RESPONSE TO THE OFFICE OF RAIL REGULATION'S CONSULTATION ON THE POTENTIAL IMPACTS OF REGULATION AND INDUSTRY ARRANGEMENTS AND PRACTICES FOR TICKET SELLING

ASSOCIATION OF TRAIN OPERATING COMPANIES

12th November, 2014

1 Introduction

This response is the result of close collaboration between ATOC and its train company members, and the response represents their collective view.

ATOC is happy for this response to be made public and published on the ORR's website.

Our response is designed to form the basis for further, detailed engagement between ATOC, TOCs and the ORR.

2 Key point summary of our response

1. The rail market has shown exceptional growth over recent years (both in historical terms and when benchmarked against relevant comparators), and does not provide evidence of any significant problem with the retail market.

2. The rail retailing market is a highly unusual combination of competition, co-operation and regulation (the latter including the specific obligations upon TOCs in franchise agreements), which has evolved since privatisation. The Review should consider the efficacy of the current balance between these factors and set out a broad strategic framework for the market going forward.

3. The wider strategic issues identified by the Review, such as the costs and benefits associated with regulation designed to preserve 'network benefits', are worth pursuing, despite the likely difficulty in achieving change. Many of these issues have not been properly reviewed since privatisation.

4. We remain concerned about some aspects of the current regulatory framework, particularly Schedule 17 of the TSA and the development of split-ticketing, both of which constitute significant market distortions. The former is also a significant contributor to industry costs.

5. The third party market has grown more quickly than the market in general and third parties have taken an increasing share of the market, suggesting that the third party market has also functioned well.

6. The current market model for third party retailing seems to have worked reasonably well, but we are open to discussion on alternatives, if a better model can be identified. ATOC hasactively considered possible alternatives as part of its consultation response. However, the alternative models identified so far all have drawbacks, as well as potentially more attractive elements.

7. TOCs/ATOC use a number of criteria to assess what commission rates should be: average transaction values, opportunities for other remuneration, benchmark rates, the cost of sale and the value added by third party retailers. The current commission structure reflects all these factors and seeks to take a balanced and equitable approach across all retailers/channels.

8. Third parties can also enter into bilateral deals with TOCs to earn additional remuneration. Such arrangements are fairly common in the TMC market and sometimes occur in the internet market. In addition third parties can charge fees, whereas TOCs can't. Finally internet retailers can enter into 'white label' and technology supply arrangements with TOCs to earn additional revenue.

9. Commission rates taken in isolation can be misleading as it is the combination of commission rate and average transaction value (which vary significantly by channel) that determines how much remuneration a retailer gets. For instance, TMCs receive 3% commission, which means that they receive £1.75 per transaction, significantly higher than the £1.15 per transaction received by TOCs for non-Season Ticket sales through station ticket offices.

10. TOCs are essentially carriers, not retailers, and whilst we agree that, in principle, there is a potential conflict of interest in the way in which TOCs through ATOC set commission rates for third parties (this was inherent in the governance arrangements set up at privatisation), this is offset by the need of TOCs, as carriers, to incentivise third parties to increase sales (the expansion in the types of licence offered is a good example of this). TOCs have also been very careful to ensure that retailers are dealt with as even-handedly as possible and that objective justifications exist for commission levels.

11. ATOC retail licences are fairly light touch and do not, we believe, impose disproportionate obligations upon third parties. Bonding is a reasonable commercial requirement and ATOC/TOCs have been proactive in introducing TARIF as a lower cost alternative to bonding for TMCs.

12. Third party retailers have generally good access to the range of products offered by TOCs. Historically, third parties have not been allowed to sell Season Tickets, but we are undertaking a pilot of third party retailing of Season Tickets in 2015 with a view to extending the retailing of Season Tickets to third parties in 2016. Apart from Season Tickets, products which third party retailers are not allowed to sell constitute only 0.3% of industry sales.

13. The Review also needs to consider the issue of TOC online discounts, where there is no collective policy, and where TOCs have differing commercial strategies.

14. The central provision of key retailing systems such as the fares database and service, National Reservation System and so on, together with assurance of their proper use through accreditation, provides the information technology, data and settlement framework that supports TOC and third party retailing. This approach is cost effective,

ensures high and consistent quality standards for customers, high levels of financial probity, and facilitates easier market entry by new players.

15. The provision of key industry retailing and passenger information data, such as fares, timetable and real time data by ATOC, RSP and NRE ensures that there is a ‘single source of truth’, ensuring that industry retailing and information is delivered to customers consistently, although we accept that more needs to be done to improve the quality of information provided to customers.

16. ATOC, RSP and NRE have an extremely open policy with regard to industry data in the retailing area, providing low-cost access to fares, timetable, real-time and other data on low-cost terms and within a light touch licencing framework. There has been significant change in this area in recent years, a good example being the much easier access to ‘Darwin’ real time data recently introduced.

17. Notwithstanding the points above, TOCs and ATOC remain open to changes to current arrangements that, based on evidence, would improve the efficiency of the market and/or provide benefits to consumers.

3 Overview of the rail retailing market

Prior to addressing the specific questions raised by the ORR in its consultation document we have set out below an overview of the rail retailing market and some of the key, strategic issues that we believe need to be addressed. We also evaluate the performance of the TOC and third party rail retailing markets since privatisation.

3.1 Competition, co-operation and regulation

The rail retailing market is not a conventional market but rather a, probably unique, mix of regulation (including the specific contractual obligations upon TOCs contained within franchise agreements), competition and co-operation, which balances the benefits of competition with the desire of the government and other stakeholders (and arguably passengers) to retain the key ‘network benefits’ associated with a single-operator market. Furthermore, co-operation, beyond that required by regulation, has proven to be an unexpectedly effective model for many industry activities.

The regulatory framework is extensive, embracing various ‘Schemes’ (such as Railcards), fares capping and other areas. Perhaps the most significant regulatory element is the Ticketing and Settlement Agreement (‘TSA’), which impacts on the rail retailing market in a number of ways including the regulation of station ticket offices, the collective arrangements for third party retailing, industry arrangements for settlement, and a whole series of other ‘network benefit’ regulatory areas including through and inter-available ticketing.

Most of this regulation has remained broadly unchanged since privatisation despite the significant changes that have taken place in the market over the last twenty years. As such, consumers continue to be protected on the basis that they have the same needs and preferences as consumers in 1995, whilst a whole range of ‘network benefits’ are implicitly assumed to be as relevant now as they were at privatisation.

Although not formally regulation, the contractual obligations upon TOCs also act as a form of regulation, prescribing and directing behaviour in line with Government franchising policy. Over time, franchise agreements have become progressively more prescriptive, in effect limiting the scope and opportunity for investment and innovation by franchisees. Relatively short length franchises exacerbate this constraint, making the business cases for investment more difficult, but also necessitating the existence of industry structures that provide greater temporal stability.

It is partly for this reason that ATOC and its sister companies, Rail Settlement Plan (RSP) and National Rail Enquiries (NRE) have expanded their range of activities over the last twenty years, as co-operation has been found to be an effective business model for significant elements of industry activity (in terms of cost, interoperability and continuity through frequent franchise changes).

As such, co-operation is an area that has probably developed more significantly than expected since privatisation. RSP has extended its activities to include the provision of a whole range of central commercial systems and services, as well as developing its responsibilities in TIS accreditation and industry standards. National Rail Enquiries has extended significantly beyond its original focus on telephone information to become the principal information provider on rail services for consumers across a range of channels. In the commercial area, joint products like Railcards have thrived and retailing has been extended into new areas.

The expansion of these co-operative areas of activity has been partly customer-driven (NRE and Railcards for instance) and partly business-driven (the economies of scale by centrally procuring key systems for instance). Underpinning this has been the need to maintain inter-operability, itself partly driven by the regulatory framework, but also driven, in part, by consumer need.

Co-operation also extends beyond inter-TOC co-operation as well. The single most important rail market, London, is characterised by a very high degree of co-operation between TOCs/ATOC and TfL. This has resulted in much of the retailing framework, in terms of products, retail channels and ticketing being joint TfL/TOC/ATOC activities. In turn, this has delivered significant consumer benefits in the form of Travelcards, Oyster (PAYG in particular) and, most recently, contactless payment/ticketing using debit and credit cards. It is difficult to see how competition could have delivered these benefits.

By contrast, in parallel with the growth in co-operation, other elements of the market have become increasingly competitive with almost half of all tickets (in terms of revenue) now being sold through other than TOC 'own' channels. The third party retailing market has grown and inter-TOC competition has increased, with the proportion of TOC 'own sales' decreasing from 60% in 2004-05 to 52% in 2013-14. Increasing competition, the development of technology, and rapidly changing consumer needs has driven significant change in the rail retailing market itself. Additionally, and in contrast to central industry systems, a new market in the competitive supply of downstream Ticketing Issuing Systems ('TIS') has developed.

It could be argued that the rail retailing market has evolved in a way that allows the most efficient approach to be used in each of the component areas of the market. In retailing, competition is rapidly becoming the dominant model, whereas for central systems, ticketing and the London market, co-operation has proved to be a more effective model. However, in both cases regulation constrains and influences behaviour.

The current balance in the market between competition, co-operation and regulation is, therefore, the result of evolution since privatisation, within the constraints of twenty year-old regulation. The exceptional growth in the market since 1995, suggests that this balance has evolved in a way that has broadly worked.

Nevertheless, there are clear areas for improvement: the cost of industry retailing is excessive, suggesting the market has been less effective in dealing with supply-side issues; and innovation has sometimes fallen short of where it should have been. Significant consumer issues remain with some aspects of fares, information, ticketing and associated activities. Tensions between collective TOC policy and activities through ATOC and third parties are evident in the market.

The latter is perhaps not surprising given the lack of a single, guiding strategy. The sheer complexity of and lack of transparency in the existing framework is in itself an issue, creating and exacerbating tensions.

Whilst, overall, it seems very likely to us that the current 'mixed' approach to the market is likely to remain the best model, we believe it to be important that, strategically, the Review looks at the balance between competition, co-operation and regulation, examining whether there are specific changes that could be made that would make the market more efficient. Perhaps, most fundamentally, the role of regulation, including that focused on the preservation of network benefits, needs to be critically examined.

It is also worth considering whether there would be benefit in defining and articulating an overall market framework and/or strategy. Potentially these could provide greater clarity for all players as to how the market is expected to function.

We would be happy to engage further and develop proposals where necessary as part of the next phase of the Review.

3.2 The TOC retailing market

The TOC retailing market has worked reasonably efficiently since privatisation. It has supported exceptional growth in passenger numbers and revenue across all market sectors, and has demonstrated the ability to evolve and change. This latter point is reflected in the significant shifts between retail channels, with the growth in TVM and internet retailing in particular.

There has also been considerable innovation, not least the development of web retailing and Ticket on Departure (ToD). Oyster smartcards and barcode ticketing have also reflected innovation in the ticketing area. The fact that there is an active market in TIS systems and related technology is also a significant change since privatisation (although we have concerns about the efficiency of the TIS supply market).

The provision of central retailing systems through RSP has proved to be cost effective and efficient, although the need for collective agreement necessarily determines the pace of change. RSP technical standards and TIS accreditation have also proved to be effective in supporting interoperability and the continued existence of a 'joined-up' railway from a passenger perspective.

However, regulation has compromised the overall efficiency of the market, most obviously schedule 17 of the TSA, which has severely constrained TOCs' commercial freedom with regard to station ticket offices. This has had two unwelcome consequences: firstly it has meant that the cost of retailing to the industry has remained higher than it might otherwise have been, ultimately with implications for consumers and taxpayers; and secondly the inability to reduce costs as a result of investment in other forms of retailing has made the business case for innovation much more difficult to make.

Both the points above are significant issues for the industry, which the Review needs to consider, as part of the wider review of regulation we advocated in the last section.

Similarly the lack of freedom for TOCs to charge fees for retail transaction or differentiate price by channel has placed constraints on TOCs' commercial freedom and created unnecessary tensions within the market.

The increasingly prescriptive nature of franchises, and relatively short franchise lengths have also constrained innovation and investment.

The TIS supply market has also proved to be less effective than might have been expected with costs high and only limited innovation on the part of suppliers.

3.3 The third party retailing market

The third party retailing market has also worked reasonably efficiently since privatisation, with strong growth and the development of new markets in the internet and international sectors.

The cost of sale has come down as well, as commission has been reduced. Whilst this has inevitably created tension with third party retailers, there is no substantive evidence that it has inhibited development of the third party market. With forward strategy based on the maintenance of current commission levels for the foreseeable future (coupled with greater visibility on future commission levels), we would expect to see continued growth from existing and new retailers. Migration to lower cost forms of fulfilment over the next few years should mean that retailer margins improve as well.

In terms of market coverage, the TMC/corporate market is probably already near saturation, given that virtually all medium and large TMCs are already rail-licenced. The internet market is more difficult to judge, given its current somewhat unbalanced structure, with one major player, one medium-sized player, and a number of much smaller competitors.

There are clearly economies of scale associated with internet retailing, which seem likely to drive the market towards a smaller number of large players. In this context, there is likely to be further change in the market and it may well eventually stabilise around a model where there are perhaps two-three major national retailers (probably third parties), a small number of major TOC retailers who focus on sale of their own products (principally the long distance operators), and a number of other smaller TOC players, retailing on a ‘white label’ basis, primarily to ensure that they have a presence in the market.

One key issue is the extent to which existing players or new entrants can successfully challenge Trainline’s strong position in the market. Marketing spend by the largest two third party internet retailers is very considerable (probably well in excess of £10m per year in total) meaning that new entrants will need deep pockets if they wish to make inroads into the market. ItThe need to spend heavily on marketing clearly makes it much more difficult for smaller players to compete in the market.

Overall, ATOC/TOCs maintain an open and positive approach to new market entrants and have, thus far, never refused a licence application. Discussions are currently ongoing with a number of possible new market entrants.

One further area that the Review clearly needs to consider is that of third party retailer access to the full product range. There are two aspects to this issue: access to industry-wide products, Season Tickets; and access to TOC products or, more specifically, ticket discounts only available on TOC websites.

The first of these issues is already being addressed through a pilot of third party Season Ticket retailing, which will begin in 2015, following a competitive tender to choose participants, which has already been initiated. However, whilst in principle, there is TOC interest in the potential for expanding the market through the extension of Season Ticket retailing to third parties, the inability of TOCs to reduce station ticket office costs should there be significant migration of Season Ticket retailing to third parties is a significant related issue.

In a normal market environment, TOCs would seek to reduce their own retailing capacity in line with any switch to third party channels. That they would be prevented from doing this by regulation represents a significant distortion in the market and, compromises the ability of TOCs either to reduce costs or re-deploy resources as in any other business.

The second product range issue has a different series of questions associated with it. At the moment, there is no central industry-wide policy on this issue and TOCs adopt quite different approaches***.*** A key issue is the extent to which TOCs as carriers should be able to discount their own fares, particularly in the context of wanting to develop closer relationships with their customers.

It is also worth noting the freedom for third parties to offer similar online discounts, although the economics are clearly less attractive. It is also worth highlighting that in the TMC market, bilateral TMC-TOC deals are often based on the provision of discounted fares to corporate customers, not available to the public.

One possible area for expansion of third party retailing is through smaller, 'bricks and mortar' type outlets (such as convenience stores or Post Offices). It is not clear that such a market exists or that the economics of such retailing would be sustainable. The planned new licence, which we plan to trial in 2015 should test whether such a market exists.

Finally, it is worth considering whether the current third party retailing model is the most efficient. Later in our response, we consider alternative models, none of which are without their own issues and risks. However, in a sense, the questions around third party retailing form part of the much wider, strategic questions for the industry in terms of the balance between co-operation, competition and regulation.

4 Responses to questions posed in the ORR's consultation document – questions from chapter 2

4.1 General comments on the chapter

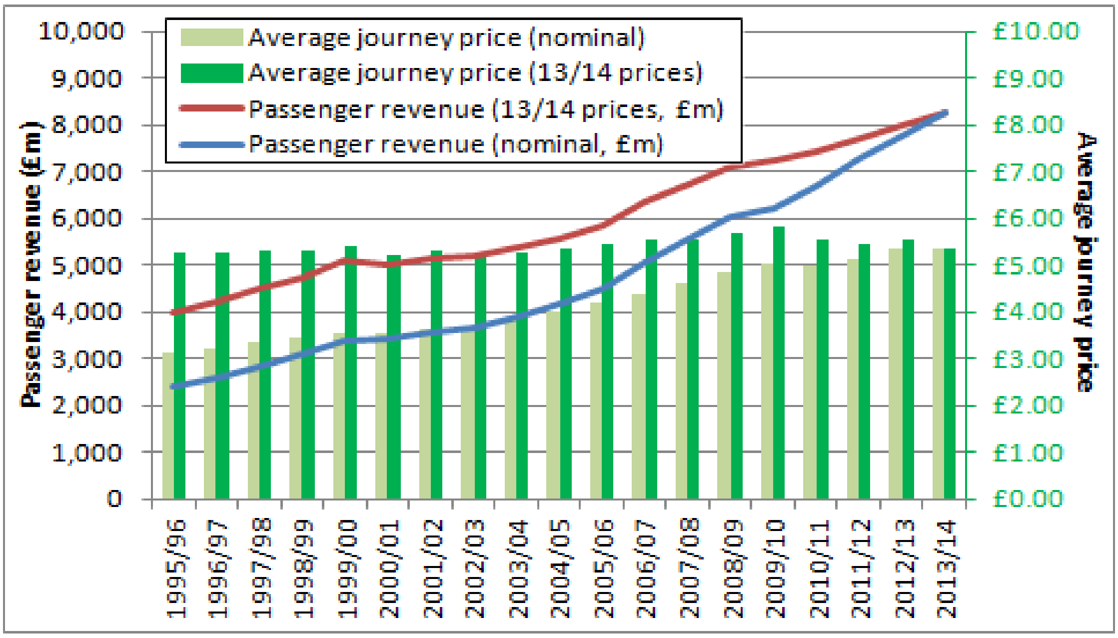
We believe that the consultation document has broadly captured the key trends in the rail retailing market but under emphasises both the exceptional growth in the overall size of the market and the extent of change within it.

4.2 Question 1: Is our description of the retail market for tickets and passenger buying behaviour correct? If not, are there any relevant trends/issues we are missing?

Whilst the consultation document generally identifies key trends, it does not give sufficient weight to the growth in the market.

Figure 1 below shows growth in the total rail retail market, as measured by revenue, in nominal and real terms (constant 2013/14 prices), between 1995/6 and 2013/14. The graph also shows average revenue per journey over the same time period, again measured in nominal and real terms.

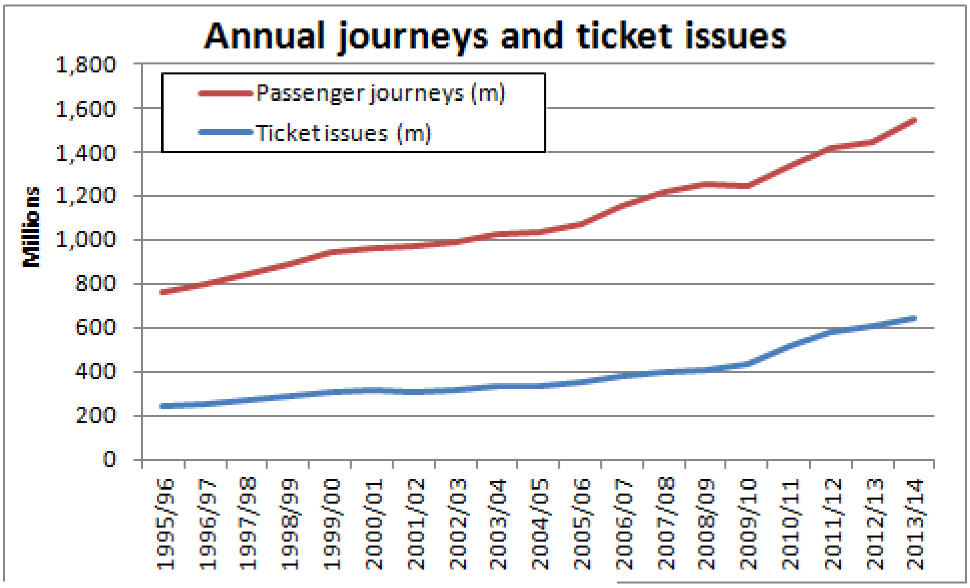
Figure 1: Rail retail market 1995/6 – 2013/14 (£b) in revenue terms (nominal and constant 13/14 prices)



Revenue has grown by 247% (107% in real terms) over the period. However, the average price per journey has remained roughly constant in real terms. This reflects significant migration by passengers towards cheaper products such as Advance fares and Railcard-discounted tickets, itself facilitated by better information on the range of fares available, through the internet in particular.

Figure 2 below illustrates volume growth in the market over the same period as measured by passenger journeys and transactions (ticket issues).

