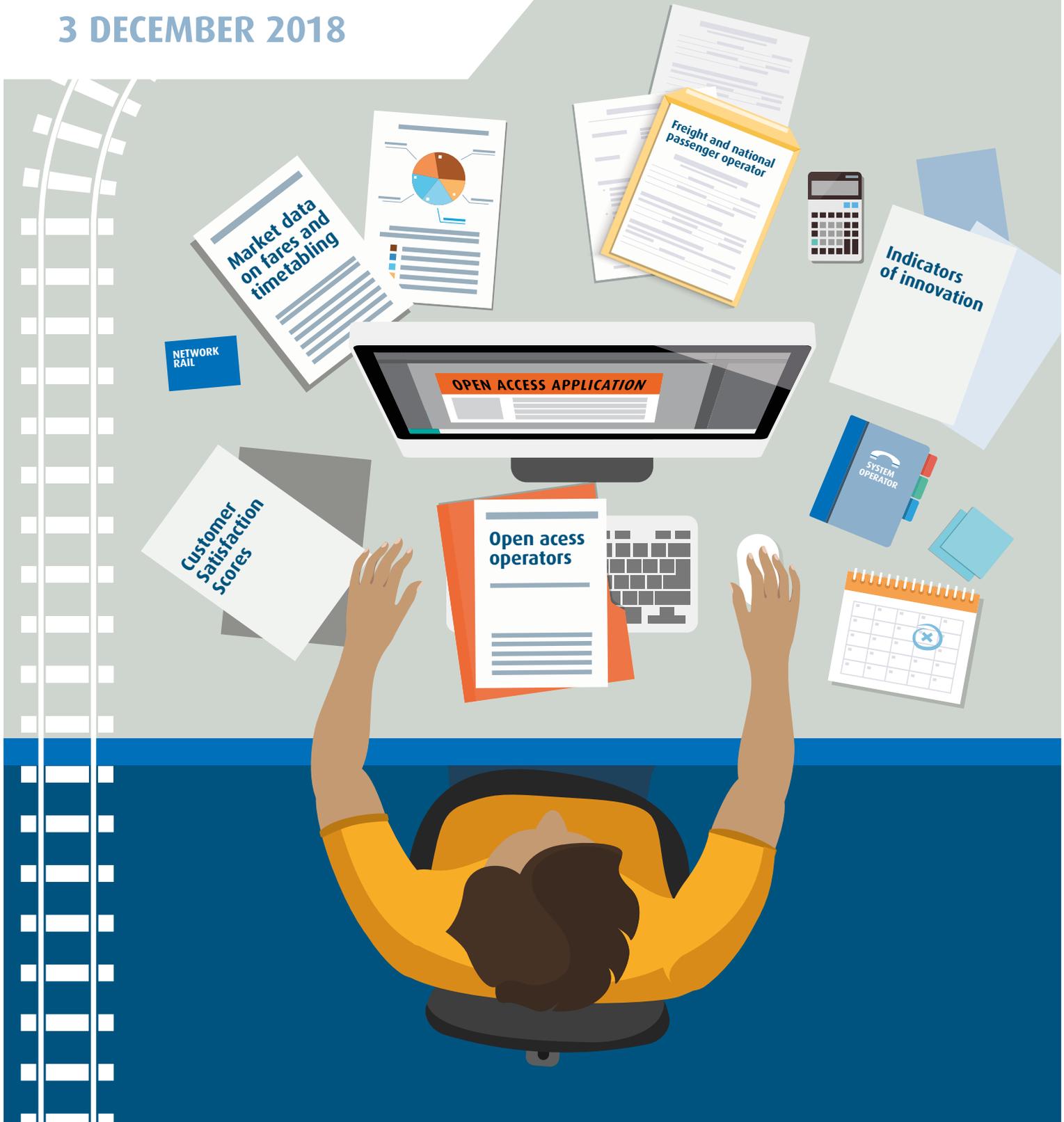


OPEN ACCESS MONITORING

ORR's plans to monitor the impact of, and response to, open access

3 DECEMBER 2018



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1. Introduction

1.1 This document sets out the purpose and scope of the Office of Rail and Road's ("ORR") work on monitoring open access. As outlined in our 2018/19 business plan, we will develop a framework to monitor the impact of, and response to, open access competition.¹ This document discusses why we are undertaking this work, what we expect the output to be, and how we intend to deliver it.

