Dear Mr McClean and Ms Gilliland

Application for a new track access contract for services between London Euston and Blackpool North

1. We have carefully considered Great North Western Railway Company Limited (GNWR)’s application for a track access contract with Network Rail Infrastructure Limited (Network Rail). This was submitted to us under section 17 of the Railways Act 1993 (the Act) in October 2017. ORR has decided to approve the application, with modifications. This letter explains the reasons for our decision.

2. We will now work up the detailed access contract that we will direct Network Rail to enter into, subject to confirmation of the final investment decision by GNWR. This will be in line with the draft contract submitted with the application, but with a mix of firm and contingent access rights, as explained below. We will also include additional requirements relating to the investments GNWR will make (that justify the contract duration of 7 years and 7 months) and rolling stock commitments, including the time by which the rolling stock must be secured and the services introduced. We will discuss the drafting of these terms with you.

Background

3. The application was for firm rights1 for 6 Monday to Friday return services, 5 on Saturdays and 4 on Sundays, between London Euston and Blackpool North. The calling pattern included firm rights to call at Milton Keynes Central, Nuneaton, Preston, Kirkham & Wesham and Poulton-le-Fylde.

1 Train operators can have two types of access rights: when compiling the timetable, Network Rail must first accommodate all Firm rights held by operators. Contingent rights are only accommodated if there is space after all firm rights are dealt with.
4. The application was for rights starting at the Subsidiary Change Date in May 2019 until the Principal Change Date in December 2026. GNWR proposed to acquire 4 Intercity 225 sets (with an option for a 5th set). The 225 sets are formed of a Class 91 locomotive, 6 Mk4 Coaches, and a Driving Van Trailer. Each set will hold around 330 passengers, and GNWR will offer both standard and first-class seating with a range of tickets.

5. In August 2015 we approved a similar application from GNWR. That contract was conditional on GNWR procuring new trains with performance characteristics at least as capable as a Pendolino by May 2016 (later extended to June 2017). GNWR did not meet this condition, citing difficulty in securing derogations from European standards. That contract therefore expired in June 2017.

6. This application was different in two main ways:

   (i) The rolling stock is existing non-tilting trains rather than new tilting trains. As it cannot run as fast as tilting trains on the West Coast Main Line (WCML), calls at Crewe, Tamworth and Lichfield Trent Valley have been removed to keep overall journey times down; and

   (ii) The contract is proposed to last for 7 years and 7 months rather than 10 years, ending as HS2 is expected to come online.

7. While we were considering GNWR’s application we were also considering an application received in September 2017 from West Coast Trains Limited (Virgin), its 21st Supplemental Agreement. That application was for 3 additional return services between London Euston and Blackpool North from the Subsidiary Change Date in May 2018 to the end of Virgin’s track access contract in December 2022. We subsequently approved firm rights for 2 return services and contingent rights for 1 return service. Our decision letter for that application can be found on our web site.

8. GNWR’s proposal will therefore increase the total number of direct services between London and Blackpool to up to 10 each way per day, once Virgin starts running its additional 3 services from May 2018 on top of the 1 per day which it currently runs.

9. GNWR has confirmed it will offer a range of discounted fares.

**ORR’s role and approach**

10. Under the Act we have an approval function in relation to track access contracts between Network Rail and train operators and any amendments to them. If Network Rail and a train operator reach agreement, they jointly submit the proposed contract for our approval, under section 18 of the Act. If they cannot reach agreement, the train operator can apply under section 17 of the Act and ask us to direct Network Rail to enter into the contract. This application was made under section 17.

11. When we consider track access applications we do so in the manner we consider best calculated to achieve our statutory duties, which are set out mainly in section 4 of the Act. The weight we place on each duty is a matter for us depending on the circumstances of each case. Where the duties point in different directions, we balance them against each other to help us reach a decision.
12. Although our duties are wide ranging, our experience generally is that a subset tend to be especially relevant to access decisions with the others not pointing strongly one way or the other. In this case we considered all our duties; these were the most relevant:

- promote improvements in railway service performance;
- protect the interests of users of railway services;
- promote the use of the network for passengers and goods;
- promote competition for the benefit of rail users;
- have regard to the funds available to the Secretary of State [for Transport] for the purposes of his functions in relation to railways and railway services;
- have regard to any general guidance given to ORR by the Secretary of State about railway services or other matters relating to railways; and
- enable operators to plan their businesses with a reasonable degree of assurance.

