



2 Marylebone Road
London NW1 4DF
t 020 7770 7000
f 020 7770 7600
which.co.uk

James Lambert
Project Director
Passenger rail services: competition policy project
Competition and Markets Authority
Victoria House
37 Southampton Row
London
WC1B 4AD

2nd November 2015

Dear Mr Lambert

Which? welcomes the opportunity to respond to the consultation on the CMA's passenger rail services competition policy project. We support the CMA acting on the Strategic Steer from the Government to play 'a key role in challenging Government where Government is creating barriers to competition'.

Which? believes that the goal of the regulatory system for rail should be to deliver the quality of service that consumers are willing to pay for at the lowest possible combined cost, whether that cost is funded by passengers or taxpayers. We are in favour of competition, and in particular competition in-the-market, where this can work. This is likely to deliver better outcomes for consumers than regulatory alternatives, including price regulation. Finally, Which? supports examining the existing approach to regulation within the rail sector, including franchising, to understand whether better approaches can be identified.

CMA's goals of the work

Which? supports the CMA's objectives to secure improvement in rail for the benefit of passengers and taxpayers through retail and upstream efficiencies, enhanced service quality and innovation and downward pressure on fares. However, we question the constraint that the CMA proposes to place on itself: that its recommended approach should not disrupt forthcoming rounds of franchise awards.

The discussion document highlights many potential benefits from increased on-rail competition. If implementing one or more of the CMA's options for reform were expected to deliver benefits that outweighed the costs of any disruption to forthcoming franchising rounds, then that option or options should be pursued in any case. What ultimately matters is improving the railways for passengers, not the smooth implementation of existing franchising plans.

Options for reform

Which? considers that the CMA has broadly identified the relevant options for reform. We note that these options are not necessarily mutually exclusive. All of these options should be



given careful consideration by the Government, including Option 4 - moving away from franchising in favour of licences.

Option 4 is the most far-reaching reform, but - because it would free operators and regulators from the rigidity of franchise agreements, and enable on-going competition in-the-market - it could offer the greatest scope for benefits.

There is considerable experience in other sectors, such as electricity, gas and telecoms, in the design of effective licence conditions, arrangements for allocating access to scarce network capacity and mechanisms for co-ordination between multiple operators. It has also proved possible across a range of sectors to deliver Universal Service Obligations for the provision of uneconomic aspects of service alongside competitive overall service provision.

Government revenue-raising

As the discussion document recognises, effective competition generally improves value for money for consumers. It achieves this in part by driving efficiency and innovation - creating pressure for provision of the right services at the lowest cost. It also enables consumers to benefit from those efficiencies - by paying a competitive rather than monopoly price, which also expands demand by enabling more consumers to afford the service.

We recognise that the railways are funded by both passengers and taxpayers. Taxpayers therefore have a legitimate interest in cost of the railways. However, we are concerned by the aim expressed in the discussion document to create 'no additional demands on the taxpayer.'

Rail competition is currently highly restricted, and increased competition would be expected to lower passenger prices towards a more competitive level. To the extent that the Treasury benefits, through franchising, from a degree of monopoly pricing in rail, increased competition would be likely to bear down on the Treasury's revenues from rail. At the same time there would be a countervailing effect, from competition reducing rail costs and increasing demand, buoying Treasury revenues and reducing the necessary subsidy.

It is not possible to say in advance which effect would be greatest. However there would be no good case for continuing to restrict competition simply because Treasury revenues were expected to fall overall.

The Treasury's general approach to revenue raising should be to raise revenues with minimum distortion to the economy. Restricting competition in a major economic sector in order to maintain the Treasury's monopoly rents is an economically distorting approach to revenue raising - with the effect of suppressing demand, efficiency and innovation. There should be clear separation between the design of arrangements for regulating business sectors and the design of arrangements for raising Exchequer revenues.

A more appropriate aim for the CMA would be to ensure its recommendations did not create additional demands on the taxpayer that were not necessary in maximising net benefits to society of the proposed reforms. Unnecessary extra demands on taxpayers would include,



for example, expecting taxpayers to make up any shortfall from an inadequate track access charging regime for Open Access Operators.


Ambition on timing

The discussion document states that none of its options for reform could be implemented until 2023 at the earliest because of the terms of current and imminent franchises. We question this conclusion.

We recognise that some of the reforms to the existing system to Open Access under option 1 and the creation of new over-lapping franchises under option 3 could have a material impact on some existing franchisees. We also recognise that those franchisees could not reasonably have made allowance in their franchise tenders for such regulatory change. Some reform options might also renege on commitments given by the Government in franchise agreements. However, this should not automatically rule-out regulatory change while existing franchises are still running.

A decision to implement any of the options for reform would be made because of expected benefits to passengers and taxpayers. There would therefore in principle be scope to compensate franchisees in some way, if necessary, who were materially negatively impacted by the changes, while maintaining an expected net benefit. Whether an acceptable agreement on compensation could be reached would depend on the changes proposed and the circumstances of the franchise. However, the possibility of such an agreement should not be ruled out at this stage.

In addition, there may be more spare capacity currently available on the network than is reflected in the discussion document and that could be used by Open Access Operators - even before new capacity is built or new signalling technologies rolled-out. We note that in its recent consultation 'System operation - a consultation on making better use of the railway network', the ORR states: 'While cost and performance are currently measured and regularly reported, the same cannot yet be said of the capacity of the system. Given the importance of having a good understanding of capacity ... we think this is an area that merits further consideration.'

Which? would be happy to discuss this response with the project team in more detail. If you would like further discussions, please contact [].

Yours sincerely

Richard Lloyd
Executive Director