ORR Retail Market Review

Response of Chiltern Railways

30 October 2014

Introduction

Chiltern Railways is the fastest growing conventional rail franchise, following our sister Arriva TOCs Grand Central (open access) and London Overground (operating concession). We welcome this consultation, and look forward to engaging directly with ORR to help develop a revised framework that will maximise consumer protection, passenger benefit and operator innovation.

Chiltern Railways has consistently been a leader in retail innovation. We were the first train operator to offer tickets by text message, the first to offer a mobile app that both sold and fulfilled tickets to barcode, the first to barcode-enable an entire commuter area and we are currently working on a pilot of a price promise guarantee, delivered using contactless payment cards, in partnership with the Department for Transport and Transport for London

With an established track record of innovation in this area, we are able to offer a clear perspective on what currently works and on areas where there is room for improvement.

Executive summary

Britain has the fastest growing rail market in Europe. Chiltern Railways is the fastest growing rail franchise within that market. Clearly, a lot is working well, so this response is written in that context.

However, there are areas where good could become better. The rail retail market suffers through regulation from multiple sources, sometimes with contradictory objectives. The consequence is that change and innovation is stifled, with businesses forced to the lowest common denominator. This is most visible in the continued preponderance of magnetic stripe paper ticketing.

The franchising system is designed around regional franchises, regulated by their franchise agreements. However, the Ticketing & Settlement Agreement creates obligations to retain a single integrated network, but based around the technology that existed in the late 1990s. The breadth of the TSA's scope has the consequence of preventing TOCs from creating positive business cases for change and innovation, as it is almost impossible to remove anything that already exists. TOCs are committed to better outcomes, but need the right incentives and structures to be able to deliver. The technology now exists for different operators to offer different fares and retail platforms, but for these to be packaged and sold as a single transaction. The customer does not need to lose the benefits of a single, integrated network but train operators are able to innovate and develop new solutions. DfT can help encourage this by supporting the industry move to this position.

Some regulation appears to be in the best interest of customers, but actually mitigates against changes that customers would welcome. Differential pricing by sales channel, for example, has been a critical component of positive change in almost every successful retail market, but is prevented in rail. Franchise tenders that specify the "right" answer are written with the intention of creating positive change, but often prevent TOCs thinking for themselves. TOCs with the incentive to grow and the right regulatory structures will come up with the right answers without being told.

The requirement for TOCs to create anywhere to anywhere pricing results in complexity, split-ticketing anomalies which risk damaging industry revenues unintentionally and result in TOCs needing to "jump together" on retail fulfilment. Passengers are already leading the market by migrating from through ticketing to self-packaging individual TOC offers, and regulation should catch up.

The rail retailing market is not broken, but it is capable of improvement. We welcome the chance to engage further.

Answers to questions

1. **Is our description of the retail market for tickets and passenger buying behaviour correct? If not, are there any relevant trends/issues we are missing?**
2. **Have we appropriately captured the most significant changes to ticket retailing in the last 10 or so years? Do you consider that the pace and level of developments and changes have been appropriate in meeting passengers' changing needs?**

While there have been significant changes, largely as described, it is also important to consider what changes have not taken place.

Compared to many other equivalent markets (for example, aviation and entertainment) there have been fewer changes to the rail retail market. Fulfilment is still dominated by paper magnetic stripe ticketing dating from the 1980s and purchase still dominated by the station ticket office.

Other markets show the potential for change. These include:

- Transport for London's successful introduction of the highly popular Oyster card
- Passbook acting as a fully electronic ticket wallet for a range of industries
- The complete migration to barcode ticketing in aviation

The rail industry has been held back by a regulatory framework that ties all train operators together through compulsory interavailable pricing on all flows and by the existence of Schedule 17 of the Ticketing and Settlement Agreement (on booking office opening hours) that prevents TOCs from reducing the costs of one channel by deploying staff more flexibly as they invest in others.

Chiltern Railways was the first operator to offer a fully integrated smart ticketing solution, with purchase and fulfilment via mobile app, and gatelines upgraded to validate mobile tickets. Chiltern Railways was the first (and is still the only) operator to offer mobile phone purchase and fulfilment across an entire commuter network.

