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Response to the ORR consultation

## **The potential for increased on-rail competition**

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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'). 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 the potential for increased on-rail competition.

## 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. 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 and can increase unreliability in congested parts of the network.
- 2.4. In addition, we feel that the ORR consultation document may have over-stated the role of on-rail competition in driving down operating costs. It seems reasonable to us to assume that the franchising process is effective in stimulating productive efficiency, as illustrated by the number of bidders active in the market and the levels of profit earned by franchised operators. It is therefore our view that the lower costs that the ORR has statistically observed for open-access operators must stem from factors beyond the control of franchised operators, in particular the impact of TUPE regulations and other regulatory constraints (such as performance management regimes). If we take the ORR's findings to their logical conclusion, the whole rail network should be provided on an open-access basis if the overarching objective was to drive down operating costs. However, we do not believe this would necessarily be in the best interest of passengers or government as it might lead to

sub-optimal capacity allocation, and, potentially, wide variation in quality standards and performance across the network.

### **On-rail competition and subsidised services**

- 2.5. 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 would 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.
- 2.6. We believe that the wider socio-economic value of local rail services is inadequately accounted for within existing rail appraisal frameworks<sup>1</sup> and the impact of this sort of outcome is likely to be under-estimated. We feel that this needs to be explicitly recognised by the ORR.

### **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.

### **Open access and congested networks**

- 2.8. The congested nature of local rail networks in most PTE areas means that the potential for new services to operate is limited. However, even a relatively infrequent open-access operation could result in undesirable impacts on local services (for example through the loss of regular interval patterns) and it is important that these impacts are also understood fully as part of any appraisal process. It's not clear to us at present how the ORR intends to take into account the value of regular, clock-face timetables and unreliability in its assessment of open-access bids.

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<sup>1</sup> For example, the externalities generated by short distance trips into main urban centres may be significantly greater than the average figures assumed; diversion factors from car to rail may be greater than the industry average; wider economic values, option and non-use values are not typically factored into calculations.