Figure 2: Rail retail market 1995/6 – 2013/14 in volume terms (million journeys and transactions)



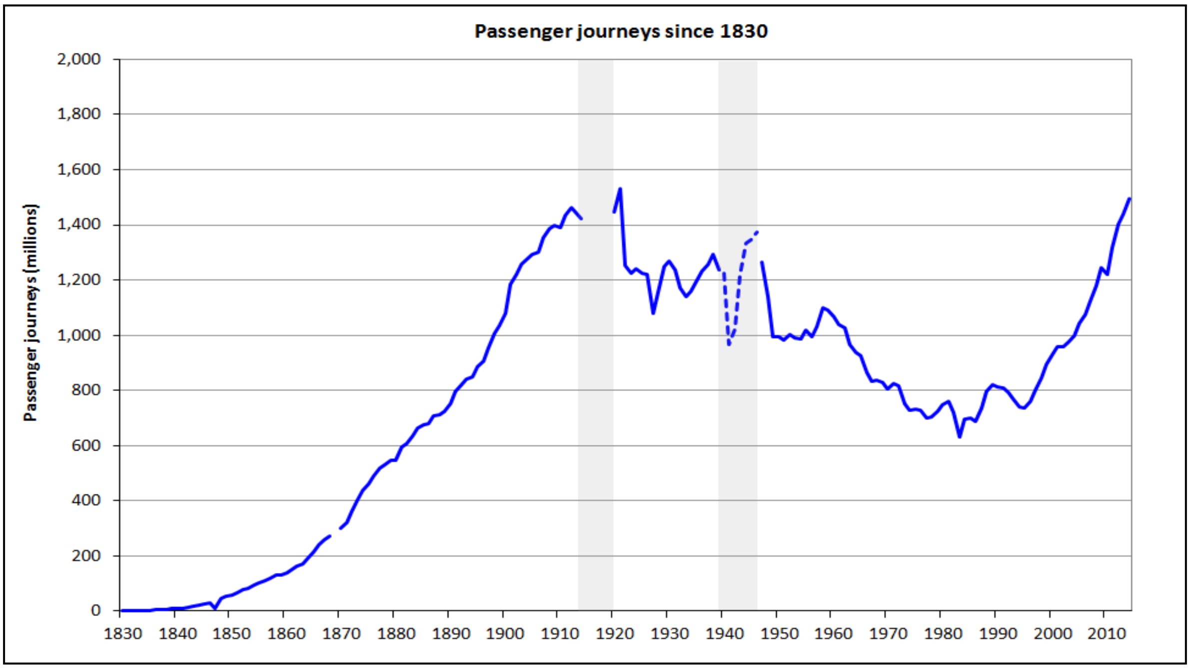
Source: Rail industry Lennon information system

To understand why this growth is so exceptional, it is necessary to consider in the context of both historical market growth and the growth experienced by comparator railways.

Figure 3 overleaf shows growth in a much longer term, historical context and illustrates that the growth in the twenty-year period since 1995/6 has reversed and completely offset the long term decline in rail travel, which had taken place over the previous seventy years.

The volume of passengers has now reached the level of the previous peace-time peak in the 1920s. Volume growth continues to be strong and is currently running at an annualised rate of over 4%.

Figure 3: Rail industry volume growth 1830 - 2014



Source: ATOC analysis of historical data

Growth rates since 1996/7 are also very high relative to the growth in rail travel seen in other developed countries. Table 1 below compares growth in Great Britain to that seen on a number of comparable continental European rail networks.

Passenger numbers in Great Britain have grown more strongly than in any of the comparator countries, and the rate of growth has been roughly twice that seen in France and Germany, perhaps the two most relevant comparators.

Table 1: European volume growth comparisons

	2011 journeys (m)	1995 journeys (m)	Change
GB	**1,429**	**761**	**88%**
Austria (OBB)	209	194	8%
Belgium (SNCB)	229	144	59%
France (SNCF)	1,090	731	49%
Germany (DB)	1,919	1,334	44%
Italy (FS)	523	453	15%
Netherlands (NS)	311	359	-13%
Spain (Renfe)	468	366	28%
Switzerland (SBB)	350	253	38%

Source: UIC

Whether measured in historical terms or against relevant sector comparators, growth over the last twenty years has been exceptional, providing clear evidence of a generally successful market, supporting strong growth in passenger usage. It does not suggest the existence of any significant problems with the rail retailing market.

The fact that the average fare paid per journey by passengers has remained roughly constant in real terms, despite the fact that fares levels overall have increased in real terms, also provides evidence that the retail market has been successful in allowing consumers to make informed choices when purchasing their tickets. This is reflected in the trend towards the purchase of cheaper tickets such as Advance fares or Railcard-discounted fares, which has offset the 'real' increases in the price levels of other fares.

It is also worth noting that growth has been reasonably consistent across rail's principal geographic markets, although the long distance market has seen the strongest growth. Table 2 below provides a breakdown of growth by key sector.

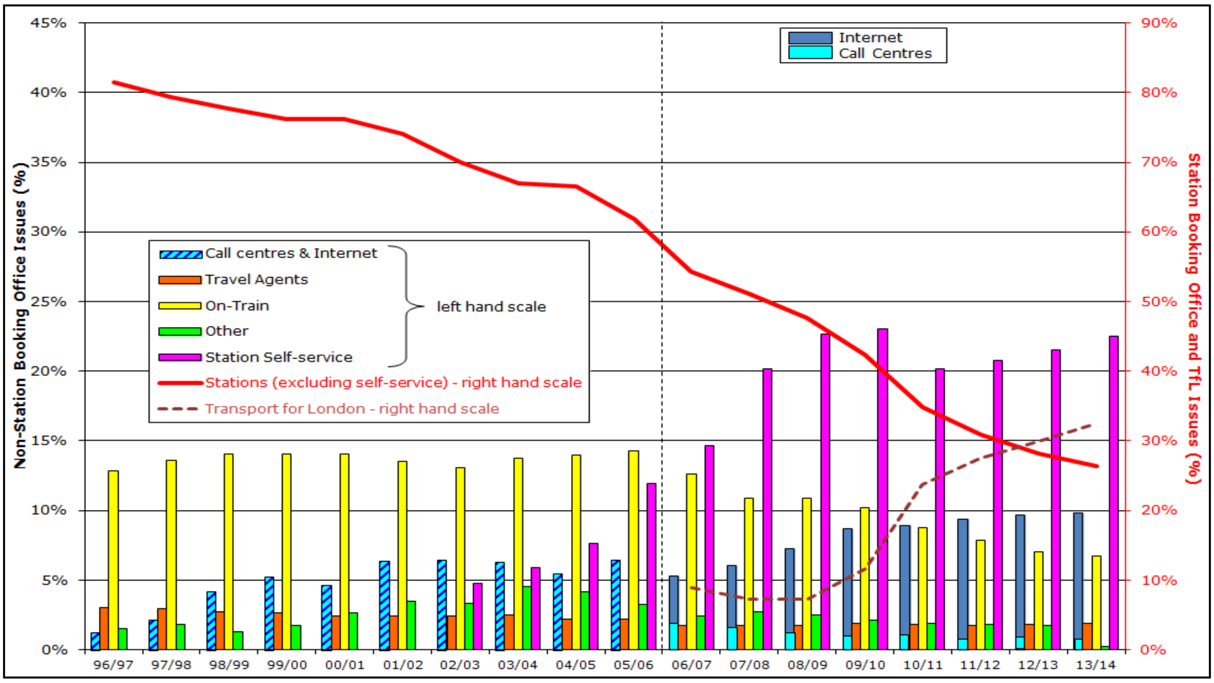
Table 2: Growth by sector 1996/7 – 2013/14

Sector	Long distance	L & SE	Regional	Total
% growth in passenger journeys	121%	96%	80%	94%
% growth in revenue (real terms)	102%	96%	86%	96%

Source: Rail industry Lennon information system

The rail retail market itself has seen very significant change since privatisation. Figure 4 overleaf provides an overview of trends in the rail retail market by channel between 1996/7 and 2013/14 as measured by the volume of transactions (ticket issues). Please note that the graph has separate right and left hand scales, denoting ticket office and non-ticket office transactions respectively.

Figure 4: Proportion of ticket issues by selling channel, 1996/97 to 2013/14



Source: Rail industry Lennon information system, ATOC analysis

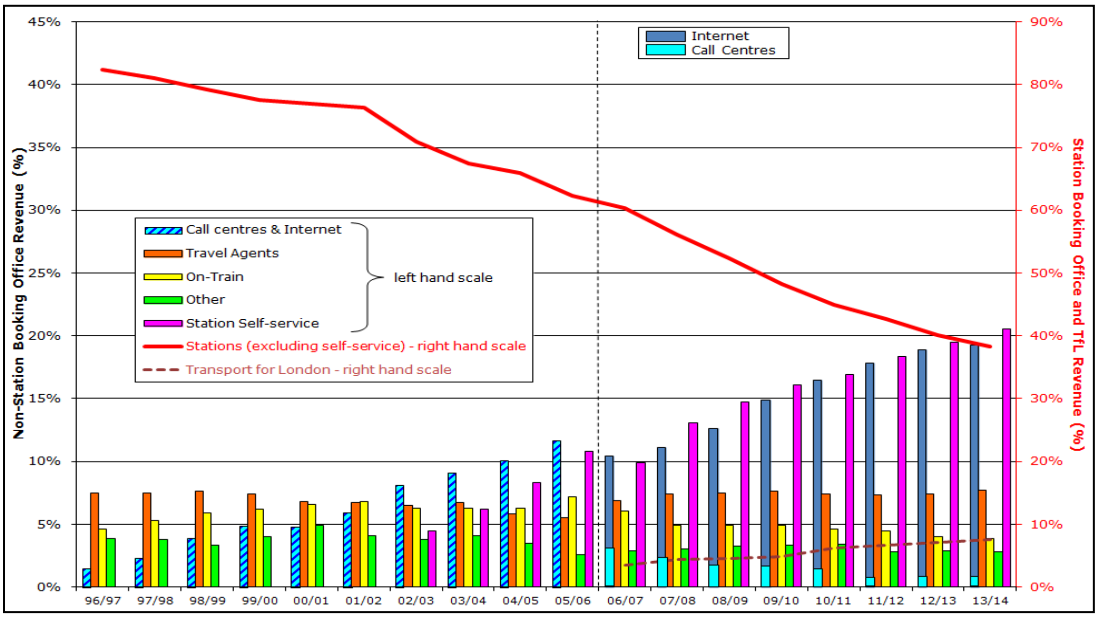
The graph shows that there has been very significant change in the market over the last twenty years. The most striking feature is the relative (and absolute) decline in station ticket office sales, which accounted for over 80% of transactions at privatisation but now account for less than 30%.

Their decline has been mirrored by the growth of internet retailing in the long distance sector, and migration to TVMs in the regional, and TVMs and TfL in the L&SE sectors. Call centre sales have collapsed. On-train transactions have declined significantly over recent years, reflecting both increasing use of station gates and the migration to Advance fares in the longer distance market.

TfL sales have increased very significantly in London, driving some of the decline in ticket office usage. Over the last four years Oyster PAYG has been particularly important in driving transaction volumes.

Figure 5 below shows the same information in terms of revenue. Similar patterns of demand can be observed but it is worth noting that the growth of internet sales has been more important in terms of revenue, with TVM and TfL sales concomitantly less important. TMCs have increased their proportion of total revenue.

Figure 5: Proportion of rail revenue by selling channel, 1996/97 to 2013/14



Source: Rail industry Lennon information system, ATOC analysis

Note: Data include non-TOC earnings (such as TfL outpayments) as TOC net earnings by selling channel are unavailable prior to 2004/05

Table 3 below shows the absolute change in revenue by channel from 1996/7 to 2013/14. Revenue is shown in real terms at constant 2013/14 prices. Some cells in the matrix remain unpopulated because historical data does not exist for the year/channel concerned. Station ticket office revenue for 1996/7 and 2001/2 includes station TVM revenue as well.

Table 3: Real revenue by retail channel 1996/7-2013/14

	Annual revenue, real terms (£m)					
Selling channel:	**96/97**	**01/02**	**06/07**	**11/12**	**12/13**	**13/14**
Station ticket offices	3,600	4,099	4,087	3,586	3,518	3,490
TVMs			673	1,540	1,706	1,869
Transport for London			237	559	624	691
TMCs	328	359	464	617	651	706
Call Centres			237	71	60	54
Internet			468	1,427	1,596	1,699
Call centres & Internet	66	317				
On-Train	201	365	412	374	354	351
Other	170	220	196	233	256	252
Total	**4,369**	**5,365**	**6,775**	**8,408**	**8,765**	**9,113**

Source: Rail industry Lennon information system

Note: Data include non-TOC earnings (such as TfL outpayments) as TOC net earnings are unavailable by selling channel for 1996/97 and 2001/02

Station ticket offices and call centres have seen absolute falls in revenue in real terms, whereas all other retail channels have seen an increase, although the trend in station ticket office sales is more difficult to determine because of the inclusion of TVM sales prior to 2006/7. Call centre sales have collapsed as consumers have migrated to the internet.

TVMs and the internet have both shown spectacular growth with growth in real revenue of 178% and 263% respectively, even though measurement is over a much more limited period (2006/7-2013/14). The growth in sales through the internet has been fuelled by sales of Advance fares. Similarly, TfL sales in the London market have increased by 192% in real terms, again over just a five year period, driven by the growth of Oyster PAYG sales. TMC sales have more than doubled in real terms.

4.3 Question 2: Have we appropriately captured the most significant changes to ticket retailing in the last 10 years or so? Do you consider the pace and level of developments and changes have been appropriate to meeting passengers' changing needs?

We found the description of change in this chapter and annex C somewhat confusing as it conflated changes in three different areas: rail products (fares, discount schemes etc.); ticket fulfilment; and ticket retailing. In order to provide greater clarity, we consider each separately in the sections that follow, noting at the outset that the pace of change has been different in each.

Rail products

Changes to the range of rail products offered to customers are not driven by retailers, but rather by TOCs as carriers individually or collectively through ATOC (the only exception to this being the 'packaging' of rail travel with other travel elements such as hotel accommodation). Thus the extent of change in this area is really only relevant to a review of the rail retailing market to the extent that retailing itself imposes constraints on product development.

Nevertheless, given the content of the ORR's consultation document, we will initially consider change and innovation as far as rail products are concerned in general before considering whether the rail retailing market itself has imposed constraints.

The pace of change in rail products has been affected by two key factors: the voluntary maintenance of a consistent range of fares on a national basis; and constraints resulting from the regulatory framework, political influence and franchising policy.

In terms of the former it is worth providing some historical context. The early years of the century saw increasing public and stakeholder concern about the complexity of rail fares; in particular the proliferation of different variants of Advance fares. In response to this concern TOCs, through ATOC, but in close co-operation with other stakeholders including Passenger Focus and the DfT, undertook a major simplification of fares in 2008.

This simplification, widely welcomed at the time, introduced a consistent range of fares across all operators: Anytime, Off-Peak/Super-Off Peak, Advance and Season Tickets. Conditions for Advance fares were harmonised across all operators, fares re-named based on customer research, and other terms and conditions harmonised.

TOCs through ATOC have maintained this consistent structure since 2008 on the basis that it makes ticket choice and purchase easier for customers. As a result, whilst the industry is still (often rightly) criticised for over-complexity, the volume and intensity of criticism has abated and focused on the content and presentation of information rather than the range of fares themselves.

This voluntarily self-imposed, co-operative consistency has inevitably constrained the potential for change, but in doing so provided some clear customer benefits.

The regulatory framework, political influence and franchising policy also provide constraints. CrossCountry's initiative to introduce close to departure Advance fares was made considerably more difficult by a regulatory framework which has remained largely unchanged in many areas since privatisation. One key problem was trying to assess the extent to which these fares were permitted by the TSA, which was largely silent on an innovation that no-one had envisaged in 1995.

More fundamentally, it is worth highlighting that around 35% of all fares by revenue are regulated by the Government, meaning that change is subject to agreement by the DfT, including, often complex, financial changes to franchise agreements. This necessarily inhibits change and means that innovation is often government/DfT-driven (for instance the current single-leg pricing and flexible commuter product initiatives are both Government/DfT-driven), in itself an unusual position for a major national industry to find itself in.

Whilst TOCs/ATOC have never argued that fares regulation should be removed where rail has a dominant market share (the London commuter market for instance), we have argued that it should be removed where rail is not dominant and the reason for regulation is essentially Political/social rather than economic.

A good example of this is Off-Peak fares on longer distance routes, where TOCs operate in highly competitive carrier markets. However, proposals have also been rejected on the basis that they would result in higher fares for some customers, notwithstanding the fact that fares for many passengers would be lower, improved demand management would lead to reduced overcrowding, and fares could be simplified through the introduction of single-leg pricing.

That such deregulation has never been implemented reflects an apparent wish on the part of Government/DfT to avoid decisions that negatively impact even a minority of customers. Whilst there is customer rationale to this (albeit one that it is likely to inhibit the vast majority of change, where typically there are winners and losers), there is also a strong Political dimension.

Franchise agreements, which have become both more prescriptive and financially demanding over time, also limit the scope for innovation, particularly where this involves revenue risk, which might impair a franchisee's ability to meet the financial obligations within its franchise.

Despite all the factors above, there has been innovation, sometimes through collective initiatives such as the Two Together Railcard but also individually by TOCs. Examples of product innovation by individual TOCs are, in the main, focused either on products for specific segments or product enhancements:

- Family Ticket (Virgin Trains): available during school holidays for 2 adults and up to 4 children travelling together
- Discounts for Senior Rover products and Student season tickets (C2C)
- Small group discount (25% for 3-9 passengers) to encourage mode switch from car to rail (East Coast)
- Carnet tickets (East Midlands Trains and others), which typically offer 5 journeys for the price of 4 (or 10 for 9)
- Standard Class tickets (sold primarily through TMC's) which entitle the customer to enjoy the benefits of 1st class travel (ranging from complimentary wi-fi, to First Class Lounge Access or even a First Class seat). Good examples of this are East Coast's Scottish Executive and East Midlands Trains' Business Standard products.

Overall, the pace of change has been relatively slow, but consciously constrained by co-operation and inhibited by a complex regulatory, political and contractual framework.

It is worth considering what the alternatives to this might be. As a contrast it is perhaps worth considering the most extreme alternative, which we have described below:

If the current regulatory obligations to offer through and inter-available ticketing were removed, we could move to a new model where TOCs set fares only for their own network of services. Fares would be TOC-specific and only available on the services of that TOC. 'Fares-capping' regulation would only be retained where market dominance existed (primarily the London commuter market and commuter markets in other major conurbations).

Inter-available and through fares would continue to exist but only where commercial agreements between TOCs allowed them to exist. For instance, where there were clear customer benefits from inter-availability such as the Clapham Junction to London route, inter-available fares could continue to be set by agreement. A degree of regulatory oversight would be needed to ensure that such agreements were in the interests of consumers.

An additional option would be to maintain 'through' fares by having a network-wide approach to the concatenation of TOC fares (perhaps with standard discount factors applied to make these, inherently longer distance fares, more attractive).

There are clear potential benefits from this approach: a significant element of complexity could be removed, making things simpler for customers, and lowering the costs of industry systems; there would be the potential for greater innovation and 'on-route' competition; and split-ticketing would cease to be a problem.

However, it would mean that there would be greater diversity in the range of fares, with no single, national structure, which might be viewed as increasing complexity. Inter-availability and potentially the availability of through fares would be reduced to a greater or lesser extent. Perhaps, most importantly there would be financial implications for franchisees and government. The new model would also need to be reflected in franchising policy.

Such a change would constitute a paradigm shift in the way that rail fares are set. It is important to emphasise that we are not necessarily advocating such a change, but insofar as the Review is considering strategic change, it is the kind of alternative model (and there are other, less radical options) that we believe should be further considered.

Returning to the extent that the retail market itself has inhibited the development in rail products, we do not believe that it has been as significant a constraint as the factors already highlighted. However, the current complexity of the market in terms of the number of retailers and technology providers does make the introduction of products that require changes to software or processes very difficult.

For instance, whilst not a new product in the conventional sense, the introduction of the new simpler design of Credit Card Sized Ticket ('CCST') has taken far longer and proved much more expensive than originally envisaged, largely because of the sheer number of downstream retail systems that need to be changed to support the new format.

Ticket fulfilment

Ticketing has proved to be one of the most challenging issues for the industry over recent years, with only partial exploitation of the opportunities provided by new technology to improve the customer experience and drive down cost, and a pace of change that has lagged behind other industries. As such, we think it is worth re-capping the history of ticket fulfilment since privatisation, which in itself, serves as a useful case study in terms of the balance between competition, co-operation and regulation within the industry, which we highlighted in the introduction to our response.