These are commercial adoptions of smart ticketing, and demonstrate that there is a willingness and enthusiasm from TOCs to innovate. However, some have had much weaker business cases than would have been the case if expensive ticket office retailing could have been reduced in parallel with the growth in modern channels. Regulation needs to anticipate changes to consumer demand (taking into account what is happening in other sectors) and be updated, encouraging innovation and modernisation as opposed to preventing it.

At Chiltern Railways we are working on a number of projects that we would be keen to discuss with ORR to highlight some of the opportunities in this area.

Moreover, because of the requirement to provide ticketing from everywhere to everywhere, every TOC needs to provide expensive magnetic stripe ticketing across its entire estate until the last TOC migrates from this platform. Given that magstripe ticketing drives cost through ticket printers and very expensive mechanical gate readers, this drives cost, inflating the industry cost base. More worryingly, there is a "prisoner's dilemma" problem that, while it would be in the interests of all TOCs to move away from magstripe and reduce costs, it is not in any TOC's individual interest to do so given that they do not know if everyone else will. As a result, most train operators still sell largely through ticket offices and print to magnetic stripe tickets. We discuss these issues in more detail in response to question 8, as moving away from this requirement does not necessarily mean the loss of the passenger benefit if regulation can be updated to support technologies that did not exist when the current regulatory regime was drafted.

The current regulatory model entrenches anachronistic solutions and undermines the business cases for new ones that drive important customer benefits.

TOCs are the potential engines for change, as TOCs have the potential both to immediate realise revenue growth and cost savings. TOCs can be the drivers of change but they need the right incentives.

3. **Are there any insights on passenger behaviour, market share and sales channels from other sectors that are worth considering?**

It is worth remembering that customers do not always have a clear view of what they want from the rail retail market. This is unsurprising: they are not the experts, and do not wish to be. They would need an expert TOC to guide and educate them. Arriva research tells us that 26% of customers do not know where they will want to buy their tickets in future. Passengers in London were not demanding the Oyster card before it was provided to them, any more than the iPod was requested before it was invented.

In this context, it is worth remembering that there will always be a short-term passenger rejection of change but this doesn't necessarily reflect passenger preferences over the long term (this is also relevant to the debate over whether the current, highly prescriptive, regulation of booking office opening hours should be retained, which we discuss in question 5). Chiltern Railways has recently undertaken a programme of research into a contactless payment card ticketing proposition in partnership with Passenger Focus and the Department for Transport. While many passengers were enthusiastic about the proposition, some were hostile. Some of those hostile admitted that they had been equally hostile to Oyster, but now have huge enthusiasm for their Oyster cards.

TfL has been able to innovate with the knowledge that it has the flexibility to respond as passengers' preferences change. For example, as TfL introduced Oyster, it implemented a programme of discouraging alternative fulfilment channels that started with differentially pricing journeys made with traditional tickets and is culminating in the closure of station booking offices. Every element of this programme would be prohibited to a TOC by TSA regulation but has been essential to TfL changing customer behaviour and preferences. Had TfL been regulated as a TOC, it is unlikely that Oyster would exist in anything like its current form, scale or popularity.

We are happy to discuss our experiences to help drive an understanding of this area.

4. **Have we accurately described the ticket selling arrangements in respect to i) retailers' incentives in selling tickets; ii) retailers' obligations to facilitate an integrated, national network; iii) retailers' governance arrangements, iv) retailers' industry rules; and v) retailers' industry processes and systems?**

We have nothing further to add to the ATOC submission, which goes into detail in this area.

However, it is also worth considering the role of Transport for London. For any journey that crosses London or enters London, TfL are a vital stakeholder. For Chiltern Railways, this includes the vast majority of our passengers. TfL control all station infrastructure and have their own well-developed ticketing programme. This can act as a constraint.

