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## **“Competition in passenger rail services in Great Britain – A discussion document for consultation” – response from the Centre for Policy Studies**

### **Introduction**

Following the collapse of the West Coast Main Line franchise award in 2012 the Centre for Policy Studies chose to re-focus on the railway sector for the first time since privatisation in 1994. Separately in 1997 the CPS focused on the potential for more private involvement in the operation and management of the [London Underground](#) network.

In 2013 the Centre for Policy Studies published [Rail’s Second Chance – putting competition back on track](#), in which the case was made for more open access rail competition, alongside franchises to boost passenger choice, fare competition, more routes and grow the railway. This research contained detailed analysis of the now established open access operations which operate on the East Coast Main Line alongside the franchise and the benefits they have brought to the passenger, the regions, the profitability and the overall popularity of the railway.

*Rail’s Second Chance* secured considerable media and political interest in the run up to the 2015 General Election and pre-dated the award of new open access services on the West Coast Main Line this summer, which the document explicitly supported. (see pages 14 and 34 of the text).

### **Options for reform as set out by the CMA – the CPS response**

#### **Option 1: existing market structure, but significantly increased open access operations**

Option 1 involves adapting the existing system by permitting a significantly increased role for OAOs, alongside franchises. Concerns regarding free-riding and cream-skimming would be addressed by requiring OAOs to pay proportionately towards fixed track access charges and a universal service levy, to largely make up for any shortfall in government revenues

from lower franchise premiums (after taking account of efficiencies). This would allow ORR to review and potentially remove the ‘not primarily abstractive’ test (paragraphs 7.13 to 7.38).

This option represents an incremental development of the current system, retaining franchising while allowing greater open access where it has the potential to outperform franchised services, and providing the government with flexibility to adjust the balance between franchisees and OAOs in a broadly revenue-neutral way.

In return for greater access to the network, the charging structure could be reformed so that OAOs pay charges that are reflective of the fixed and variable costs of the infrastructure they use, potentially reflecting the opportunity costs of their access rights. (We note and welcome the fact that ORR is currently undertaking a review of the structure of access charges paid to Network Rail, in preparation for the next five-year ‘control period’ for access charges which starts in 2019.) Overall, OAOs and franchisees would have broadly similar risks and broadly similar charges in this framework.

Funding for unprofitable but socially valuable services (i.e. PSOs) currently provided by cross-subsidisation between franchises could well be eroded by competition. This funding could instead come from a levy imposed on OAOs with long-term access rights and franchisees that operate profitable services. In order to mitigate any risk to financial viability, it may be sensible for the levy paid by OAOs to increase over time.

***CPS response to Option 1:*** We are very supportive of this option and hope the CMA will seek to undertake extensive examination of its scope and potential in line with the conclusions of the soon to be finalised EU Fourth Railway Package. On PSO’s Article 12 of EU Directive 2012/34 allows operators of commercial services to support PSO services with a levy but the DfT has chosen to opt out and make it illegal. This should change.

### **Option 2: two franchisees for each franchise/Option 3: more overlapping franchises**

In this option, there would be two successful bidders for each franchise – either symmetrically (each having 50% of services), asymmetrically (for example, with a 60:40% split in terms of service frequencies and unprofitable but socially valuable services) or with one ‘anchor franchisee’ being responsible for the unprofitable but socially valuable services and both franchisees responsible for more commercial services (paragraphs 7.39 to 7.57). The choice of specification within this option depends on achieving the right balance between the benefits of competition and the risk of operators engaging in tacit collusion on fare levels. Increasing the degree of asymmetry between operators reduces the risk of tacit collusion between operators.

***CPS Response to Options 2 and 3:*** The key question here is the extent to which the high specification and micromanagement culture of the DfT can and would be replaced with a genuine strategic and independent system operator whose job it would be to deliver and justify its decisions and its choices for the franchises appointed to compete against other. We need less civil-servant DfT micromanagement on the railways, especially in light of the recommendations of the EU Fourth Railway Package.

This option would involve redesigning the franchise map over time to generate more overlapping franchises, creating more flows on which there would be competition between franchisees (paragraphs 7.58 to 7.77). In practice, this would reverse the conscious decision taken over the last 15 years to reduce substantially the number of overlapping franchises.

**Option 4: licensing multiple operators, subject to conditions (including public service obligations)**

In this option, there would be multiple operators and the system of formal franchises would be replaced with a system closer to that of competition between OAOs, but with a licensing regime placing some restrictions and obligations on their activities (e.g. to provide a certain number of PSO or other unprofitable but socially valuable services) (paragraphs 7.78 to 7.97).

Licences could be implemented in a number of ways, including by way of administratively designed licences (where a central planning body designs the licence) or through a trading-based allocation (where an operator chooses PSO or other unprofitable but socially valuable services from a 'list' and is able to trade these with other operators or subcontract them to third parties).

***CPS Response to Option 4:*** This proposal needs much wider and deeper thought and consideration, both in line with the EU Fourth Railway Package and also the extent to which sections of the loss making or "social" railway is to be retained. This raises the question as to which the multiple operators would in themselves include a requirement for cross operator subsidy so to cover PSO responsibilities.

The risk is that so called multiple operators on one line could in fact be part of a wider monopoly which determines to run services which reduce genuine competitive service. This must be prevented and legislation would be required to empower an independent systems operator to prevent and warn against such a multi-head monopoly developing or making any initial application.

The Centre for Policy Studies congratulates the CMA on this welcome and long overdue study and looks forward to seeing its final post-consultation conclusion.

ENDS

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