At privatisation, only paper ticketing existed, mainly in the form of the ubiquitous, CCST paper ticket, albeit supplemented by other forms of paper tickets. The advent of smartcard technology in the late 1990s seemed to provide clear opportunities to move away from paper ticketing and the DfT focused its ticketing strategy on ITSO smartcards, with significant amounts of taxpayer funding being used to support the development of ITSO.

However, exploitation of ITSO was hindered by delays in its technical development, exacerbated by the DfT's belief that a commercial business case existed for the investment required to smart-enable the rail network. In reality the significant capital expenditure required to smart-enable even high volume, commuter routes was impossible to justify commercially, particularly in the context of short franchises, but also, more importantly in the context of a regulatory framework that made realising potentially offsetting cost savings or improvements to customer service through station ticket office re-structuring virtually impossible.

As a result, the DfT strategy of including very limited ITSO smartcard trials in franchise specifications in the belief that they would be sufficient to engender TOC investment proved to be ineffective.

By contrast, TfL developed a clear vision for their own ticketing strategy, based on Oyster, and single-mindedly pursued it, aided by strong political support from successive Mayors. As a result Oyster has proved to be a major success for both TfL and TOCs alike, driving usage of public transport through an improved customer experience. However, the result is a successful smartcard scheme in London that does not conform to the DfT's preferred smartcard strategy.

Whilst it has proved largely impossible to make a business case for the investment required to support smartcards, it has proved much easier to make the case for investment in barcode technology (where significantly less capital investment is required) with the result that a number of TOCs, principally in the long distance market, offer barcode ticketing (either in the form of 'print at home' tickets or on mobile phones). Whilst these are popular with customers, schemes have been implemented on a TOC by TOC basis and tickets have not been inter-operable. In addition, such new ticketing has been limited in its availability to retailers, both TOC and third party.

More recently, the pace of change has quickened with funding for smart enablement of much of the south-east being provided by the DfT through its South East Flexible Ticketing ('SEFT') programme. In addition, TfL has continued to innovate and Contactless Payment ('CPAY') in London was launched on TfL and National Rail services in September. In addition, some TOC owning groups have launched smart card schemes, exploiting ITSO technology. Finally, RSP has just launched a major trial of inter-operable barcode ticketing involving TOCs and third party retailers.

However, significant problems have been encountered with even these developments; SEFT has suffered from a lack of agreement over technology and escalating costs, whilst various factors have delayed the 'ITSO on Prestige' (IoP) scheme that would allow ITSO smartcards to be used on the TfL estate, a crucial issue from a passenger perspective.

As a result of this history, the CCST ticket, inherited at privatisation, remains the one most commonly used by far across the network (albeit with Ticket on Departure having provided it with a new lease of life). Oyster has been successful in London but is, in essence, not joined-up with the rest of the network, where roll-out of ITSO smartcards has been extremely limited. Barcodes have proved popular but roll out has been patchy, non-inter-operable and limited in retailing terms.

In order to address this, ATOC advocated strongly in its submission to the DfT's Fares and Ticketing Review, published in 2013, that an industry-wide ticketing strategy should be developed, as the only way of achieving more rapid progress, given industry complexity and the failure of piecemeal initiatives to effect substantive change on a national basis.

The Fares and Ticketing Review report accepted this view in principle but didn't set out a substantive longer-term strategy or say how such a strategy should be developed, focusing instead on more immediate objectives such as SEFT. However, following the Review and further engagement at a Ministerial level, a DfT-RDG jointly chaired industry steering group, also involving TfL and the PTEs has now been set up with a view to developing and overseeing the implementation of a national ticketing strategy.

For ticketing, we have broadly come to the view that there does need to be a collaboratively-developed, industry-wide strategic framework, even if within this, TOCs and other players can choose from a range of possible technologies (allowing some scope for competition and innovation).

Much work remains to be done, but the end result is likely to be a better-defined balance between co-operation, competition and regulation, supported by governance structures and initiatives that support industry strategy, and with ultimate benefits for consumers in terms of innovation, ease of access to the rail network and the continuation of an interoperable, joined-up railway.

Ticket Retailing

As our response to question (1) illustrated, ticket retailing has seen significant change since privatisation, arguably more so than either rail products or ticket fulfilment.

We won't repeat the arguments set out in our response to question 1, but it is worth highlighting that the observed and significant changes in the market have essentially been customer-driven.

The 'traditionally' predominant channel, station ticket offices, has seen an absolute fall in the volume and value of sales, despite station ticket office retailing capacity being maintained at roughly constant levels due to the regulatory framework.

Instead, customers have migrated in significant numbers to TVMs, particularly for shorter distance, low value journeys. In London, Oyster PAYG has proved to be the channel of choice for increasingly large numbers of customers.

In longer distance markets, customers have increasingly opted for the internet, particularly in the leisure market. This has partly driven the convenience of this channel but the growth in Advance fares (particularly well suited to purchase over the internet) and ToD/barcode ticketing has also made purchasing at home much more convenient. In the longer distance business travel market there has also been migration to the TMC channel.

Given that station ticket office retailing capacity has remained fixed, these significant changes in ticket-buying patterns are essentially customer-driven reflecting that TVMs, the internet, PAYG and TMCs represent easier and more convenient methods of ticket purchase.

Whilst there has been significant change, normal market dynamics have, nevertheless, been distorted by station ticket office regulation in particular. Without the constraining factor of this regulation it is likely that even faster migration away from station ticket offices would have been seen, as the business case for investment in alternative channels would have been stronger.

Unlike rail products and ticket fulfilment, the ticket retailing market has been characterised by a greater degree of competition and change, although regulation has been an inhibitor to change in some areas.

Nevertheless, it is worth noting that such competition has been supported by the co-operative arrangements between TOCs in terms the IT infrastructure and commercial framework that supports retailing, itself partly emerging out the regulatory framework (the arrangements for third party retailing in the TSA for instance).

4.4 Question 3: Are there insights on passenger behaviour, market share and sales channels from other sectors that are worth considering?

We have already provided the ORR with reports by LEK Consulting, commissioned by ATOC, that benchmark specific aspects of the rail market in Great Britain with relevant comparator markets such as air travel and the rail markets in other developed countries. They highlight the greater competitiveness of the market in Britain and the generally more favourable terms enjoyed by third party retailers.

The key conclusions from these reports have been included in appendices B and C to our response.

We believe that the evidence from these reports, which have examined key comparator markets is highly relevant to the ORR's Review. We also note that LEK's findings are, in some key areas, corroborated by the findings in the report by CEPA, commissioned by the ORR.

5 Responses to questions posed in the ORR's consultation document – questions from chapter 3

5.1 General comments on chapter

In responding to this question, we will not comment on the arrangements themselves, as we address this issue in our responses to chapters 4 and 5. However, we have set out below some comments on the accuracy of chapter 3 and some points of clarification.

5.2 Question 4: Have we accurately described the ticket selling arrangements in respect to i) retailers incentives in selling tickets; ii) retailers obligations to facilitate an integrated, national network; iii) retailers' governance arrangements; iv) retailers' industry rules; and v) retailers' industry processes and systems?

Paragraph 3.2 (d): It is not correct to say that TOCs/ATOC have developed the industry rules. Many were set by the Government at privatisation and have evolved in most part subject to approval of the DfT. The TSA is an example of this evolution, although it remains substantively unchanged since privatisation. TOCs/ATOC have set specific rules in retailer licence agreements, although some of these reflect the template Travel Agents Licence, contained within the TSA at privatisation.

Paragraph 3.7: TOCs are not restricted by the TSA or any other aspect of the regulatory framework to changing fares at only three points during the year. The restriction is that fares may only be changed at a 'permanent fares setting round', and the fact that there are three of these per year reflects current practice and the existing contract with our fares system supplier. The new fares system (called the Product Management System or 'PMS') will allow the industry to introduce additional permanent fares setting rounds if these are required.

Paragraph 3.10: Third party retailers earn a base rate of commission from TOCs through the centralised ATOC arrangements but can earn additional remuneration through bilateral arrangements with individual TOCs or owning groups. This is relatively uncommon in the internet retailing market but much more widespread in the TMC/Corporate market where there are over 40 bilateral arrangements currently in place (covering between 60 and 90 TMCs). We provide more information on this in appendix C.

It should be noted that the vast majority of third party retailers choose charge fees. Appendix C of our response provides evidence on this point.

Paragraph 3.14: This paragraph potentially confuses accuracy and impartiality. The obligation upon retailers to provide accurate information essentially stems from general consumer law as well as the rail industry's specific regulatory framework.

Furthermore, accuracy is not synonymous with impartiality. For instance a retailer might provide information on all the available fares for a specific journey accurately but still sell partially (for instance by giving greater prominence to the fares of one train company over others).

The impartiality obligation in the TSA was designed to ensure that partial retailing of the kind highlighted above did not happen. This was driven by the fear that post-privatisation, private sector train companies would, through their own retail channels, give greater prominence to their own fares rather than those of their competitors. Safeguarding against discriminatory behaviour was, therefore, the principal driver behind the impartiality obligation.

Paragraph 3.15: Retailers do not have to offer the same prices as other retailers or through every channel. However, all retailers, TOC and third party must settle with RSP at the full price as specified by the operator who has created the fare. As such there is very limited incentive for third party retailers to vary price (with gaining access to or 'ownership' of more customers providing the only commercial rationale). The same constraint applies to TOCs in respect of inter-available and through fares, which are subject to the allocation of carrier revenue through ORCATS, but does not constrain discounting of Advance fares where all revenue is allocated to the relevant carrier TOC.

However, whilst the TSA does not explicitly prohibit TOCs setting different prices for specific retail channels, the whole process of setting and retailing fares specified in the TSA constrains this to a very significant degree as in practice it can only be achieved through mechanisms that apply only to 'temporary' fares.

Paragraph 3.19: Appendix A sets out evidence on the relative cost of sale of different retail channels.

Paragraph 3.21: TOCs have a regulatory obligation to offer Senior, 16-25 and Disabled Persons Railcards. Other Railcards are offered by TOCs on a voluntary basis.

Paragraph 3.23: DB Schenker Rail (UK) is a member of ATOC, but only by virtue of owning Rail Express Systems Ltd (Parcels) which was created at privatisation. Rail Delivery Group ('RDG') does have freight company members.

Paragraph 3.24 and 3.25: This paragraph characterises the TSA and other industry 'Schemes' as being 'owned' by TOCs. However, for 'mandatory' schemes (the TSA, Senior, 16-25 and Disabled Persons Railcard Schemes and NRE Scheme), which form part of the regulatory framework, this is essentially not an accurate description.

Whilst they are inter-operator agreements, all were drafted prior to privatisation and became immediate regulatory obligations upon the newly created franchises. After this, any change to the agreements was subject to DfT (in effect Government) approval. Whilst this has been given in some areas, it has been denied in others. In particular, long standing proposals from TOCs/ATOC to reform fundamentally the TSA have been consistently rejected over a period of around ten years by the Government.

In effect this amounts to the TSA and other mandatory schemes being Government/DfT created arrangements that are subject to Government/DfT change control. These are not inter-operator schemes 'owned' by the TOCs in the sense that TOCs created them or have unfettered freedom to change them.

Paragraph 3.32: In terms of trying to encapsulate the purpose of accreditation, we don't believe that 'impartiality' is the essential driver. We have set out below an extract from the ATOC/RSP website, which sets out the main purposes of accreditation:

'Accreditation is the process by which RSP ensures that various Ticket Issuing Systems (TIS) used to sell and issue National Rail tickets for travel on UK passenger train services are able to:

- produce tickets that conform to industry standard specifications (RSP Standards), so that they can be accepted by all Train Companies (TOCs) and thus support interoperability across all TOCs in line with the Ticketing & Settlement Agreement (TSA);
- generate the associated ticket transaction data ensuring it conforms to the relevant RSP Standard and is therefore acceptable to the centralized RSP settlement systems, in order to ensure accuracy and probity of settlement;
- generate data which interfaces appropriately with other RSP systems and allows for interoperable functionality between TIS for seat reservations, Ticket on Departure (ToD) and other systems;
- maintain RSP Standards of security and integrity in relation to RSP systems;
- assure TOCs that their TIS comply with the terms of the TSA, and assure third party retailers that their TIS comply with the terms of their retailing licence;
- ensure that the TIS uses RSP standard data feeds in their retailing processes to meet consistency and impartial retailing requirements; and
- support disaster recovery/business continuity and recovery from system fault conditions, error handling and preserve an audit trail.'

The reason that accreditation certificates require renewing every three years or for certain incremental change is to ensure that the rail retailing system keeps pace with amended RSP Standards or newly developed RSP Standards that are associated with new and emerging technologies such as smartcards and barcode ticketing. The consultation document does not adequately explain why there is this requirement.

Paragraph 3.32: Footnote 50 should read as follows: 'There are only a handful of parties who supply APIs to the retail market.'

Paragraph 3.34:

(a) This requirement does not apply to all third party retailers as implied by this paragraph, but only to Third Party Investor Licence (TPIL) holders (of which there are currently three) and to International Sales Licence (ISL) holders of which there are now five. The Marketing & Promotion Plan ('M&PP') provides a review of the previous year's performance together with a forward view of sales volumes/revenues for the next 12 months. The M&PP is treated as a confidential document by ATOC and is specifically not shared with the TOCs.

(b) Rail retailing qualifications: For third party retailers (TMCs, TPIL and ISL holders) a minimum of 20% (or 2, whichever is the greater) of customer-facing staff must achieve and maintain the Certificate of Rail Agent Competency (CORAC). The CORAC qualification consists of a National Rail module (covering such items as GB rail geography, National Rail products/fare types, fulfilment methods and refunds) and two TOC-specific modules of the agent's choice.

(c) Bonding requirements: All third party retailers are required to provide security against settlement default. For TPIL and ISL holders this is typically provided in the form of a bond or a combination of a bond plus cash. TMCs with a history of at least three years rail retailing, without settlement problems, may apply to join the Travel Agents Reserve Insurance Fund (TARIF) scheme. TARIF is funded by a levy (currently 0.18% but being reduced to 1.09% in 2015) on the value of the TMC's sales in the previous settlement period.

(d) Footnote 53: The TARIF levy was reduced from 0.36% to 0.18% with effect from May 2014, although new entrants to the scheme pay 0.36% for the first two years. The levy will be reduced to 0.09% from May 2015.

(e) Third party retailers (TMCs, TPIL and ISL holders) are generally able to sell all fares included in the RSP fares feed, although a limited number of exclusions apply:

- Season tickets – the more complex administrative and customer service obligations associated with Season Tickets, along with other issues, have historically presented a barrier to the extension of sales to third parties. However, ATOC/TOCs will be running a pilot in 2015 to assess the feasibility, security and attractiveness of selling season tickets through third parties;
- Tickets purchased with the benefit of a railways staff 'privilege' card;

- Disabled Person's Railcard and HM Forces Railcard (since these require validation of entitlement and there are specific security issues with the administration of HMFRC sales);

- ITX fares (may be sold by ITX licence holders);

- Eurostar interlining fares (may be sold by agreement with ATOC and Eurostar).

However, with the exception of Season Tickets, which will be the subject of a third party retailing pilot in 2015, these excluded products are not material in value. In 2013/14 total sales were £21m**,** representing just 0.3% of total industry revenue.

Paragraph 3.34: Footnote 51 should now read that we have removed this requirement.

Table 2: At the request of the retailer, interim licences can extend beyond twelve months.

Paragraph 3.38 (g): There is also a £0.90 ToD fee for tickets issued through ticket offices, although only around 7% of ToD fulfilment happens this way.

Paragraph 3.38 (h): Lennon uses the ORCATS allocation file to allocate revenue to TOCS based on sales data it has received from all rail retailers, whether TOCs or third parties. The ORCATS allocation file determines the allocation to each TOC on an individual flow basis. Quite separately, rail retailers, whether TOC or third party, are allocated sales commission at the appropriate rate, this being deducted from sales prior to revenue allocation through ORCATS.

Therefore, if a TOC sells a product that can only be used on its services, it does effectively retain 100% of that sale as it is effectively paying sales commission to itself and there is no allocation of revenue to other TOCs through ORCATS. However, if a third party or other TOC makes the same sale, then sales commission will be payable to that retailer at the appropriate rate.

Paragraph 3.38: Footnote 56 is incorrect. TSA Chapter 6-26 does not discuss settlement but covers the retailing requirement as far as issuing a physical ticket is concerned. It refers to non-RSP settled products, in terms of retailing not settlement and the inference draw in the footnote is not correct. TSA Chapter 12-2 covers the 'PROVISION OF SERVICES IN RESPECT OF RSP-SETTLED PRODUCTS' and states that 'The RSP will provide clearance and settlement services on the terms of this Chapter in respect of **RSP-settled Products** and **RSP-settled Refunds** in relation to which the information specified in Clauses 12-3 to 12-8 below is provided to it in accordance with Clause 12-9.'

6 Responses to the questions posed in the ORR's consultation document – questions from chapter 4

6.1 General comments on chapter

We have no general comments on this chapter.

6.2 Question 5: What are your views on the impact of the retailers' incentives in the way they sell tickets? To what extent do the incentives discussed herein impact retailers' approaches, and how do these differ by retailer type? From the point of view of a retailer, what factors have to be present to make the development of new products an attractive proposition?

The current industry framework has been successful in driving exceptional growth in sales over the last twenty years, suggesting that incentives, whether in the form of remuneration, competitive advantage or commercial incentives within franchise agreements have generally been effective. This growth has been consistent across all market segments. Within the retail market itself, both TOCs and third parties have seen very strong growth, with the market share of third parties gradually increasing over time.

However, this is not to say that there is not scope for improvement, and we highlight opportunities for improvement in other elements of our response.

In terms of how incentives differ between retailers, perhaps the primary difference is that TOCs are primarily carriers rather than retailers. Their retailing activity is, therefore, driven by the need to increase travel revenue rather than solely remuneration from retailing. In this context, particular emphasis is placed on customer ownership and the opportunity for repeat sales.

This also drives TOC incentives to innovate, which are largely predicated on earning a commercial return through investment in new services or facilities that meet customer needs. Good examples of this are the risk-based investment in barcode ticketing by longer distance operators and Go Ahead's investment in the 'Key' ITSO smartcard.

However, the relatively short terms, prescriptive natures, and increasingly demanding financial requirements (for instance, payment of premia to the government) within franchise agreements constrain such investment and the innovation it funds.

These constraints are exacerbated in the retailing area by the inability of TOCs to vary supply in relation to demand because of the regulatory constraints on station retailing. This significantly weakens the business case for investment in new services and facilities because the potential cost savings or improvements to customer service from the restructuring of station retailing cannot be realised.

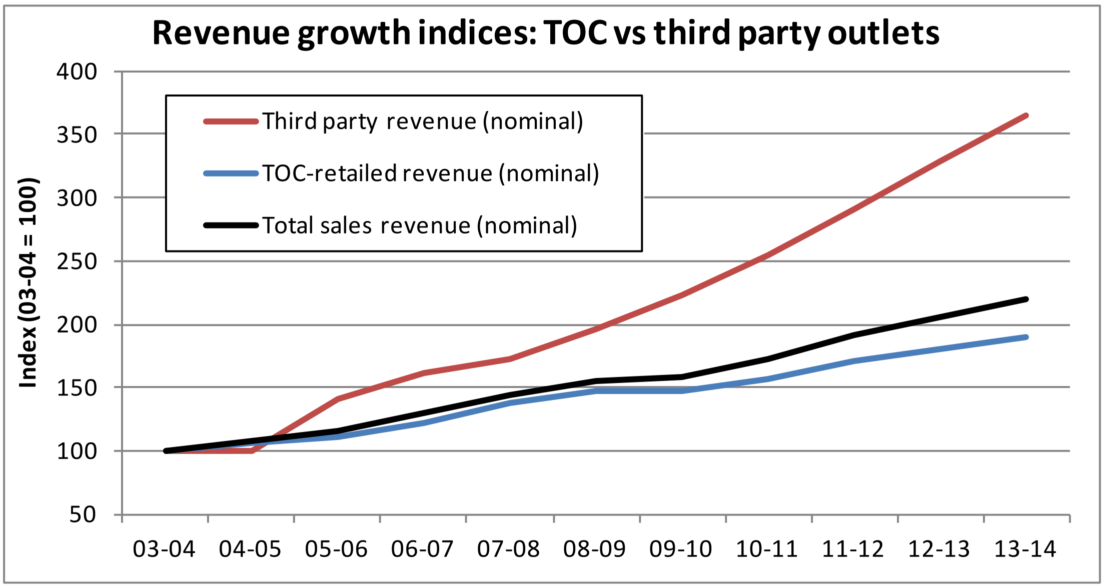
For third parties, remuneration, whether in the form of ATOC/TOC commission or customer/client fees, is clearly a key driver. However, investment in new services or facilities to increase market share (and drive remuneration) is also a driver, as is the ability to leverage investment more widely through technology supply deals or 'white label' arrangements for instance.

We set out in appendix C the rationale for the current industry approach to remuneration, and in appendix D our planned forward strategy for the third party sector of the market. This maintains commission at current levels but provides longer term visibility to retailers.

