

John Larkinson
Director of railway markets and economics

13th November 2017



Mark Garner
Customer Manager
Network Rail Infrastructure Limited
George Stephenson House
Toft Green
York
YO1 6JT

Jonathan Cooper
Head of Contracts
Alliance Rail Holdings
88 The Mount
York
YO24 1AR

Dear Mark and Jonathan,

Sixth supplemental agreement to your track access contract

1. The Office of Rail and Road (ORR) has today rejected the sixth supplemental agreement to the track access contract between Network Rail Infrastructure Limited (Network Rail) and Grand Central Railway Company Limited (Grand Central), submitted to us formally on 9 September 2016 under section 22A of the Railways Act 1993 (the Act). The purpose of this letter is to set out the reasons for our decision.

Purpose of the application

2. Grand Central applied for access rights necessary to operate an additional early morning Wakefield Kirkgate to London King's Cross service and an additional late evening London King's Cross to Wakefield Kirkgate service. The proposal included allowing these services, and two existing Grand Central services, to call at Peterborough.

Industry Consultation

3. Network Rail consulted the industry about these services on behalf of Grand Central in the usual way in August 2016.

4. Minor comments were received from Abellio Greater Anglia, West Yorkshire Combined Authority, DB Regio Tyne & Wear Limited and Transport Focus, to which Grand Central responded.



5. The proposal was opposed by Virgin Trains East Coast (VTEC). VTEC considered the services would be 'primarily abstractive' from existing VTEC services. Further, VTEC considered that no additional rights should be approved on the ECML beyond May 2019, until there is greater certainty around the delivery of ECML Connectivity Fund schemes and that VTEC's contingent rights beyond May 2019 could be honoured.

6. The Department for Transport (DfT) also opposed the proposal. DfT noted that passengers on the route, particularly between Peterborough and London, already benefit from competition between VTEC and Govia Thameslink Railway (GTR). DfT's view, based on its own modelling, was the services would be highly abstractive and would not pass our 'not primarily abstractive' (NPA) test. Further, DfT noted that the services would use 5-coach rolling stock and would provide less capacity per train than (GTR) services, and could cause performance issues on the route.

Statutory Consultation

7. As required by the Act, on 12 September 2016, we sought Network Rail's representations on the application. It replied on 10 October 2016 saying it could not support the application as it had not satisfied itself there was capacity available on the route to accommodate the rights at an acceptable level of performance. On 13 October 2016 we asked Network Rail to explain what it had done so far in terms of capacity and performance analysis, what it still had to do, and when it planned to reach a conclusion. Network Rail responded on 28 October explaining the analysis it had undertaken up to that point, and what work it still had to do. We further pressed Network Rail for its conclusions on 17 November 2016 and 24 January 2017.

8. On 21 February 2017 Network Rail informed us that it had resolved its operational and safety concerns and it was content to agree to the rights requested from the Principal Change Date (PCD) 2017 but only until the Subsidiary Change Date (SCD) 2018; Network Rail advised that it was still considering its approach to selling additional access rights on the ECML to any operator beyond SCD 2018 and it would provide a statement on this as soon as possible.

ORR's review

9. We reviewed the application following the statutory consultation and concluded that we had no operational or performance concerns with the proposals. We were satisfied the capacity existed to operate the proposed services, at least in the short-term.

The NPA test

10. Where new proposed services would compete with another operator's existing services we conduct our NPA test. In the test we evaluate the impact of the proposed services in terms of new revenue they are likely to generate and revenue they are likely to abstract from other operators' services. We have a long-standing policy of not approving new open access services that we consider would be primarily abstractive of an incumbent's revenue. In practice, this means we will not normally approve new services with a generation/abstraction ratio of less than 0.3 : 1 (i.e. that do not generate at least

30p of new revenue for every £1 abstracted from incumbents). The threshold is set at a relatively low level which reflects the value we place on the benefits competition can bring.

MOIRA Analysis¹

11. On 11 October 2016 Grand Central submitted demand forecasting analysis carried out by its consultants AECOM. Its analysis included modelling based on timetable changes and the impact of Grand Central offering lower fares. It forecast the new services would achieve a generation/abstraction ratio of 0.48 : 1.

12. To estimate revenue generation and abstraction, we need to make assumptions about the timetable, even though the approval will not be for a specific timetable. We analysed the application using an indicative timetable submitted by Grand Central on 3 March 2017.

13. Our own analysis based on timetable impacts forecast a generation/abstraction ratio of 0.23 : 1. We also made an initial assessment of the impact of Grand Central offering lower fares but our analysis suggested this would still not be sufficiently generative to pass the NPA test.

14. We reviewed AECOM's forecast and noted a number of errors in how it applied its fares overlay which modelled the impact of Grand Central offering lower fares. These concerned the use of incorrect market segmentation and some computational errors. We discussed our findings with Grand Central who acknowledged these issues which it said it would consider further.

