July 2015 noting the UK's financial position and that the Government does not at this stage support any increase in open access competition (without changes in the approach to access charging).

Both flagged worries around the potential impact of Alliance's proposed services on capacity at Euston during and after HS2 upgrade works. We were able to take full account of the issues raised in both letters. Most of these are dealt with below, and we have also written separately to the Secretary of State on the wider points he raised.

24. Transport Focus was broadly supportive of the application, provided there was no significant disbenefit to existing passengers.

25. The concerns raised by consultees generally related to the availability of capacity, the effect on performance and the impact on the funds available to the Secretary of State.

26. In addition to industry consultation, when reviewing an application we may hold discussions with the parties, seeking and clarifying the information we need to make our final decision. In this case we have engaged fully with GNWR and its consultants throughout the course of this application including meetings on 13 April and 13 July 2015.

27. At these meetings we explained our emerging conclusions on the NPA test and gave GNWR the opportunity to challenge the results and provide additional information in support of its application. GNWR took this opportunity and provided further detailed submissions to us. In reaching our decision we considered all the material provided by GNWR (and indeed other stakeholders including the July letters from VTWC and the Secretary of State).

28. The remainder of this decision is structured in six sections: the NPA test, other issues potentially affecting our modelling; capacity and performance issues (including project dependencies); the impact on the funds available to the Secretary of State, contract duration and conclusions.

## **The NPA test**

### *MOIRA Analysis*

29. The NPA test looks at the impacts of new services in terms of revenue generated and revenue abstracted from other existing services. To estimate revenue generation and abstraction, we need to make assumptions about the services' timetable, even though the approval will not be for a specific timetable. We analysed the application using an indicative timetable submitted by GNWR on 26 June 2015.

30. Although GNWR applied for firm rights to operate services to/from Queen's Park, its application also included contingent rights to operate to/from London Euston, its preferred destination. GNWR propose to terminate services at Queen's Park if capacity is constrained at Euston due to HS2 enabling works. Demand for such services would be

very difficult to model, for example due to passenger interaction with the London Underground and changing travel patterns. Therefore, for the purpose of the NPA test we modelled services to and from London Euston. We discussed this approach with GNWR who agreed this was appropriate.

31. We used the industry standard software MOIRA to calculate an initial forecast of the impact of GNWR’s new services, modelling its proposals against the May 2015 timetable. Based on changes in generalised journey times only, this forecast an NPA ratio of 0.295.

**Initial Demand Forecasting Results using MOIRA (2014-15 demand and prices)**

<b>GNWR revenue as forecast using MOIRA</b>			
<b>Total</b>	<b>Generated</b>	<b>Abstracted</b>	<b>Generation / abstraction ratio</b>
£27.88m	£6.32m	£21.56m	0.295

32. We then considered if there were other factors not adequately reflected in the MOIRA modelling that could affect the generation / abstraction ratio.

33. MOIRA does not take account of differential fares, service quality differentials or marketing. However, consistent with our analytical approach to GNWR’s previous application, our view is that these would affect revenue in absolute terms but they would not in this case materially affect the NPA ratio.

34. We took account of analysis by GNWR’s consultants AECOM. Their initial results were similar to ours.

35. AECOM undertook further analysis adjusting its initial forecast using two different modelling approaches to forecast a revenue generation / abstraction ratio in the range 0.31 - 0.57.

36. Both approaches used sought to take account of MOIRA’s tendency to under estimate demand where stations gain new direct services to/from London, i.e. where the new services are thought to deliver a transformational change in service levels resulting in greater revenue generation. This impact has been observed at some stations where open access operators have introduced new services.

37. The first approach using a station choice model gave an NPA ratio in the range 0.31 - 0.36. Passengers may change their choice of station in response to a new direct rail service (“rail heading”). This can have both abstractive and generative impacts. Abstraction occurs when existing passengers switch stations to use the new service.

There is generation associated with this abstraction, for example people travelling more frequently as a result of being able to use a more convenient station. In addition, a lack of available station car parking can suppress demand for rail at a station and so when demand is abstracted due to switching, the released car park capacity will allow some passengers previously dissuaded from travelling by rail to do so, increasing the level of generation. We reviewed AECOM's approach and found it to be sensible; analysis of station choice gives us greater confidence that the NPA ratio is above 0.3.

38. AECOM also used a gravity model as an alternative to its station choice model. It based this on the gravity model recently developed by our consultants CH2M Hill for its economic assessment of ECML access applications we are currently considering.

39. For the ECML, CH2M Hill developed a gravity model by estimating for stations on or near the ECML the total annual journeys made to particular destinations (notably London) as a function of characteristics that influence the level of demand including level of service provision (e.g. catchment population, wages, and a composite measure of service attributes). AECOM applied the parameters derived by CH2M Hill to estimate the level of suppressed demand that could be released by the introduction of new services. Under this approach, AECOM forecast a higher revenue generation / abstraction ratio in the range 0.55 - 0.57.