It is worth noting that whilst third party retailers have raised concerns about the level of commission and commission differentials between channels, there is little evidence that remuneration has constrained third party sales. Figure 6 below compares growth in the third party retailing market over the last ten years with growth in the TOC retailing market. TfL sales have been excluded.

Revenue from third party retailer sales has consistently grown more quickly than TOC sales, over the last ten years, with particularly strong growth since 2007/8.

Figure 6: Relative growth rate of TOC and third party retailers (indexed with 2003/4 as base)



Source: Rail industry Lennon information system

Table 4 overleaf provides a breakdown of TOC, third party and TfL sales by year since 2003/4. Over the ten year period being considered, non–TfL, third party sales grew by 164% in real terms compared to 38% growth in sales through TOC outlets. TfL sales have increased by 451% in real terms. Oyster PAYG significantly increased the pace of TfL growth from 2010/11 onwards.

Table 4: Relative growth of TOC and third party retailer sales 2003/4-2013/14 (£m)

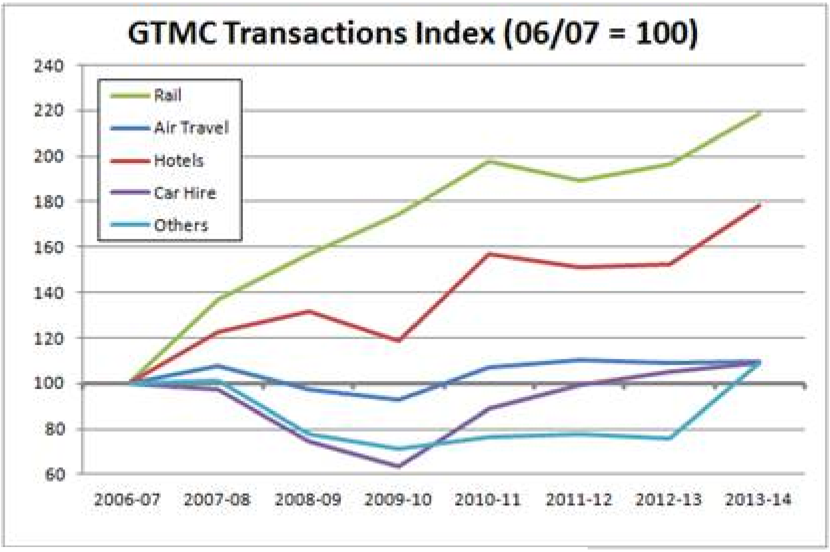
	Revenue from TOC outlets (£m)		Revenue from TfL sales (£m)		Revenue from third party retailers (£m)	
Year:	**Nominal**	**Real**	**Nominal**	**Real**	**Nominal**	**Real**
03-04	3,666	5,057	91	126	396	546
04-05	3,900	5,217	187	250	394	527
05-06	4,046	5,275	213	277	555	724
06-07	4,494	5,647	261	328	641	805
07-08	5,023	6,062	248	300	684	826
08-09	5,374	6,298	274	321	777	911
09-10	5,405	6,306	304	354	881	1,028
10-11	5,739	6,379	445	495	1,005	1,117
11-12	6,247	6,626	527	559	1,153	1,223
12-13	6,615	6,806	606	624	1,297	1,334
13-14	6,982	6,982	691	691	1,441	1,441
Growth since 03-04	**90%**	**38%**	**659%**	**451%**	**264%**	**164%**

Source: Rail industry Lennon information system

Note: Real revenue data are expressed in 2013-14 prices. Data are gross sales, including non-TOC earnings

Evidence from the Guild of Travel Management Companies ('GTMC') also suggests that sales of rail products have outstripped sales in other travel sectors in recent years. ATOC is a partner (a form of associate member) of the GTMC, and Figure 7 below summarises GTMC-supplied information on relative trends in TMC transaction volumes over the period 2006/7 to 2013/14. Rail transactions have increased by 119% since 2006/07 versus 10% for air, 78% for hotels, 9% for car hire and 9% for others.

Figure 7: Transaction data by calendar year by mode



Source: GTMC

In terms of the incentives needed to make the development of new products attractive, we are a little confused by the question, as it is generally TOCs as carriers rather than retailers generally that develop new products. For TOCs, the primary drivers behind product development are commercial, in particular the ability to earn a commercial return on any investment through market expansion, increased market share or higher yields.

This also generally underpins collective products such as Railcards. The Two Together Railcard for instance was driven by the prospect of market expansion. Occasionally, products are developed or changed for reputational or corporate and social responsibility reasons. A recent example is the extension of the HM Forces Railcard to include Reservists.

6.3 Question 6: What are your views on the impact of the impartiality obligation? What is your view on passengers' awareness of impartial retailing? How does the cost of impartial retailing impact passengers' services? How could this be addressed?

Although we have no evidence on the issue, we strongly suspect that passengers are largely unaware of the impartiality obligation, not least because it is not really communicated by retailers, ATOC or the DfT.

However, this is not to say, that it has not delivered customer benefits. ATOC's annual mystery shopping programme has found high levels of accuracy in retailing, driven in part by the impartiality obligation (accuracy is a necessary but not sufficient condition for impartiality).

The need to offer the full range of fares to support impartiality almost certainly drives cost, although the quantum of these costs has never been estimated as far as we are aware. When coupled with the regulatory obligations with regard to through and inter-available fares, this certainly drives a degree of complexity for both retailers (and their supply chain) and customers.

At the moment, it's worth noting most industry retailing is undertaken on an impartial basis, with the only exception being in the TMC sector where partial retailing is allowed. Even in this sector, most retailing is in actuality impartial although TOC bilateral deals will, in most cases, be based on partial retailing in favour of the TOC concerned.

In general, we don't have a specific problem with impartiality, but believe that it is worth considering whether the current, virtually blanket approach is still optimal, or whether partial retailing could, in some circumstances, provide consumer benefit (albeit with the key requirement that retailers made clear to customers whether they were retailing on a partial or impartial basis).

In conclusion, we believe that the impartiality obligation should be considered as part of a more general review of 'network benefits' regulation, that seeks to examine the balance of customer benefits and customer/industry disbenefit that results from such regulation.

6.4 Question 7: With respect to split-ticketing, what are your views? Are passengers appropriately safe-guarded against the risks attached to split-ticketing? To what extent do industry processes and systems enable split ticketing to be developed by the industry and used by passengers? Where there are issues, what could be done to address them?

We believe the questions posed are essentially second order issues and do not address the core issue of the fares anomalies that underpin split-ticketing.

Although the combinations of tickets made possible by split-ticketing can be cheaper than the equivalent through fare, split-ticketing is inherently complex and confusing for customers. If the practice became widespread it would mean that rail pricing was partly or largely driven by fares anomalies rather than the usual market drivers, with fares for longer distance services, in particular, effectively being set at prices levels lower that the market would normally determine. As such, split-ticketing could potentially lead to a significant distortion in the market, with a material impact on industry finances and the level of taxpayer support required by the industry. Given this, it is worth considering why split ticketing is possible at all.

Since British Rail (BR) abandoned the previously-used mileage tariff in the late 1960s, rail fares have been set on the basis of market conditions. In shorter distance markets, fares have tended to be set at relatively low levels reflecting the strength of competition from car and bus. By contrast in longer distance markets, fares have tended to be set at relatively higher levels, reflecting rail's stronger competitive position and the higher quality of service offered on longer distance services (on board catering etc.). These differing approaches to pricing by market have created the widespread 'anomalies' that underpin split ticketing and which have been in existence since the 1970s.

This would not be a problem if fares were specific to each train company (in other words that a train company set fares only for its own network of services, and which were available only on its own services), which would be a normal market model. However the regulatory obligations upon TOCs to offer through and inter-available fares mean fares priced for shorter distance, often slower, lower quality services are available on longer distance, higher quality services as well.

Even where specific anomalies exist that could be removed, TOCs are prevented from doing this as the necessary inter-TOC discussions would count as collusion under competition law. It is also worth noting that fares capping regulation also exacerbates the problem, particularly now that reduced flex provides less opportunity to remove anomalies.

This core problem needs to be addressed if we are to avoid the perverse outcome of industry pricing policy being driven by fares anomalies, themselves the unintended consequence of the combination of market pricing and regulation. In market terms this is a serious and material distortion.

In the short term, we remain concerned that split-ticketing will lead to considerable additional complexity for customers, create customer care issues for TOCs, undermine demand management, drive additional cost and ultimately reduce revenue as a result of prices being effectively set at below market rates.

It is worth noting that split-ticketing is in direct contravention of the three key principles for rail pricing set out in the McNulty Report of 2011:

- utilising fares to improve demand management;
- reducing the complexity of fares;
- utilising fares to help realise efficiencies in ticket office retailing.

We have, nevertheless, made clear that split ticketing is permissible under the National Rail Condition of Carriage, subject to retailers ensuring that customers are provided with all the relevant information to make informed choices and journeys that comply with the terms and conditions associated with their tickets. An important aspect of this is that retailers make clear if buying a combination of tickets results in multiple transaction/booking fees being charged to the customer.

Thus far, the evidence is that there is very limited consumer appetite for split-ticketing but it would represent a significant omission should the Review focus solely on short-term presentational issues. Instead, we believe that the Review needs to address the underlying market distortion that allows split-ticketing to be exploited by retailers. This is potentially a key issue not only for train companies but also Government.

6.5 Question 8: What are your views on the requirement on TOCs to create and retailers to sell inter-available and through tickets and to offer a timetabled walk-up service? What are your views on the benefits passengers and TOCs derive from these tickets and the timetabled walk-up services? What challenges does this obligation give rise to, if any? Where there are issues, what could be done to address them?

We believe that there is quite an important difference between the requirement to create and sell inter-available and through tickets, and the requirement to offer a timetabled walk-up service.

The latter (which we understand to mean walk-up fares that can be used on timetabled services) is a core element of the railway, particularly on shorter distance routes where advance purchase is uncommon and consumers expect to be able to purchase a ticket and travel. It is not clear that there is any obvious market rationale for changing this.

On longer distance routes, an increasing proportion of demand is accounted for by advance purchase tickets (around 60% of passengers now on key longer distance routes). However, walk-up demand is still an important, albeit declining, element of the market. It is also worth highlighting that there is some convergence between these two approaches to ticketing, given the current trial of close to departure Advance fares.

We have already set out our views on through and inter-available fares in our response to question 2. These regulatory obligations have provided clear customer benefits, but have also driven complexity for customers, retailers and the supply chain.

We believe that they together with other ‘network benefit’ elements of the regulatory framework need to be reviewed critically to evaluate whether, on balance, they still provide benefits to consumers.

6.6 Question 9: With respect to having minimum obligations on TOCs to have their ticket offices open, what are your views on the impact of these obligations on how the market can develop in line with passengers' needs?

Markets exist to allocate finite resources efficiently. This does not mean that they meet the needs of every individual in all respects, but, in general, they are the least-worst way of maximising the meeting of consumer need at lowest cost. In order to do this, supply needs to be able to be varied to meet demand, and incentives need to exist to encourage investment to meet unmet demand.

The rail retailing market does not satisfy the conditions of an efficient market because the ability to vary supply for a key channel to market, station ticket offices, is constrained by regulation (Schedule 17 of the TSA).

This has two important effects from a consumer point of view: supply-side costs are higher than they need to be, ultimately driving higher prices for consumers; and the business case for investment in new consumer services and facilities is weakened because the cost savings from varying supply-side capacity cannot be realised.

Taking the first of these two points, we have set out in appendix A information on the cost of retailing to the industry. The overall industry cost of retailing is just under half a billion pounds, equating to around 6% of industry revenue.

Station ticket office costs account for around 50% of all industry retailing costs, despite station ticket offices representing less than 39% of total sales and just 26% of industry transactions. Furthermore, current market trends mean that this disparity is growing. In our response to chapter 2 of the consultation we highlighted the relative and absolute decline in station ticket office retailing over recent years, a market trend, which is continuing unabated.

Given the high cost of this channel, there is little doubt that in an unconstrained market, TOCs would have chosen to reduce retailing capacity in line with falling demand, and incentivised customers to move to more cost-effective channels through differential pricing.

TfL, unconstrained by regulation, have pursued exactly this strategy, progressively phasing out staffed ticket offices as consumer demand has moved to TVMs and Oyster PAYG. More widely, virtually every industrial sector has seen migration to self-service channels, whether through the internet, mobile apps or self-service checkouts in High Street retail outlets.

If the cost of station ticket office retailing was brought in line with the industry average of 6%, savings of around £65m a year would be possible, equivalent to roundly 0.75% of the average price of a ticket.

There is also an important customer service issue as well. Increasingly under-utilised staff in ticket offices could be redeployed onto far more far more effective customer service activities that would provide real benefit to passengers.

Taking the second point on the effect of regulation on investment, it is clearly more difficult to make a business case for investment in new forms of retailing or ticketing, which, in most cases would reduce demand at station ticket offices, if the cost saving possible from re-aligning capacity to meet reduced demand cannot be realised.

East Coast, for instance, have highlighted the difficulty they have had in making the business case for improving TVMs or investing in innovative approaches to retailing such as video kiosks.

6.7 With respect to TOCs being prohibited from charging fees, what are your views on the impact of this requirement? To what extent, if any, does this give rise to a distortive effect between TOCs and third party retailers?

The ability to earn additional remuneration is a key differentiation in the consumer retail market. TOCs are generally prohibited from charging additional fees, as the DfT has consistently interpreted this as non-compliant with the TSA. This has meant that TOCs have not been able to charge fees of any kind, including credit card fees, for station retailing (either ticket office or TVM), on-train retailing, or sales through the internet and call centres.

Although a small number of TOCs have very limited fees for some types of internet transaction, in general fees have not been a feature of TOC sales to the general public.

The business travel market is somewhat different in that TOCs do charge fees to corporate customers who use Business Travel Service (‘BTS’) units, although generally, additional, value-added services are included within these arrangements. However, TOCs share of this ‘managed travel’ market is very low (2.2%), as they find it difficult to compete with TMCs who are able to offer a much wider range of travel services to their corporate clients, and for whom client fees form the most important element of their revenue.

The most significant area of competition between TOCs and TMCs in the business travel market is through stations, call centres and the internet. TOCs are not allowed to charge fees for sales through these channels.

It also ought to be noted that TOCs have long-argued that they should be allowed to charge fees. TOCs, through ATOC, lobbied intensively from 2004 onwards for complete reform of the TSA, including the abolition of regulatory restrictions on the charging of fees. ATOC’s, fully worked-up, proposed replacement for the TSA, the Regulatory Agreement on Fares and Ticketing (RAFT) made explicit the freedom for TOCs to charge fees. Ultimately these proposals were rejected on several occasions by the DfT and Ministers, concerned about the likely adverse reaction from passengers.

Third parties, by contrast, have always been allowed to charge fees, with this being made explicit in their licences. This has been a deliberate policy on the part of ATOC/TOCs, reflecting the development of transaction fees more widely in the travel and entertainment markets. Appendix C provides a summary of the fees currently charged by third party retailers.

The inability of TOCs to charge fees in the consumer market is a clear market distortion, allowing third party retailers the benefit of recovering some or all of their cost of sale and earning higher margins. A linked issue is the effective inability of TOCs to differentiate price by channel, which is common place in other industries.

The combination of fees and discounting would not only allow TOCs to reflect better the relative costs of different channels, but it would also incentivise customers to migrate towards more cost-effective channels.

It is important to note that we are not arguing for standard fees to be introduced on a uniform basis across all TOCs or specific channels. Rather we are arguing for the freedom for TOCs to charge fees on an individual, discretionary basis at whatever level they thought appropriate (subject to the normal constraints of consumer law).

It is, in some ways, ironic that third parties have the same concern as TOCs in this area, albeit from a totally different perspective, with the principal complaint that TOCs promote their lack of fees, placing third parties at a competitive disadvantage. This, in turn, leads to an argument that commission should be higher in order that third parties do not have to charge fees.

In a market sense, it is unsurprising that TOCs turn a regulatory obligation into a competitive virtue. However, it would be entirely counter-productive to drive, already high, industry retailing costs higher by increasing commission when regulatory reform to allow TOCs to charge fees would remove the underlying market distortion. This would move the rail industry into line more generally with the travel and entertainment sector where transaction fees, transparent to the consumer, are now ubiquitous.

7 Responses to the questions posed in the ORR's consultation document – responses to the questions in chapter 5

7.1 General comments on the chapter

We are concerned that the consultation document sometimes seems to quote opinions expressed by stakeholders as apparent fact when, in some cases, the statements are either incorrect or asserted without supporting evidence. Furthermore, such opinions are sometimes not balanced with contrary evidence that we have already provided.

We will highlight some of these issues in our responses below, but have also attached appendices, which provide additional evidence in some areas.

7.2 Question 11: What are your views on the current form of industry governance? Are there specific examples where the governance has enabled or limited retail innovation? Where necessary, how could industry governance be improved?

Industry governance arrangements are relatively complex but, in general have worked well in supporting the operation of the rail network and the central provision of key business services to train companies and third party retailers.

In the rail retailing market, these governance arrangements have supported the development of a range of key central systems and services by RSP/ATOC as well as providing the commercial framework through central licencing that has allowed the third party element of the market to grow strongly.

They have also supported the development of new network-wide products such as the Two Together Railcard and innovative ticketing like Oyster PAYG and CPAY in London (both supported by new TOC collective 'Scheme' agreements).

There are, however two sets of issues with current governance arrangements worth highlighting.

The first is that they are complex and, with the advent of RDG, have become even more complex. There is a need to simplify current arrangements to improve their efficiency, something that it is planned to address over the next twelve months. Linked to this is planned, albeit limited, reform of the regulatory framework, the TSA in particular.

The second is that current arrangements with regard to third partly retailers almost inevitably create tensions within the market, given that TOCs through ATOC, set commission for third party retailers, who compete with the TOCs in the rail retail market.

There is, in principle, a potential conflict of interest in this arrangement. However, whilst TOCs compete with third party retailers in the retail market, they are fundamentally carriers, not retailers, and have a strong vested interest in maximising sales, through whatever channel. As such they have a strong commercial imperative to ensure that third party retailers are incentivised to maximise sales. This significantly diffuses the potential conflict of interest highlighted in the ORR's consultation document.

Furthermore, ATOC/TOCs go to very considerable lengths to be even-handed in the way that they deal with third parties. TOCs and ATOC are mindful of competition law in particular and consider this explicitly when making decisions. As already stated, ATOC, in essence, performs a quasi-regulatory role in the market, which it takes very seriously. Appendix C sets out the background to commission arrangements and sets out the factors that TOCs/ATOC take into account when setting commission rates.

It is perhaps partly because of this that ATOC commission rates for third party retailers are relatively high compared to benchmark rates. Appendix C summarises the work undertaken by the consultants, LEK in this area which benchmarks ATOC rates against rail commission rates in comparator countries and other travel sectors. Perhaps worth highlighting in particular is that we understand that Eurostar, who are also major rail players in the UK market, but completely outside the ATOC arrangements, do not offer commission at all to third parties.

The ORR consultation document suggests that current governance arrangements are insufficiently transparent and may contribute to market tensions. In this context, it is worth noting that, although not required to by the regulatory framework,ATOC/TOCs do undertake a degree of consultation with third parties on key changes, such as commission, although agreement on issues like reductions in commission is unsurprisingly very difficult to achieve. The sheer number of third parties also makes effective consultation difficult, with key players and trade associations inevitably being the main focus of discussion.

Nevertheless, it is worth summarising the kind of consultation that has taken place over recent months around the proposed forward strategy for third party retailing. This included: a significant joint piece of work with the Trainline to assess the value provided by third party retailers; presentations to Commercial Board by RedSpottedHanky, the GTMC, Advantage Travel Group and the Trainline; a presentation to and debate with the GTMC's Surface Transportation Working Group; a presentation to and evening dinner with the top twenty TMCs; and ongoing dialogue with a number of key players including the Trainline and Evolvi.

As a result the two largest players in the internet market have now signed letters of variation reflecting the forward strategy, whilst all others bar one have indicated they will sign in the near future. Dialogue with the TMC community is continuing with a view to addressing TMC issues, prior to finalisation of future strategy.

It is perhaps also worth noting that commercial tensions of the kind seen in the rail market exist in many, if not most, other markets. When the airlines reduced commission at the turn of the century it created enormous controversy and market tension in that sector of the travel market. We accept that there are some unusual features of the rail market that contribute to tensions but the rail market is certainly not alone in experiencing differences of view on key commercial issues.

In the context of the above, it is worth considering the possible alternatives that exist to the current arrangements. We have identified six alternative options:

a. Involve third parties formally in in industry decision-making arrangements for issues such as commission or the development of central systems;
b. Remove the current collective arrangement through ATOC and allow an open market based on bilateral arrangements between TOCs and third parties;
c. Retain the current collective arrangements for the licencing of third parties centrally, through ATOC, but remove the current collective arrangements with regard to remuneration and allow TOCs/third parties to agree commission bilaterally;
d. Appoint an independent body to set commission and other commercial terms;
e. Retain the existing arrangements but make them subject to review by the ORR;
f. Adopt a more managed approach to the market and award retail licences through competitive tender.