15. On 5 May 2017 Grand Central submitted a revised forecast which showed an initial generation/abstraction ratio of 0.27:1. Although Grand Central accepted that this alone would not pass the NPA test, it argued that we should take account of the impact of forthcoming additional VTEC services on its future revenues. Grand Central argued that the forecast level of abstraction in future years should be reduced by the forecast level of revenue that VTEC's additional services would 'win back' from Grand Central (what it referred to as 'negative abstraction'). Based on this construction, Grand Central argued that its generation/abstraction ratio would increase to 0.36 : 1 once the additional VTEC services started.

16. We carefully considered this argument and discussed it and our concerns with Grand Central at a meeting on 29 June 2017. On 3 July 2017 we confirmed to Grand Central we were not persuaded to adopt this approach. We considered that using this methodology would be a significant departure from our established procedure which would amount to a change in policy. This would require much further thought and most likely consultation with the industry. We were also concerned about the wider effects and potentially unforeseen consequences of using this approach which could potentially

¹ MOIRA is a software tool that models the impact of timetable changes on both the overall rail market and individual train operating companies.

disadvantage future open access applications. Grand Central said it would consider the points we raised.

Benchmarking

17. On 15 August 2017 Grand Central wrote to us suggesting that additional benchmarking evidence should be taken into account to address MOIRA's tendency to underestimate generation, as in previous applications involving incremental service level increases. Grand Central submitted additional analysis carried out by AECOM benchmarking the revenue impact on Doncaster to London and Wakefield to London flows since the introduction of Grand Central's 4th West Riding service. Based on this benchmarking analysis Grand Central presented a revised generation/abstraction ratio of between 0.40 to 1.04 : 1 suggesting that Grand Central's services would pass the NPA test.

18. We carefully considered this analysis but decided that further adjustment to our generation/abstraction forecast was not justified in this case. Benchmarking has been an important element in previous applications due to MOIRA's historical tendency to underestimate generation from significant changes to services, such as the introduction of wholly new services. However, an update to the model parameters now means that the latest version of MOIRA (PDFH5.1) more accurately models generation. In this case this has resulted in a much higher ratio being calculated at stage 1 of the NPA test, 0.23 : 1 versus 0.14 : 1 if the old MOIRA parameters had been used. Nevertheless, in assessing this application, we considered whether a benchmarking adjustment would be justified.

19. We recognise that at some stations the growth in actual demand has been significantly higher than forecast at the time of application. However, our analysis has shown this has been at stations which have offered both new direct London services and significant savings in journey times, for example more than ~10%.

20. Neither Wakefield nor Doncaster are poorly served stations with both having a high level of direct services to/from London. Doncaster has around 66 trains per day (~5 per hour) in each direction, with an average journey time of around 1 hr 40 min. Wakefield has around 36 trains per day (the majority from Wakefield Westgate served by VTEC with an average journey time of ~2 hr 5 min) and Grand Central's four daily services to/from Wakefield Kirkgate, with an average journey time of ~2hr 30 min. These stations are only 1.2 miles apart and easily inter-changeable for passengers. Wakefield Westgate is the more central of the two stations.

21. The journey times of the new services offered by Grand Central at these stations would be similar to, or slower than, those of existing direct services on these flows so are unlikely to deliver the levels of generation achieved by previous incremental service changes. Therefore, we do not consider benchmarking to be applicable in this context and have made no further adjustment to our forecast of the NPA ratio.

22. Our conclusion, based on our own assessment and that of AECOM/Grand Central is that the revenue generation/abstraction ratio for this application is in the range 0.23 to 0.27 : 1.

ORR's conclusions

23. We are content that there are no operational concerns which should preclude our approval. We are also satisfied the capacity to operate the services was available, at least in the short term. However, our economic analysis shows the proposals would likely be primarily abstractive of incumbent revenues. In other words, the new services would not generate sufficient new revenue to pass our NPA test.

24. Our policy is that we will normally reject applications that do not pass the test. We are satisfied there are no additional factors not already in the test or otherwise considered that would cause us to approve the application in this case. We have therefore rejected the application.

25. In reaching our decision, we have had to weigh and strike the appropriate balance in discharging our statutory duties under section 4 of the Act. We have concluded that rejection of this agreement is consistent with our section 4 duties, in particular those relating to:

- protecting the interests of users of rail services;
- promoting the use of the railway network for the carriage of passengers and goods, and the development of the railway network, to the greatest extent that ORR considers economically practicable;
- promoting competition in the provision of railway services for the benefit of users of railway services;
- having regard to the funds available to the Secretary of State for certain purposes and his guidance; and to
- enabling persons providing railway services to plan the future of their businesses with a reasonable degree of assurance.

26. Copies of this letter will be sent to Keith Merritt at DfT, Peter Craig at Network Rail and Phil Dawson at VTEC and 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