GNER is the second-largest funder of the railway after Network Rail.

GNER FINDS OUT WHO ITS ENEMIES ARE

Financial turmoil at GNER's parent company, Sea Containers, is just one more headache that the beleaguered train operator could do without. Alan Whitehouse **reports**

The Office of Rail Regulation was bound to ratify its decision to grant pathways to open-access operator Grand Central to run three trains a day from Sunderland to London.

If Chris Bolt's team had backed down under intense pressure from the Department for Transport its credibility would have been shot to pieces.

But ORR's ruling not to allow GNER to run extra services to Leeds has badly dented the East Coast operator's franchise ambitions and thrown into doubt its ability to pay the £1.3bn premium to the Treasury in return for a 10-year franchise.

The setback could hardly have come at a worse time for GNER, with its parent company Sea Containers facing financial difficulties of its own.

GNER's surprise and anger is palpable. Chief executive Christopher Garnett slammed the ORR's 'incredible decision' and has been busy dropping girder-like hints that legal action may not be far away. He has also repeatedly said that the East Coast franchise has effectively been devalued by an open access operator stepping in and siphoning off profits.

He has a point. GNER is already handing back to the Department for Transport over 50 per cent of everything it takes in ticket sales and is now the second largest funder of the railway after Network Rail. And the curve carries on getting steeper with premium payments rising year by year. Everything depends on filling more trains with more passengers.

But even before the decision to allow Grand Central on to the network – and to grant Hull Trains an extra pathway on the East Coast – there was enough anecdotal evidence to suggest that GNER was already finding the going tough. Last year's London bombings, which deterred many people from travelling, led to a dramatic downturn in GNER's revenues. Now, to add to the train operator's woes, the economy is showing signs of coming off the boil. Retail sales are down; the housing market is uncertain; utility bills are going through the roof. Under those conditions, why would anyone spend money on unnecessary trips to London or Edinburgh?

So it's no wonder that GNER is complaining long and loud about the profits it claims Grand Central will be creaming off in less than a year from now. This is Christopher Garnett's view: 'We bid on a four per cent margin. That's all franchises go for these days. You can work out what our revenue is.

You can work out what our profits are and you can work out what you think Grand Central is going to take. It comes straight out of our profit. And we have nowhere to go.'

A genuine *cri de coeur*! But not one that is attracting sympathy from rivals. One defeated bidder for the East Coast has said that everyone in the contest was warned of the possibility of an open-access operator. A senior source said: 'They [GNER] should not be able to change the rules everyone else had to follow and renegotiate the terms of the contract.'

GNER is angry because it thought it had signed one deal – a £1.3bn payment to the Government in exchange for the right to run the East Coast main line – when in fact the Government, or at least the ORR, takes the attitude that the train operator bought a franchise, not a line of route. So Grand Central has a perfect right to run its three trains per day because those are the rules.

Garnett says he finds this 'distasteful' and argues that the Government '...having then bought what it is they've bought, they then almost deny that that's what they've bought and start to blame the franchisee.......Sorry guys, that game isn't on. You, the Government ha let the franchise. You live with what you've bought.'

It is difficult to get to the bottom of what really went on during the race for the East Coast. The deal was brokered by the SRA. The Department for Transport says the people involved have since moved on and they themselves are still trying to establish exactly what guidance was given.

The only possible pointer is the fact that the standard franchise agreement contains a clause

Garnett: angered by ORR's 'incredible decision'.

which places all risk from potential open access operators on the shoulders of the franchise-holder. If that default position was applied to the East Coast franchise discussions – and the deal which emerged – it seems likely that all bidders were warned that open access was a possibility and it was up to bidders to factor that risk into their bids.

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So was the GNER bid a huge gamble that is now going spectacularly wrong? What evidence we have is circumstantial. When GNER was declared the winner, jaws dropped at the sight of the financial profile and the way the curve on the graph of premium payments went up relentlessly.

Industry sources think GNER bid around a third higher than its nearest competitor, and comments from Garnett lend weight to the idea that GNER and Sea Containers were determined to win whatever the cost: 'There is no doubt that emotion plays a part. We were determined to hang onto GNER. We spent nine years building that up. We were not prepared to let it go to someone else.'

The authority to bid so high that success was virtually assured must have come from someone very high-up at Sea Containers. And that could be GNER's next problem. There is no doubt that the driving force behind Sea Containers' entry into the rail industry was its founder, the charismatic James Sherwood. Much of what GNER stands for is an espousal of his ideas of what rail travel ought to be about: customer service, a sense of occasion, and romance. The use of adapted antique prints in refurbished Mallard stock sums it up perfectly.

But Sherwood stepped down – unwillingly it seems – as chairman of Sea Containers in March, just ahead of news of a £288m write-down in the value of the Bermuda-based company's assets. It is now busy 'restructuring', which includes off-loading unprofitable parts of the business.

What will Robert MacKenzie, president and chief executive, make of a subsidiary that returns him a four per cent margin? There is no evidence that he shares James Sherwood's love of railways. He could put GNER's cash in a building society and get a better return. And this before Grand Central shaves even more off of that slim margin.

MacKenzie must be giving careful consideration to GNER's claim that Grand Central could cost it £100m in lost revenue. Revenue that Christopher Garnett himself admits can never be recouped, just as the losses caused by the 7 July bombings can never be replaced.

Soon after he took over, MacKenzie said: 'Some of the sales growth assumptions made at the time of the bid appear to be challenging.'

He may soon be wondering, as others before him have, whether the railway game is really worth the effort.

Alan Whitehouse is transport correspondent for BBC North