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Competition and Markets Authority
Victoria House
37 Southampton Row
London WC1B 4AD

Dear Sir

**COMPETITION IN PASSENGER RAIL SERVICES IN GREAT BRITAIN – A
DISCUSSION DOCUMENT FOR CONSULTATION**

1 Introduction

Arriva is pleased to have the opportunity to respond to the Competition and Markets Authorities (CMA) discussion document relating to competition arrangements associated with the provision of passenger rail services in Great Britain. We note the objectives of this review are to seek improvements in the railways in Great Britain to create benefits for passengers and taxpayers by reviewing whether greater on-rail competition is desirable and deliverable.

The current industry structure, while it has predominantly focused on competition for the market, has allowed a degree of on-rail competition and it is clear that this combined approach has supported the delivery of some of the significant achievements the rail industry has delivered. However, the current arrangements for on-rail competition lack coherent structure and are not congruent with other elements of the current industry structure. At the same time, significant elements of the rail market have become essentially commercial in nature.

This situation is creating increasing levels of tension where on-rail competition exists or attempts are made to increase its scope. Therefore, the consultation is very timely given the success that the industry is achieving, the evident opportunities available for further improvements and the scope of the industry reviews which have the potential to enable significant industry structural reform.

Arriva has been involved in the development of the Rail Delivery Group (RDG) response to the consultation and is supportive of that response, but would like to build on it further. We have therefore not repeated the detail of the response but have added to it.

2 Context

The GB rail industry at privatisation was understood to be an industry in decline that required a different commercial approach in order to improve the service provided to passengers while also reducing the burden the industry was seen to place on the taxpayer. The structures put in place included specific restrictions on on-rail competition in order to safeguard the potentially vulnerable Franchises which were mainly non-commercial at that time. However, it was expected that these restrictions would be progressively reduced as the industry matured and growth enabled on-rail competition between increasingly commercial services.

Today, the rail industry in Great Britain is highly successful in the delivery of its core functions of enhancing mobility and connectivity. As a result, rail is increasingly seen not as a drain on society but as an enabler of social and economic growth. At the same time, the cost of the railway to the taxpayer is reducing. In addition, the prices paid by users are almost static in real terms (RDG report September 2015, "GB rail: better services, better journeys and better value").

This improved position, delivered incrementally over the last 20 years, has been created by growth in use of the railways by both passengers and freight customers and by the strong competition for the market driven by the DfT's Franchising process. Given the highly competitive nature of the overall transport and mobility sector and the pressures on the public purse, this suggests that the choice which rail offers passengers and freight users is increasingly an attractive one and the value that rail provides to the taxpayer is high.

With this background and in the light of emerging industry developments and trends, it is timely to consider whether, if the industry were structured to provide greater choice to passengers through greater on-rail competition in commercial market segments, it would be able to further improve its already impressive performance.

As the CMA highlight, cross-referencing to other sectors where consumers have a broader level of choice would suggest that in-market competition delivers significant consumer benefits. We note for example the success of the deregulation of the air industry in 1997. This led to a greater choice in carriers and routes. In addition air fares were reduced, most notably this led to an “average reduction of 75% in cheaper fares ... and contributed to an increase in the number of flights of 78%”¹. Therefore, the opportunity should be taken to explore whether similar benefits could be achieved in the rail industry.

However, the approach to enabling the necessary competitive environment within which train operators could provide attractive choices while operating stably and successfully will need careful consideration to reflect the nature of the rail industry. In particular, the mixed use made of the rail network, the need to secure investment in network infrastructure and the societal requirement to ensure the operation of a range of non-commercial Public Service Obligation operations (PSO) will need to be addressed. In addition, for a network industry such as rail, there is a need to develop frameworks in a coordinated fashion such that all elements are congruent, aligned with industry objectives, and are implemented in a manner that ensures stability for all industry stakeholders.

However, none of these factors should act as a barrier to considering the establishment of an industry structure where increased levels of on-rail competition in commercial market segments could create greater consumer choice and so drive further improvements in the rail industry’s performance.

