



Peter Swatridge
Head of Regulatory Economics
Network Rail

To: Rail@cma.gsi.gov.uk

16 October 2015

Network Rail's response to CMA's consultation on competition in passenger rail services

We welcome the opportunity to respond to CMA's consultation on competition in passenger rail services in Great Britain. CMA has identified a good range of options, and we are keen to engage with CMA as it develops its thinking both through RDG and bilaterally. In progressing with this project, it is important that CMA engages with all stakeholder groups in an open and transparent way, including during the impact assessment phase of the project.

When CMA comes to fully consider each of its proposed options, along with the status quo, it may wish to adopt the following criteria to use as a framework for its assessment:

1. The extent to which each option improves safety;
2. The extent to which the option improves passenger and freight user experience; and
3. The extent to which the option improves value for money for the taxpayer.

This suggested framework makes no presumptions about the impact of increased competition on any of the above criteria. Before suggesting any changes to a system, it is however good practice to fully understand all the impacts, whether positive or negative. For example, the assessment should consider the likely improvement, or otherwise, on safety. We suggest that CMA adopts this approach for its impact assessments.

Whichever option is preferred, we strongly believe that Network Rail should be financially incentivised to grow all types of traffic.

This letter sets out Network Rail's high level comments on CMA's consultation. Detailed points about specific areas of the consultation are contained in the annex to this letter.

Purpose and consistency of approach

Currently, there are several differing views among stakeholders regarding what we are trying to achieve as an industry with regards to on-rail competition. CMA has the opportunity to 'sit above' these differences, and lead an open and honest conversation about the purpose of on-rail competition. This should help to address the conflicting views among different stakeholder groups. It will also help to focus discussions on what the industry really wants to



achieve, rather than jumping to detailed solutions (e.g. seeking to create more competition) before being clear what outcomes the industry would want to see.

In terms of what the industry should be working towards, Network Rail considers that, through on-rail competition, we should be seeking ways to:

- Make best use of the available network capacity; and
- Provide the best service to end users.

It is unlikely that a purely market-based approach will be able to achieve this, neither will a completely planned approach. The optimal solution most likely lies between these two extremes, in the form of a 'reasonably' planned system which still provides opportunities for all operators to innovate.

Throughout CMA's work, and specifically in developing a final proposal, it is important that CMA is consistent in how it approaches access rights and access charging. However, we recognise that different approaches may be appropriate for different parts of the network, given that these parts, and their use, are not homogeneous.

The role of System Operator

The options presented in CMA's consultation would all require a stronger System Operator role, in terms of maximising capacity through timetabling and allocating train paths to operators in a non-discriminatory way. Having a clearly defined System Operator role would help to maximise the use of the railway without stifling innovation amongst operators and, as such, should support any of the options that CMA is considering.

Capacity optimisation

In considering the proposed options, CMA should recognise that capacity optimisation is one of the best ways to deliver value for money for funders and end users. In a mixed use railway, the balance between different types of trains is important in terms of meeting customer needs. However, different types of trains can be associated with a less efficient use of available capacity. This is because, to maximise the use of available capacity, train usage patterns need to be similar. This trade-off between a greater mix of services and an efficient use of capacity should be recognised when CMA comes to consider its options.

The 'State of the World'

Prior to suggesting any changes to the current regime, it is important to understand what 'State of the World' we are currently in and where we may be in the future. For example, if franchises became more rigidly specified and 'use up' available network capacity, there would be little point creating a regime to encourage more competition. As noted above, we need to focus on what we are trying to achieve, and then design a system which better delivers these goals within the constraints that the industry faces. The reasons for (and benefits of) any change should be clearly articulated.



As part of its Review of Charges work programme, the Rail Delivery Group (RDG) has been considering the current, and potential future, 'States of the World' and how any changes to the charging regime would fit in with these. CMA should consider engaging with this work, in the impact assessment phase of this work.

Franchising rigidity

In the current system, franchised passenger operators can face a great deal of rigidity through their franchise agreements in terms of what services they can offer. In developing the preferred approach, CMA should consider the effects that this franchising rigidity has on franchised operators' abilities to respond to increased competition.

Freight

We would encourage CMA to think about the potential consequences for freight operators in all of its suggested options, and be clear how each option might affect freight. The rail freight market can be vulnerable to even the suggestion of changes. For example, if changes in the way that Network Rail recovers its fixed costs were being considered, the potential for allocating these costs to freight operators could deter investment in the rail freight sector for at least the duration of the discussions. This could have a real impact on freight operators' businesses. Given the importance of rail freight, in terms of economic and societal benefits for the country, it is important that these effects are understood.