It is also worth saying that TOCs and ATOC are willing to engage on any of the above options if they seem likely to support a more efficient or competitive market. However, analysis suggests that all have strengths and weaknesses.

Option (a) would present problems in that both TOCs and third parties would have vested interests in lowering or increasing commission, and would almost certainly have differences of view in other areas such as the allocation of costs. It is not clear, therefore, on what basis decisions would be made, and the outcome might well be to formalise tensions rather than remove them.

It is also worth re-emphasising that commission arrangements are often the subject of commercial negotiation. For instance prior to the reduction in TMC commission rates to 3% in 2011 there was an extensive period of negotiation with the GTMC conducted through a joint working group. At the end of this negotiation, the GTMC issued a media release welcoming the new arrangements.

As has already been highlighted, such negotiation inevitably focuses on the larger players or trade associations in the market. Nevertheless, in effect, there is already a degree of third party involvement in decision making with commercial negotiation similar to that inherent in more conventional markets.

Option (b) would certainly remove any potential conflict of interest, but it is not clear that it would necessarily lead to a more competitive market. Under this option, third parties would have two possible approaches to licencing arrangements with TOCs. The first approach would be to be awarded a ‘national retailing’ licence by a specific TOC under TSA Schedule 26 arrangements. However, it seems extremely unlikely that an individual TOC or a combination of TOCs would be prepared to licence all the currently licenced third parties. Even where licences were awarded, third parties would still have the problem of finite franchise lengths and the uncertainty caused by this.

There is also a TOC issue with this approach, as potentially it could mean that one TOC could enter into licencing arrangements that had a very material impact on the businesses of other TOCs. For instance, a TOC might licence Amazon or Google, who would immediately command a significant presence in the market and materially affect the sales of all TOCs. This would be an unusual market arrangement and potentially remove TOC control over a significant element of their businesses.

Although, in principle, this risk exists at the moment it has never been realised because third parties have tended to seek licencing through ATOC, providing TOCs with a collective voice in the development of this element of the market.

The second approach would be for each third party to enter into separate licencing arrangements with each TOC for sale of that TOC’s products and services. This seems even less attractive than the first option. At best it would create a very large number of licencing arrangements, all of which were still subject to the issue of finite franchise lengths. However, a more likely outcome would be that TOCs were not prepared to individually licence many current third parties, because there would be little commercial gain to them in doing so. This would mean that many third parties would be unable to sell rail either in part or at all.

Under this operation, remuneration would essentially be market-driven. As a result, it is quite possible that an airline-type business model would develop with commission generally very low or non-existent, but with greater use of specific marketing and incentive arrangements. Although these types of arrangements already exist in the rail TMC market, it is less clear how they would work in the public internet market, given current impartiality requirements.

Option (c) would address the issues of licencing associated with option (a) and would allow an open market to operate in terms of remuneration. As in (b), remuneration would be market driven. Nevertheless, it has considerable merit in terms of addressing the disadvantages associated with a non-collective approach, whilst allowing the operation of a more conventional market.

Both options (b) and (c) would, potentially, create a far more complex set of commission arrangements. RSP's initial, high level assessment is that current industry systems would not be able to support this approach. However, the two key systems concerned, Lennon and Automated Settlement, will be replaced over the next 3-4 years and their replacements could be specified to support the more complex commission arrangements, inherent in options (b) and (c). As such, this alternative market model would be possible from 2017 or 2018 onwards.

Option (d) would again remove any potential conflict of interest but begs questions in terms of who the independent authority would be and against what criteria they would take key decisions, such as in setting the level of commission. It would again be an unusual market where the key service providers (TOCs) had important commercial terms effectively imposed on them.

There is a significant risk that this arrangement would replace current tensions within the market with a new set of tensions. Finally, it is not clear how an independent body would develop the market in the way that ATOC/TOCs have (introduction of the TPIL and international licences for instance), driven by the commercial imperative, as carriers, to increase sales. There is a strong risk that the pace of market development and the innovation associated with it would be constrained.

Option (e) is a more pragmatic approach and would probably reduce tension within the market, although the ORR may not regard such a role as appropriate. One approach would be to make TOC collective decisions on commission rates subject to ORR agreement, or to introduce formal periodic reviews of arrangements by the ORR.

Option (f) would be to adopt a completely different approach to the market by introducing similar arrangements in the domestic market to those currently used in the international market. This could work on the basis of ATOC undertaking competitive tenders for retailing partners every, say three or five years. This would be an open, transparent process which allowed competition between retailers and allowed TOCs/ATOC to choose, high-quality retailing partners more selectively. It is an approach that has worked well in the international market.

However, there are clearly issues in terms of the number of retailing partners that might be appointed, commission arrangements in the context of competitive tenders and so on. There would also be very significant transitional issues in moving from current arrangements to this alternative model. It requires considerably more thought but potentially fits better with a more structured approach to market/industry management.

We are open to any of the ideas above, but our initial view is that options (c) and (e) look to be the most promising.

7.3 Question 12: What are your views on the current form of industry rules? What benefits do they give rose to, and how? Are there specific aspects of industry rules that limit or dampen innovation in retail? How could they be addressed?

Current industry rules are relatively light touch, providing third party retailers with considerable freedom to innovate and develop their businesses.

We were quite surprised at some of the rules cited, with the implication that they imposed a significant burden on retailers. As such, it is worth commenting specifically on the examples quoted:

Licence rules

(i) The consultation document states that third parties must submit an annual marketing plan to ATOC, with the implication that all third parties are subject to this obligation.

As we highlighted in our earlier response to Chapter three of the consultation document (specifically paragraph 3.34 of the consultation document) this obligation only applies to holders of full TPIL and ISL licences and not to other licenced third party retailers. The marketing plans submitted have been primarily used in the past to ensure that the retailers concerned complied with the £1m per year investment requirement. The plans have always been kept confidential to ATOC and never shared with TOCs.

The submitted plans have always been quite high level, and we will supply the ORR with copies of the plans submitted by the retailers concerned to illustrate this.

We considered dropping the requirement to provide us with plans at the same time as we removed the £1m annual investment requirement in the TPIL licence, but decided, on balance, to retain them as they allowed us to monitor the market more effectively. However, it is not something that ATOC/TOCs feel particularly strongly about and we would be quite happy to remove the requirement.

(ii) The requirement with regard to the CORAC qualification is also quite light touch and designed to ensure that retailers have a minimum number of staff who have undergone basic training in the retailing of rail products, and who, as a result, have a reasonable understanding of the rail network, services and product.

The cost of CORAC training is £99 (plus VAT) per staff member. The total cost to third parties of CORAC training undertaken in 2013/14 was £33.4k, equivalent to 0.06% of the total commission paid to third parties.

We think it worth noting that some retailers, such as the Trainline, are very positive advocates of CORAC and voluntarily train far more staff than required by their licence.

(iii) The requirement to hold a bond against settlement default is a reasonable requirement and a not uncommon commercial arrangement. Agents are only required to hold a bond or other form of financial security that this is equivalent to the risk TOCs are exposed to, based on the sales of that agent.

In response to TMC complaints that bonding was expensive, ATOC worked closely with the GTMC and other TMC bodies (through a joint working group) to develop the 'TARIF' scheme which buys insurance against settlement default on behalf of member TMCs. TARIF was introduced in 2011.

The scheme, which is managed by ATOC, is, in effect, a co-operative arrangement that reduces the cost of providing cover against settlement default through bulk purchase of insurance. The costs of purchasing the insurance and other costs are covered by a levy on TMCs, which is administered by ATOC. The scheme is designed to cover all potential losses caused by default of any TARIF participant(s) up to the value of the insurance cover limit set for the largest scheme participant. Governance is exercised through a joint ATOC/TOC and TMC Scheme Management Board, which takes all key decisions relating to the scheme.

TARIF has proved to be a success and the scheme is now 'fully funded' (the point at which Scheme reserves are sufficient to cover the various deductible and 'excess' elements of the insurance policy). As a result the levy on TMCs was reduced from 0.36% to 0.18% in 2014. Following a successful re-negotiation of terms with the insurer a further reduction to 0.09% has been agreed from May 2015, with the remaining levy covering insurance premiums and operational costs.

Whilst third party retailers highlight that there have been very few retailer defaults over recent years, this does not remove the risk of default. There have certainly been periods over the last fifteen years when sizeable retailers have been through periods of financial difficulty. One factor influencing the low number of defaults is that ATOC/RSP have always taken a positive approach to managing retailers in financial difficulties, largely because, on balance, it was less risky to 'nurse' retailers through periods of difficulty rather than see them foreclose with potential loss of the monies owed to TOCs.

We believe the current arrangements with regard to mitigating the risks associated with settlement default are fair and proportionate. Only the minimum necessary amount to mitigate against default is required to be held as a bond or other financial security.

Furthermore TOCs/ATOC have been extremely flexible in working with third parties to minimise the level of bond required (through more frequent settlement for instance) and in the range of financial instruments accepted as providing cover. Finally, TARIF was a proactive and collaborative initiative on the part of TOCs/ATOC, which has reduced the cost of bonding for those agents that participate.

Accreditation

In terms of the industry rules associated with accreditation, they ensure that all rail retailing devices interact correctly with central industry systems and present the passenger with correct and reliable information.

These rules also ensure that the interfaces between rail retailing devices and central industry systems are operating correctly and in a controlled manner, so that the central systems can operate at maximum efficiency and deliver a reliable service to TOCs, third party retailers and technology suppliers. Clearly this is very important in terms of key industry systems such as Ticket on Departure and the National Reservations Service.

Given the sheer volume of transactions and revenue passing through the wide variety and increasing number of retail devices, industry rules are also important in ensuring the probity of settlement, the integrity of management information exported from central industry systems, and that TOCs, third party retailers and technology suppliers have a level playing field on which to actively compete.

The consultation document suggests that the process of accreditation appears to be too demanding in terms of cost and time. However, the result of not being able to carry out robust end-to-end accreditation can be very costly in terms of money and reputation.

For example, there is currently a settlement dispute worth in the region of £1m ongoing between ATOC (on behalf of the TOCs) and a third party in relation to a particular third party supplier device operating on rail self-service ticket machines in the London area. This has not impacted on passengers but has impacted on the back office settlement process.

One of the key issues in this dispute is that at the time of accreditation RSP were reliant on a certificate from the supplier of the third party device as RSP wasn't permitted to engage in its normal level of end-to-end accreditation.

It is clearly in the interests of TOCs, third party retailers/suppliers and passengers for rail retailing devices to operate correctly and, on this basis, accreditation is a necessary process to achieve this end. It should be noted that the various emerging smartcard initiatives currently underway emphasise the importance of accreditation and, in relation to the South East Flexible Ticketing project (SEFT) being funded and directed by the DfT, it's apparent from recent discussions that the DfT see this as a crucial role for RSP to perform.

Clearly there is a cost associated with providing a sufficiently resourced central accreditation service that is subject to variable use depending on the activity of each third part retailer and technology supplier, but by introducing more efficient working practices, RSP has been able to freeze accreditation costs at the same level for the last 6 years. In that time we have also introduced accreditation contracts which allow the same users to secure reduced charges by committing to a defined level of accreditation usage. But the actual cost of any given accreditation is ultimately down to the third part retailer and technology supplier and how well they present their test evidence for assessment.

Perhaps comparing rail industry rules with those in similar sectors such as banking or payment card acquiring, might provide a useful benchmark in terms of the cost of compliance in a complex environment where probity of settlement is equally important.

It is not our view that such rules dampen or inhibit innovation, but that they actually ensure that such developments are completed to the high standards of quality that customers expect, and which support the high volumes of use that associated with successful innovation.

In relation to footnote 82, ATOC/RSP is not aware of any evidence that supports this stakeholder assertion.

Conclusions

Overall, we do not believe the rules placed on retailers to be excessive or disproportionate. For the most part they are designed to ensure that retailing is conducted to the high standards that customers might reasonably expect and that industry systems work efficiently and financial probity/risk managed properly. As such, licences are relatively light touch, providing retailers with considerable freedom.

It is also worth noting that, within the regulatory framework, TOCs are subject to a wide range of rules relating to retailing, include the many requirements contained within the TSA.

However, we are open to further engagement on this point and would re-consider constructively any current rules, where there is clear <u>evidence</u> of an adverse impact on the market.

Conversely, there is arguably a need to strengthen rules in some areas. In this context, we note the parallel ORR initiative to develop a 'Ticketing Information Code of Practice', which we understand will also apply to third party retailers. We strongly support this initiative, accepting the need to improve the clarity of information provided to consumers. However, the Code highlights both the wide range of non-ATOC set rules that exist, and the benefits that such rules can deliver.

It is worth considering as part of the Review whether there are other areas where additional quality-related rules might benefit customers.

One final point is that we believe that there is scope for rationalisation of the current range of licences (perhaps into a single retailing licence, customised through schedules for each type of retailer or channel) to provide greater consistency and to address some of the misconceptions that seem to exist in the market.

7.4 Question 13: With respect to third party retailers' arrangements, to what extent does the nature of their relationship with TOCs enable them to benefit passengers, including bring about competition and innovation? How are the arrangements between the wholesale provider and the third party retailers in other sectors relevant to rail? What is the impact of third party retailers in rail not having access to a wholesale market/wholesale price? Do the industry governance, rules, processes, and systems pose additional impacts for third party retailers that we have not captured?

Appendix B summarises the results of further work by LEK, commissioned by ATOC, which benchmarked the rail market in Great Britain against some relevant international comparators. LEK found the rail retailing market in Britain to be possibly the most competitive in the developed world. Furthermore, the evidence suggests that it is becoming more competitive with the market share of third party retailers steadily increasing.

This level of competition benefits TOCs by driving passenger numbers and revenue. Work undertaken by ATOC, as part of the recent TOC review of third party retailing, concluded that industry revenue was higher as a result of third party retailing.

This comes about as a result of third party retailers extending the 'reach' of rail (TMCs in the corporate travel market for instance), advertising and other marketing activity (particularly in the public internet market), and innovation (improving the usability of websites or new, mobile 'apps' for instance).

Reflecting this, TOCs/ATOC have taken steps to expand the third party retailing market in recent years with the introduction of the TPIL amd ISL licences.

However, this should not be taken as a given, nor that the whole of the third party retailing market adds value (we have many licenced TMCs that seem to be largely dormant in terms of rail activity). Markets change over time, and third party retailing may not always add value, so periodic review is necessary.

Consumers also benefit more directly from the competitive nature of the market, through greater choice of retailers and innovation. We believe that this choice and the competitive nature of the rail retailing market has been one of the contributory factors to the exceptional growth in passenger numbers enjoyed by the industry in recent years, although this is difficult to prove given the multiplicity of factors that affect demand.

Customer satisfaction with retailing in general certainly seems to be quite high. Table 5 overleaf provides a summary of data from the National Passenger Survey dealing with ticket purchase, broken down by retail channel. The results are based on the two waves of NPS research in Spring 2013 and Autumn 2013.

The results suggest a relatively high degree of satisfaction with industry retailing. The internet records the highest level of satisfaction, although most channels have 80% plus satisfaction ratings.

Table 5: Passenger satisfaction with ticket buying facilities

Purchasing channel:	% of passenger who rate ease of purchase as very or fairly good
Internet	89.3%
Travel agent	87.9%
Station booking office	86.7%
Call centre	83.7%
Ticket vending machine	83.2%
Smartcard	80.7%
On train	78.3%
Overall	**83.3%**

Source: National Passenger Survey, Passenger Focus

These results are broadly mirrored by ATOC's own annual mystery shopping and customer satisfaction survey work, the most recent results of which, from 2013, have been summarised in Table 6 overleaf.

Table 6: Levels of accuracy and customer satisfaction by retail channel

Channel:	% of tickets sold accurately	% customer satisfaction	Confident purchased correct ticket	Satisfaction with ease of use
Station TOs	96%	-	-	-
TVMs	94%	-	87%	-
Internet	97%	89%	99%	91%
Notes	1799 TO shops, 200 TVM shops, 400 internet shops	based on % of respondents who would recommend the website to others		

Source: ATOC annual mystery shopping and customer survey 2013

Around 95% of transactions were found to be accurate (and impartial) by the ATOC mystery shopping programme. The level of customer satisfaction with internet retailing was the same as that found by the NPS at 89%.

Wholesale market

With regard to the potential opportunities offered by a wholesale market in rail products, there are a couple of points worth making on current arrangements:

(a) The current ITX licence does provide a form of wholesale arrangement, with agents able to combine and mark-up net fares with other travel elements to form 'packages' for consumers;

(b) Other agents are entitled to combine public fares with other travel elements to form packages, adding a mark-up to the rail fare if they wish (they are only required to settle at the public rate).

More generally, we would be open to further discussion on this potential opportunity. It is not immediately apparent what the benefits would be to TOCs or consumers, but we would certainly be open to any development for which there was a strong commercial rationale.

Question 14: What are your views on the current form of industry processes and systems? What benefits do they give rise to, and how? Are there any specific aspects of industry processes that limit or dampen innovation in retail? Do these processes have other impacts, either causing problems or leading to benefits?

The systems and processes which support the retailing of train tickets are designed to keep a balance between the positive benefits of preserving 'network benefits' (i.e. the fully interoperable railway), and the positive benefits of enabling individual train companies and third party retailers to innovate in terms of the customer experience.

In practice this means there are shared back office systems primarily operated by RSP, and front office systems, particularly TIS and Customer Relationship Management Systems run by train companies and third party retailers. Whilst it may be that individual train companies could drive innovation more quickly if they also ran their own back office, this would inevitably dilute the current range of network benefits enjoyed by customers.

A further benefit of central procurement is that investment can be written off over the life of the asset (sometimes 15 or more years), and the relatively short term nature of franchises doesn't, therefore, impact on investment decisions. Finally, there are clearly economies of scale in procuring single central systems compared to TOC or third parties procuring individual systems.

Multiple reservation systems for instance would almost certainly be more expensive than the current single, national system, as well as driving higher costs for retailers who would have to connect to multiple systems. Having to cope with a more complex IT architecture of this kind would, in its own right, provide a barrier to market entry.

RSP's track record in terms of innovation is also good, with the current modernisation programme, following from previous replacements for or improvements to all the key systems inherited at privatisation.

A couple of examples are useful to note in supporting the arguments above:

The issue of multiple IT systems was explored more than thoroughly when the question of the DfT-sponsored SEFT project (South East Flexible Ticketing) HOPS architecture was discussed, and the consensus was that a central service was the cheapest and simplest solution.

The Rail Journey Information System was replaced in a very reasonable timescale, given the complexity of the system, and was operational before the expiry of the legacy system contract, with a 70% saving in operational costs.

In addition to the arguments above, we have commented below on a number of specific paragraphs in chapter 5:

5.25 (a): TOCs have the ability to choose between different TIS types across different channels, for example, there are four types of ticket office TIS to choose from and three types of self-service TIS to choose from. TOCs also have the ability to fund individual developments and indeed some Owning Groups are considering this approach, so whatever the perceived challenges are in terms of complexity and cost, TOCs are finding ways of overcoming these issues.

5.25 (a) and Case Study 6: SEFT hasn't been delayed because of trying to interface new and old technologies, but because it has taken considerable time to formalise the various agreements between the DfT and TOCs that have been required to underpin the programme, and the scope and funding of the project itself.

5.25 (b) (i) Footnote 93: One of the benefits of central procurement is that investment can be written off over the life of the asset (sometimes 15 or more years), and the short term nature of franchises don't therefore impact on the investment decisions.

Case Study 7: In terms of undertaking a full OJEU procurement process of a multimillion nationwide IT system, we don't believe that three years in an unreasonable timescale. It would be useful to assess the evidence in this area by benchmarking RSP projects against reasonable comparators such as the DVLA project.

5.25 (b) (ii) Third party retailers are currently being consulted in relation to the requirements associated with the potential replacement of the National Reservation System (NRS), so their views are taken into account when considering the replacement of such systems. The RSP Modernisation programme is designed to drive down cost and make innovation easier, which will benefit third party retailers and TOCs. However, as it is TOCs that fund the vast majority of central system projects, it is reasonable that they should direct them.

5.25 (c) RSP inherited the central systems based on legacy mainframe technology, such as the Fares Service, at privatisation and we are in the process of modernizing these systems. RSP is moving to open source and using cloud technology where possible, in order to make them cheaper to run and innovation easier for those integrating their devices or systems with them.

5.25 (d) There are four types of ticket office TIS to choose from and three types of self-service machine, but only one type of on-train device.

5.26 Central industry systems were inherited from British Rail at privatisation and unlike the comparator industries cited the government retains a far greater influence over the direction of the rail industry. For example, the government sets franchise requirements and in some cases takes revenue risk on franchises.