About ORR

1.2 ORR is the independent economic and safety regulator for the railways in Great Britain ("GB"), and the monitor of performance and efficiency for England's motorways and trunk roads. As the designated sectoral regulator for rail, we keep the provision of railway services under review² and monitor the competitive situation in rail services markets.³ Additionally, ORR is a designated national competition authority with powers held concurrently with the Competition and Markets Authority ("CMA") to apply competition law in markets relating to the supply of services relating to railways.⁴

1.3 ORR has strategic objectives which include ensuring: better rail customer service; value for money from the railway; and the promotion of a dynamic and commercially sustainable rail sector.⁵ ORR also has a wide range of statutory duties, as set out mainly in section 4 of the Railways Act 1993. In exercising its functions ORR must weigh, and strike the appropriate balance between these duties.⁶

ORR's work on open access

1.4 ORR supports more "on-rail" competition where it delivers sustainable benefits to passengers. We consider that the dynamic created by on-rail competition delivers demonstrable benefits to passengers; provides comparators to inform franchising decisions; and better holds Network Rail to account in its role of identifying and allocating capacity.

¹ http://orr.gov.uk/_data/assets/pdf_file/0006/27465/orr-business-plan-2018-19.pdf

² Section 69(1) of the Railways Act 1993 ('Railways Act').

³ Regulation 34 of the Railways Access, Management and Licensing of Railway Undertakings Regulations 2016.

⁴ Section 67 of the Railways Act.

⁵ <http://orr.gov.uk/about-orr/what-we-do/our-strategy/our-strategic-objectives>

⁶ We consider the following duties under section 4 of the Railways Act to be particularly relevant: s.4(d) to 'promote competition in the provision of railway services for the benefit of users of railway services', and s.4(5)(c) to 'have regard to the funds available to the Secretary of State for the purposes of his functions in relation to railways or railways services'.

- 1.5 A key source of on-rail competition in the GB rail system comes from Open Access Operators (“**OAOs**”). OAOs offer commercially-operated passenger services which operate alongside franchised Train Operating Companies (“**TOCs**”). Despite the benefits that their presence can generate, OAOs do not currently operate on a significant scale in GB; non-franchised operators account for less than 1% of passenger miles.⁷ There are currently only two active OAOs on the GB mainline: Hull Trains⁸ and Grand Central.⁹
- 1.6 In May 2016 ORR accepted an application by FirstGroup to run five off-peak return services a day between London and Edinburgh from May 2021.¹⁰ While these services will not contribute a significant amount in passenger miles, ORR’s modelling produced an estimated Net Present Value¹¹ (“**NPV**”) for these services of £72m.
- 1.7 Developing a framework for monitoring the impact of, and response to, open access competition will enable ORR to better understand the challenges that OAOs face in trying to establish themselves in the GB market. It will also act as an early warning system, enabling ORR to be a more proactive competition regulator.
- 1.8 Our work is being launched alongside the publication of our consultations on the implementation of the Infrastructure Cost Charge (“**ICC**”) and the Economic Equilibrium Test (“**EE Test**”).¹² This marks a significant change in the regulatory and policy framework for open access.

⁷ See page 60, [Competition in passenger rail services in Great Britain, CMA](#)

⁸ Hull Trains is owned by FirstGroup operates long-distance services between Hull (and Beverly) and London King’s Cross.

⁹ Grand Central is owned by Arriva UK Trains and operates services from Sunderland and Bradford Interchange to King’s Cross. It is proposing to run a number of additional services which are currently under consideration by ORR, as detailed here: <https://www.grandcentralrail.com/about-us/news-press/grand-central-submits-application-to-run-additional-services-on-its-north-east-and-west-riding-routes/>

¹⁰ http://orr.gov.uk/_data/assets/pdf_file/0006/21885/2016-05-12-ecml-decision-letter.pdf

¹¹ The NPV is the value, in today’s money, of all current and future cash flows less the initial investment.

¹² <http://orr.gov.uk/rail/consultations/pr18-consultations/pr18-consultation-on-implementing-infrastructure-cost-charges-for-open-access-operators>; and <http://orr.gov.uk/rail/consultations/policy-consultations-by-topic/access-and-licensing/consultation-on-orr-guidance-on-the-economic-equilibrium-test>

2. Benefits of open access

Summary

2.1 There is evidence of the benefits that greater on-rail competition, through enhanced open access, can deliver. ORR is keen to ensure that these benefits can be realised and that any barriers that may be created through the actions of incumbent operators, can be identified quickly and addressed.