In addition to our high level comments set out in this letter, please find enclosed an annex which sets out further, more detailed comments on other aspects of CMA's consultation. The annex addresses:

1. General, but more detailed comments on CMA's consultation;
2. Network Rail's comments on each of CMA's options; and
3. Detailed comments on specific areas of CMA's consultation.

Next steps

When CMA undertakes its impact assessments for each option, we recommend that it fully engages with the industry in an open and transparent way. We would also encourage CMA to join up this project with other areas of industry work, for example the 2018 Periodic Review (PR18) and the RDG Review of Charges project.

I would be happy to discuss any aspect of this response with you in more detail.

Yours faithfully,

Peter Swatridge

ANNEX – DETAILED COMMENTS ON CMA’S CONSULTATION

1. General, but more detailed comments on CMA’s consultation

Area	Network Rail comment
Safety	Any safety implications should be considered for each the option.
Reasons for change	Changes should not be made for a marginal improvement only. There needs to be sufficient improvement in outcomes to warrant an overhaul of the current system (CMA should be cautious about suggesting a change from a regime that has helped deliver significant traffic increases - “first, do no harm”).
	It is important that CMA uses the right counterfactual to assess its proposals against. For example it could be the case that a lot of the additional capacity generated by Digital Railway will be used in franchises to address anticipated traffic growth. In its assessment of options, CMA discusses traffic growth that could come from more competition. CMA should be clear how much of this traffic would come in the counterfactual case, anyway.
Cost recovery	Consideration should be given to the likely financial impact (in terms of cost and financial risk) of the options across the whole railway value chain (rather than just TOCs and passengers), and the behaviours they seek to drive.
Stability	In the current system, even small changes can have large, unintended consequences. For example, the East Coast franchise (which has the most competition from OA operators) has failed before. CMA should examine the reason for this failure before concluding that increased competition offers the best outcome for passengers.
	There has been a significant amount of change in the industry recently. There could be merit in the industry having some stability to allow it to deliver for its customers in a ‘steady state’.
Capacity utilisation	Operators could be permitted to bid for access rights, in a system akin to the Premier League TV rights. Without a system such as this, there could be a risk that scarce network capacity is left vacant in the anticipation of OA competition, which could be wasteful of network capacity.
	CMA’s chosen option should not use scarce capacity less efficiently than currently.
	Network Rail welcomes that CMA recognises that a greater level of flexibility in terms of access rights could allow additional capacity to be freed up (i.e. through more efficient timetabling). However, the rigid service specifications that are often present in franchises can prevent this, as other traffic has to ‘fit around’ franchised services.
The OA proposals rely on additional network capacity being created through Digital Railway, which highlights the	

	<p>importance of the Digital Railway project.</p> <p>CMA's chosen option should not prohibit the ability of 3rd party funders, such as regional governments, investing in the railway network in return for a degree of guaranteed access over a period.</p>
Service specification	<p>It is important to be mindful that some services are not commercially viable, but are justified by the societal benefits they generate. CMA's options impact on how those services are specified (as there is unlikely to be competition for these services). CMA should take this into account.</p>
Freight	<p>Increased passenger traffic could result in freight being 'squeezed' off the network. CMA should recognise that the railway is mixed use, and any capacity allocation should take this into account (e.g. through administrative mechanisms).</p>
Unintended consequences	<p>Possible consequences of each of the options should be considered. For example, industry transactions costs may increase as a result of more operators (e.g. there would be more interfaces in how Network Rail allocates capacity, interacts with operators and recovers its costs).</p>



2. Network Rail’s comments on each of CMA’s options.

Option	Overview of option	Network Rail comment
1	<p>Retain the existing market structure, but with <u>significantly more open access operations</u></p> <p>This would require a reform of the current access charges:</p> <ul style="list-style-type: none"> • OA would contribute towards NR’s fixed costs; • OA would pay a ‘universal levy’ to cover the shortfall in franchise premiums as a result of more competition; and • All operators would be subject to charges reflecting the opportunity cost of their access rights. <p>Funding for unprofitable (but socially valuable) services would come from an OA levy on profitable services.</p> <p>Under this option, the NPA test is likely to be removed.</p>	<p>An increased number of TOCs could increase transactions costs for the industry. The benefits from this option would need to outweigh these additional costs.</p> <p>This option would require a consistent approach with regards to access charging and access rights, as noted in the main body of our response.</p> <p>There is an argument that OA operators should contribute to the fixed costs of the railway, but if Network Rail charges more than the short run marginal cost, there is a risk that economically valuable traffic will no longer be able to afford to use the network.</p> <p>Under this option, there is a risk that Network Rail would under-recover its fixed costs if OA operators decide to stop running services.</p> <p>Network Rail is not opposed to extending the opportunities for OA operators, but we need to be clear what the purpose of that approach is, to avoid perverse outcomes. For example, as noted above, there is a risk that a charging approach seeking to recover Network Rail’s fixed costs could be introduced which could have the effect of pricing-off valuable OA traffic.</p> <p>Franchise specifications would need to ensure that more OA is possible.</p> <p>This option is based on the assumption that more OA operators would want to enter the market.</p> <p>The universal levy should apply to all operators, not just OA. However, this could be considered as a mark-up. According to relevant EU legislation, this would therefore require that the operator/market being exposed to this mark-up was able to afford to pay it.</p> <p><i>“The level of charges shall not, however, exclude the use of infrastructure by market segments which can pay at least the cost that is directly incurred as a result of operating the railway service, plus a rate of return which the</i></p>

