3rd Floor, E Block,
Macmillan House
Paddington Station,
London
W2 1FG

Valentina Licata
Office of Rail Regulation
1 Kemble Street
London
WC2B 4AN
Email: draft.determination@orr.gsi.gov.uk

Dear Valentina

FirstGroup Response to (1) The Office of Rail Regulation's Consultation of the Periodic Review 2013: Draft determination of Network Rail's outputs and funding for 2014-19, and (2) In relation to legal drafting in the July 2013 Consultation on Implementing the Periodic Review 2013

Thank you for the opportunity to respond to the Periodic Review 2013 Draft Determination in relation to Control Period 5 (PR13) and the associated legal drafting.

FirstGroup is a UK based international transport group with bus and rail operations spanning the UK and North America. In the UK we are the largest rail operator. We operate the First Great Western, First ScotRail, First Capital Connect and the First TransPennine Express franchises and, one of the UK's open access train companies, First Hull Trains. This response is on behalf of FirstGroup's Rail Division and is supplemented by those that are made by the individual train operators within our division, which address specific local issues.

1. **Response to the Draft Determination**
   Our comments cover a number of areas, which are addressed in turn in this response, and are as follows:
   - Development of PR13
   - Structure of charges and incentive regimes, including Schedule 7 charges
   - Operational performance
   - Schedule 8 benchmarks
   - Schedule 4 costs
   - Electricity Charge for Traction
   - Enhancements
   - Efficiency targets
   - Asset Management including Depots & Stabling

   <u>Development of PR13</u>

   We have been actively involved with ORR throughout the development of PR13 and welcome the approach that the ORR has taken in terms of dialogue with the industry during the process. However, we have two concerns with the approach taken during this process.

Firstly, the approach that has been taken to address various elements of the charging structures and incentive regimes on an individual basis is not really appropriate, as it can lead to unintended consequences on other elements. For example Schedule 8 has been considered in isolation, but this has ignored the relationship between Capacity Charge and Schedule 8.

Secondly, we are not convinced of the benefits of Network Rail taking the lead in consulting on various elements of the structure of charges. Network Rail seems to have determined that this approach means it is responsible for developing new proposals on individual elements of charges which are only then issued for consultation. This has led to an increase in workload for operators and owning groups as increasingly detailed consultations are launched by Network Rail on issues that have previously been dealt with through industry dialogue and joint development. An example of this was a proposal by Network Rail to alter the regime for cancelled possessions which appeared to be at odds with the policy proposed by ORR.

Structure of Charges & Incentive Regimes

We have been engaged with the rest of the industry on the overall policy approach concerning Schedule 8, Schedule 4, the Capacity Charge and Volume Incentive and would like to emphasise that policy decisions concerning these elements must be taken together. Consultations tend to be released in a piecemeal way, dealing with issues in isolation and leaving consultees to model and discover for themselves the likely collective impacts on their business, which increases the workload for businesses and does not provide an effective approach. We accept that PR13 is now well advanced and as such any benefit from a change in approach will now be limited, but for future charges reviews there needs to be a more integrated approach with regards to regulatory development and impact assessments.

In general our view is that:

- ORR should promote greater regulatory stability, which is paramount to discharging its duty to enable persons providing railway services to plan the future of their businesses with a reasonable degree of assurance
- Network Rail should continue to be financially incentivised to grow traffic in all parts of the network
- Such incentives should be based on consistent principles, for the whole network;
- Incentive and compensation regimes should be considered for their collective impact, as well as individually. They should reflect the best available evidence and be robust over a range of different performance scenarios;
- There needs to be an effective and transparent transmission mechanism to incentivise Network Rail managers to balance appropriately the benefits, costs and performance consequences of additional rail traffic and show how it is securing the intended behaviours;
- The Capacity Charge should, as far as possible, be designed to charge Network Rail's incremental costs of growth above the control period baseline;
- Capacity Charge rates that were set in 1999 are unlikely to be consistent with the usage of the network over CP5;

- Freight services should be treated differently to passenger traffic due to the nature of the business and as such it is reasonable for an alternative Capacity Charge framework to be levied;
- Open Access operators should not be subject to a major step change in charges as currently proposed, rather CP5 should be a transition ahead of a full review of charges in CP6, such that there is not a distortion to the business model of these operators; and
- For CP6 a realistic Capacity Charge that is not levied on every train service should be developed, as part of the wider consideration of the structure of charges.