Evidence

2.2 In 2016, the CMA undertook a project, with the assistance and support of ORR, to consider the impact of increased competition “in the market” for passenger rail services.¹³ The CMA found that, despite their currently limited role in GB, OAOs:

- Compete with franchised TOCs on price, frequently offering lower dedicated fares both for ‘walk-up’ and advance tickets;
- Have developed improvements to service levels and introduced innovations, including selling a wider range of tickets on-board and free Wi-Fi. This has subsequently been reflected in high passenger satisfaction with OAOs; and
- Appear to have generated some growth in the market for rail travel overall.

2.3 Analysis of on-rail competition by Arup and Oxera¹⁴ for ORR also cited wider economic benefits, including major opportunities for businesses resulting from new direct routes to London from previously unserved urban areas of GB.¹⁵

2.4 An impact assessment by Arup found that, over a 20-year period, an enhanced role of OAOs within the current market structure could generate benefits of approximately £1.5bn across the East Coast, West Coast, and Great Western Mainlines.¹⁶ As noted above, forthcoming services to be operated by FirstGroup between London and Edinburgh from May 2021, are alone estimated to generate an NPV of £72m.¹⁷

2.5 On-rail competition has also delivered price and service quality benefits to passengers across Europe. Recent analysis by the Economist indicated that new operators in the Czech Republic have achieved costs per seat kilometre that are 30

¹³https://assets.publishing.service.gov.uk/media/56ddc41aed915d037600000d/Competition_in_passenger_rail_services_in_Great_Britain.pdf

¹⁴ Arup is an engineering and transport consultancy and Oxera is an economic consultancy with expertise in competition and transport.

¹⁵ For example, First Hull Trains introduced a line from the Hull and Humber Ports City Region to London which was one of the few major urban areas in GB that was not served by direct connections to London.

¹⁶ This is a central estimate of the NPV (in 2010 prices) based on assumptions for a range of factors, including changes in journey times due to timetable changes, and changes in operating costs.

¹⁷ http://orr.gov.uk/_data/assets/pdf_file/0006/21885/2016-05-12-ecml-decision-letter.pdf

to 50% lower than those of the state operator.¹⁸ The Economist also identified a number of innovative strategies being adopted by firms in response to the new rivalry they face. For example, Deutsche Bahn, which faces some private competition, now offers e-bike hire as well as train tickets in some German cities. ORR notes, however, that findings in other (European) markets do not necessarily have direct applicability in GB due to the different ways in which the market and competition is structured.

Policy and regulatory landscape

- 2.6 A number of regulatory and policy changes are currently underway in GB and across Europe. These changes will likely have a significant impact on open access and the industry as a whole, making this, in ORR's view, the right time to launch our work.
- 2.7 In GB, non-franchised operators can, under certain circumstances, already operate on the network alongside franchised operators. However, this is not the case for much of Europe where, historically there has been very little or no competition. This is due to change with the introduction of the Fourth Railway Package¹⁹ which will, from 2020, grant railway undertakings in EU Member States the right of access to railway infrastructure for the purpose of operating rail passenger services.²⁰ This legislation also introduces a new test – the EE Test - which ORR will, upon request, be required to undertake as part of its overall access assessment.²¹ ORR has issued a public consultation on proposed guidance on how it will apply this test.²²
- 2.8 In conjunction with these changes, ORR has published a consultation finalising some implementation issues for the ICC – which will apply to some open access services from control period 6.²³ While the introduction of an ICC on certain open access services represents an additional cost to potential operators, concurrent changes to ORR's access policy will increase the likelihood of services that are subject to the ICC being granted access rights. This should encourage more competition in the passenger rail market.
- 2.9 The introduction and potential expansion of competition “in the market” means that the impact of, and response to competition by incumbent providers becomes a

¹⁸ <https://www.economist.com/business/2018/06/28/european-state-rail-firms-face-scraggy-new-competitors>

¹⁹ <https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32016L0798&from=EN>.

²⁰ DfT intends to implement the Fourth Package by the deadline of 25 December 2018. Given that GB already has liberalised rail markets, we anticipate that the Directive will have minimal impacts on the rail market in GB. The introduction of further legislation will help in fixing the inoperabilities created by Brexit. The Government has issued technical notices setting out information to allow the rail sector to understand what they would need to do in a ‘no deal’ scenario, so they can make informed plans and preparations: <https://www.gov.uk/government/publications/rail-transport-if-theres-no-brexite-deal/rail-transport-if-theres-no-brexite-deal>

²¹ The EET will only apply to proposed new rail passenger services, and not freight services.