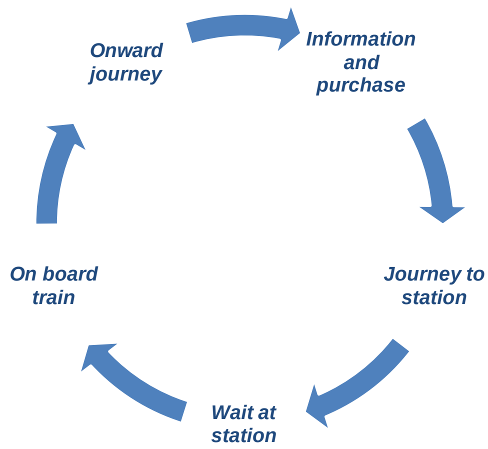
5. **What are your views on the impact of the retailers' incentives in the way they sell tickets? To what extent do the incentives discussed herein impact retailers' approaches, and how do these differ by retailer type? From the point of view of a retailer, what factors have to be present to make the development of new products an attractive proposition?**

Distinction between TOCs and third party retailers

There are two types of retailer in the rail industry; TOCs and third party retailers. The consultation document makes several references to train operators competing with third party retailers to sell fares. This implies that the duties of an operator to run trains and the duties of an operator to sell tickets are capable of perfect disaggregation. This is not the case. Train operators have a duty to consumers at all stages of their journey, from information gathering through to post-journey support.

A train operator will provide information on its website covering all aspects of customer service, will publish timetables and printed material, operates customer service at stations and on trains and provides after care support.

The diagram below shows a typical customer journey for a train operator:



The train operator needs to consider the service offered at every touchpoint, ensure they are integrated and consistent and, overall, that the service is attractive enough to deliver the growth required in the franchise agreement.

This is a very different proposition from a third party retailer, who is simply focused on selling tickets and does not have the same business driver to deliver after sales services, including those that, for a TOC, is a condition of its licence.

Having market players specialising in both the holistic product (operators) and pure retail (third party retailers) is helpful and healthy, but it is a misnomer to regard train operators and third party retailers as engaging in pure competition in the retail market. Train operators are responsible for the entire customer experience and are held liable for that experience by customers. It is therefore essential that train operators remain at the centre of the decision-making process for rail retail decisions.

At the core of this consultation should be the question of who has the greatest incentive to improve the customer experience and therefore grow industry revenues and reduce industry costs. These are the TOCs. TOCs are those with the greatest commercial incentive to sell and have been the drivers of innovation in rail retailing with new fulfilment technologies, added value services such as 'choose your seat', ticket alerts and packaging of non-ticket add-ons such as catering, car parking and WiFi; and consumer marketing approaches to reward regular users, incentivise repeat purchase and identify opportunities for growing revenue. TOCs have the greatest incentive to grow the overall rail market as they earn the resultant revenues, benefiting both fare payers and taxpayers.

This incentive provides greater passenger benefit than activity simply designed to redistribute rail retail market shares between retailers. Pure retail competition can often result in large amounts of spend expended on advertising as opposed to delivering the service. The structure of the retail market and its regulatory framework should be designed to maximise growth and reduce the industry's cost base.

While third party retailers can be vocal, it is notable that the period of major passenger growth for the aviation industry coincided with a period of major expansion in airlines' direct sales capabilities. It is therefore important that leadership remains with the entities with the greatest growth and cost reduction incentives, while maintaining the thriving third party retail market that exists today.

<u>Franchising</u>

The UK rail retail market has supported an unprecedented period of growth. The market has widened choice and provided a plethora of retailers. Given that the UK rail sector is the fastest growing in Europe, the current model must be seen as the one upon which to build.

However, there are a number of areas where TOC incentives do not align perfectly with consumer interest. One of these is in the area of franchising and regulation.

Innovation is best encouraged by creating an operating environment in which operators will gain a commercial return for investing in new technology, and have the freedom to develop solutions to passengers' problems. In many cases, franchises do not offer the ability for operators to gain a return, with the result that Government is forced to take the lead.

The franchising system should be discouraged from being too prescriptive as this results in TOCs delivering their franchise terms through 'tick boxes', as opposed to innovating for growth.

For open access operators, where the business model and indeed granting of the license depend on opening up new markets and generating 'not primarily abstractive' journeys, the ability to innovate and unlock revenue in an agile way is essential.

In the franchise market, franchise tenders that specify the detail of the retailing solution required should be discouraged as operators with the flexibility to innovate will generate the highest growth.