40. We recognise a gravity model is a potentially useful approach in some contexts for estimating levels of suppressed demand that are not reflected in MOIRA-based estimates. AECOM appears to have applied the CH2M Hill gravity model correctly, but we have not been able to verify whether its application avoids the potential weakness of the gravity model to double-count population catchments and thereby overstate generation. Further, AECOM used parameters derived for stations on or close to the ECML, spanning a much wider range of service offers than are relevant here. We therefore consider that there is a significant risk that this methodology overstates the likely NPA ratio.

### *Benchmarking*

41. AECOM's analysis includes further adjustment to its forecast NPA ratio to take account of evidence from historical open access about actual levels of demand. This was based on analysis carried out by AECOM for Arriva Trains. AECOM argued this is required because it considers there has been significant under-estimation of generation, particularly involving London markets in previous open access cases that led to an under-estimation of the NPA ratio. Its adjustment for this apparent under generation increased its forecast NPA ratio to 0.38 (based on the station choice modelling approach; AECOM did not adjust its gravity model forecast on this basis).

42. We take account of readily available benchmarking and survey information from any comparable situations elsewhere on the network in order to refine our earlier results.

43. We recognise that for some stations the growth in actual demand has been significantly higher than forecast at the time of application. However, our analysis to date of stations exhibiting substantial growth has found those stations have offered both new direct London services and significant savings in journey times, for example more than ~10%. Though the services in this application offer journey time improvements in excess of 10% from Lichfield and Tamworth, these stations already have direct off-peak services. For stations where the application would result in a new direct service, the journey time offered by the new service would be similar to, or slower than, that of existing indirect services. Therefore we do not consider the evidence to be applicable in this context and have made no further benchmarking adjustment to our forecast of the NPA ratio.

44. Our conclusion, based on our own assessment and that of AECOM/GNWR is that the revenue generation / abstraction ratio for this application is in the range 0.295 - 0.57. Noting the significant risk that AECOM's application of the gravity model overstates revenue generation, we consider the central estimate to be close to but above 0.3; our judgement is that the application passes the NPA test.

45. In conducting the NPA test we were conscious that GNWR and Network Rail would have flexibility to change the timetable within the scope of the access rights granted, for example with respect to stopping at certain stations, and that these changes could materially affect the levels of generation and abstraction.

46. The NPA test result is indeed sensitive to calls at Kirkham & Wesham and Poulton-le-Fylde. Therefore to secure the key passenger benefits from serving these stops, we will make including these calls in any access proposal in the timetabling process a requirement in GNWR's access contract.

#### **Other issues potentially affecting the NPA test**

47. We considered if there were any further aspects of this application that were relevant to our duties and which should affect the way we calculated the NPA ratio or interpreted the results. For example:

- (a) GNWR argued that experience shows open access stimulates growth in the market, benefiting franchisees and offsetting any passenger revenues lost initially to abstraction. However, we consider that this is already taken into account in the threshold that we apply for the NPA test.

- (b) DfT's view was that the abstraction effects of the GNWR services will feed through to the Secretary of State's budget, by way of increased franchise subsidies and/or reduced franchise premia. We agree the GNWR services could reduce future revenue generated by franchised services. However, this impact is already included in the NPA analysis.
- (c) GNWR pointed to additional benefits arising from the particular 'offer' it was planning for its services. These included factors already captured in the MOIRA modelling but also other benefits to passengers and prospective passengers. For example, greater choice of destinations and a different service quality offering. However, we judged these benefits to be largely incremental improvements on the incumbents' offer and incumbents might continue to offer aspects of service that are different and potentially 'better' than GNWR (e.g. a First Class lounge at Euston).

## **Capacity and performance**

### *Operational viability*

48. We expect applicants to show they are willing and able to use the access rights applied for. We consider whether proposals are operationally viable and if they are supported by a plausible business plan. We consider this application meets these requirements. We cover the issues of contractualising the use of the rights elsewhere.

### *Capacity and performance*

49. In 2012 we asked Network Rail to report on capacity and performance options on the WCML, taking account of upgrade works in the Watford and Stafford/Norton Bridge areas. In October 2013 it concluded there was no spare capacity on the WCML for extra peak services, but up to 3 extra paths an hour could be fitted in, off-peak. However, Network Rail was only prepared to allocate one of the three theoretical hourly paths due to the likely negative performance impact on existing WCML services of allocating any more.