²² <http://orr.gov.uk/rail/consultations/policy-consultations-by-topic/access-and-licensing/consultation-on-orr-guidance-on-the-economic-equilibrium-test>

²³ Control period 6 will run from 1 April 2019 to 31 March 2024.

practical concern for ORR as the competition regulator. A number of regulators have already considered cases of anti-competitive behaviour by market incumbents in response to new entry.²⁴

²⁴<http://www.mondaq.com/x/628336/Antitrust+Competition/Dutch+Competition+Authority+Fines+Dutch+Rail+Operator+NS+Record+Fine+Of+Almost+41+Million+For+Various+Abuses+In+Winning+Tender>. The competition authority in the Netherlands published a decision in 2017 imposing a fine on the Dutch Railways Operator for abusing its dominant position to foreclose its competitors through predatory pricing. In the same year, the Spanish competition authority fined state-owned Renfe, and Germany's Deutsche Bahn for colluding to exclude competing freight operators.

3. Scope and purpose

Summary

- 3.1 The scope of our monitoring work will primarily be limited to open access. However, we will consider the extent to which findings may also apply to the freight sector.
 - 3.2 Our overarching objective of this work is to ensure that OAOs face market conditions which enable them to prosper and to grow their businesses – so long as the potential benefits that their presence can generate can be realised in a sustainable way.
 - 3.3 This work may also influence ORR’s representations to Department for Transport (“**DfT**”) on its recently announced review of rail.
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Scope

- 3.4 Our monitoring activities will focus on open access and will assist us in fulfilling our obligations under competition law as a regulator with concurrent enforcement powers.²⁵ This area is also relevant to, and may influence how, we perform our role in assessing open access applications and as regulator of Network Rail and its System Operator (“**SO**”) and Freight and National Passenger Operator (“**FNPO**”). Freight and other non-franchised operators, including charter services, are out of the direct scope of our work. However, to the extent that any of our findings could apply to the freight market²⁶, we will consider what steps can be taken.

Objectives

- 3.5 In light of the wide-reaching benefits that open access can deliver, the objectives of this work are set out below.
 - **To ensure the right conditions are created for competition to be fostered through the growth of open access** – Through this work, ORR will seek to ensure that any barriers to the growth of open access, which may include anti-competitive changes to fares or timetabling by incumbents, do not prevent the realisation of the benefits that on-rail competition can deliver.
 - **To ensure the fair treatment of OAOs by making clear what we expect of market participants** – Competition law prohibits agreements, decisions or concerted practices that have as their object or effect the prevention, restriction

²⁵ Under section 67 of the Railways Act, ORR is a regulator with powers, held concurrently with the CMA, to enforce against infringements of Chapter I (anti-competitive agreements) and Chapter II (abuse of a dominant position) of the Competition Act 1998.

²⁶ For example, any findings in relation to timetabling may apply to OAOs and freight operators.

or distortion of competition.²⁷ It also prohibits conduct by companies that would constitute an abuse of a dominant position.²⁸ ORR has extensive powers to investigate companies believed to be involved in anti-competitive activities.²⁹ We plan to set out in broad terms what types of behaviours we would consider to be, in principle, anti-competitive, as opposed to lawful and legitimate, in the context of open access. ORR will use these broad principles to inform how we use our competition enforcement powers.

- **To become a more proactive regulator.** ORR has a range of powers to address and enforce against anti-competitive behaviour.³⁰ ORR considers that developing a framework that enables regular monitoring of responses to open access activity would help to evidence and address potentially anti-competitive behaviour more quickly and effectively than at present. Further, we expect our work to improve ORR's engagement with stakeholders which should also enable earlier identification of issues.
- **To influence the government's rail review,** which will set out its intentions for reform of the rail sector, and is expected to conclude in autumn 2019. ORR is keen to ensure that open access is given due consideration as part of this review. It is important that the rivalry generated by the presence of OAOs can continue to deliver benefits for passengers within different franchise models.

²⁷ Under section 2(1) of the Competition Act 1998.

²⁸ Under section 18(1) of the Competition Act 1998.

²⁹ Under section 67(3) of the Railways Act, ORR has concurrent powers with the CMA to investigate and enforce infringements of competition law under the Competition Act 1998 and under Articles 101 and 102 of the Treaty of the Functioning of the European Union. ORR's concurrent enforcement powers relate to the provision of railway services in Great Britain.