Booking offices

All TOCs are seeing a shift away from booking offices and towards other channels, and this is mirrored by the experiences of all retailers. The same trends are also seen internationally, such as in the main market of our parent company DB.

However, the inflexibility in flexing booking office opening hours as prescribed by the Ticketing & Settlement Agreement (TSA) makes it much more difficult to construct the business case to invest in alternative technologies. In other sectors, retailers are able to gradually migrate passengers to electronic channels with the ability to gradually reduce costs in one channel as they increase them in the other. In rail, booking office costs are mainly fixed and can only be varied through a cumbersome, lengthy and costly consultation process. This makes the business case harder to justify. In effect, there is a vicious circle which can only be unlocked by allowing operators to vary booking office provision much more dynamically.

The majority of staffed stations only have one member of staff provided at any one time. While that member of staff is locked away fulfilling transactions that could be fulfilled another way more effectively, that member of staff is prevented from delivering a much wider range of station services. This includes customer service throughout the station, passenger assistance and customer reassurance. To achieve this, however, requires a reduction in the notion of booking offices having very fixed hours of being open and closed, and a move towards a much more flexible operating model.

Moves to migrate booking office opening hours from the TSA to individual franchise agreements are welcome.

TSA

However, the franchise structure also requires TOCs to sign the Ticketing & Settlement Agreement, which creates very comprehensive requirements on TOCs for interoperability. This forces all TOCs to use at least one common fulfilment platform, currently magstripe ticketing. As passengers' behaviour changes, consideration should be given to whether the full plethora of interoperability requirements in the TSA is still the best way to deliver the benefits of a single, national network. We discuss this in more detail in response to question 8 that it may be that these benefits can be retained but in a modern way.

Back office systems

It is widely believed TOCs could learn from online retailers and airlines in presenting and communicating conditions and restrictions. This is something that TOCs are very keen to achieve. The main reason why progress has been slow in this area is because rail back-office systems are old and complicated, and require significant investment. For too much of the recent past, too few TOCs have been in a position to justify investment as they are close to the end of their franchise terms.

This is a systemic weakness in the franchising system, as central systems that are collectively owned require all to "jump together" but do not create the circumstances in which this is possible.

Providing longer, more commercially driven franchises will unlock the investment necessary to enable TOCs to deliver these improvements, especially if residual value mechanisms can be developed.

Frequently, TOC managers have been frustrated by the fact that too few franchises are simultaneously in a position to invest to enable change to take place. If the franchising structure creates attractive franchises with the ability to earn a return from investment, many of these problems will solve themselves without need for further intervention.

As an owning group that has consistently sought to lead the industry and innovate, we acutely feel the frustration that this causes. While the problem is in the systems collectively owned by TOCs, the solution sits with Government in the way franchises are specified and let to enable TOCs to be able to invest in solutions that deliver longer-term benefits, even towards the end of their franchise term.

6. **What are your views on the impact of the impartiality obligation? What is your view on passengers' awareness of impartial retailing? How does the cost of impartial retailing impact passengers' services? How could this be addressed?**

It is appropriate for ticket offices to retail impartially. However, the definition of what impartial means should be reviewed as the obligation to offer impartial retailing currently prevents sensible differentiation by retail channel.

In most sectors, the higher cost of certain channels can be passed on to the consumer. In rail, however, the highest cost channels come with impartiality obligations that prevent differential pricing. This acts against the customer interest by preventing pricing being used to migrate a critical mass of volume towards modern channels that offer greater customer convenience, but which require guaranteed volumes to ensure a positive business case.

The adoption of the London Oyster card is a clear example of where differential pricing has been used in the overall consumer interest to ensure widespread adoption of Oyster.

Chiltern Railways is currently working in partnership with DfT and TfL to introduce a price guarantee proposition delivered via contactless payment cards. This has required financial support from DfT's SEFT programme. However, future adoptions of similar technology may be commercially viable if differential pricing can be used to support the business case.

