

Andrew Murray
Deputy Director Rail Performance & Operations
Rail Commercial
Department for Transport
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24 April 2014

Dear Andrew,

Alliance Section 17 proposal for services to West Yorkshire and Lincolnshire

Thank you for your email addressed to Rachel Gilliland, dated 31th March 2014 regarding Alliance Rail Holdings' (Alliance) Section 17 proposal. It is encouraging that the Department for Transport (DfT) states it welcomes, in principle, the increased passenger choice and competition brought to the market by Open Access operators - although there is little to show the DfT actually means it.

Alliance is not aware of any new charging structure and would welcome clarity from the DfT regarding the new charging structure it remains cautious about. Alliance is aware that the ORR intends to review access charging early in CP5, however, we would again point out that there is currently no difference between the access charges paid by Open Access and franchised operators. Open Access and franchised operators both pay the variable usage charge. This charge is the best measure of the costs directly incurred by Network Rail as a result of the specific train service being operated. In addition franchised operators pay a fixed access charge, which is a mark-up paid over and above the costs directly incurred by Network Rail to allow it to obtain full recovery of its costs.

The DfT is well aware (or should be) that fixed access charges are a residual figure calculated by deducting the variable usage charge and network grant from Network Rail's total revenue requirement, and so they are an "artificial construct", as stated by Mr Justice Sullivan in the case of (the then) *GNER and the ORR & others [2006]*, and do not represent the actual cost directly incurred by Network Rail in maintaining a specific section of route a specific train service operates over.

The fixed access charge is paid by franchised operators who act merely as conduits for government money destined for the infrastructure manager. Open Access operators cannot pay the fixed access charge as they receive no income from government and can therefore not act as a conduit for government money.

The fixed track access charge forms part of the industry money-go-round and reduces the network grant, but it need not be paid by franchised operators as it could be paid via the

network grant. Indeed in 1999 the government supported this view as evidenced in the witness statement provided by the then Rail Regulator Tom Winsor in the case of *GNER and the ORR & others [2006]*.

Alliance notes that you will be writing to the ORR regarding the expected impact the DfT believes our proposals will have on the funds available to the Secretary of State. It would be welcome if some of this evidence could be made public as this argument is used by you on every occasion an Open Access application is made - yet no evidence is ever published to support the argument. Indeed the only evidence published regarding this suggests the complete opposite. Where Open Access competition exists (e.g. York to London), fares have increased at a much lower rate than at stations where no competition exists, yet the East Coast operator has been able to increase its premium payment year on year.

In your letter you focus heavily on the assumption that there will be “significant abstraction” from the forthcoming Inter City East Coast (ICEC) franchise. However, I am sure you are aware that under the current process the ORR undertakes the Not Primarily Abstractive (NPA) test to gauge any impact on the Secretary of State’s funds. This test does not just take into account the amount of revenue a new service will abstract. It balances this against the likely new business that would be generated and other compensating economic benefits. The government policy, as recently re-stated by current Rail Minister Stephen Hammond MP, is “*to support the not primarily abstractive test in its current form*”, and “*our assessment is that for this very different part of the rail market the open access system works well for both customers and the public purse*”. It appears that the Minister and the Department are at odds on this issue.

GNER’s application comfortably passes the NPA test and evidence of this will be provided to the ORR as part of the complete business case.

That said we would ask the DfT what legal right it believes that franchises have above Open Access operations? The DfT appears to believe that it has a right to create operator monopolies on the rail network and remove competition. Alliance believes that the way in which the DfT procure franchise services is contrary to EU legislation. We are of the view that the franchising process, particularly for commercial services, is severely flawed and anti-competitive, and works against the passenger interest. As the ORR reported on 16th April, passengers are now the main funders of the railway, covering almost 60% of costs. We trust that compliance with all relevant EU legislation will be properly considered in awarding the new InterCity East Coast franchise.

Alliance would also welcome clarity on the financial protection the DfT is offering to the forthcoming ICEC franchise should an additional path not be awarded. From the way your statement is worded we believe this would amount to illegal state aid. It would also appear that the perceived impact on the DfT’s funds would not be as a result of the introduction of GNER services but more the poor management of the East Coast franchising process.

You refer to investment in both rolling stock and infrastructure and that the case for funding future investment may be weakened if a precedent is set for additional capacity to be

allocated in such a way that it is no longer possible to assume that additional capacity from the Secretary of State's investments will be utilised in a manner consistent with the business cases which underpinned those investment decisions.

This statement clearly highlights the DfT view that no further competition should ever exist as any capacity created should receive 'first refusal' by the DfT. This is clearly anti-competitive, with the aim to foreclose competition in the market. This is contrary to EU law by which the government retains general responsibility for the development of the appropriate Railway Infrastructure in order to boost competition. (Directive 2012/34/EU Paragraph 8). I would urge the DfT to read the above mentioned directive to further understand its responsibility with regards to competition.