50. Uncertainty around the capacity at Euston during the planned HS2 rebuild was an additional concern.

51. This application would use up to one off-peak path an hour on the WCML and on that basis Network Rail has agreed the application. In addition, it seeks firm rights to Queen's Park rather than Euston, avoiding the short-term HS2 Euston rebuild uncertainty, albeit that GNWR's intention is to operate services from Euston before and after this period of disruption. There are some operational details to be finalised around Queen's Park working and timetabling around current freight services, but Network Rail is confident these can be resolved.

52. On 20 July VTWC wrote to Network Rail repeating some of its original concerns around the application and raising others relating to fair treatment and rolling stock clearance processes. Although this letter arrived very late in the process, we nevertheless were able to discuss the key points made with Network Rail and form a view.

53. In summary:

- (a) VTWC was concerned capacity on the route was unclear. However, Network Rail is clear about the dependency on key projects, discussed below, and stands by its 2013 analysis. There is uncertainty around the HS2 works at Euston and the potential impact of GNWR services, wherever they terminate. But we agree with Network Rail it is for it as system operator to lead development of workable plans for Euston. It is doing this with the involvement of all stakeholders and, at this stage, is aiming to develop plans accommodating both current services and GNWR and others' aspirations. Although it is GNWR's intention to run into and out of Euston, and it believes this will be achievable in practice, Network Rail is not prepared to sell new firm rights now due to uncertainty around capacity available at the station during HS2 works. In deciding to support the application Network Rail has already satisfied itself that a Queen's Park turnaround, if necessary, is feasible in principle; and Network Rail still supports the application.
- (b) VTWC said no dates had been set for an Event Steering Group that will be needed to recast the WCML timetable and to optimise it in light of new GNWR services. Network Rail told us there is time to run any ESG process necessary before GNWR services started in 2018; it will make the necessary arrangements.
- (c) VTWC was concerned GNWR's new rolling stock could not be procured and tested in time for its planned start date. GNWR is confident that it will be. Regardless, we note the planned services will not be able to run without appropriate clearances.
- (d) VTWC thought Network Rail had been inconsistent in its analysis of performance impacts for the GNWR proposal and its own June 2014 proposal to run extra trains between Blackpool and London. VTWC also argued for greater certainty new services will not undermine a railway already facing performance challenges. Network Rail told us it rejected the suggestion it had been inconsistent. It said there were good reasons why it thought the performance impact of the GNWR services would be less severe, including flexibility around the timing of the proposed services. On the wider issue, we agree Network Rail has good reasons to think the performance impact from GNWR trains is likely to be small and manageable. In particular, the rolling stock proposed by GNWR is new, tilting 125mph capable trains with similar or better traction characteristics to those using the route today.

54. Network Rail highlighted, in the previous GNWR application, performance and capacity problems connected to current Trans Pennine services that an additional hourly train might exacerbate. This current application does not concern the Trans Pennine route.

55. Overall, our judgement is the application is acceptable on capacity and performance grounds, provided the rolling stock used has the traction characteristics necessary to deliver the proposed services without compromising others' performance on the route. We are also keen to minimise the risk that capacity is reserved by access rights which will not subsequently be used.

56. We will include conditions requiring appropriate rolling stock to be secured and the services introduced by specified dates. If these are not met, the access rights will lapse. We will discuss the drafting of these terms with you.

#### *Project Dependencies*

57. GNWR's proposed services will benefit from the completion of the Stafford Area Improvements Project (Norton Bridge). They are also dependent on the completion of the Blackpool-Preston electrification project.

58. The Norton Bridge works (which will provide extra capacity on the WCML) have a completion date of August 2017 and the overall Regulated Milestone for GRIP 6 completion is December 2017. The project is currently reported to be on schedule.

59. From our own monitoring of Network Rail projects, there is some risk to the completion date for the Blackpool-Preston electrification project (currently February 2017). The project is also subject to the on-going Network Rail review of project deliverability.

60. Since submitting the application GNWR has told us that, realistically, it is likely their services would not be able to start until early 2018 anyway due to the length of time it will take to procure and ready the rolling stock.

#### **The funds available to the Secretary of State**

61. One of our statutory duties is to have regard to the funds available to the Secretary of State for the purpose of his functions in relation to railways and railway services. The NPA test with its threshold ratio for the entire service of 0.3 : 1 is intended to help balance our duties, particularly those to promote competition for the benefit of passengers and to have regard to the funds available to the Secretary of State.

62. Therefore we need to distinguish between arguments that are already incorporated into the NPA calculation (such as the need to consider the potential impact on future

franchise revenues) and any additional arguments. The additional arguments we considered most relevant in this case are discussed below.

63. The NPA test looks at revenue generation relative to abstraction, and gives no additional weight to levels of abstraction that are large in absolute terms. We considered this issue given our statutory duty to have regard to the funds available to the Secretary of State.