7. **With respect to split ticketing, what are you views? Are passengers appropriately safe-guarded against the risks attached to split ticketing? To what extent do industry processes and systems enable split ticketing to be developed by industry and used by passengers? Where there are issues, what could be done to address them?**

We strongly endorse the ATOC submission on this question. Split ticketing is inherently complex and confusing for customers. It means that an increasing element of rail pricing is driven by fares anomalies rather than the usual market drivers, with fares for longer distance services in particular being set at price levels lower that the market would normally determine. This is a distortion of the market, which if allowed to grow any further, will have a material impact on industry finances and the level of taxpayer support required by the industry.

Different ticket products can have different terms and conditions which the customer may frequently not appreciate when they are sold in a context for which that product was not intended. The widespread customer confusion caused by multiplicity of choice in rail products is exacerbated by the existence of nominally valid but overwhelmingly complex split ticket options.

The consultation notes that some consumers prefer the price benefits of split ticketing over the perception of complexity. While this is true of some consumers, there is a much wider externality, with the perception of complexity affecting all consumers, reducing trust in the rail industry unnecessarily and reducing industry revenue. There is a very important distinction to be made here between split ticketing and customers self packaging commercial products. This is discussed in more detail in response to question 8.

It is important to note that passengers' interests are not served by a free-for-all in rail ticketing. Research consistently shows that one of the biggest issues that passengers face is one of confusion. One of the reasons for this is that multiple actors in the retail market all present information differently (and sometimes incorrectly), with the result that passengers struggle to understand ticket validities. Customers may not appreciate that the dedicated walk up fare they have bought as part of a split ticket journey (possibly for an operator that only runs a handful of journeys per day on a specific flow) has limited scope to be used.

The objectives of ensuring a fully integrated network, permitting retail of unlimited combinations of fares and of supporting a large and independent retail market are all reasonable policy objectives. However, combining them risks allowing massive confusion if it results in different combinations of tickets being sold for similar journeys.

8. **What are your views on the requirement on TOCs to create and retailers to sell inter-available and through tickets and to offer a timetabled walk-up service? What are your views on the benefits passengers and TOCs derive from these tickets and the timetabled walk-up services? What challenges does this obligation give rise to, if any? Where there are issues, what could be done to address them?**

Most of the innovation that has occurred since privatisation has been single operator specific. This is unsurprising: franchises are let with very different specifications, timeframes and incentives. These innovations have resulted in choice for passengers and greater value for money. While inter-operability is important, there needs to be space for operator innovation and different technologies to coexist.

Ticket fulfilment

The requirement for interoperability between TOCs, as currently defined, can sometimes drive standards to the lowest common denominator and reduce the scope for innovation and new entrants. This can most clearly be seen with the continuing preponderance of magnetic stripe ticketing, but it is not necessary for the retention and development of a single, integrated and national network.

The ability to buy through tickets should be amended in the interests of wider innovation. Possible options could include the ability to buy tickets to all stations served by direct trains from the station in question but not all stations nationwide. However, even if different operators fulfil to different ticketing platforms, it is possible for RSP to act as a clearing house to ensure that these can be purchased online via a single transaction. This would maintain the benefits of a single integrated network but fulfilled in a modern way. A passenger travelling from point A to point B via point C could buy a single ticket but have it fulfilled using the relevant fulfilment mechanism for the TOC in question. This could mean that part of the journey was made using a magstripe ticket and part using a barcode, for example. DfT's support in helping the industry move in this direction would be helpful.

Fare pricing

Consumers are migrating from through ticketing in favour of self-packaging commercially focused products and fares. Journeys between small stations which, ten years ago, would have been made on a through ticket will now typically be made using multiple separate tickets to benefit from operator-specific offers. This has increased consumer choice and reduced prices, but retention of the obligation for everywhere to everywhere pricing means that the industry cost base remains inflated and innovation is suppressed.

There is an important distinction to be made with split ticketing, as discussed above. Split ticketing is the exploitation of anomalies caused by the preponderance of fares in the fares system that do not offer commercial value. By contrast, passengers choosing to self-package commercial offers from individual TOCs allows passengers to get the best deal and enables the industry to maximise its growth potential.

Migrating from a situation in which most fares in the fares system serve no useful purpose other than to create anomalies and towards a situation in which fares have been created to respond to market need will be in the interests of fare payers and taxpayers.

