Arriva's comments on PR13 Draft Determination, June 2013

These comments are made on behalf of Arriva plc, its subsidiary Arriva UK Trains Limited and its wholly owned train operating companies, Arriva Trains Wales/Trenau Arriva Cymru Limited (ATW), DB Regio Tyne & Wear Limited (DBTW), Grand Central Railway Company Limited (GC) and XC Trains Limited (XC). Arriva is a wholly owned subsidiary of Deutsche Bahn AG (DB AG). Our subsidiary The Chiltern Railway Company is making a separate response.

Arriva has contributed to the development of the ATOC response to the Draft Determination and it has our full support. We also welcome the recent effort by Rail Delivery Group (RDG) to propose a workable balance of incentive regimes for the start of CP5 and gain time for a more comprehensive review of the underlying issues, to which we refer further below.

We would also like to make the following comments:

General level of settlement
We recognise that the Draft Determination represents a significant challenge to Network Rail. However, given Network Rail's funding structure, the general development of costs in the rail industry over 20 years and ORR's work on comparators, we consider, firstly, that the Draft Determination is more likely than not to be achievable and, secondly, that Network Rail has greater robustness to withstand a settlement that proves inadequate than its customers have to withstand higher charges. Such charges bear directly on open access passenger and freight operators, which are both subject to intense competition from rail and other transport modes. Whilst franchised train operators can pass many charge variations to their client bodies, this increases the public funding cost of the rail industry and is not a reason to lessen the challenge for efficiency from a regulated monopoly supplier.

Renewals and access
We note that work by RDG has endorsed our view, expressed in previous consultation responses, that the efficiency of use of possessions is poor and, in consequence, many more are taken than would be required if efficiency were higher. We remain extremely concerned that the large discount to Schedule 4 rates available by booking possessions two years in advance encourages excessive possession taking. The original assumption behind this discount was that with plenty of notice passengers could adapt by travelling on other days and revenue loss would be mitigated. We believe this is no longer valid as Sundays have become a day on which people expect normal services to be provided. Also, on longer services, such as operated by ATW and XC, the impact of multiple Network Rail Route, Renewal and Project functions leaves so few weekends of full service that adaptation means travel by car rather than by train on another day, with consequent large loss of revenue.

We have sought to encourage Network Rail to plan and spread renewals more efficiently and to prioritise by using local knowledge and tools such as XC's Rules of the Revenue document. We would like to see clearer incentives on Network Rail to reduce the scale of possessions, but to ensure this is not achieved by under-renewal, a feature of the early years of privatisation that we certainly do not want to see reappearing. To protect against this we suggest ORR considers the role of output volume reporting as part of a balanced package of incentives and regulatory controls.

Asset knowledge and gauging
We support and welcome ORR's new approach to enforce better asset management by Network Rail. Whilst recognising the enormous problem of legacy and inadequate historic records, we are disappointed at the apparent slow progress Network Rail is making with asset knowledge, which has continuing consequences of failures and disruption. It also appears to be the underlying cause of continuing difficulty with gauging of new or cascaded rolling stock, leading to an over-cautious approach of absolute gauging to more conservative standards. This approach typically suggests, at least initially, that new deployments of stock equivalent to types currently operating will require extensive and costly works. We consider ORR should make clear that the Determination is sufficient to maintain the capability of the network and that capability includes the substitution of rolling stock equivalent in size and capability to that currently operating or recorded as having operated on a route.

Alliancing and benefit sharing
We support the view that Network Rail should be "commercially responsive to the needs of its customers" (para. 12, Introduction to the PR13 Draft Determination), however, we are concerned that the only initiatives being taken to address this are bi-lateral 'alliancing' and the Regional Efficiency Benefit Sharing (REBS) mechanism. We believe an over-emphasis on alliancing as the means to fix myriad issues runs the risk of, at minimum, overlooking the importance of other customers, including those in competition with the dominant franchisee and/or traversing multiple Route boundaries. We have already had cause to raise issues of unfair and inconsistent treatment of different operators with Network Rail and ORR and would wish to see tight safeguards to protect the position of other Railway Undertakings from abuse by any alliance. We also consider that the imbalance of detailed knowledge and level of allocated central costs in Network Rail make REBS of doubtful benefit.