13. ORR is supportive in principle of open access, by which we mean passenger services provided outside of a franchise or concession. This reflects our duty to promote competition for the benefit of rail users and our recognition that competition can make a significant contribution to innovation in terms of the routes served, ticketing practices and service quality improvements, by both the new operator and through the competitive response of existing operators.

14. But we must also consider our other duties when making access decisions. These include duties to have regard to the funds available to the Secretary of State in relation to railways and to protect the interests of users of railway services, both passengers and freight customers. These require us to consider the impact of new open access services not just on the passengers benefitting directly from those services but all users of railway services.

15. With those issues in mind, our approach is to test whether new services such as these would be “not primarily abstractive” (NPA) as explained in our published criteria and procedures for the approval of track access contracts. In essence, the NPA test aims to limit cherry-picking and help us balance our duties, in particular those to promote competition for the benefit of users and to have regard to the funds available to the Secretary of State. The extent to which we value the potential benefits competition can bring is reflected in the threshold for the test that we expect new services to reach – we would not expect to approve applications that did not generate at least 30p of new revenue for every £1 abstracted from existing operators (i.e. achieve a ratio of 0.3).

16. In addition to the NPA test, our criteria and procedures explain the range of other issues we expect to look at, including capacity and performance. We also consider the absolute impact on the funds available to the Secretary of State. We discuss these later.
Industry consultation

17. In advance of submitting the application to ORR, and in line with our published guidance, Network Rail carried out an industry consultation in June and July 2017 on behalf of GNWR. Several train operators and other stakeholders responded:

(i) Arriva Rail North was supportive of the proposal;

(ii) The Department for Transport (DfT) welcomed in principle the benefits such as wider competition that open access services can provide. But it had concerns about the potential implications of this particular application for the funds available to the Secretary of State, the rolling stock GNWR planned to run, performance impacts, and possible impacts on HS2;

(iii) London Midland raised concerns over available capacity, particularly at London Euston;

(iv) Transport for London queried whether additional services at London Euston could be accommodated without negatively affecting performance;

(v) TransPennine Express had concerns over available capacity, particularly on the Preston Fylde Junction to Euxton Junction section of the WCML;

(vi) Transport Focus was supportive of the application;

(vii) Transport for Greater Manchester supported the application on the proviso that it will not negatively impact existing connectivity and the performance and reliability of existing services to/from Manchester Piccadilly and through Wigan North Western both now and during the HS2 construction period;

(viii) Virgin Trains East Coast questioned the availability of the proposed rolling stock; and

(ix) Virgin (West Coast) raised several queries, particularly concerning the rolling stock proposals and performance impacts.

18. The concerns raised by consultees generally related to the availability of capacity, the effect on performance and the impact on the funds available to the Secretary of State.

Statutory Consultation

19. As it did not support the proposal, as required by the Act, we consulted Network Rail in October 2017. It provided an initial response on 17 November 2017 and further updates to its position on 22 December 2017 and 9 February 2018. Initially, Network Rail said it could not agree to GNWR’s proposal due to concerns about available capacity, train performance, and rescue and recovery plans. However, following further work, in February 2018 Network Rail concluded that it was content to agree firm rights for the majority of the proposed services, and contingent rights for the remainder.
Engagement with the parties

20. In addition to the industry and statutory consultations, when reviewing an application we may hold discussions with the parties, seeking and clarifying the information we need to make our final decision. In this case we have engaged fully with GNWR and its consultants, and Network Rail, throughout the course of this application.

21. GNWR also took the opportunity to provide further detailed submissions to us. In reaching our decision we considered all the material provided by GNWR and indeed other stakeholders.

22. This included recent correspondence from the Department for Transport, which raised several points including concerns around the performance impacts of the proposal, access rights post-2026 potentially impacting on HS2 and track access charges.

23. The remainder of this decision is structured in 6 sections: capacity and performance; the NPA test; the impact on the funds available to the Secretary of State; contract duration; track access charges; and conclusions.