Understanding customer benefit

Increasingly, the requirement for anywhere to anywhere ticketing is anachronistic. As an illustration, compare the London Overground and Tyne & Wear Metro services (both operated by Arriva). Both are metro services specified and let by the local authority. Both operate partially over Network Rail infrastructure and partly local authority-owned infrastructure. However, the former (as a former British Rail service) is covered by the anywhere-to-anywhere obligation while the latter is not. There is very little evidence that customers on the Tyne & Wear Metro feel disadvantaged by their inability to buy through tickets onto the wider National Rail network, nor that customers of London Overground are aware of their ability to buy tickets to stations outside London.

Both Tyne & Wear and London Overground are unusually discrete and segregated networks, and it is not recommended that other TOCs are managed on a self-contained basis. However, these illustrations highlight that interoperability requirements (when not reviewed regularly) can entrench requirements that no longer offer a customer benefit. A combination of ticket offices only being required to sell, for example, tickets to stations on the same TOC or directly served, the ability to fulfil single journeys to multiple fulfilment platforms and the replacement of anomalous "everywhere to everywhere" pricing with packaging the individual journey legs would retain the vast majority of network benefit while reducing the anomalies, confusion and interdependencies that currently exist.

9. **With respect to having minimum obligations on TOCs to have their ticket offices open, what are your views on the impact of these obligations on how the market can develop in line with passengers' needs?**

We have discussed this issue in response to question 5. We believe that this obligation, as currently framed, is overly prescriptive and anachronistic. Chiltern Railways will be piloting a new approach to operating stations when its new Oxford branch opens next year. This will demonstrate that excellence in customer service (and full staffing) can be better delivered without a traditional "ticket office" style of operation. However, current regulation will make it very difficult to roll out this model to a wider geography, despite the consumer benefits.

Cash machines at banks, self-service checkouts at supermarkets and even self-service desks in libraries are all well used and accepted innovations within other sectors. In each case the question of accessibility and usability has been addressed from the point of view of what the consumer actually needs. It is our view, that it should be possible to frame the availability to purchase a ticket as an output specification. This reflects the much wider range of options now available.

Chiltern Railways has made substantial investments in barcode ticketing, including producing the first app to enable sale and fulfilment to barcode and the first gates to read barcodes. However, it has been frustrated in gaining a return on this investment by the inability to reduce other retail costs proportionately to the increased costs driven through its investment. These cost reductions do not necessarily mean reduced staffing, but can mean more intelligent use of staff as will be piloted on its new Oxford service.

10. **With respect to TOCs being prohibited from charging fees, what are your views on the impact of this requirement? To what extent, if any, does this give rise to a distortive effect between TOCs and third party retailers?**

It is very unlikely Chiltern Railways would wish to charge fees were this permitted. However, it is a clear distortion of the market that it is prevented. As discussed earlier in response to question 6, all regulatory constraints that prevent TOCs reflecting the differential costs of sales channels in pricing (and using sales channel pricing to ensure appropriate volumes for new sales channels) should be withdrawn. This would ensure that the rail retail market reflects wider market norms, including in the air and coach industries against which rail directly competes.

11. **What are your views on the current form of industry governance? Are there specific examples where the governance has enabled or limited retail innovation? Where necessary, how could industry governance be improved?**

Rail industry governance processes are partially effective, but overly complex. The area of rail retailing is subject to regulation via industry agreements (e.g. the Ticketing and Settlement Agreement, which all TOCs are obliged to sign), via franchise agreements (which will often specify details of ticketing technologies), via industry governance processes (some of which are mandated by the TSA and some of which are not, but are necessary for pragmatic reasons) and by the Office for Rail Regulation. These different governance processes do not always result in aligned objectives. For example, the TSA contains obligations to ensure a single integrated network, while franchise and license agreements contain obligations that are bespoke to individual operators.

There is a danger that a perverse position has been reached, in which the volume of regulation (all of which was created to achieve a specific objective) is now preventing much larger macro-level objectives being achieved, such as innovation and growth.