Growth and incentive regimes
We are disappointed that the process for developing elements of the Determination relating to charges and incentives has dragged on and some issues remain unresolved at this very late stage. In some respects the consultation process does not seem to have been as effective as it might have been. Much input has been provided by many industry parties but there has been no effective resolution of several issues raised. In addition, amendments or revised proposals have emerged from Network Rail very late in the process, particularly in the area of the incentive regimes (Schedules 4 & 8, Capacity Charge, etc.). Some of these proposals, for example on the Capacity Charge, have been made without, at least initially, the essential background papers being made available for wider scrutiny. This is unacceptable and, given the respective sizes of Network Rail and its users, unfair.

We note that this Periodic Review is being undertaken just as the industry celebrates achievement of a doubling of passengers since privatisation, a rate of growth unmatched elsewhere in Europe, as well as major gains in safety and performance. We believe there is scope for this strong growth to continue, to the overall economic benefit of the country. There remains a fundamental problem, that whilst train operators are incentivised to grow their businesses by revenue, Network Rail appears to lack the normal incentives of a major supplier to help its customers grow their businesses. Whilst a Volume Incentive exists, its form and distribution does not appear to influence the key functions of timetable planning and Route management that can facilitate growth. We wish to see this addressed in the forthcoming review.

Capacity charge
It is essential that any recalibration of the Capacity Charge should align with the objectives of that regime. It is also important that the impact of the recalibration should have the same impact on all operators whether Franchised, Freight or Open Access Passenger Operators. In particular, the charges falling on an individual operator should only reflect the marginal

increase in Network Rail's costs associated with the operation of any additional trains. We believe the current proposals do not meet these objectives in two regards:

- In the case of Freight and Open Access Passenger Operators, the Capacity Charges raised would cover all trains run rather than the additional trains to which it should apply
- Review of the process for the recalibration of the Capacity Charge suggests that the Network Rail's proposed new rates substantially over-state the increase in costs that would be caused by the operation of additional trains. This situation seems to have arisen as a result of the methodology used for the calculation of the Capacity Utilisation Index (CUI), which does not conform to normal practice, from the assessment that any increase in the CUI causes an exponential rise in performance impact, which is a tenuous deduction from the available data, and from a lack of credit to the ability of robust timetable planning to make more efficient use of the network without loss of performance.

These issues only became evident late in the consultation process and only through the review of source documents used by Network Rail to develop its proposals. It is unfortunate that, despite these issues being raised in the consultation process, they remain unaddressed. As a result we consider any change to these regimes for CP5 must be very limited in scope and the issue must be addressed in more depth and with greater openness for CP6.

We note that RDG's proposal provides a temporary fix, to enable businesses to continue operating without unreasonable and excessive cost shocks, but if maintained indefinitely potentially introduces new distortions.

Cost of capital

We fully support ORR's view that there is no realistic prospect of the use of private funds in Network Rail and hence it is inappropriate to continue to employ the higher cost of capital allowed under previous Periodic Reviews to permit this eventuality. The rate should reflect Network Rail's present status and funding mechanism and hence be very close to the cost of Government borrowing. Indeed we feel that the recent forward assessment of interest rates from the Bank of England would suggest an even lower trajectory than assumed in the Draft Determination.

Open access

We repeat the position expressed at greater length in our response to ORR's recent consultation on on-rail competition that two reforms are urgently required in the criteria for approval of new open access applications:

- From the start of CP5, an updating of the Not Primarily Abstractive (NPA) test, taking advantage of actual results now available, to codify modifications to standard industry revenue models
- Introduction by April 2015 of a new category of Open Access, not constrained by the NPA test, in which Network Rail would have its incremental costs covered and be reasonably incentivised to identify and sell the necessary paths.

Future development of charging

It is clear in retrospect that insufficient time was allowed in PR13 to address charging on a holistic and coordinated basis and that the fragmentation of debate by regime, whether intentional or not, has led to the process being disjointed and now timed out. To avoid this happening again, we believe there must be early and wide engagement on a comprehensive review of the charging and incentives mechanisms. This should involve ORR, Network Rail and train operators, with the objective of establishing a coherent set of charging and incentive mechanisms. The work should start immediately with a view to identifying the approach for CP6 by the end of 2014.

This work must address on a pragmatic basis the wide range of business models that exist among Railway Undertakings on the British network. The aim should be to incentivise them all to grow where there is a commercial return and/or sufficient economic benefits, and to incentivise Network Rail to support such growth, hence increasing and optimising use of the network. Care must be taken not to introduce unintentional dis-incentives or costs by placing risks on parties unable to manage or bear them.