Capacity and performance

Capacity

24. Network Rail initially had concerns with the application around capacity, train performance and rescue and recovery plans. However, following further capacity analysis work and discussions with GNWR, in February 2018 Network Rail confirmed to us that it was content to agree firm rights for the following:

(i) 5 weekday services each way, except Wednesdays where it was only prepared to agree to 4 services in the down direction due to a clash with a New Measurement Train every two months;

(ii) 5 Saturday and 4 Sunday services each way; and

(iii) Calls at Milton Keynes, Nuneaton, Preston, Kirkham & Wesham and Poulton-le-Fylde (except for 1 weekday up service call at Milton Keynes)

25. Network Rail was not prepared to agree firm rights for the 6th service each way, due to a potential clash with a London Euston – Blackpool North service applied for by Virgin (see paragraph 7). It was content to agree contingent rights for the remainder of the proposed services (i.e. the 6th weekday service each way, 1 down service on Wednesdays and 1 weekday up service station call at Milton Keynes).

26. In considering this application we reviewed the capacity analysis which Network Rail had undertaken and also revisited the analysis which it undertook for Alliance’s previous Blackpool application in 2015. In its previous analysis, Network Rail had concluded that there were 3 theoretical paths per off-peak hour available out of Euston but, because of concerns about performance, it was only prepared to sell 1 path per off-peak hour.
27. From a capacity perspective, if at least 1 off-peak path per hour was previously shown to be available and nothing else had changed, while Network Rail may not be able to accommodate both operators’ preferred train slots in the same hour, it would seem logical that capacity should at least exist to accommodate the total quantum requested by both operators. It may be that one of the proposals may have to be flexed, perhaps to an alternative hour, to avoid the clash. We also noted that the rights requested are quantum only and have no entitlement to specific hours.

28. We raised this with Network Rail which said, while this may seem logical, the nature of the route made this a difficult assumption to accept. It said there are interacting trains at several points on the WCML which mean that each hour is not standard.

29. GNWR said it believed capacity existed for both operators and was confident a solution would be found. On 6 April 2018 it submitted a capacity assessment which it had commissioned from an independent train planning consultant which aimed to show that all GNWR’s services could be accommodated alongside the 3 additional Virgin services and the New Measurement Train.

30. We asked Network Rail for its views on GNWR’s capacity assessment. It said that the level of assurance it would need to support firm rights would be significant. It was unable to commit to undertaking this work until the development process for the May 2019 timetable which starts on 10 August 2018, as its planning resources are currently engaged with the significant timetabling work for the development of the of the December 2018 timetable as well as recovering Informed Traveller timescales to T-12.

31. From the evidence available we are content that there is adequate capacity for at least the quantum of rights Network Rail can agree to, as set out in paragraph 24. We therefore approve firm rights for these services. We consider the potential clash of 1 down service on occasional Wednesdays with the New Measurement Train can be dealt with via a footnote to the rights, rather than making the rights for one service contingent on all Wednesdays.

32. Before approving firm rights for the 6th service we would want to be confident that it could be accommodated alongside Virgin’s 3 additional services at an acceptable level of performance. While GNWR’s capacity assessment shows some ways in which the services might be included and, to some extent, reflects our views above, without Network Rail’s detailed assessment we do not have the confidence we would need in order to direct Network Rail to accept firm rights. We therefore approve contingent rights for this service.

33. We expect Network Rail to undertake the necessary analysis to determine whether it can accommodate all of GNWR’s and Virgin’s services as soon as possible. If, as we expect, it is able to do so, Network Rail should agree promptly further supplemental agreements with both GNWR and Virgin to convert the contingent rights to firm rights.

Access to Euston during HS2 works

34. As part of its assessment for works at Euston to deliver the HS2 programme Network Rail assessed whether the station could accommodate services planned for the December 2018 timetable, including growth services, with the reduced platform capacity. This assessment included GNWR operating 6 services per day using 125mph rolling stock.
(as per GNWR’s previous application). Although the timings of GNWR’s new proposal would differ, the quantum remains the same. On that basis, Network Rail confirmed it was satisfied that its original assessment was sufficient to demonstrate that capacity would be available during the HS2 works.