In this context, one of the forms of regulation should become dominant to avoid the different forms of regulation arguing with each other.

The strength of governing rail retailing via franchise agreements is that it creates a platform for innovation, allows different solutions to be tested and developed and allows for pragmatic evolution. By contrast, the TSA (which applies to all TOCs regardless of franchise agreement) codifies practices that are now thoroughly outdated having been based around early 1990s technology.

When the TSA was created, the smartphone did not exist. Today 90% of the 28 million mobile phones are smartphones. When the TSA was created, internet retailing did not exist. Today, per capital annual spend online is £636, with travel a leading sector. When the TSA was created, 87% of transactions were made by cash or cheque. Today, 46% of payments are electronic. When the TSA was created, less than 250m transactions were made by ATM each year. Today it is 2bn.

It is recommended that the DfT absorb into franchise agreements as many regulatory requirements as possible, to enable the TSA to be thinned down to its absolute essentials. In this context, it is therefore recommended that the DfT consider carefully whether all of the interoperability requirements that exist in the TSA are strictly essential. The more the network can operate as a series of aligned but individual businesses, the faster and more effectively individual franchises will be able to innovate for consumer benefit.

A review of the TSA is currently taking place by ATOC, and DfT's support for this process is essential to ensure a positive outcome.

At the core should be a recognition that if franchises are let with the right commercial incentives, detailed regulation becomes less necessary. This can be seen in other industries, such as air and coach.

With regard to season tickets, the strength of the current industry governance processes can be seen. Third party retailers have an ambition to sell season tickets. However, the season ticket market is unusual. The transaction for an annual season ticket occurs once per year, after which the customer will make around 500 individual journeys with many thousands of individual touchpoints with their train operator. It is worth reviewing the diagram shown under question 5 for a reminder of these touchpoints. The distinction between TOC and third party retailer comes into sharpest focus, therefore, in the season ticket market.

However, TOCs have responded to third party retailers' requirements and a trial is being developed to seek to find a solution that works for TOCs, retailers and, above all, customers. As discussed under question 5, TOCs have a much wider responsibility to consider customers' entire journey experience and the commercial imperative to ensure this is optimised.

12. **What are your views on the current form of industry rules? What benefits do they give rise to, and how? Are there specific aspects of industry rules that limit or dampen innovation in retail? How could they be addressed?**

Our response to questions 5, 6, 8 and 13 covers our response to this question.

13. **With respect to third party retailers' arrangements, to what extent does the nature of their relationship with TOCs enable them to benefit passengers, including bring about competition and innovation? How are the arrangements between the wholesale provider and the third party retailers in other sectors relevant to rail? What is the impact of third party retailers in rail not having access to a wholesale market/wholesale price? Do the industry governance, rules, processes, and systems pose additional impacts for third party retailers that we have not captured?**

We believe the third party retail market is working effectively, as demonstrated by the growth in overall rail revenues and the expansion in the market. Options for wholesaling, however, need to take into account passengers' very strong preference for simplicity in the rail retail market. Wholesaling in aviation works well because passengers accept a situation in which different consumers will pay different prices for the same product through different retailers. We would be very concerned that a retail market that results in TOCs losing control of pricing will place their customer service staff in a very challenging position, as consumers do not have the same attitude to rail pricing. This is especially the case for season ticket products, where wholesaling could result in very unpopular perceptions of unfairness if third party packages appeared to advantage or disadvantage certain customer groups.

Markets in which third party wholesaling tends to work well are those for which purchases tend to be high value and infrequent (e.g. air tickets, mobile telephony, some events) in which customers are willing to devote time to research and are not going to have a fixed expectation of the cost or the best retail channel. For rail tickets, purchases can be very frequent and customers expect to be able to get the best deal easily without complex research requirements. A position where train companies could not guarantee that they were selling the cheapest fare available at the time would damage trust in train operators and the wider rail retail market.

It is important that the outcome of this review is focused on the key objectives: creating incentives for growing the overall market and delivering an outstanding service for passengers. Ideas that risk detracting from these objectives should not be progressed.

