



Response to the ORR consultation

On-rail competition: consultation on options for change in open access

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1. Introduction

- 1.1. **pteg** represents the six Passenger Transport Executives (PTEs) in England which between them serve more than eleven million people in Tyne and Wear ('Nexus'), West Yorkshire ('Metro'), South Yorkshire, Greater Manchester, Merseyside ('Merseytravel') and the West Midlands ('Centro'). The West of England Partnership, Leicester City Council, Nottingham City Council, Transport for London (TfL) and Strathclyde Partnership for Transport (SPT) are associate members of **pteg**, though this response does not represent their views. The PTEs plan, procure, provide and promote public transport in some of Britain's largest city regions, with the aim of providing integrated public transport networks accessible to all.
- 1.2. **pteg** welcomes the opportunity to respond to the ORR's consultation on open access options.
- 1.3. Our response starts by summarising the key points made by **pteg** at the time of the 2011 on-rail competition consultation. We then set out our views on the proposed options in the current consultation document.

2. Consultation response

Context

- 2.1. The PTEs are seeking a greater devolved role in the delivery of local rail services in the West Midlands and the North of England, and discussions are currently underway between the PTEs and the DfT on this issue. The McNulty review identified potential benefits relating to devolved funding, specification and management of local rail services and **pteg** will be looking for the ORR to facilitate this wherever possible.
- 2.2. The PTE devolution process could result in PTEs having a much more significant financial stake in the running of the railways. As such we have an extremely keen interest in both reducing rail industry costs, and in managing the different types of risk which bidders and sponsors are exposed to. The regulatory framework governing on-rail competition could have an important impact in both areas and we feel that this needs to be clearly acknowledged and understood.

The value of on-rail competition

- 2.3. **pteg** recognises that on-rail competition can produce benefits where it acts to drive down operating costs, reduce fares or improve service levels. Indeed, many open access operators have significantly widened the range of destinations available from some parts of the network which are poorly served by franchised operators.
- 2.4. However, it also needs to be recognised that greater on-rail competition can lead to a more fragmented network, growing confusion amongst passengers, and hence a worsening perception of the rail product. On-rail competition is also unlikely to lead to the optimal use of scarce capacity from an operational point of view and can increase unreliability in congested parts of the network.
- 2.5. As such, we do not take it as given that more on-rail competition will always be in the best interest of passengers and believe that there is an on-going need for a regulatory mechanism to mediate the interests of open access operators, other rail industry stakeholders and passengers.

On-rail competition and subsidised services

- 2.6. It is important to note that the local rail services supported by PTEs require a substantial amount of operating subsidy, justified on the basis of the positive externalities and wider socio-economic value which they generate. And while it's unlikely that open-access operators would provide additional services in direct competition with most short distance services there is a real threat of cream skimming on medium or long distance flows. This in turn could put additional pressure on public sector support for local services (as there is a significant amount of cross-subsidy within individual routes at present) and may lead to the withdrawal of some local services.

Impact of revenue risk on franchise bids

- 2.7. In addition to the direct effect of open-access services on franchised operators' revenues, the uncertainty surrounding the possibility of on-rail competition could affect bidders' revenue forecasts (and hence the bid price) even if no open access bid was ever to materialise. We therefore believe that the ORR needs to take into account the impact of its on-rail competition policy on operator behaviour and how that might contribute to industry-wide risk and cost levels.

Options for reform

- 2.8. In assessing the reform options proposed by the ORR, our key concern has been to ensure that the regulatory regime ensures franchised operators (and sponsors) are adequately compensated for any detrimental financial impact due to the introduction of open access services.
- 2.9. In relation to Option 1 (status quo), we agree with the ORR's assessment that the current system does create a barrier to entry in those cases where open access operators would be willing to compensate franchised operators for the loss of revenue or to contribute to fixed infrastructure costs. As such, there is merit in exploring alternative options.
- 2.10. In relation to change options, we are opposed to option 3B as this could lead to a greater revenue reduction for franchised operators than at present without having any impact on the track access charges that they pay to Network Rail.
- 2.11. In contrast, option 3A could lead to a direct reduction in fixed access charges for those franchised operators most directly affected by the open access operator. However, there is no guarantee that this saving would cover the loss of revenue incurred by an individual franchised operator. Our understanding of option 2 is that, while the additional track access charges paid by the open access operator could reduce the charges paid by franchised operators, no mechanism is provided for ensuring that this reduction is passed on to those operators who stand to lose revenue as a result.
- 2.12. On balance, we feel that of the three change options put forward, 3A is the one which is worth exploring further.
- 2.13. However, even this option has the potential to add greater uncertainty to the franchise process which could increase the risk premium employed by franchise bidders. We would therefore suggest that any further work by the ORR in this area needs to include an explicit assessment of the impact of changes on industry-wide costs and, specifically, the net financial impact on the public purse.