5.31 This demonstrates the challenges created by the current complexity of the rail retail environment, particularly the number of TIS and technology suppliers.

In conclusion, we would strongly argue that RSP's provision of central industry systems has facilitated innovation and supported the strong growth in the market experienced in recent years.

Question 15: With respect to industry data, how does access to and quality of data manifest? What is the impact?

One of the fundamental principles underlying the data related to the retailing of rail tickets (including data on passenger information), is that there should be a single point of truth to ensure that the information provided to customers is accurate and of consistent quality.

As a result, we support a single fares database which feeds all rail retailing systems, use the Network Rail timetable as the basis for all journey planners, have a central seat reservation system, and so on. This enables the best quality data to be made available at the right time in the right place, and ensures that it is consistent. A specific ticket priced at, say £15.00, will be £15.00 in every one of our 10,000 points of sale because that data is sourced from a single point. This provides significant passenger and operator benefits.

In recent years we made access to data for third parties much easier, firstly with fares and timetable data on our 'Data on Demand' website, making data freely available under the terms of a Creative Commons Licence, and more recently with real time train running data provided by National Rail Enquiries. This has facilitated the development of new channels, whilst preserving the principle of the single point of truth.

ATOC, RSP & the TOCs are also engaged in a data modernisation project with the aim of trying to simplify and then codify data that is currently held in mainframe systems. The 'Fares Initiatives' programme is not only designed to deliver direct customer benefits in terms of improved information but is simplifying data and making it available in formats that will be easier and cheaper for suppliers to use and exploit.

At www.atoc.org/about-atoc/rail-settlement-plan/data-feeds anyone can find out about and request regular feeds of fares, timetable and routeing data, providing they accept the associated terms and conditions, which include using RSP data accurately, impartially and in a professional manner, as well as complying with any subsequent instructions, procedures or standards issued by RSP relating to the use of RSP data.

There are fees and charges associated with receiving regularly updated feeds of RSP data, but in turn users are permitted to use this data for their own commercial purposes. An example of this is users being rail ticket machine suppliers who incorporate the RSP data into their retail devices and then sell these devices to TOCs and third parties.

As mentioned above, anyone wishing to receive regular feeds of RSP data is required to pay a licence fee and sign an RSP data licence. The cost of the RSP data licence depends on the frequency of data supply that is being requested and the fees for 2014/15 are shown below:

RSP Licence Fee for 2014/15

Monthly Frequency	£1,036 per annum
Daily or Weekly Frequency	£5,180 per annum

Whilst a licence fee must be paid to RSP, the user then has an option to source the RSP data directly from RSP, in which case they will also be required to pay a datafeeds charge to RSP, or they can source it from an approved supplier, in which case they will have to negotiate a fee with that approved supplier. Below are the range of RSP datafeeds charges for 2014/15 and again the cost is driven by the frequency of data supply that is requested.

Charge for Fares, Timetable & Routeing Guide data for 2014/15

Monthly	£1,588 per annum
Weekly	£5,436 per annum
Daily	£28,390 per annum

Charge for Fares & Routeing Guide data for 2014/15

Monthly	£1,238 per annum
Weekly	£3,027 per annum
Daily	£14,504 per annum

Charge for Timetable data only

Weekly	Available from www.atoc.org/industry-data Updated Weekly Free of Charge & No Licence Fee
Daily	£13,886 per annum & Licence Fee applies

Charge for Fares data only

January, May & September	Available from www.atoc.org/industry-data Updated 3 times per annum Free of Charge & No Licence Fee

RSP also make the following specification documents openly available online and free of charge in order to support the datafeeds we supply:

RSP Data Feeds Interface Specification for Fares and Associated Data

Fares data consists of fares information relating to permanent fares offered by the TOCs. The data will typically include general fares information such as price, validity, class of travel and restriction information. This specification provides details of the structure and content of the fares data.

RSP Data Feeds Interface Specification for Timetable Information

Timetable data consists of the train service timetable information provided by the TOCs. The data includes general timetable information such as departure and arrival times for all stations at which a train calls on its journey (e.g. origin, intermediate and terminating). This specification provides details of the structure and content of the timetable data.

Network Rail's CIF End User Specification

The timetable data supplied as part of the RSP timetable data feed is sourced from Network Rail in a Common Interface Format (CIF) and is filtered to exclude non-passenger train services. Details of the structure and content of the data in the CIF can be found in this specification.

RSP Data Feeds Interface Specification for Routeing Guide Data

Routeing data is created by RSP from the information used to specify route validity for certain fares and prescribed passenger journey route options. Details of the structure and content of the routeing data can be found in this specification.

In terms of those who are using and paying for the supply of RSP data, there are currently 16 key users of the Data Transformation & Distribution Service (which supplies RSP data) who, in the most recently recorded timeframe, downloaded various data 636 times between 14 September 2014 and 11 October 2014. The 16 users represent the following companies, most of who are either rail ticket machine suppliers or third party retailers:

Smart 421	VIX ACIS	Trapeze Group (UK) Ltd	Worldline
Parkeon	Fujitsu	SilverRail Technologies	
iBlocks Ltd	NAVITIME1	Raileasy	
Click Travel	Northgate	Scheidt & Bachmann	
iBlocks Limited	Cap Gemini	theTrainline.com	

National Rail Enquiries

National Rail Enquires also provides data feeds relating to timetables from its real time system Darwin; these feeds are openly available for use in the public domain. Darwin is a real time system that takes in data from a wide range of sources then uses predictive and heuristic technology to convert that data into useful predictions of train running. Darwin holds the original planned schedules, updated schedules and any new schedules provided through operational amendments in real time from train operators.

National Rail Enquiries provides free feeds from Darwin for commercial, public sector and for small independent developer use. Prospective users are able to access Darwin directly through an online registration platform at the following URL http://realtime.nationalrail.co.uk/OpenLDBWSRegistration

Real time data charging for high volume usage

Some NRE feeds are subject to charges if they are used heavily – the charges raised for the use of Darwin feeds specifically, are listed below:

≤5 million enquiries per railway period	**Free**
>5 million enquiries per railway period	**0.04p per enquiry over 5 million**

Free Darwin Timetable feed

There is a Darwin Timetable feed – available as an XML data feed - that continuously pushes out information from Darwin about schedule changes made in real time, such as train cancellations or timetable alterations. The service does not include any information about live train movements and delays, however it is automatically updated as and when changes to the schedule occur. The Service can be used to inform journey planners with up-to-date schedules rather than static timetabled information.

The Darwin Timetable service is also available for use by 3rd party developers under specific licensing arrangements. This service is free and is made available in order to ensure that all journey planner suppliers have access to the most up-to-date timetable information.

8 Responses to questions posed in the ORR's consultation document – responses to the questions in chapter 6

8.1 General comments on chapter

We have no general comments on this chapter.

8.2 Question 16: What are your views on our proposed approach to assessing the materiality and relevance of the impacts? Please particularly consider the extent to which the incentives, obligations, governance, rules processes and systems in place facilitate or inhibit (i) passengers being active, empowered and engaged in the market, causing suppliers and retailers to reduce costs and raise quality; and (ii) retailers can compete to deliver services that meet consumers' needs and expectations.

We believe that the proposed approach to assessing the materiality and relevance of the impacts is reasonable and we have no specific comments. However, we would stress the need for arguments and statements to be evidence-based.

Turning to the latter points in question 16, we have provided evidence, in our response on the exceptional growth in the rail market over the last twenty years, the maintenance of the same level of the average fare paid by passengers over the same time period, and the high levels of customer satisfaction with rail retailing. We have also provided evidence that benchmarks the rail retailing market in Britain against relevant comparators.

We believe that this evidence consistently points to a retailing market that has provided customers with a wide choice of retail options, accurate and relevant information about the range of rail products available (allowing them to make informed choices with regard to ticket purchase), and consumer-friendly retailing processes that have supported exceptional growth in passenger numbers. This suggests that passengers have been active, empowered and engaged.

We have also provided evidence that demonstrates the growth in the competitiveness of the market, the greater competiveness of the market in Britain compared to relevant comparators, and the above average growth in the third party retailer element of the market. We have provided an evidence-based rationale for the current approach to third party retailing, including commission rates and the provision of central systems and processes, and highlighted the proactive steps taken by TOCs/ATOC to expand the market through the introduction of new licences.

We have, however, also highlighted the issues associated with the current regulatory framework, making a case for changes in some areas (Schedule 17 of the TSA for instance) and encouraging review in others. We emphasise that supply-side costs are excessively high, largely due to market-distorting regulation but partly due to an insufficiently competitive supply chain.

Finally, we have highlighted the unusual nature of the rail retailing market, which is a balance of competition, co-operation and regulation, and emphasise the need for a better understanding and definition of this balance, as well as the possible need for re-calibration.

8.3 Question 17: What are your views on proposed approach to Stage Two of the Review?

We have already engaged closely with the ORR on Stage One of the Review and plan to continue this close level of engagement during Stage Two. We support the consultative and inclusive approach suggested in the consultation document.

We agree that it is sensible for the ORR to develop options for change as a first step in Stage Two. To support this approach, we have outlined in our consultation response a number of possible options for consideration.

8.4 Question 18: What other views have you regarding the Review that has not been captured in the questions above?

We have provided an opening section in our response, chapter 2, which sets out our wider views on the issues raised by the Review.

Appendix A: The cost of industry retailing

1. Introduction

This appendix deals with the cost of retailing. It provides an estimate by sales channel of the cost of retailing and, where possible some additional analysis of cost drivers. At the end of the appendix we estimate total industry retailing costs.

2. Cost of station retailing

ATOC commissioned the consultants, LEK Consulting, to undertake detailed analysis of the cost of sale through stations.

Six TOCs provided LEK with data on a confidential basis, allowing LEK to produce aggregated (and anonymised) cost of sale estimates for station ticket offices and, separately, for TVMs, with a further break down by sector. LEK was able to quantify costs by size of station (using the standard Network Rail classification of stations) and then to estimate industry and sector totals by using Lennon data to weight the results for each type of station.

A summary of their analysis has been provided below in tables 7 and 8.

Table 7: Cost of sale through station ticket offices and TVMs

	% of receipts						Cost per transaction (£ per issue)					
	Ticket office			TVM			Ticket office			TVM		
Costs	**R**	**LSE**	**LD**	**R**	**LSE**	**LD**	**R**	**LSE**	**LD**	**R**	**LSE**	**LD**
Direct	15.0	6.5	5.3	2.0	1.8	0.3	1.48	1.46	1.28	0.15	0.16	0.05
Indirect	0.5	0.9	0.7	4.0	2.9	0.4	0.05	0.21	0.16	0.30	0.25	0.07
Total	15.5	7.4	6.0	6.0	4.8	0.7	1.54	1.67	1.44	0.45	0.41	0.12
Including opportunity cost	N/A	10.1	6.5	-	-	-	-	2.28	1.56	-	-	-

Source: LEK, 2014

Table 8: Industry-level costs of sale for station ticket offices and TVMs

Cost of sale	Channel	
	Station TO	**TVM**
% of sales	8.3	3.9
% of sales including opportunity cost of station space	10.1	n/a

Source: LEK, 2014

Direct costs are defined as the cost of ticket office staff, ticket stock and credit card commission. Indirect costs include Ticket Issuing System (TIS) maintenance, cash handling and management overheads.

Whilst reasonably comprehensive, the LEK cost estimates are likely to relatively conservative, as it is difficult to discretely quantify all costs associated with station retailing (such as station staff who provide assistance to customers using TVMs).

Based on the sample of stations analysed, the cost of station ticket office retailing as a proportion of all sales (including season tickets) was estimated by LEK to be 8.3%. However, within this average there are some fairly significant differences by sector, with regional stations having a cost of sale of 15.5% and L&SE ticket offices having a cost of sale of 7.4% compared to 6% for long distance TOCs.

Significantly, based on more recent LEK analysis, if Season Tickets are taken out of the calculation, the cost of station ticket office retailing is estimated by LEK to increase to 12.9%.

The cost of TVM retailing is lower at 3.9% of sales, but again there are significant differences by sector with long distance TOCs having a much lower cost of sale through TVMs, reflecting both higher Average Transaction Values ('ATVs') and higher transaction volumes per machine.

Part of the variation in cost of sale by sector derives from LEK's finding that the cost of sale at smaller stations is significantly higher than at larger stations, probably because fixed costs are spread across a lower volume of transactions.

LEK also looked at the opportunity cost associated with station ticket office retailing. This reflects the potential retail rental or other commercial value that the space occupied by station ticket offices might otherwise produce. Data was limited but it seems clear that opportunity costs are potentially material.

Given that the LEK work is necessarily an approximation of costs, we have taken the cost of sale of station ticket offices and TVMs to be 8% and 4% of sales respectively. These costs of sale are broadly consistent with work previously undertaken, most recently by ATOC in 2011.

3. Cost of internet retailing

In order to estimate the current cost of sale through the internet, ATOC invited TOCs to provide, in confidence, details of their own online costs of sale. To ensure consistency of data, ATOC provided a cost and revenue template to participating TOCs. The cost element of the template included:

- Ticketing Issuing System (TIS) costs;
- Ticket fulfilment costs;
- RSP charges;

- Web marketing costs; and
- Payment card processing costs

Eight TOCs, who together account for more than 80% of TOC online sales, provided cost and revenue data. While most were long distance operators, sector data was also received from two regional and L&SE TOCs. Two of the TOCs were excluded from the final analysis as their TIS supply contracts were subject to specific terms which appeared to result in an unrepresentative cost of sale (one very high and one very low).

Although TOCs provided the same types of revenue and cost data, there are a number of factors which make it difficult to establish a consistent view of online cost of sale: ATOC's analysis identified three principal areas of difference.

TIS

The biggest difference in cost of sale between TOCs is driven by their approach to technology procurement. There are two options for TOCs: either to buy TIS access from an existing technology supplier (in which case the TOC acts as the retailer), or to use a TOC-branded version of a third party website (a so-called 'white label' solution).

These two types of arrangement will typically entail different commercial terms between the TOC and its supplier. Under technology supply arrangements, TIS costs, fulfilment costs and RSP charges are identified separately, whereas white label arrangements are more difficult to analyse, due to the confidentiality and complexity of the commercial arrangements that underpin them.

Treatment of web marketing costs

The amount of budget allocated to web marketing by a TOC will be driven by the importance the TOC attaches to the channel. The costs supplied by TOCs range from zero (no direct expenditure on the web channel apart from mentioning the website address in communications activity) to more significant budgets covering dedicated marketing, online/offline advertising and search engine activity.

Treatment of revenue/commission from other TOCs' sales

In calculating cost of sale, two approaches to revenue can be taken: either, to use all sales (both TOC 'own' and inter-TOC) or, TOC 'own sales' plus commission on the sale of products for other TOCs. We have analysed the cost of sale using both approaches. Table 9 below summarises the conclusions from our analysis.

Table 9: Summary of TOC online cost of sale

Revenue base	Lowest Cost of Sale	Highest Cost of Sale	Weighted/Indicative Cost of Sale
TOTAL WEBSALES (TOC own sales + sales of other TOCs' tickets)	3.0%	6.5%	4.5%
TOTAL INCOME (TOC own sales + commission received on sale of other TOCs' tickets)	4.2%	7.3%	5.0%

Source: ATOC, based on TOCs' data

Overall, we concluded that the current cost of 'internet retailing' for TOCs is around 5% of sales, although some TOCs clearly enjoy a lower cost of sale (primarily as a result of having secured advantageous terms for their TIS supply arrangements).

Data provided to us by third parties suggest that they have a higher cost of sale than TOCs, particularly if their marketing costs are included. A major third party retailer also shared with ATOC, in confidence, a more detailed breakdown of their costs and margins. This suggested that although their cost of sale (including marketing) exceeded commission, a margin was still being earned overall, once fees and other income were taken into account.

Overall, our best estimate of the cost of sale through the internet, across both TOCs and third parties is around 5%, with third parties generally above this average and TOCs at or below it.

TOCs are able to recover costs through commission. For third parties it means that margins can be earned once fees, ancillary income (such as insurance or advertising) and exploitation of technology through white label or technology supply deals is taken into account.

4. Cost of telesales

The current cost of telesales is unknown, although historically this has been a relatively high cost channel. However, in the absence of any known issues with commission rates, and given the rapidly declining importance of the channel, the current cost of sale has not been evaluated. For analysis purposes later in this chapter, we have assumed that the cost of sale for telesales is 9%, equivalent to the current level of commission.

5. TMC costs

ATOC does not have visibility of TMC costs, but, in principle, it seems reasonable to assume that TMC costs should not exceed the cost of sale observed through station ticket offices.

In fact, there is a strong argument that the cost to a TMC for taking and fulfilling an order from a corporate client should generally be cheaper than for a TOC selling through a station. This is because research undertaken by LEK indicates that around 70% of TMC sales are bookings made by a traveller themselves using 'self-booking' software provided by TMCs.

Ticket retailing through self-booking tools ought, in principle, to be cheaper than a TOC selling through a staffed, 'bricks and mortar' outlet, although our analysis suggests that there may be supply side issues that increase costs for TMCs.

TMCs would probably argue that the range of services they provide to their corporate clients (such as travel policy compliance or the provision of detailed management information) all drive costs, over and above simple order taking and fulfilment. However, the value added by these services is enjoyed by the corporate clients that receive them, not TOCs. In effect they reflect the partial or complete outsourcing of travel management by corporate clients, who remunerate TMCs through fees for their provision.

If we assume that a typical station ticket office transaction should represent an 'upper end' cost for a TMC, and take the average cost of a ticket office transaction (excluding season tickets) based on the LEK analysis (i.e. 12.9% of the ATV for station ticket office, non-Season Ticket sales of £12.76, equivalent to £1.65 per transaction) and divide this by the ATV for TMCs (£57.32), the cost of sale equates to 2.9%**.**

Based on this analysis, we have used 3% as the indicative cost of sale for TMCs in the rest of this submission, although we should re-emphasise that this is probably an upper band estimate given the preponderance of self-booking in the TMC market.

6. On-train

The cost of on-train retailing is difficult to quantify, given that the staff concerned have customer care and safety-related duties as well as on-train-retailing duties. Costs will vary significantly depending on whether on-train staff costs are treated on a marginal cost basis or average cost basis.

Most on-train staff are, however, paid commission on sales. This forms an element of their overall remuneration and is, in effect, a direct staff cost of retailing for the TOC concerned.

As on-train sales form a relatively minor element of total industry sales, we have not analysed them in detail. In order to provide an indicative estimate, we have taken 50% of the LEK estimate of the cost of station ticket office retailing and combined this with an average staff commission payment of 3.5%, to derive a cost of sale estimate of roundly 8%.

7. Oyster PAYG/TfL

The sale of TOC and, more importantly, 'joint' products (such as Travelcards) by TfL is underpinned by a series of relatively complex commercial agreements.

Overall we estimate that the commission paid to TfL for National Rail and joint products is 2.1% of sales. For Oyster PAYG, commission equates to around 1.7% of sales. However, in both cases it is worth emphasising that TOCs also receive payment of commission and other fees from TfL for TOC retailing of joint products as well as activities such as the provision of Oyster PAYG 'top-up' services. Based on this, we estimate that the indicative cost of sale through TfL is around 2%.

8. Overall industry cost of retailing

Our analysis of the cost of sale by channel has been summarised below in Table 10. We have also used the data obtained to estimate an overall industry cost of sale.

Table 10: Overall industry costs of sale 2013/14

Channel	Estimated % cost of sale	Revenue 2013/14 (£m)	Total costs (£m)	Notes
Station ticket office	8	3,183	255	Cost of sale taken from ATOC analysis
TVMs	4	1,383	55	Cost of sale taken from ATOC analysis
Internet	5	1.660	83	Cost of sale taken from ATOC analysis
Call Centre	9	54	5	Cost of sale taken from ATOC analysis
TMC	3	685	21	Cost of sale taken from ATOC analysis
On train	8	346	28	Cost of sale taken from ATOC analysis
TfL	2	691	14	Cost of sale taken from ATOC analysis
International	8	38	3	Commission rate taken as cost of sale
Other	6	216	13	Cost of sale unknown, so industry average assumed
Total	**5.8**	**8,257**	**482**	

Source: Rail industry Lennon information system, LEK analysis 2014, ATOC analysis, TOC data

Note: Revenue data are TOC earnings and exclude non-TOC receipts

The overall industry cost of retailing is just under half a billion pounds, equating to around 6% of industry revenue. This does not include the cost of central ATOC/RSP systems that support industry retailing. Inclusion of these costs would take total industry retailing to above £0.5b per annum.

This is a significant proportion of industry costs and raises questions in terms of the supply-side efficiency of the market. In this context, it is worth highlighting that station ticket office costs reflect around 50% of all industry retailing costs, despite station ticket offices representing less than 39% of total sales and just 26% of industry transactions.