**Performance**

35. Initially Network Rail was concerned about the potential impact GNWR’s proposed services might have on train performance but, following discussions with GNWR to discuss mitigating measures and detailed engagement with the LNW route performance manager, in February 2018 it confirmed that the performance impact of introducing the additional services was acceptable.

36. GNWR provided us assurance on the reliability and recovery plans for its proposed rolling stock which we agreed were satisfactory and sensible. In particular, GNWR confirmed that it would be part of the established contingency plans on the route and that its proposed rolling stock is equipped with draw hooks and buffers that are compatible with all locomotives for rescue purposes. GNWR also provided recent Miles per Technical Incident Data for the 225 sets, demonstrating adequate reliability.

37. Overall, our judgement is the application is acceptable on performance grounds.

**Operational viability**

38. We are keen to minimise the risk that capacity is reserved by access rights which will not subsequently be used. We therefore expect applicants to show they are willing and able to use the access rights applied for. We also consider whether proposals are operationally viable and if they are supported by a plausible business plan. We consider this application meets these requirements.

39. We will include conditions requiring appropriate rolling stock to be secured and the services introduced by specified dates. If these are not met, the access rights will lapse.

**The NPA test**

**MOIRA Analysis**

40. The NPA test looks at the impacts of new services in terms of revenue generated and revenue abstracted from other existing services. To estimate revenue generation and abstraction, we need to make assumptions about the services’ timetable, even though the approval will not be for a specific timetable. We analysed the application using an indicative timetable submitted by GNWR on 13 March 2018.

41. We used the industry standard software MOIRA to calculate an initial forecast of the impact of GNWR’s new services, modelling its proposals against the May 2016 timetable. Based on changes in generalised journey times only, this forecast an NPA ratio of 0.28.

2 We used the May 2016 timetable as later timetables included rail replacement bus services on the Blackpool North to Preston corridor, due to electrification works, and would result in an overestimation of generation.
Initial Demand Forecasting Results using MOIRA (2015-16 demand and prices)

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<tr>
<th>GNWR revenue as forecast using MOIRA</th>
<th>Generation / abstraction ratio</th>
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<tbody>
<tr>
<td>Total</td>
<td>£16.7m</td>
</tr>
<tr>
<td>Generated</td>
<td>£3.6m</td>
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<tr>
<td>Abstracted</td>
<td>£13.1m</td>
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<td>0.28</td>
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42. We then considered if there were other factors not adequately reflected in the MOIRA modelling that could affect the generation / abstraction ratio. We also took account of analysis by GNWR’s consultants AECOM. Their initial results were similar to ours.

43. AECOM undertook further analysis using a fares model as MOIRA does not take account of the impact on generation and abstraction of differential fares. It also used a gravity model to account for MOIRA’s tendency to underestimate demand where stations gain new direct services to/from London, i.e. where the new services are thought to deliver a transformational change in service levels resulting in greater revenue generation. This impact has been observed at some stations where open access operators have introduced new services. The results of this further analysis are described below.

AECOM’s Fares Analysis

44. AECOM’s initial fares modelling used PDFH5.1 fares elasticities and spread parameters. Since this initial analysis, the PDFH has been updated (to PDFH 6.0) incorporating the latest research underpinning PDFH parameters such as fares elasticities. We recognise that GNWR/AECOM could not have known about any changes to PDFH at the time of making the application\(^3\), however, we should take account of the latest available evidence. As such, we asked GNWR to submit a revised forecast based on PDFH6.0 parameters.

45. The results below are based on PDFH6.0 parameters. These resulted in a lower forecast generation/ abstraction ratio than that based on PDFH5.1.

46. AECOM’s fares modelling is based on the assumption that GNWR would offer discounted fares (full and reduced) in line with the level of discount on fares typically offered by Grand Central on its East Coast Main Line (ECML) services compared with VTEC fares. GNWR confirmed in its Business Plan submission to ORR that it would offer some discounted fares in this way. Based on this fares offer, AECOM forecast an increase generation / abstraction ratio in the range of 0.28 - 0.30. We therefore expect GNWR to offer such discounted fares on the services applied for in this application.

The May 2016 timetable, which contains a full rail service on this route, provided the most appropriate base against which to compare GNWR’s proposed services.