3 Key enablers to deliver an effective in market competition in rail through greater on-rail competition

In order to deliver an effective competitive market with greater on rail competition we believe the industry will need to develop a structure that incorporates the following key aspects.

3.1 Timeframe

¹ MVA report Assisting Decisions -2011 para 2.3.15

Implementation of any structural changes should align with the industry's planning and commercial timescales. Arriva would endorse the CMA's observation that a timeframe stretching to 2023 for the development and incremental implementation of such changes is sensible, would ensure stability and would be deliverable.

3.2 Clear identification of rail market sectors

In order for stable and sustainable on-rail competition to deliver its potential benefits through the creation of clear customer choice, there needs to be a rational identification of the market segments where on-rail competition is to be enabled. Arriva would endorse the CMA's observation that these market segments are those related to the operation of rail services which can and should operate commercially without the need for direct or indirect financial support other than from the passenger fare box. It would be expected that these rail market segments would be ones where the passenger has a high degree of choice between alternative modes or where their journey is to some extent discretionary. As highlighted by the CMA, these features are clearly evident in the InterCity or Long Distance Highspeed rail sector.

At the same time, the process of clearly identifying the contrasting rail market segments or service elements which do require such financial support would allow these to be identified and treated as PSOs.

Consideration of such matters has been central to the EU Rail market reform programme and the arrangements for establishing properly structured Public Service Contracts for the provision of PSOs have been detailed in Regulation 1370/2007. Applying these arrangements in a way that focuses on the PSO requirements would enable funders to be confident that they were getting value for money in the provision of the services and operations they sponsor. Such arrangements have been used for several years in the provision of non-commercial bus services where whole operations or individual services have been procured transparently alongside the continued operation of commercial services.

Arriva continues to have the view that the DfT's increasingly focused Franchising process provides a dynamic environment for completion for the market to provide PSOs ensuring high quality and good value to both passengers and taxpayers. An increased clarity of the distinction between commercial and PSO market segments with appropriate competition environments for each would make the Franchising process even more effective in delivering these key aims.

3.3 Value for money provision of PSOs

If an on-rail competitive environment were enabled for the provision of commercial passenger services, arrangements would be necessary to continue to ensure value for money provision of PSOs. These arrangements would need to include:

- Clear definition of PSOs in accordance with Regulation 1370/2007 and relevant case law.
- Processes to allocate appropriate network capacity for PSOs
- Strong and effective competition for the market to provide PSOs
- Clear "sponsorship" of the PSOs by suitable funders whether this be at a national or devolved regional level.

As noted above, Arriva continues to have the view that DfT's Franchising process provides the necessary structure to deliver these outcomes in non-commercial rail market segments.

3.4 Cross subsidy of PSOs

Arriva acknowledges that currently Franchises made up of highly specified commercial services cross subsidise genuine PSOs operated by other Franchises. Therefore, if these commercial services were to be operated in a competitive on-rail environment, there would need to be a transparent and objective mechanism put in place to ensure that the commercial services continued to support the funding of the network and the provision of PSOs, while ensuring the sustainability and stability of the commercial services themselves.

Article 12 of Directive 2012/34 allows operators of commercial services to support clearly defined PSOs by way of payment of a levy. Arriva is supportive

of arrangements being put in place to allow commercial operators to be charged a levy in accordance with Article 12 in order to support PSOs and has discussed such mechanisms with DfT.

3.5 Access for freight

Sustainable mechanisms to ensure the continued provision of competitive freight services need to be incorporated into any new industry framework. If greater on-rail competition were to be enabled for commercial passenger services, arrangements will be necessary to ensure the continued provision of freight services. These arrangements would need to include processes to allocate appropriate network capacity for freight services.

3.6 Consumer Protection

Arriva believes that appropriate consumer protection arrangements are in place through existing industry mechanisms including the provisions of the range of Operator Licences held by all service providers. These ensure that all service providers, including commercial operators, continue to provide key network benefits such as information provision, complaints handling, provision of interavailable tickets and passenger support in times of disruption.

Clearly, such mechanisms can and should be kept under review and a change in the degree of on-rail competition could be a factor in such a review.