As previously highlighted, we believe that the high cost of station ticket office retailing and the resulting impact on overall industry retailing costs is a significant issue that needs to be addressed as part of the ORR Review.

Appendix B: Third party retail market in Great Britain compared to benchmark retail markets in other developed countries

In order to provide some international context, ATOC commissioned LEK to compare the third party retailing market in Great Britain with that in a number of developed rail markets around the world. The work consisted of desk-based research complemented by a number of interviews with representatives of railways and/or ticket distributors in each market.

The research looked at rail ticket distribution arrangements in:

Europe: France, Germany, Sweden, Belgium, Netherlands

Rest of World: Australia, US, Japan

The key findings from the LEK report have been summarised in Table 11 below. While it has not been possible to obtain a complete picture for each market, the results are considered to be sufficiently detailed to provide a representative overview of the global retailing landscape.

Table 11: Rail ticket distribution in international markets

Channel	GBR	FRA	GER	SWE	BEL	NL	AUS	USA	JPN
Train Operators (selling own tickets)	✓	✓	✓	✓	✓	✓	✓	✓	✓
Travel Agents (High St/leisure travel)	✓	✓	✓	✓	✓	✓	✓	✓	✓
TMC (corporate clients / business travel)	✓	✓	✓	✓	✓	✓	✓	✓	✓
Third party internet retailers	✓	✓	✓	✓	✓	✗	✗	✗	✗
Market penetration of third party internet retailers (ATOC est)	8%	<1%	2%	<1%	<1%	0%	0%	0%	0%
Other retailers (incl non-rail retailers and transport authorities)	✓	✗	✓	✓	✗	✓	✓	✗	✗

Source: LEK, 2014

While tickets can be bought through train operators and through the traditional leisure and business travel agent/TMC outlets in all developed markets, penetration of online retailing and non-rail outlets is much lower. Tickets can be bought in certain convenience store chains in a number of markets (Germany, Sweden, Netherlands, Australia), but there is no evidence of tickets being distributed on a large scale through non-rail outlets.

Online retailing of tickets through independent retailers hardly exists outside of the GB market, although there are signs of movement in France and Germany, where the French retailer Capitaine Trains is starting to achieve a presence. It is understood that the Trainline has just entered the German market.

Qualitative input from overseas participants in the LEK research suggested that the dominant presence of national railways has, until now, limited the scope for independent retailers to become established. However, there was a general feeling among respondents, particularly in European markets, that the monopoly position of national railways is starting to be eroded.

Overall, the market in Great Britain emerges as probably the most competitive amongst the basket of countries analysed. The LEK analysis, taken together with ATOC's more general knowledge of the global rail retailing market, draws us to conclude that, arguably, the rail retailing market in Great Britain is the most competitive in the developed world.

The LEK report also looked at remuneration levels in each market. The results of this work have been summarised in Appendix C.

Appendix C: Retailer remuneration

Introduction

Changes to inter-TOC commission rates are agreed through Ticketing and Settlement Scheme Council, whilst third party rates are agreed through Retail Agents Scheme Council, now part of Commercial Board. Changes to inter-TOC rates have to be formally ratified by the DfT, whereas this is not the case for third party rates. In practice Commercial Board tends to provide guidance on overall policy for both third party and inter-TOC commission rates, given the need for a ‘level playing field’ market to exist.

ATOC publishes all commission rates (both inter-TOC and third party) and related remuneration on its website.

A brief history of commission

The position at privatisation

A number of rail industry commission rates were ‘inherited’ at privatisation from British Rail. These were primarily the commission rates through TOC ticket offices, TVMs and telephone call centres, all of which were set at 9% for non-Season Ticket sales and 2% for Season Ticket sales. In addition, licenced travel agents were offered a rate of 9% for non-Season Ticket sales (their licences did not allow them to sell Season Tickets).

The origin of the 9% rate is unknown but it had been in existence for some considerable time (at least from the early 1980s but quite possibly for some considerable time before that). It is believed that there was no specific rationale for the 9% rate, but rather that it mirrored the generally prevailing rate in the travel industry more widely at the time.

In this context, its origins probably lie in the development of ‘agencies’ designed to strengthen and extend the sales networks of transport companies (originally shipping companies). The rate itself probably reflected the commercial agreements between shippers and agents.

Over time, the 9% rate became an established benchmark rate across the travel industry and proved difficult to change. This largely reflected the market power of travel agencies who, prior to the advent of telephone retailing and the internet, provided the only way that travel companies could extend sales beyond their own ticketing outlets.

Certainly, British Rail made determined efforts in the late 1980s to reduce the 9% rate but was always forced to retreat in the face of strong opposition from travel agents and their trade associations.

Equally, the origin of the 2% rate for Season Tickets, again inherited at privatisation is unclear, but the accepted rationale is that it reflected the much higher Average Transaction Values associated with Season Tickets.

TMC and BTS rates

Prior to privatisation, British Rail (BR) licenced third party travel agents to sell rail products. We do not have detailed records of the number of licenced agents extending back to privatisation, although it is believed that there were around 500 licenced agents trading through around 2,000 branches. The vast majority traded in the leisure travel market through ‘bricks and mortar’ outlets, often situated in high streets or shopping centres.

However, from the late 1990s onwards, the travel agency sector went through a period of very significant change in the face of competition from, initially, call centres and Teletext, and then the internet. The leisure travel market, which had been the most important element of the travel agency market, largely migrated to the new retail channels.

As a consequence of this, very large numbers of travel agents ceased to trade, with ‘high street’ travel agents particularly badly affected. This decline was reflected in the number of rail-licenced agents that ceased to trade or rescinded their licences. The number of licenced agents declined from over 500 at privatisation to 166 licenced agents in 2007, despite the fact that commission remained constant at 9% during most of this period.

The growth of new sales channels also had a significant impact on the air market, where airlines for the first time could sell directly to their customers on a volume basis (previously sales had been restricted to a relatively small number of ‘bricks and mortar’ sales outlets).

As a result, a good deal of the market power held by agents was dissipated and airlines refused to continue with previous levels of commission. From the late 1990s onwards, airline commission payments were reduced and, in most cases, eventually withdrawn; a trend exacerbated by the emergence of low-cost air carriers, who largely refused to sell through travel agents at all.

In the face of these market pressures, the travel agency sector went through a period of rapid re-structuring. A number of specific trends emerged:

- large scale withdrawal from the leisure market, with remaining agents often specialising in niche markets such as bespoke holidays;
- a new focus on the corporate travel market, where a wider and more diverse range of client needs could not so easily be met by direct channels like call centres or the internet;

- re-engineering of the travel agency business model to focus on the provision of value-added services to corporate customers, including complete outsourcing of their travel arrangements;
- a shift in remuneration away from commission paid by carriers to fees charged by TMCs to corporate customers; and
- consolidation through merger and takeover to create larger companies that enjoyed economies of scale.

It was through this process that Travel Management Companies (TMCs) emerged from the remaining rump of the previous travel agency sector. Symbolically, their principal trade association, the Guild of Business Travel Agents (GBTA) became the Guild of Travel Management Companies (GTMC).

Against this backdrop of rapid change, TOCs, through ATOC, also began to re-consider their approach to the travel agency market. In particular, there was a new focus on the cost of the channel.

As a result it was decided to move away from the policy of ATOC providing TMCs with rail TIS systems. Following privatisation a new market in TIS systems had developed (previously, British Rail had procured a single TIS on behalf of the whole industry, usually on the basis of bespoke hardware/software commissioned directly from manufacturers), and TMCs had the opportunity for the first time to procure their own TIS in the market.

Apart from increasing the cost of the TMC channel to TOCs, ATOC provision of TMC TIS had provided TMCs with an unfair advantage in a market where all other retailers had to procure their own TIS.

As a result, TMCs were told in May 2004 that they would have to procure their own TIS by the end of 2007 in order to retain a rail licence. ATOC worked with TIS suppliers to develop alternatives, including the new Evolvi system, which was developed on a risk-taking basis by a licenced TMC, Harry Weeks Travel, and launched in 2004.

In concert with this, a decision was taken to reduce commission rates, partly in the light of declining benchmark commission rates in the air sector, but more particularly in the context of the major changes to the TMC business model. TMCs continuing to use ATOC TIS had commission reduced to 7%, whilst those procuring their own TIS retained 9% commission, up to the final withdrawal of ATOC TIS at the end of December 2007, when all TMC commission was reduced to 5%.

Commission was reduced again in July 2010 to 4% or 3% depending on whether the TMC had arranged a financial bond against settlement default, and in April 2011 to 3% for all TMCs.

This phased reduction in commission was, in essence, a step-by-step re-alignment of commission for rail sales with changes in the wider travel market.

In order to ensure that a 'level playing field' existed from a competition perspective, the commission rate for TOC BTS units (which provided an analogous, but much more limited travel management service to corporate clients) was separated from station commission rates in 2010 and set at 3% (for sales with no limit on the fee charged to corporate customers) and 6% (for sales where fees are limited to the current Warrant Account fee of £275 per year).

Although there is no evidence of abuse of these dual rates it is planned, that TOC BTS rates will be standardised at 3% later this year in order to ensure complete consistency with TMC rates.

Internet and telesales rates

As the internet had not existed for commercial transactions at privatisation, a new commission rate for internet sales was created to coincide with the introduction of the new TPIL licence in 2005 (previously internet sales had attracted a rate of 9%). The rate was initially set at 9% to mirror existing industry commission rates but also to reflect the high start-up costs of internet retailers (who were typically building their own TIS from scratch).

Following periods of negotiation, principally with the Trainline, as the key player in the market, internet rates were reduced to 5.5% in 2008, 5.25% in 2012 and 5% in 2013 reflecting both reducing costs of sale as economies of scale were realised and TIS development became cheaper

Again, in order to ensure a level playing field from a competition perspective, inter-TOC commission rates were reduced in line with third party rates, although third party retailers had the additional opportunity to earn additional remuneration through customer fees, an opportunity precluded by regulation for TOCs.

Telesales rates were set at 9% for third parties in line with the TOC rate. They have been maintained at this level over time for both TOCs and third parties.

ToD fulfilment fees

Partly offsetting these reductions in commission was a parallel reduction in the ToD fulfilment charges made by TOCs from £0.80 for TVM fulfilment in 2010 to £0.40 in 2012. This saving was equivalent to around 1.5% commission based on the ATV for internet sales. TOD fulfilment through TVMs now accounts for around 75% of third party internet sales.

Station rates

Although inter-TOC internet and BTS rates have been reduced over recent years, station commission rates have not been reduced, reflecting the relatively high cost of station retailing, and the inability of TOCs to reduce costs because of regulation (Schedule 17 of the TSA in particular), or recover costs through fees.

ATOC analysis in 2011 and the more recent analysis by LEK have both found that the TOC cost of sale through station ticket offices was broadly in line with commission, although significantly higher than commission if Season Ticket sales are excluded.

International commission rates

Commission rates for BritRail passes and BritRail/TCV PtP fares have traditionally been high (historically around 20%). This reflected the relatively high cost of distribution and fulfilment in international markets, particularly in markets which often had intermediaries between the agent and the end customer.

The introduction of the new ATOC licences in 2010 provided an opportunity to sell to customers directly through online retailing, with a cost structure which was more aligned with the domestic public internet retailing market (which was remunerated at 5.5% at that time). However, in recognition of the higher costs of development of overseas markets and of the fact that a number of key markets still functioned according to an 'intermediary' model, it was agreed that sales of the domestic fares range would be remunerated initially at 9%, reducing to 8% after two years.

Commission on BritRail passes has been reduced steadily over recent years and will stand at 9% from October 2014. The BritRail/TCV PtP fares, which currently attract commission at over 20%, will be withdrawn from the end of 2014.

Current commission structure

Table 12 overleaf provides the summary of the current commission structure, which can be found on the ATOC website, whilst Table 13 overleaf summarises the proposed future structure based on TOCs'/ATOC's recent review of the third party market.

It should be noted that channel commission rates apply irrespective of the type of licence held. For instance, Travel Agents' Licence holders can earn 9% commission if they trade in the public telesales market. Similarly TPIL holders can sell directly to corporates through intranet/self-booking tools, as TMCs do, but earn 3% commission for doing so.

Table 12: Current commission structure

Market	Channel / Threshold	Third Party Sales	Inter-TOC Sales	Notes
Public internet	Non-Season Ticket sales Season Ticket sales	5.0% Not allowed under third party licences	5.0% 0.0%	• Third party retailers may charge additional fees as allowed within law • Third party retailers may enter into additional bilateral remuneration arrangements with TOCs • TSA prohibits charging of fees by TOCs
Public telesales	All sales	9.0%	9.0%	• Third party retailers may charge additional fees as allowed within law • Third party retailers may enter into additional bilateral remuneration arrangements with TOCs • TSA prohibits charging of fees by TOCs
TMC/TA and TOC BTS sales	All sales	3.0%	3.0% or 6.0%	• TA/TMCs may charge additional fees • TA/TMCs may enter into additional bilateral remuneration arrangements with TOCs • TOCs receive 3% if additional fees are charged or 6% if fees restricted to annual Warrant Account fee
Business Account Facility (Public internet sites)	Sales up to £50k Sales over £50k	5.0% 3.0%	N/A	• Once £50k threshold per account is exceeded in any RSP year, all future sales in all future years will be subject to TMC rates
Station and On-train sales	Ticket Offices, Ticket Vending Machines and On-Train	Non-Season Tickets Season Tickets	9.0% 2.0%	• Season Ticket rate applies to tickets with weekly or longer durations • TSA prohibits charging of fees by TOCs and restricts ability to change ticket office opening hours or to close ticket offices
International sales (from 1 Oct 2014)	BritRail Passes Domestic point to point fares	9.0% 8.0%	N/A	• Non-UK originating sales through third party retailers holding a dedicated International Sales Licence
Ticket on Departure fulfilment fees (per transaction)	TVM Issue Booking Office Issue	£0.40 £0.90	£0.40 £0.90	• ToD fulfilment fees are payable by all participants (TOCs, Third Party Retailers and TA/TMCs)

Source:ATOC

Table 13: Proposed future commission rates – 2015-2019 (rates apply to all retailers using channel)

Market	Threshold / Channel	Non-Season Ticket Sales	Season Ticket Sales	Notes
Public internet	All sales	5.0%	2.0% (TBC)	• 5% rate subject to review from 2017/18 in light of realised reductions in industry costs • Third party retailers may charge additional fees as allowed within law • Third party retailers may enter into additional bilateral remuneration arrangements with TOCs • TSA prohibits charging of fees by TOCs
Public telesales	All sales	9.0%	2.0% (TBC)	• Third party retailers may charge additional fees as allowed within law • Third party retailers may enter into additional bilateral remuneration arrangements with TOCs • TSA prohibits charging of fees by TOCs
TA/TMC and TOC BTS sales	All sales	3.0%	2.0% (TBC)	• TOCs and TMCs may charge additional fees • TOCs and TMCs may enter into additional bilateral remuneration arrangements with TOCs
Business Account Facility (Public internet sites)	Sales up to £50k Sales over £50k	5.0% 3.0%	TBC	• Once £50k threshold per account is exceeded in any RSP year, all future sales in all future years will be subject to TMC rates
Station and third party over-the-counter sales	Ticket Offices and High Street outlets	9.0%	2.0%	• Season Ticket rate applies to tickets with weekly or longer durations • TSA prohibits charging of fees by TOCs and restricts ability to change ticket office opening hours or to close ticket offices • New OTC licence for face to face sales in high street outlets, with potentially restricted ticket range (commission rate TBC)
On-train sales	On-train	9.0%	2.0%	• Channel restricted to TOCs
Ticket Vending Machines	TVM	9.0%	2.0%	• Channel currently used only by TOCs but, in principle, open to third parties
International sales (from 1 Oct 2014)	BritRail Passes Domestic ptp fares	9.0%/8.0% 8.0%	N/A	• Non-UK originating sales through third party retailers holding a dedicated International Sales Licence
Ticket on Departure fulfilment fees (per transaction)	TVM Issue Ticket Office	£0.40 £0.90	£0.40 £0.90	• ToD fulfilment fees are payable by all participants (TOCs, Third Party Retailers and TA/TMCs)

Source:ATOC

ATOC/RSP police commission arrangements quite rigorously to ensure that commission rates are applied correctly; it clearly not being in TOCs' commercial interests to over-pay commission.

Rationale for commission structure

ATOC/TOCs find themselves in an unusual position with regard to the setting of commission for industry retailing, on one hand having to reflect our own business interests (both providing incentives to increase revenue but also reducing the cost of sale), as well as being mindful of competition law and the need to ensure that rates are set at equitable levels, and that differentials are objectively justifiable. As previously highlighted this gives us a quasi-regulatory role in the market, a responsibility which we take very seriously.

ATOC works very closely with TOCs in this regard, not just in terms of ensuring that their wishes are fully understood, but also in terms of assessing the market and providing advice on trends and issues.

Overall, the objective has been to try and achieve a fair balance in terms of TOC and wider industry imperatives to drive down costs (noting that, as described in appendix A, retailing is a significant area of cost for the industry), and the need to set rates at levels that support volume and revenue growth, as well as ensuring that the overall structure is coherent and provides a level playing field for retailers.

In order to achieve this, a number of factors, are taken into account when setting commission rates:

- general, benchmark rates applying in the travel sector;
- the cost of sale through different channels;
- the average transaction value ('ATV') to which commission rates are applied;
- the ability of retailers to earn other remuneration through fees or ancillary income; and
- the extent to which third party retailers are adding value, in particular supporting growth and market expansion.

The commission structure reflects a judgemental view across all these elements rather than adopting a purely mechanistic approach based on a single element (such as cost of sale or benchmark rates) or subset of elements. Overall this approach seems more likely to reflect the kind of outcomes that might be expected in a purely market driven environment.

It is also worth emphasising that there is also an important element of commercial negotiation involved in setting commission levels. Section 7.2 recent examples of this. Although such negotiation is collectively from a TOC perspective, it nevertheless represents the kind of market dynamic that would normally be a feature of retail and distribution markets.

However, as noted before one issue associated with this is the inevitable tendency for such negotiation to focus on the major players within the market.

It is also worth emphasising that the ATOC commission rate forms a base rate and there remains the opportunity for third party retailers to enter into additional bilateral arrangements with TOCs. In the TMC market, where there is no impartiality requirement, a considerable number of these arrangements exist, often focussed on specific routes/corporate clients.

ATOC does not get involved in these bilateral arrangements but based on information provided by TOCs, we understand that over 40 such arrangements are currently in place, covering 60-90 TMCs (one bilateral arrangement involves 53 TMCs). As such, it seems likely that the majority of of the top 50 TMCs, which account for around 95% of TMC revenue, have at least one TOC bilateral arrangement in place. In addition there are TOC bilateral arrangements with ITX licence holders (one TOC has thirteen such arrangements), as well as TOC arrangements directly with corporate customers

Bilateral arrangements are considerably less common in the internet retailing market (with the impartiality requirement on third party retailers providing less scope for such arrangements), although 'white label' deals with TOCs for the provision of web TIS do provide significant additional third party remuneration opportunities. Around a half of TOC retailing is undertaken through such 'white label' arrangements.

One final point to make is that commission rates are at the same level for all retailers within each channel (for instance public internet rates apply to all public internet retailers). This reflects the strong, frequently stated, desire of third party retailers for a 'level playing field' with no differentiation by type or size of retailer.

Below, we consider each of these elements in turn, before summarising the current rationale and then addressing the specific issues raised by third party retailers.

Benchmark commission rates

Table 14 overleaf summarises benchmark commission rates, based on work commissioned by ATOC from the consultants LEK. Wherever possible, LEK has used published remuneration rates, with additional information gleaned through other desk research and interviews with a number of industry players. The full LEK report has been provided to the ORR.

Within Great Britain, airlines do not generally offer commission for TMC or online sales (with some exceptions such as Emirates who offer 9% and Virgin Atlantic who offer 2%). Similarly, Eurostar does not offer commission on TMC or internet sales.

However, both airlines and Eurostar do offer other forms of remuneration, particularly bespoke marketing or incentive agreements. These, essentially, appear to be specific payments designed to incentivise retailers to favour the carrier providing the incentive. In the air market, ‘net fares’ (which allow the retailer to make a mark-up of their choosing) are also sometimes offered, although generally in the long-haul air market.

In the hotel market, the approach to remuneration seems to vary by type of hotel. Commissions (typically 6%-8%) still exist at the upper end of the market (although not where corporate clients have agreed specific rates with the hotel/chain concerned), but do not exist at the lower end of the market which is characterised by a smaller number of high volume players. This seems to reflect the more fragmented nature of the upper end of the market, together with the higher margins which seem likely to be enjoyed by this segment of the market.

Internationally, from a rail perspective the picture is mixed. Internet commission rates, where they are offered, seem to be consistently below those that apply in Great Britain.

For TMCs, commission rates vary more widely, with the rate in France roughly comparable to Great Britain, lower rates in the US (for comparable types of service) and Belgium and a higher rate in Germany (although market intelligence suggests that TMC rates in Germany are on a downward trend).