\(^3\) Although GNWR/AECOM should have known about the potential impact of new fare spread parameters as these were published in the Leigh Fisher Report for ORR, ‘Evidence of revenue generation and abstraction From historical open-access entry and expansion,’ 7 January 2016. It could therefore have taken account of these at least as a sensitivity in its analysis.
AECOM’s gravity model

47. AECOM based its gravity model on the gravity model developed by our consultants CH2M Hill for its economic assessment of ECML access applications (2016). CH2M Hill developed a gravity model by estimating for stations on or near the ECML the total annual journeys made to particular destinations (notably London) as a function of characteristics that influence the level of demand including level of service provision (e.g. catchment population, wages, and a composite measure of service attributes).

48. AECOM applied the parameters derived by CH2M Hill to estimate the level of suppressed demand that could be released by the introduction of new services. Based on this approach and taking account of the fares impact discussed above AECOM forecast a revenue generation / abstraction ratio of 0.30 - 0.39.

49. We recognise a gravity model is a potentially useful approach in some contexts for estimating levels of suppressed demand that are not reflected in MOIRA-based estimates. AECOM appears to have applied the CH2M Hill gravity model correctly, but we have not been able to verify whether its application avoids the potential weakness of the gravity model to double-count population catchments and thereby overstate generation. Further, AECOM used parameters derived for stations on or close to the ECML, spanning a much wider range of service offers than are relevant here. We therefore consider that there is a risk that this methodology overstates the likely NPA ratio. However, given our conclusions below, we did not need to test the extent of this further.

50. Our conclusion, based on our own assessment and that of AECOM/GNWR is that the revenue generation / abstraction ratio for this application is in the range 0.28 - 0.37. Noting the risk that AECOM’s application of the gravity model overstates revenue generation, we consider the central estimate to be close to but above 0.3. Our judgement is that the application passes the NPA test.

51. The NPA test result is sensitive to calls at Kirkham & Wesham and Poulton-le-Fylde. To secure the key passenger benefits from serving these stations, we will make including these calls in any access proposal in the timetabling process a requirement in GNWR’s access contract.

The funds available to the Secretary of State

52. One of our statutory duties is to have regard to the funds available to the Secretary of State for the purpose of his functions in relation to railways and railway services. The NPA test with its threshold ratio for the entire service of 0.3 : 1 is intended to help balance our duties, particularly those to promote competition for the benefit of passengers and to have regard to the funds available to the Secretary of State.

53. Therefore, we need to distinguish between arguments that are already incorporated into the NPA calculation (such as the need to consider the potential impact on future franchise revenues) and any additional arguments. The additional arguments we considered most relevant in this case are discussed below.

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4 http://orr.gov.uk/rail/access-to-the-network/track-access/east-coast-main-line
54. The NPA test looks at revenue generation relative to abstraction, and gives no additional weight to levels of abstraction that are large in absolute terms. We considered this issue given our statutory duty to have regard to the funds available to the Secretary of State.

55. In its response to the application the DfT said that it had not undertaken detailed modelling but GNWR’s previous application would have involved significant revenue abstraction from franchised services and it expected this to be the case with this application. It said it was likely to have substantially greater concerns given the decline in rail revenue growth and Network Rail enhancement issues.

56. However, our analysis estimates the proposed GNWR services could abstract ~£13m p.a. from other operators, primarily Virgin. This is significantly lower than the £22m p.a. which we forecast for the previous GNWR application reflecting longer journey times and the different calling pattern.

57. The WCML franchise is currently managed by Virgin as a Direct Award. To aid transparency and minimise uncertainty surrounding GNWR’s start-up processes, we will make the access contract conditional on the timely procurement of rolling stock and require the new services to be introduced by an appropriate longstop date (failing which the access rights would lapse).

**Contract duration**

58. GNWR applied for a 7-year 7-month access contract. Under EU rules, contracts longer than 5 years must be justified by the existence of commercial contracts, specialised investments or risks. We are satisfied a 7-year 7-month duration is justified here, given the proposed investment in rolling stock, refurbishment of the rolling stock and enhanced station facilities. We will link the contract duration to these investments being made.