3.7 Consistent treatment of operators

All operators involved in the provision of commercial services and therefore faced with on-rail competition should have the same opportunities to access the network in accordance with the overarching EU and UK specific legislation. The access processes must be managed in a fair and non-discriminatory manner by an independent infrastructure manager.

The competing operators of commercial services must also have the same degree of flexibility to develop and adjust their service offer in the light of developing market conditions and be subject to a transparent and objectives Access Charges structure in line with the applicable regulations.

The timetable development process will need to continue to ensure that timetables are produced which reflect capacity allocation decisions and also make the most effective use of Network capacity to support an operationally efficient and effective railway.

The current industry processes for timetable development already address the needs of a mixed traffic operation with multiple service providers. However, some parts of the capacity allocation process would need to be revised in order to provide a fully level playing field between different operators deemed to be in the same market segment. For example, current industry capacity allocation processes favour the provision of commercial franchise services through mechanisms such as the Not Primarily Abstractive test and restrictions placed on Access Rights which continue to moderate the degree of competition faced by commercial services operated by Franchises.

3.8 Government role in the rail industry

Rail is an important part of the Government's and EU strategy, economically, politically and in terms of environmental policy. Likewise Government is important to the rail industry in terms of the support provided to PSOs and network development. However, since privatisation, government has taken an increasing role in the direction of the rail industry.

We believe that in a rail industry where greater on-rail competition is allowed, operators of commercial services will be better placed to respond to commercial market opportunities and will need the flexibility and freedom to do so. This will, in turn, free Government to focus on areas where the taxpayer is at risk or where broader policy aims need to be addressed. Such a balance could be achieved through existing mechanisms - for example the clear definition of PSOs, the increasingly effective Franchising process and the protection of returns on investment by rebate mechanisms (See below).

3.9 Government Investment in the Network

Page 12 of the review suggests that there is a risk of “free-riding” on investment in the industry by Open Access operators. This part of the report perpetuates the myth that investment in the network is only intended for the benefit of the franchised operators. This notion is incorrect.

Directive 2012/34 states in recital 8 the following:

“In order to boost competition in railway service management in terms of improved comfort and the services provided to users, Member States should retain general responsibility for the development of the appropriate railway infrastructure.”

It is clear from the Directive that investment in the infrastructure should be made “in order to boost competition”.

We also note at page 128 of the review the suggestion has been made that *“having multiple operators on a route may undermine the business case for investment as the government is less able to forecast the utilisation of the new infrastructure”*.

Again we note recital 8 of Directive 2012/34 that investment should be made in order to boost competition.

However, returns on investment made in the infrastructure can be protected by a number of industry mechanisms. These include the establishment of Access Options for PSOs and through the rebate mechanism ensuring recovery of commercial returns from investment from any operator of commercial services using the enhanced infrastructure.

3.10 Operator Investment in the network

We note that genuine third party funded investment in the infrastructure is limited and tends to be small scale. This is partly due to the limited timeframe for operators to secure a return on large scale investments requiring payback over long periods. Arriva believe that, were revised industry arrangements to be developed such that there were reduced constraints on operator business

planning timescales, there is a significant opportunity to leverage genuine third party investment into the industry.

A new industry structure with larger scale Open Access operation of commercial services could be the catalyst for a move away from reliance on infrastructure funding by Government towards longer term investments through Operators in return for longer term access rights. The Railways Infrastructure (Access and Management) Regulations 2005 (as amended) already provide the legal framework for access contracts in this respect.

Encouragingly, many of the factors identified above are already addressed by existing arrangements or are under active consideration by the industry and associated bodies through a variety of work streams including:

- Franchise Review
- Review of Charges
- Access Rights Policy
- Industry Access Programme
- System Operator implementation.

However, it is important that these work streams are able to do their work and develop arrangements that are congruent with each other and with the model adopted for in-market competition.