		<i>market can bear</i> " EU2012/34 Art.32
2	<p>Appoint <u>2 franchisees for each franchise</u>. This franchise could be split based on service frequencies, or unprofitable services. This could be asymmetrically (e.g. with an 'anchor franchisee') or symmetrically (50:50).</p>	An increased number of TOCs could increase transactions costs for the industry. The benefits from this option would need to outweigh these additional costs.
		This could also increase transactions costs for DfT in terms of the franchising process. There could also be increased complexity for the management of the network.
		The dynamic effects of competition would need to outweigh any <i>ex ante</i> franchise value loss as a result of the competition.
		Multiple franchisees could make it more complicated for passengers (for example, with regards to ticketing).
		With multiple franchisees, it may be that the service offering of the different franchisees may not differ significantly. This is because, to maximise the use of available capacity, train usage patterns need to be similar. Similarly, different train fleets may change service pattern capabilities and may actually reduce capacity (as fewer services can be fit into a timetable with differing service patterns).
3	<p>Redesign current franchises so that there are <u>more overlapping franchises</u>. This goes against the action of 15 years ago to reduce the number of overlapping franchises.</p>	This option is most similar to current system, which could suggest that this is a reasonable approach to pursue.
		The dynamic effects of competition would need to outweigh any <i>ex ante</i> franchise value loss as a result of increased competition.
4	<p>License <u>multiple operators within one franchise</u>, creating restrictions and obligations on their activities (e.g. in terms of running unprofitable but socially valuable services).</p>	An increased number of TOCs could increase transactions costs for the industry. The benefits from this option would need to outweigh these additional costs.
		This could also increase transactions costs for DfT in terms of the franchising process. There could also be increased complexity for the management of the network.
		The dynamic effects of competition would need to outweigh any <i>ex ante</i>

		<p>franchise value loss as a result of the competition.</p> <p>CMA's option 4 discusses quite a lot of operators on each part of the network. If this approach were to be adopted, in order to be able to make best use of network capacity, a system akin to the Premier League TV rights could be appropriate. This could see pre-determined packages of access rights being bid for, with a limit on the total number of packages that any one train operator is allowed to win. With this approach, it might be most appropriate for the infrastructure manager to carry out the auction (as is the case with the Premier League).</p> <p>CMA would need to be clear why this option would be better than option 2.</p> <p>Multiple franchisees could make it more complicated for passengers (for example, with regards to ticketing).</p>
--	--	---

3. Detailed comments on specific areas of CMA's consultation

Area	Network Rail comment
Upstream efficiencies (summary, para 39)	These should not introduce additional complexity to Network Rail for little gain. It may also require that Network Rail has more ability to enforce Network Change.
"Network Rail could take a more active role in managing the timetable" (summary, para 46)	Network Rail requests that CMA clarify this statement (what is CMA expecting Network Rail to do?).
"Schedule 8...incentivises operators to plan their services..." (summary, para 47)	This should be "operate" rather than "plan".
Capacity Charge (summary, para 6.30) "ORR undertook a recalibration of variable charges resulting in a substantial increase in the capacity charge, reflecting scarcity ..."	The Capacity Charge is not designed to reflect scarcity – it recovers the additional Schedule 8 costs as a result of increased traffic on the network.
Greater complexity in operating the network (summary, para 44)	Whilst this could increase the difficulty of planning the timetable due to different service patterns, experience to date (e.g. on the East Coast) has demonstrated that, with enough development time the timetable can be planned effectively. This, therefore, is unlikely to be a significant barrier for Network Rail, providing that all operators have the same track access conditions and provided that the passenger market is relatively stable.
Recovery from disruption (summary, para 48)	Increased competition from multiple operators may actually help performance and service recovery. This is because OA operators are especially incentivised for their services to perform well, as they are seeking to attract new customers in new markets.