59. Normally there is a presumption in favour of the rollover of access rights at the end of a contract, except where we have said otherwise. Due to the step-change impact that the HS2 project will have on the whole of the WCML, DfT requested that should GNWR’s rights be approved, there should be an explicit statement that there is to be no presumption of rollover so that the Government's business case, and the funding available, for HS2 are protected. DfT said that such a statement would not prevent GNWR from applying for similar rights in the future, but would ensure that any such application could be considered fully at the appropriate time alongside all other competing applications, ensuring the most effective use of the network.

60. In responding to this GNWR said: “The application made on behalf of GNWR does not seek access rights beyond December 2026. We do not believe that there is a need to have an explicit requirement other than the expiry date in the contract”.

61. In our statement on track access issues arising with HS2 we said “If we receive any open access proposals to use capacity between now and 2026 (with an end date prior to the start of HS2 operations) which, if extended beyond 2026 could impact DfT’s proposals, we will explicitly look at this aspect to ensure there is clarity about the pre and post 2026 position and the impact of any future application to extend the rights.”
62. In this case, we agree with DfT and confirm that the usual presumption in favour of rolling over existing access rights should not apply to GNWR’s services beyond December 2026. If we receive a further open access application which interacts with DfT’s proposals before it has secured access rights, we would envisage allowing it time to firm up its proposals to help us ensure the best overall use of capacity in line with our duties.

Track access charges

63. DfT asked that if ORR approved the application, we should make clear that the access rights would be subject to the access charging proposals put forward as part of the Periodic Review 2018 and any future Public Service Obligation levy. In response GNWR said it did not disagree with DfT in this area.

64. In our May 2016 decision on First Group’s ECML open access application, we were clear that First Group should not take any comfort about how future charging decisions may affect them. Equally, GNWR will be subject to the relevant access charging proposals we put forward as part of the Periodic Review 2018, and potentially to any future Public Service Obligation levy as progressed by DfT.

Conclusion

65. The proposed new GNWR services will bring significant passenger benefits in terms of competition, more direct London – Blackpool services, new journey opportunities including additional direct services to and from Poulton-le-Fylde and Kirkham & Wesham. To secure the key passenger benefits from serving Poulton-le-Fylde and Kirkham & Wesham, we will make including these calls in any access proposal in the timetabling process a requirement in GNWR’s access contract.

66. We are satisfied GNWR’s proposals are viable and that capacity exists for the services. We are keen to minimise the risk that capacity is reserved by access rights which will not subsequently be used so we will include conditions in GNWR’s access contract requiring rolling stock to be secured and the services introduced by specified dates. If these are not met, the access rights will lapse. We will also link the duration of the contract beyond 5 years to proposed investment in rolling stock and enhanced station facilities.

67. We agree with Network Rail that the performance risks posed by the new services for existing passengers should be manageable. We will make procurement of appropriate rolling stock a contractual requirement to help mitigate any performance risk.

68. We will not normally approve an open access application that does not pass the NPA test which is our main analytical tool for helping us balance some of the duties we have found especially relevant in these decisions. Our assessment is that the revenue generation / abstraction ratio of this application is in the range 0.28 - 0.37 with the central estimate close to, but above, 0.30. We therefore consider the application passes our NPA test.

69. We considered the absolute level of abstraction and estimated that GNWR’s services could abstract ~£13m p.a. from other operators, primarily Virgin. This is significantly lower than the £22m p.a. which we forecast for the previous GNWR.
application and which we approved. We do not therefore consider that DfT’s argument against our approval of this application on this issue is persuasive.

70. Overall, our judgement is the passenger benefits in terms of competition, new journey opportunities, investment in rolling stock and station facilities outweighs the potential abstraction and the effect this could have on the funds available to the Secretary of State.

71. Having considered this application fully and balanced all our duties as we are required to do, we have decided to approve the application but with the modifications and additional contractual requirements outlined.

72. We have approved a mix of firm and contingent access rights as set out above. GNWR explained to us that its business case was developed on the basis of acquiring firm rights for all services and, in the light of our decision, will need to reconsider the business case before making any final investment decision. If GNWR decides to go ahead on the basis of the rights that we have approved in this letter, it will be able to submit an application for a supplemental agreement to obtain firm rights for the remaining paths at a later date. We will consider any such application in the usual way on the basis of the evidence provided at that time.

73. We will place a copy of this letter on our website.

Yours sincerely

[Signature]

John Larkinson