Overall, remuneration in Great Britain seems to be reasonably consistent with or above benchmark rates. It is also worth noting that commission rates seem to have been reduced in most sectors in recent years, albeit partly offset by carrier-specific incentive deals.

Whilst benchmark, comparator rates are not used as the basis for setting commission, they are used to ‘sense check’ rail rates and to ensure that more general trends in the market are taken into account.

Table 14: Benchmark commission rates

Sector/carrier	UK airline market	UK hotel market	Eurostar	SNCF	DB	NMBS/SNCB	NS	US
TMC commission	Typically 0%	Typically 8% - 10% for top end of market and 0% for budget end	0%	2.4% published rate	6% - 8%	0%	Unknown	0% in high frequency/speed markets (such as NE Corridor) and 8%-10% for specified long distance services
Internet commission	Typically 0%	Unknown	0%	Unknown	2%	0%	3% - 3.75%	0%
Other remuneration	Net fares in long haul market, growth incentives and marketing agreements		Marketing agreements for internal retailers, net fares for ITX operators.	Additional payments suggest commission range of 2.4% to 6% with average commission at 4%	Additional bilateral advertising incentives in the internet market, and separate affiliate programme-	-	-	-
Notes	Remuneration is focused on achieving switch to carrier concerned	Commission at top end is typically zero when specific corporate rates have been agreed	Remuneration is focused on achieving carrier switch to Eurostar. Eurostar pays GDS costs. Eurostar offers deals to corporate customers directly.				Published commission appears to apply to NS Hispeed services only	Commission only applies on long distance routes of roundly 10 hours or more

Source: LEK, 2014

Channel cost of sale

We summarised our analysis of costs of sale by channel in Appendix A. This showed a range of costs from 2% for TfL costs to 4% for TVMs, 5% for the internet and 8% for stations. Whilst, as emphasised, previously, we do not adopt a mechanistic approach to setting commission, the cost of sale is an important consideration.

Overall, commission is generally set at levels, where in combination with other remuneration opportunities open to the retailer, the cost of sale can be recovered and a margin on sales earned.

Average Transaction Values by channel

ATVs vary significantly by channel, as summarised in Table 15 below.

Table 15: Average Transaction Values by retail channel 2013/14

Channel	Average Transaction Value (£)	Commission (%)	Average Retailer Remuneration per Transaction (£)	Index of Average Retailer Remuneration per Transaction (Station TO non-Season Tickets = 100)
Station TO – non-Season Tickets	12.76	9	1.15	**100**
Station TO – Season Tickets	153.66	2	3.07	**270**
TVM – non-Season Tickets	12.07	9	1.09	**95**
TVM – Season Tickets	50.05	2	1.00	**87**
Stations total – non-Season Tickets	12.48	9	1.12	**97**
Stations total – Season Tickets	112.01	2	2.24	**195**
Stations total	**18.76**		**1.19**	**103**
TOC internet	26.67	5	1.33	**116**
TOC call centre	34.61	9	3.12	**271**
TOC on train	8.08	9	0.73	**63**
Third party internet	29.23	5	1.46	**127**
Third party call centre	29.94	9	2.69	**234**
TMC	58.47	3	1.75	**152**
TfL	3.49	2	0.07	**6**

Source: Rail industry Lennon information system

TfL sales have by far the lowest ATV reflecting the fact that the market they serve is composed mostly of relatively short distance journeys within London.

Station non-Season Ticket sales have relatively low values, at around half the ATV for internet sales. The highest ATV is in the TMC sector, where the ATV is around five times that of non-Season Ticket sales through stations.

We have calculated average remuneration per transaction ('ART') based on ATVs and the relevant base commission rate. The ART measure does not include remuneration from fees or, in the case of third party retailers, any additional bilateral arrangements with TOCs.

With the exception of Season Ticket and TfL sales, ARTs are reasonably consistent across channels with, although the ARTs for non-station channels tend to be higher than the benchmark station ART. For TMCs the ART is 50% higher than the station benchmark shown in the table.

Whilst ARTs for Season Ticket sales are generally higher, it is worth noting that there are higher after-sales costs associated with Season Tickets, especially around refunds, duplicate Season Tickets and the application of Charter discounts.

The ability to earn other remuneration

The ability to earn additional remuneration is a key differentiation in the market. TOCs are generally prohibited from charging additional fees, as the DfT has consistently interpreted this as non-compliant with the TSA. This has meant that TOCs have not been able to charge fees of any kind, including credit card fees, for station retailing (either ticket office or TVM), on-train retailing, or sales through the internet and call centres.

Although a small number of TOCs have very limited fees for some types of internet transaction, in general fees have not been a feature of TOC sales to the general public. It ought to be noted that TOCs do charge fees to corporate customers who use BTS units, although generally, additional, value-added services are included within these arrangements.

Third parties, by contrast, have always been allowed to charge fees, with this being made explicit in their licences. This has been a deliberate policy on the part of ATOC/TOCs, reflecting the development of transaction fees more widely in the travel and entertainment markets.

Table 16 overleaf summarises the fees currently charged by licenced online retailers. The lowest fee is charged by RedSpottedHanky, who until recently had not charged fees. Raileasy charge the highest fees.

The TMC business model is now largely based on charging fees to their corporate clients. In order to gain a better understanding of the TMC business model, ATOC asked LEK to investigate TMC fee structures and levels, as well as the charges levied by Evolvi, the market leader in the TMC TIS supply market.

LEK found that TMCs typically offer corporate clients a range of value added services, which LEK summarised in Figure 10**,** also shown overleaf.

It is worth noting that most of these services are value-added for the corporate client but not for the carrier. At the most extreme, they reflect a complete outsourcing of travel by the corporate client.

Provision of the services described is typically either on a ‘high touch’ or ‘low touch’ basis. High touch often involves a dedicated account team for the corporate customer and a high degree of human involvement (through call centre or face to face interaction), whereas low touch services are typically managed through ‘self-booking’ tools, where the TMC provides the client’s personnel with access to an online booking system that allows them to book travel directly.

LEK found that around 70% of the TMC rail market is ‘low touch’ with transaction fees typically in the £5-£9 range. Fees for the 30% of the market that opted for a ‘high touch’ service were typically £12-£16 a transaction. In general, rail booking fees were lower than those charged for air bookings, which LEK concluded was due to greater competition and lower barriers to switching to other sales channels in the rail market.

Even so, the fees charged provide significant additional remuneration for TMCs making rail bookings. Assuming that £9 is a conservative estimate for the overall average of booking fees charged, this adds around 16% additional remuneration to the 3% received from ATOC. However, it is worth noting that the client fee charged by TMCs needs to recover the cost of the full range of services enjoyed by the client.

It is also worth highlighting LEK’s findings with regard to the costs of TIS in the TMC market, Based on an analysis of Evolvi, who have a 60% share of the TMC market, it seems that ATOC commission is largely matched by the transaction fees charged by Evolvi. These costs seem high and it may be that the limited competition in the TMC TIS supply market is leading to relatively high costs. Many TOCs take a similar view of the TOC TIS-supply market.

Table 16: Online retailer fees November 2014

Online retailer	Booking fee	Transaction fee	Other fees
Trainline	**Web and Mobile Sites:** Booking fees are £0.75 per transaction up to £30 and £1.50 per transaction over £30 **Mobile App**: for an Android/iPhone phone a tiered fee structure applies: ranging from a fee of £0.25 to £1.50 depending on total transaction value .	No debit card fee. Credit cards (and Paypal) charged at 2% unless booked through a non-Android or non-iPhone app, in which case a fixed £1.50 fee applies.	Most delivery and ticket collection options are free. For next day delivery or international delivery a fee of £7.50 applies.
Raileasy	£2.50	No debit card fee. Credit Cards: 4.5% of total transaction, unless the value of the total transaction is more than £200, when a charge of 2.5% applies	1st class post charged at £1.50 Special Delivery at £7.50. Insurance at £1.50 per transaction.
Redspottedhanky	£1.00	No credit or debit card fees	No delivery fees (unless next day delivery - £10)
My Train Ticket	£1.50 booking fee per transaction. Possible to purchase multiple tickets per transaction	No debit card fee. Credit Cards: Amex, MasterCard, Visa: 2% Maestro, Visa Electron: no fee	First Class post free if no ToD collection available at departure station, otherwise £1.00 Special Delivery £7.50
TrainGenius	£1.00	No debit card fee Credit card fee: 2%	1st class post - £1.70 Special Delivery £8.50
Take the Train	No booking fee	No credit or debit card fees	1st class post - £1, Special Delivery - £6
Loco2	No booking fee	No debit card fee Credit card fee: 2.5%	1st class post - £2.25 Special Delivery £6.25

Source: ATOC review of information provided on each retailers' website

Figure 8: TMC process breakdown

TMC charging structures to corporates

TMCs can get involved at all stages in the travel management process, but their core activities are managing suppliers, booking trips and reporting

Travel management process

	Travel policy & compliance	Sourcing & procurement	Trip planning & trip booking	Handling expense claims	Admin billing function	Measuring and reporting
	• Activities linked to the establishment of best policies, in line with the corporation's business needs, enforcing compliancy and correcting any shortfalls	• Core TMC activity • Management of long-term agreements between corporations and their suppliers • Includes negotiations with airlines, hotels, car rentals, TMCs and system suppliers	• Core TMC activity • Developed by travellers and travel arrangers for every trip • Filling requests and obtaining approvals to identifying travel needs, carrying out the booking and managing changes	• Control and approval of expense reports	• Travel accounting involving expense invoices, settling and matching them	• Core TMC activity • Data (providers, TMC, credit cards, expense reports and online booking system) is collected, analysed and distributed to feed into travel policy compliance
Value add for:						
Clients	✓	✓	✓	✓	✓	✓
Suppliers	✗	✗	✓	✗	✗	✗

Source: An essential guide to purchasing business travel services, CIPS Knowledge; Corporate Travel Management in Western Europe: *Opportunities and Challenges*, Hermes

Source: LEK, 2014

The extent to which third parties add value and support market growth and expansion

ATOC and TOCs undertake detailed analysis from time to time to assess the value added by third party retailers. This focuses in particular on the extent to which they are driving market growth and expansion, and their impact on the overall cost of sale. This analysis provides the strategic background for decisions on commission levels.

Sales growth and market trends are analysed to gauge the overall health of the market and, typically, decisions on commission will involve detailed analysis of these trends, which are also monitored by ATOC on an ongoing basis. Detailed analysis of sales is conducted by ATOC on a four weekly basis.

The most recent review of third party retailing strategy, which analysed the third party retailing market in considerable detail, found little evidence that the current commission structure, or indeed the reductions in third party commission over recent years, had negatively impacted on growth.

Indeed, we have already highlighted the strong growth in rail demand and revenue experienced since privatisation. We have also highlighted that the rate of growth of sales by third party retailers has outstripped TOCs and the market more generally, suggesting that commission reductions have not undermined growth in this section of the retail market.

Overall rationale for commission structure

Table 17 overleaf summarises the rationale for the current commission structure.

Station ticket office rates, whilst inherited at privatisation, largely reflect the current overall cost of sale through ticket offices, although commission in the most recent LEK analysis suggests that commission is below the cost of sale for non-Season Ticket transactions. Commission forms the only source of remuneration for TOC retailers, given the TSA prohibition on charging fees, and effectively allows them to recover the cost of inter-TOC sales.

Station ticket office commission rates could be reviewed if TOCs had greater commercial freedom to reduce costs or earn additional remuneration through fees.

The lower rate for Season Ticket sales reflects the higher ATVs associated with this product. Even so ART is higher than for other products, although there are higher after-sales costs associated with Season Tickets. It is also worth noting that the migration of Weekly Season Tickets to TVMs has increased the ATV of Season Ticket sales through ticket offices, increasing the ART over time.

TVM commission rates are arguably out of line with the rest of the commission structure as current ARTs exceed the cost of sale, as estimated by LEK, although at smaller stations, in particular, it is probably more reasonable to consider TVMs in combination with ticket offices, given that the cost of sale for the letter is likely to exceed commission. At larger stations, there is also likely to be a degree of shared cost, for instance in terms of station staff.

ATOC/TOCs have considered separating TVM commission rates from ticket office rates and lowering them to a level more consistent with the cost of sale. However, this would result in significant swings of commission income between TOCs with impacts on current franchise agreements.

However, we would be willing to work with the DfT to effect a simultaneous change to TVM commission levels and offsetting changes to franchise agreements if there was a willingness to do this.

It is worth noting that, in competition terms, TVMs are generally serving relatively short distance, low transaction-value markets, whereas third party retailers are primarily focused on longer distance markets with higher transaction values.

The commission rate for internet sales, which is the same for TOCs and third parties, effectively allows the cost of sale to be fully or partly recovered, leaving third parties the ability to make a margin on fees, ancillary income and ‘white label’ services. It is worth noting that a typical £1.50 booking fee provides over 5% additional remuneration to an internet retailer, based on the current ATV for this channel.

The commission rate for call centre sales is again the same for TOCs and third parties. We have not estimated the cost of sale for this channel given that is now little more than a niche activity and is in continued (although probably not terminal) decline. The ability of third parties to charge fees provides them with the opportunity to earn a margin on sales, whilst TOCs do not enjoy this freedom.

Although we do not have detailed visibility of TMC costs of sale, our earlier analysis suggested that 3% for basic ticket booking and fulfilment was a reasonable estimate, meaning that commission covers the basic cost of sale. However, as already highlighted, TMCs are able to earn far higher remuneration through the fees charged to their corporate customers, which forms the basis of their business model.

The commission rates for international sales are set at relatively high levels, reflecting the investment in marketing needed to grow these markets, but also higher levels of fraud, and higher costs given the need to trade through intermediaries in some markets.

Table 17: Summary of rationale for current rail industry commission structure

Retail channel	Commission rate (%)	Benchmark rates (%)	Industry average cost of sale per transaction (%)	ATV and ART (£)		Ability to earn other remuneration	Notes
Stations ticket offices – non-Season Tickets	9	N/A	8	12.76	1.15	No, prohibited by TSA	Cost of sale based on average station ATV
Station ticket offices – Season Tickets	2	N/A	8	153.66	3.07	No, prohibited by TSA	Cost of sale based on average station ATV
Station TVMs – non-Season Tickets	9	N/A	4	12.07	1.09	No, prohibited by TSA	
Station TVMS – Season Tickets	2	N/A	4	50.05	1.00	No, prohibited by TSA	
On train	9	N/A	8	12.48	1.12	No, prohibited by TSA	
TOC call centre	9	-	9	112.01	2.24	No, prohibited by TSA	
Third party call centre	9 (plus TOC bilateral deals	-	9	29.94	2.69	Yes	
TOC internet	5	0-3	5	26.67	1.33	No, prohibited by TSA	
Third party internet	5 (plus TOC bilateral deals)	0-3	5	29.23	1.46	Yes, typically £1.50+ per transaction plus TOC bilateral deals	Third party cost of sale higher than industry average
TMC	3 (plus TOC bilateral deals)	0-8	3	58.47	1.75	Yes, typically £9 per transaction plus TOC bilateral deals	
TOC BTS – non-Season Tickets	3 - 6	0% - 8%	-	34.13	1.02	Yes	BTS cost of sale not estimated. Commission will be 3% from January 2015.
TOC BTS – Season Tickets	2	N/A	-	1,360.99	27.22	Yes	High ATV driven by one BTS unit.
TfL	2	N/A	2	3.49	N/A	No	

Source: ATOC analysis

Overall, we believe the current commission structure to provide reasonable levels of remuneration by channel, as reflected in the strong market growth highlighted. Differential commission by channel has allowed a more equitable approach overall given the significant difference in ATVs and opportunities for other remuneration between each channel, whilst also ensuring that the industry has been able to exercise a degree of control over retailing costs.

Total Third Party Remuneration

Based on the fees and assumptions detailed above, Table 18 below summarises total third party remuneration by channel, broken down by sales commission, booking fees and credit card charges (where known and applicable).

Table 18: Total Third Party Remuneration

All amounts in M or £M	COMMISSION INCOME			BOOKING FEES			C/CARD FEES	TOTAL REMUNERATION (£m)
Channel	2013/14 revenue (£m)	Comm rate	Commission income (£m)	Number of bookings	Booking fee (Avg)	Total Booking Fees (£m)	C/Card fees	
Internet total	712.1	5%	35.6	10.6	£1.30	13.8	7.1	56.5
Trainline - Call Centre	21.9	9.0%	2.0	0.4	£1.50	0.6	0.2	2.8
Third Party non-TTL Call Centre	0.3	9.0%	0.0	0.0	£1.50	0.0	0.0	0.0
Trainline – Corporate	288.9	3.0%	8.7	2.8	£9.00	25.4	0.00	34.1
TMC/corporate total	706.2	3%	21.2	8.1	£9.00	73.0	n/a	94.2
Total Third Party	**1478.6**		**61.8**			**87.3**	**7.3**	**156.5**

Source: ATOC analysis

Note: Internet booking fee average £1.30 due to 'no booking fee' policy of RedSpottedHanky. RSH has introduced £1.00 booking fee from October 2014, which will increase the average to above £1.50.

Note: Credit card fees assumed to apply to 50% of internet/call centre bookings.

In total, we estimate that third parties earn over £150m from commission and fees, excluding the additional remuneration earned through TOC bilateral arrangements, white label arrangements, and technology supply arrangements.

Appendix D: Forward TOC/ATOC strategy for the third party retailing market

Future strategy for the third party retail market

Over the last fifteen months, TOCs/ATOC, through Commercial Board, have been undertaking a review of future strategy in the third party retailing market. This review has more recently extended to some aspects of the TOC retail market.

The review is now largely complete and the planned forward strategy has been summarised below.

Internet retailing market (Third Party Investor Licence)

- Continue to licence internet retailers on a positive basis but not proactively seek new market entrants;
- Extend the current 5% internet and 9% telesales commission levels to 2019 and, thereafter, continue to offer it on a three year rolling basis (i.e. provide three years' notice of commission charges from 2016 onwards);
- Undertake an open book review of realised cost savings resulting from new technology by the end of 2017/18 (depending on the pace at which new technology is rolled out) with identified net cost savings being shared on an equal basis with retailers (this could potentially result in commission being reduced, if material cost savings are realised);
- Make available new technology (in particular, ticketing technology such as barcode ticketing and smartcards) to third parties where we are able to do this (noting that the stakeholders, such as the DfT, have major influence in this area); and
- Remove the £1m per year investment requirement from current and future licences

The forward strategy is designed to provide retailers with sufficient long term visibility to allow them to invest in marketing and technology. The level of commission has been held as analysis indicated that margins were being earned on commission when taken in combination with fees and ancillary income. However, the opportunity will be taken to review further the level of commission in the light of savings from new technology, smart ticketing, in particular, albeit with any identified cost savings being shared on an equal basis with third parties.

The removal of the annual investment requirement reflects the fact that this is now a largely irrelevant obligation given that investment well over this level is required to compete effectively in the internet market.

The strategy does not include the proactive search for new market entrants, partly reflecting the failure of ATOC's previous attempt to attract new players, but partly due to uncertainty as to how many players the market can support, and concerns about the reaction of existing players (and unsuccessful new entrants).

Nevertheless, ATOC/TOCs will maintain a positive and supportive approach to new entrants, given that there is clearly potential for further market development. In this context, there is ongoing discussion with possible new market entrants.

Travel Management Company (TMC) market (TAL)

- Continue to licence TMCs on a positive basis but not proactively seek new market entrants;
- Extend the current 3% commission level to 2019 and, thereafter, continue to offer it on a three year rolling basis (i.e. provide three years' notice of commission changes from 2016 onwards); and
- Make available new technology (in particular, ticketing technology such as barcode ticketing and smartcards) to third parties where we are able to do this (noting that the stakeholders, such as the DfT, have major influence in this area).

The forward strategy is designed to provide retailers with sufficient long term visibility to enter into contracts with corporate customers (typically these are for three year terms).

It terms of new market entrants it is worth noting that 94% of the top 50 TMCs by size of business are already rail licenced, so the potential to expand the market further is limited. There is also a steady stream of new entrants. ATOC/TOCs will maintain a positive and supportive approach to new market entrants.

Wider retailing strategy

- Conduct a trial of third party sale of Season Tickets on a level playing field basis with TOCs (sale of full product range, full after sales service, exchange of customer information with TOCs and comparable commission rates);
- Trial a new form of ATOC licence for 'across the counter' retailers (supermarkets, newsagents etc) probably on a station commission / no fees basis;
- Increase the current inter-TOC commission rate for the sale of Season Tickets through the internet from 0% to 2%; and
- Remove the current 6% commission rate for TOC Business Travel Service (BTS) units and standardise all BTS commission at 3%, to align it with TMC rates.

These additional elements are designed to explore the potential for further extensions to third party retailing, as well as encouraging more inter-TOC sales of Season Tickets.