³⁰ ORR's concurrent competition law enforcement powers are set out in s.67 of the Railways Act. In addition, the Railways (Access, Management and Licensing of Railway Undertakings) Regulations 2016 give powers to ORR to monitor the competitive situation and to issue directions on its own initiative where there is an undesirable development in competitive situation in the rail services markets (sections 34(1) and 34(3)(c)).

4. Deliverables

Summary

- 4.1 Over the coming months, we will undertake work to develop improved knowledge of the commercial realities facing OAOs. In particular, we will gain a better understanding of the types of behaviours and responses that might hinder greater open access on the GB railway, and the impact of open access on a range of competitive parameters.
- 4.2 It is crucial that market participants understand what is expected of them, and what behaviours might, in principle, be in breach of competition law. As such, we plan to set out the broad types of behaviours we would have concerns about. We will also determine what variables we will collect information on going forwards, and how we will practically monitor any changes in these.

Key deliverables

- 4.3 The key outputs that we expect to deliver from our work include the provision of information to industry to aid understanding of the application of competition law; the creation of a set of variables to monitor over time; and the development of a framework for monitoring them. This is illustrated in more detail in the table below.

Key deliverables on open access	
Deliverable	Intended outcome
1. Information provision	
Information for market participants on what ORR considers, in broad terms, to constitute anti-competitive conduct , as opposed to “competition on the merits”. This might include, for example, predatory pricing which has as its sole purpose the maintaining of market share. It could take a much broader definition; for example, the seeking of access rights to limit access for, or undermine the business model of, a competing operator.	We will use these broad principles to inform how ORR uses its competition enforcement powers, particularly in relation to open access.

Deliverable	Intended outcome
2. Monitoring variables	
<p>A defined set of variables that we plan to monitor. We expect this to include some information that ORR already collects, and some new information. It will also likely contain a mixture of data that is relatively easy to measure (such as fluctuations in fares and timetabling), and information on things which are more difficult to assign value to (such as innovation).</p>	<p>Any changes that we observe in the evidence will alert us to changes in firms' behaviours. ORR will consider whether further investigation is warranted, in particular to determine possible drivers of these changes.³¹ If, following further investigation, ORR found evidence indicative of anti-competitive behaviour, we would consider launching enforcement action under competition law.</p>
3. Monitoring framework	
<p>A framework for monitoring the chosen variables, including how frequently we will monitor them.</p>	<p>This will act as an early warning system, enabling ORR to take a more proactive approach to its competition and regulatory functions. Monitoring activities will therefore need to be sufficiently frequent to enable an efficient response, balanced against the additional burden that regular monitoring places on ORR's limited resources.</p>

4.4 Further, we expect our work to lead to overall improved engagement with stakeholders, including existing and aspirant OAOs, which will in itself bring about benefits. These are likely to include more efficient processing of access applications and earlier identification of issues and/or risks.

³¹ ORR will consider how to control for changes in variables which occur for reasons that cannot be explained by the existence of, or entry by, a competing OAO.

5. Next steps

Summary

- 5.1 At the centre of our work over the coming months will be engagement with affected stakeholders and, in particular, existing and aspirant OAOs. We will be seeking views on all areas of our work, including:
- What information market participants would find beneficial in relation to their competition obligations;
 - The variables that ORR should consider monitoring; and
 - How ORR should control for external factors such that it captures (primarily) the impact of, and response to, open access.
- 5.2 We will also undertake intelligence gathering to understand what information ORR already collects and how it can be used for our monitoring purposes, and what other work can be undertaken to influence open access policy.

Next steps

- 5.3 Over the coming months ORR will do the following:
- **Extensive stakeholder engagement** – In order to ensure fair market conditions for OAOs, ORR must first improve its knowledge of the commercial realities facing OAOs. The best way to do this is to engage those concerned – most notably existing and aspirant OAOs – but also TOCs and industry bodies. We will consider how best to engage interested stakeholders, including through bilateral meetings and workshops. We will also engage the SO and FNPO.
 - **Intelligence gathering** – Before setting about determining what new information to collect, we will consider what information ORR already gathers. For example, ORR already receives an extensive amount of data from LENNON³² – which holds revenue information for the vast majority of national rail tickets purchased in GB.
 - **Consider what else we can do** – We will consider what else ORR can do to facilitate the sustainable growth of open access, including through feeding into the government’s recently announced rail review.

³² Latest Earnings Network Nationally Over Night.



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