You state that the business case for IEP and the East Coast connectivity fund are dependent on the additional revenue created as a result of the investment being captured through franchising and therefore being used by the DfT to off-set the initial public sector costs. Firstly there is no particular requirement for the DfT to invest in rolling stock. Rolling stock should be a commercial decision for train operators and ROSCO's, as has often been stated by both Ministers and the DfT. Alliance's proposals are based on the introduction of brand new rolling stock at no cost and no risk to the taxpayer. Secondly you appear to say that the DfT is gambling with public funds on the outcome of a franchise competition with no clarity on what success looks like. I would again remind you of the significant cost to the taxpayer from the last franchise competition you undertook.

It is misleading to suggest that the investment in IEP trains for the East Coast franchise is being made by the taxpayer. Alliance understands that the finance for the new fleet will be sourced from a number of commercial banks, and the lease payments made by the new franchise holder to Agility Trains will pay off these loans over 27½ years. This makes it clear that the investment will be funded primarily by the fare-paying passenger rather than the taxpayer – unless, of course, the DfT is expecting the new East Coast franchise to require an operating subsidy. You are also wrong of course on any 'business case' for the East Coast Main Line Connectivity Fund being dependent on additional revenue through franchising – as the fund was established by the ORR some time prior to the timetable for the franchising of the East Coast being decided.

The investment from the Secretary of State in the infrastructure is welcome. However there is no requirement for any capacity benefits realised by this investment to be utilised only by franchised services. As mentioned above, if this is the case, then on every occasion the DfT is foreclosing competition in the market.

Alliance's position in relation to capacity is that capacity exists as it was funded by way of "The CP4 Delivery Plan, Programme 18 – East Coast Main Line improvements". The output of which is as follows:

Output

These schemes deliver both the HLOS passenger kilometre specification for strategic route 8 and the London capacity specification for the East Coast.

The following will be provided (the baseline being the December 2008 timetable):

- *up to two additional freight paths per hour between Peterborough and Doncaster;*
- ***up to one additional long distance high speed passenger path per hour off peak {note: there are currently 7 paths in many off-peak hours};***
- ***up to two additional long distance high speed passenger paths in each peak hour; and***
- *operation of up to ten outer suburban services per peak hour, with up to six of these being 12-car formations, subject to calling pattern.”*

Network Rail and ORR have confirmed that the May 2011 Timetable recast was not reliant upon this programme of works. Alliance concludes that the capacity is available as a result of the CP4 Programme 18 schemes the value of which was just under £700m.

In addition during CP5 Network Rail has been funded by ORR in relation to the East Coast Main Line Connectivity Fund. This is £247m to improve capacity and journey times. Alliance is confident that the £900m of funding on ECML schemes during CP4 and CP5 will deliver the stated benefits in Network Rail's Delivery Plan. If it does not then one must question the value to the taxpayer, the government and the rail industry.

Alliance believes that following a timetable recast to optimise the network, capacity will exist to accommodate all of our proposed services and we are working with Network Rail to prove this capacity. Should capacity still remain constrained we would look to the ORR to explore the use of the provision set out in Paragraph 18(5) of the Access and Management Regulations to make better use of the network. If no capacity exists, the route will need to be declared congested by Network Rail and a suitable plan prepared to address the congestion.

Alliance is confident that any risk to performance and operations will be minimal, and certainly no greater than the introduction of any further franchised IEP services. A high level timetable will be provided to both Network Rail and ORR

You make particular reference to the East Coast Connectivity Fund and provide full details in Annex A of your response. Alliance has some specific comments in relation to some of the statements made in this Annex.

Under service levels you state that because of the critical nature of timings through and beyond central London, Thameslink trains will have to be 'first on the graph'. This is not a decision that can be made by the DfT. This statement (which has been challenged previously by Alliance) appears to be a specific instruction to both Network Rail and ORR to allocate capacity and award rights in an extremely discriminatory way. As I am sure you are aware under EU law the ORR "shall not seek or take instructions from any government or

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other public or private entity when carrying out the functions of the regulatory body..." (Directive 2001/14/EC Article 30 – now Article 55 2012/34/EU, Clause (3) Paragraph 4). It is also the case that *"The infrastructure manager shall perform the capacity-allocation processes. In particular, the infrastructure manager shall ensure that infrastructure capacity is allocated in a fair and non-discriminatory manner..."* (Article 39 2012/34/EU).

In addition, for the DfT to assume that Thameslink services will be 'first on the graph' challenges the process set out in Part D of the Network Code and is contrary to legislation set out in the Access and Management Regulations 2005. This is an extremely serious and anti-competitive statement made by the DfT.

It is disappointing that the DfT has now taken to even more meddling in the railways for its own aims by actively pursuing such anti-competitive behaviour. Britain's Railways were, for many years, ahead in terms of market liberalisation, however the further anti-competitive approach taken by the DfT is fast making the UK lag behind the rest of Europe, whilst offering little comfort to the railways biggest funders – its passengers.

As chief executive of the ORR Richard Price commented: *"Passengers are increasingly the main funder of railways and must be central to developing its plans for the future"*. There is little evidence in your response that passengers are of any concern to the DfT.

Yours sincerely,



Ian Yeowart
Managing Director