It remains our view that given the lack of change in the structure of proposed CP5 charges Schedule 8 and the Capacity Charge should continue to be linked such that the cost impacts for Network Rail of accommodating additional trains on the network from increased disruption are borne by the additional trains brought onto the network.

This is consistent with our response to the ORR's consultation on incentive regimes in February 2012 where we outlined that the balance between improving capacity (i.e. available, effective paths) and network performance would be best enhanced if the cost and benefits to NR of an extra path are properly weighed up against the costs and benefits to NR of any differences in performance. It is therefore crucial that any path charging regime, either through a straight cost per mile or enhanced VTAC, is made symmetrical with any Schedule 4 or 8 regimes. We wish the latter to remain as liquidated sums compensation regimes, as these do drive appropriate behaviours, providing that the NR benchmarks (as in the case of Schedule 8) are set appropriately, particularly given the desire from passenger groups and stakeholders for greater levels of right time performance.

We would therefore recommend that core issues relating to the charging of incremental capacity are addressed as part of an industry led fundamental review of the structure of charges ahead of CP6, rather than a piecemeal approach at this late stage in the PR13 process.

<u>Schedule 8 Benchmarks & Rates</u>

As we have previously documented, we remain supportive of Schedule 8 as an incentive regime providing that the benchmarks are correctly aligned with expected performance during the Control Period. We have been and remain heavily involved in the industry work on this subject matter, which is continuing and currently subject to a further consultation process. We are supportive of the recent communication issued by ORR in August on the principles of how benchmarks should be set for CP5.

In summary, our view is that Network Rail benchmarks should be set on the following basis:

- For each year of CP5 the annual and therefore funded performance targets set by ORR are disaggregated by TOC in line with the industry work to agree the TOC targets for both PPM and CaSL; and
- Use the most recently available performance data

In respect of changes to benchmarks during the Control Period we support the use of the existing mechanisms within Schedule 8 that the TOC can invoke (i.e. SPP). We also support the proposal that benchmarks could be adjusted as a result of a change process to the NR regulatory outputs. These should be limited to changes as a result of refranchising or a change to the impact of an enhancement, providing that the proper change control process is used.

As regards payment rates we support the current structure whereby TOC rates reflect accurately the TOC-on-TOC impacts such that the Star Model concept remains intact. Network Rail payment rates should be set to reflect, as accurately as possible, the revenue associated with service groups. We would stress that the opportunity should have been taken during PR13 to review the Monitoring Points and their relative weights as well as cancellation values such that they accurately reflect passenger flows, considering that the last major review was undertaken in 1999.

We are keen that a full review of the process used for Schedule 8 during this Periodic Review is undertaken. The lessons from this review can then be used to streamline and improve the process for CP6 and also ensure that each element of the regime as a whole, including the impact of passenger behaviour as a result of changes in performance, are addressed.

Operational Performance

We support the overall aim to deliver 92.5% PPM by the end of CP5, and to ensure that all operators are performing at 90%, without significant deviation from this level within individual service groups. We would support the validation of the proposed Network Rail plans by the ORR in this regard.

We are, however, keen to ensure that the 90% aim is a minimum and that targets for those operators already performing in excess of this level are not reduced so that resources are solely focused to those poorer performing operators.

Schedule 4

As already alluded to, we are uncomfortable with the approach taken by Network Rail during the development of PR13 to undertake consultations as a means to propose alterations to Schedule 4 that were not previously envisaged. This approach has the potential to undermine the linkage between incentive regimes and charges for use of access.