4 The Options

Arriva has reviewed the four options put forward. We also note that there are other possible models that the industry could adopt. In particular we refer the CMA to “Assisting Decisions - Modelling the Impacts of Increased On-rail Competition Through Open Access Operation – 22nd July 2011”. In due course we would hope that the CMA develop and examine other possible options with industry input.

The observations below assume that key enabling factors detailed earlier have been addressed in order to deal with the current incongruities in the industry structures that impact on-rail competitive interaction.

4.1 Option 1

We are supportive of this option on the basis that the Franchises would be focused on the provision of PSOs operating alongside Open Access operators delivering commercial services. However for this approach to succeed there would need to be a clearer identification of PSOs in accordance with Regulation 1370/2007.

Alternatively, if the Franchise Operator were also delivering commercial services, they would require suitable commercial flexibility with regard to its commercial operations in order for it to be able to compete effectively. At the same time, the Open Access Operator would need equivalent freedom to access the Network.

4.2 Option 2 and Option 3

These options would increase the extent on on-rail competition and therefore has the potential to unlock some of the associated benefits. However, as highlighted before, the issue of the central role played by the DfT in specifying and limiting the flexibility of franchise operators to respond to market conditions remains. This is particularly an issue with regard to the operation of commercial services. Therefore, for these options to be effective, it would be best if the DfT's role was to ensure that its involvement in the market related to ensuring the provision of PSOs and protecting the taxpayer's interest. This would be most readily addressed by the DfT's on-going role of procuring Franchises being focused on those rail market sectors where on-rail competition had not been fully enabled.

It is worthwhile also noting that in the 2011 MVA report ² that they modelled whether it would be better to split a franchise into two and have two franchised Operators competing or whether it would be better to split the franchise in two and hand over one half to a new large scale Open Access operator. In its conclusions at page 7.4 they noted:

"... the more significant benefits were achieved through relatively large scale Open Access operation and specification of Franchised Operator services , thereby

² Assisting Decisions - Modelling the Impacts of Increased On –rail Competition Through Open Access Operation – 22nd July 2011.

allowing sufficient economies of density to maximise reductions and the cost to government”

In short, rather than split the franchise into two franchised operators the biggest benefits were modelled with a large scale Open Access operator and Franchise operator competing. We would suggest that the CMA review examines the options included in the MVA report.

4.3 Option 4

While this option appears to be the clearest arrangement with all operators established with the same operational and commercial freedoms, the detail of the Option includes two examples of licences. In both examples these seem to create an obligation to provide what appear to be PSO requirements. We are unsure how these arrangements fit with Regulation 1370 on the definition of Public Service Contracts.

Recognising the objectives that the Option is addressing, Arriva would propose that these issues are addressed by further consideration of this Option.

5 Conclusions

Having considered the CMA’s discussion document in detail, Arriva believes that it is both feasible and desirable to increase the extent of on-rail competition in the commercial passenger market sector. Arriva would agree with the CMA’s suggestion that increased levels of on-rail competition in this market sector, implemented in an incremental manner in line with other industry structural changes would improve the rail industry’s ability to deliver its core objectives by driving further growth in passenger revenue as a result of increased levels of choice made available to passengers.

These observations sit side by side with Arriva’s view that the increasingly effective DfT Franchising process provides a highly effective process of competition for the market to provide non-commercial PSO services.

Arriva notes the options put forward by the CMA. We are strongly in favour of a model where PSOs are clearly specified and defined in accordance with Regulation 1370/2007. We believe that if greater on-rail competition is to be successful then

operators of commercial services should be free to operate as fully commercial organisations responding to market conditions within a framework of clear consumer protection obligations. We are supportive of operators of commercial services paying suitable contributions to the operation of the PSOs through levys and rebate payments towards enhancement costs. At the same time, we would suggest that the process for gaining access to the network would need to provide equal opportunities to the operators of all services.

Arriva looks forward to the opportunity to work with the CMA and other stakeholders to explore the development of the competition model for the rail can support the delivery of the industry's objectives in an efficient and cost effective manner to the benefit of passengers and taxpayers.

Yours faithfully

Richard McClean

**Arriva representative on Railway Delivery Group Contractual
and Regulatory Reform Working Group**