64. We estimate the proposed GNWR services could abstract around £22m p.a. (2014-15 demand and prices) from the current services of other operators, based on operating to and from Euston. GNWR's own equivalent figures were £26.9 - 29.2m and the DfT's estimate was in the range £7.7 – 23.5m p.a. depending on whether GNWR services were to and from Queen's Park or Euston (we agree the abstraction is likely to be lower in the event services run to Queen's Park). GNWR's forecasts were based on comparison with 2013-14 demand and prices. DfT's forecasts were based on 2018-19 demand and prices. DfT also said its Queen's Park estimate of abstraction was likely to be too low.

65. Potential revenue abstraction of £20 - 25m p.a. is higher than for any previous open access application we have approved, which have typically been in the range of £6 - 8m p.a. (2014-15 prices). This application represents a step-change in the level of rights sought in a single application, which explains the higher numbers. The largest single open access application we have approved previously has been for 3 return services per day, whereas this application is for 6 return services per day. In total, we estimate the abstraction from GNWR's services would likely be less than the total cumulative abstraction from all open access services we have approved to date on the ECML. Moreover, both the revenue abstracted and the number of new services would be smaller as a proportion of franchise revenues and services than was the case on the ECML.

66. The WCML franchise is currently managed by VTWC as a Direct Award. The franchise is to be re-tendered in 2016 to start in 2017 and the London Midland franchise is due to be retendered on similar timescales. To aid transparency and minimise uncertainty surrounding GNWR's start-up processes, we will make the access contract conditional on the timely procurement of rolling stock and require the new services to be introduced by an appropriate longstop date (failing which access rights would lapse).

### **Contract Duration**

67. GNWR applied for a 10-year access contract. Under EU rules, contracts longer than 5 years must be justified by the existence of commercial contracts, specialised investments or risks. We are satisfied a 10-year duration is justified here, given the proposed investment in new rolling stock and GNWR's commitment to invest £1.5m in

station works to support its new services. We will link the contract duration to these investments being made.

## Conclusions

68. The proposed new GNWR services will bring significant passenger benefits in terms of competition, more direct London – Blackpool services, new journey opportunities including new direct services to and from Poulton-le-Fylde and Kirkham & Wesham, some improved journey times, and substantial investments in rolling stock and stations.

69. We will not normally approve an open access application that does not pass the NPA test which is our main analytical tool for helping us balance some of the duties we have found especially relevant in these decisions. Our assessment is that the revenue generation / abstraction ratio of this application is in the range 0.295 - 0.57 with the central estimate close to but above 0.3. We therefore consider the application passes our NPA test.

70. The NPA test is sensitive to stopping patterns. Therefore to secure the key passenger benefits from serving Poulton-le-Fylde and Kirkham & Wesham, we will make including these calls in any access proposal in the timetabling process a requirement in GNWR's access contract.

71. We are satisfied GNWR's proposals are viable and that capacity exists for the services. We are keen to minimise the risk that capacity is reserved by access rights which will not subsequently be used so we will include conditions in GNWR's access contract requiring rolling stock to be secured and the services introduced by specified dates. If these are not met, the access rights will lapse. We will discuss the drafting of these terms with you.

72. We agree with Network Rail the performance risks posed by the new services for existing passengers should be small and manageable, partly because of the traction characteristics of the rolling stock GNWR will use. We will make appropriate rolling stock a contractual requirement to help mitigate any performance risk.

73. We have considered carefully whether there are any issues affecting the funds available to the Secretary of State that are not already included in the NPA test.

74. The level of abstraction will be affected by whether services run to Queen's Park or Euston, which we cannot know for certain at this stage. The DfT estimated abstraction to be £7.7m p.a. at Queen's Park (although it considers this is likely to be an underestimate), while our central estimate (based on services to Euston) is £22m p.a. with a range of £20 - 25m p.a. We took account of how potential abstraction in this range from current

operators is higher in absolute terms than for previous applications. We noted this was likely to be less than the cumulative impact of open access services previously approved on the ECML, and that the impact on the most affected operators would be proportionately less than it was on the ECML.

75. The contractual conditions mentioned in paragraphs 70, 71 and 72 will also aid transparency and minimise uncertainty surrounding the interaction between GNWR's start up processes and overlapping refranchising of VTWC and London Midland.

76. Overall, our judgement is the significant passenger benefits in terms of competition, new journey opportunities, some improved journey times, and substantial investments in rolling stock and stations outweighs the potential abstraction and the effect this will have on the funds available to the Secretary of State.

77. Having considered this application fully and balanced all our duties as we are required to do, we have decided to approve the application but with the additional contractual requirements outlined.

78. A copy of this letter will be placed on our website.

Yours sincerely

A handwritten signature in black ink, appearing to read 'John Larkinson', written in a cursive style.

**John Larkinson**