Electricity Charge for Traction (EC4T)

We are keen that an effective means of ensuring the involvement of Network Rail in the volume wash-up for EC4T does not lead to unintended consequences. Network Rail should be incentivised to minimise transmission losses and to maintain the electrification infrastructure effectively without regard as to the methodology for calculating consumption.

Enhancements

We welcome the proposed incentive scheme for Enhancements in CP5, which will help to improve the anticipated and actual cost of schemes included within the settlement.

However, the detail of how the scheme will operate needs to be refined, particularly as regards change of franchise during the process. As currently proposed, if there is a transfer of TOC, through franchising, just before the project is completed then the new incumbent will receive 100% of the benefit of outperformance of the AFC, when it was not involved in developing or delivering the scheme. We would propose that there should either be an overlap of up to 6 months beyond the end of the franchise, or perhaps a sliding scale based on the scale and scope of the project. With the franchising programme already published, it should be reasonable to determine where the benefit should fall.

Other comments are as follows:

- For multi-operator routes clarity is needed on how any incentive payment is distributed
- It is assumed that the price for each scheme incorporates all TOC costs, as NR is responsible for determining the total cost of scheme delivery, if this is not the case then the price of the scheme may increase
- What is the situation if a scheme's cost increases as a result of further development, which given the status of a number of the schemes and the lack of clarity in the elements required to deliver the output is a possibility

<u>Efficiency Targets & Benefit Share</u>

We support the overall approach to efficiency targets, but there needs to be a coherent and transparent way of this being devolved to Network Rail routes. This links to the Regional Efficiency Benefit Share proposal, which we support, although we believe that bespoke alliance and cooperation agreements between operators and Network Rail are more likely to be effective in deriving improvements in costs. As such it must be the position that where an alliance exists any benefits accruing to the alliance partners should be paid out ahead of any REBS payments.

Given the difficulties in EBS allocation during CP4 we would also support the ORR clearly setting out ahead of CP5 how it proposes to manage the process of REBS allocation.

<u>Asset Management Including Depots & Stabling</u>

We are supportive of the ORR's commitment to improve NR's capability for asset management and quality. This is crucial to ensuring that the industry can work together to improve the overall affordability and value for money required by all parties with an interest in the railway. There is a need for improved asset management policies for depots and stabling sites which recognises their importance in delivering reliable, fleets and consequential impacts on operational performance.

The delivery of regulated outputs in this Control Period for capacity and the long term forecasts for passenger growth in the industry both necessitate increasing volume of rolling stock. Whilst new stock is often contracted with purpose built depots, the level of electrification and associated cascade of diesel stock will increase the need for sidings and improved depot facilities in existing locations. Existing franchises and Network Rail do not appear to be funded to provide enhanced facilities during CP5. Indeed in the case of one of our TOCs, whilst there is a regulated output to provide infrastructure capable of operating cascaded stock there are no funds to enhance existing facilities to accommodate these trains (this being the gauge clearance of Great Western routes for diesel stock cascaded from the Thames Valley). This issue is a critical one, nationally, for Control Period 5 and funding to improve facilities must be made available.

Indexation of Charges

We are not convinced of the proposed approach for a new approach to indexation of track access charges, as the proposal will lead to uncertainty and complexity without providing any definitive incentives for TOC influence. We do not support the transfer of inflation risk to operators. An RPI-based indexation, based on a specific month before the start of the financial year in question, is both clearer and more appropriate, particularly given the current franchising timetable that DfT has published.

2. **Response to the legal drafting in the July 2013 Consultation on Implementing the Periodic Review 2013**

   As a member of ATOC we have been involved in the review of the proposed legal drafting relating to the implementation of the Periodic Review. We fully support the comments made by ATOC in its response to these elements, which reflect our consultation response on the various elements of the Draft Determination made above.

If you would like to discuss any aspects of our response, please do not hesitate to contact myself or Russell Evans, Policy & Planning Director.

Yours sincerely

Hugh Clancy
Commercial Director, Rail