14. **What are your views on the current form of industry processes and systems? What benefits do they give rise to, and how? Are there any specific aspects of industry processes that limit or dampen innovation in retail? Do these processes have other impacts, either causing problems or leading to benefits?**

The provision of central processes and systems in a market with a high degree of commonality is a sensible means to reduce costs. This applies to both development and operating cost and the costs of doing business (by avoiding need for multiple contracts or multiple interfaces).

However, this benefit needs to be balanced by the downsides of maintaining full inter-operability in a railway operated on a regional franchise basis. This is a topic we discussed in response to question 8. Individual TOCs are often unable to develop new systems or innovative solutions by the impossibility of a positive business case in the context that all existing systems need to be retained in parallel.

15. **With respect to industry data, how does access to and quality of data manifest? What is the impact?**

We support the recent moves to widen access industry data. However, it is important that TOCs retain an element of control of how data is used to ensure that it is not used in an inaccurate or misleading way. For example, pricing data (which will become more easily accessible following completion of the Product Management Service, currently being delivered by the TOCs) needs to be used in such a way that it provides accurate descriptions of the validities and restrictions of individual tickets.

16. **What are your views on our proposed approach to assessing the materiality and relevance of the impacts? Please particularly consider the extent to which the incentives, obligations, governance, rules processes and systems in place facilitate or inhibit (i) passengers being active, empowered and engaged in the market, causing suppliers and retailers to reduce costs and raise quality; and (ii) retailers can compete to deliver services that meet consumers' needs and expectations.**

It is important that this review does not regard the retail market in isolation. TOCs do not sell tickets as pure retailers: TOCs sell tickets as train operators responsible for the entire customer experience and with an incentive to create growth. It is possible that outputs from this review, if not carefully calibrated, could make the retail market more pure but at the expense of allowing TOCs sufficient incentive and leverage to innovate for growth. Making it easier to share the existing cake should not be the objective, but instead the focus must be on how to make the cake bigger. This is a shared objective of Government, TOCs and fare payers.

In this context, it is worth looking at the areas of focus. In section 6.3 (b), the consultation refers to a potential inhibition of innovation. This is something that TOCs within the Arriva group have experienced and would be happy to share their experience with the ORR team. However, the way in which the point is phrased in the consultation suggests the issue is that the franchising system prevents retailers working together in innovating. Sometimes, innovation is best driven by working together. Equally, given that Government policy is for regional franchises, it is important that the surrounding regulatory structure is designed to enable those franchises to create positive business cases for retail innovation as independent entities.

Regarding the perceived conflict of interest of train operators, it is important that train operators are not seen simply through the prism of retail. TOCs are responsible for the entire customer experience. It is right that they are able to exercise greater influence than pure retailers, who do not have the much wider responsibilities that TOCs do.

The approach outlined by the ORR to assess the materiality of the issues is important. In this context, it is important to consider the opportunity cost. As well as looking at the negatives (and many positives) of the current arrangements, it is also worth noting what the current arrangements have failed to deliver. While they have delivered a thriving third party retail market and significant choice for passengers, there has been an absence of innovation and this may be caused by too many different forms of regulation without a consistent objective.

In this your discussion in this chapter, you focus heavily on comparators with other markets and note four key differences:

- Absence of wholesaling
- Narrow routes to market
- Common systems
- Perceived complexity

In your commentary you note that perceived complexity exists in these other markets as well. While this is true, it is important to note the point highlighted in our response to question thirteen. The markets in which wholesaling, broad routes to market and federated systems tend to exist are those with infrequent, high value purchases. The rail market is different in that many customers purchase several times per week. In that context, rail has more in common with the retail market, in which retailers typically have a single price for a good and do not retail that good via multiple third parties. If a TOC is seen as equivalent to, for example, a clothes or food shop (both providing and retailing a service for which there is demand for frequent, low value purchases), the absence of wholesaling does not seem so strange.

In this context, it is important that customers' preferences for simplicity is taken into account and respected.

We support the approach for stage two to initially focus on high level principles and look forward to engaging in discussion on what these principles should be.

17. What are your views on proposed approach to Stage Two of the Review?

Our response to question 16 covers our response to this question.

18. What other views have you regarding the Review that has not been captured in the questions above?

We have covered everything in response to the questions.