STAGECOACH GROUP

10 Dunkeld Road
Perth
PH1 5TW
Scotland

T +44 (0)1738 442111
F +44 (0)1738 643648

stagecoachgroup.com

Valentina Licata
Office of Rail Regulation
1 Kemble Street
London WC2B 4AN

Cc Alan Price, ORR

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Dear Ms Licata

Consultation on the draft determination of Network Rail's charges

Thank you for the opportunity to comment on the Rail Regulator's draft determination for Control Period 5. As a result of our participation in the South West Trains/Network Rail Alliance, Stagecoach has a unique perspective from which to respond. The Wessex Route/South West Trains combination is also the only railway that essentially covers its costs. This means that farebox revenue generation and the trade-off between costs and farebox revenue is arguably more important (and drives greater opportunities) here than anywhere else.

This letter comments (for the avoidance of doubt, on behalf of Stagecoach and not the wider Alliance) on the specific periodic review issues relating to the Alliance and does not comment on the wider issues contained in the draft determination.

Regulatory imperatives

There is significant evidence (as our customers will attest) that the condition of the infrastructure in business critical parts of our route is poor - and significantly below the level that a whole-industry benefit maximising model would require. For example, the number of track faults in the Wessex Route has been rising steadily (on a trend) for a number of years. In turn, this has driven the largest number of delay minutes per route area of any route, by an order of magnitude – and all of this despite the Alliance being succesful in managing incidents when they happen and driving down the delay per incident. In a railway with a farebox of almost £1bn a year, the economic effects of the poor infrastructure are enormous.

In our view, the asset condition on our route is driven essentially by many of the track assets being beyond the end of their economic lives - because the rate of renewals has not been high enough, particularly in relation to the highly economically valuable track around the Waterloo approaches.

Our experience is that the lack of renewal in places like the Waterloo approaches is driven in turn by the Network Rail's requirement to meet its regulatory objectives, which often act as a poor proxy for achieving greatest whole-industry benefit.

For example, Network Rail has a regulatory imperative to meet average renewal unit cost targets. Inevitably, this targeting means that, other things being equal, easier renewal schemes (usually on less busy bits of railway) become more attractive than renewing expensive (but net benefit maximising) renewals at critical places like the Waterloo approaches. The same imperative also arguably drives under-investment in wagons, locomotives and specialist plant (which would increase unit cost). In turn, this lack of equipment often causes renewals to be cancelled.

This same effect also hinders innovation because if regulatory targets can be met in easier ways, there is little incentive to innovate to renew high unit costs assets. As examples, the high output track renewal and ballast cleaning trains have not previously worked on third rail infrastructure (track renewal on third rail systems currently using very inefficient (essentially Victorian crane technology), and since privatisation no mid-week relaying has been undertaken. Both examples are now changing under the Alliance.

It is also clear that the regulatory imperative to undertake renewals only to achieve like-for-like outputs also has a significant distorting effect. For example, the existing like-for-like scope of the CP5 Feltham resignalling scheme is extremely unambitious and risks missing a once in a generation opportunity to optimise the cost, capacity and farebox revenue trade-off at little additional cost. We must not let this happen.

Although we recognise that in some instances the proposed approach to REBS helps to unwind this regulatory distortion, we believe that more needs to be done to allow Network Rail to focus on the net economic value of assets and renewals. The current Alliance mechanism does this through the farebox revenue risk share, which incentivises Network Rail to undertake and scope renewals where there is most bottom-line benefit but arguably it is only part of the answer.

Implications for CP5

In the context of the current very poor asset condition (and even given a potentially different regulatory imperative), a very detailed bottom up analysis of the optimal level of renewal to maximise overall net value has been undertaken, supplemented by an external validation.

The result of this exercise has been to demonstrate that (for the Wessex Route) the draft determination does not provide for sufficient scope of renewal of assets to optimise the overall railway benefit (nor indeed for the increased maintenance that such poor assets require to keep them in optimised condition before they are renewed).

You will be aware of our (Plan C) proposals to the Department for Transport to increase capacity at Waterloo and increase route resilience. However, although Plan C does cause the renewal and upgrade of a large number of assets, most infrastructure in the Waterloo approaches will otherwise remain untouched. For example, we know that around 74 point-ends are completely life expired and are planned to be renewed, but like-for-like in the original 1936 layout. It is essential that these condition based renewals are enhanced and form part of the wider programme to enhance capacity and reliability. A piecemeal approach will result in continued and escalating severe disruption to customers over the next few years.

Renewals of this extent at such a heavily congested London terminal with no diversionary route will be enormously challenging to undertake and disruptive to passengers and farebox (which is partly why they have not been done before). Nevertheless, in overall business benefit terms they are clearly the right thing to do (the Euston remodelling and condition improvement scheme being a clear example of the net economic benefits of such an approach).

It is also clear that an Alliance offers the best (perhaps only) approach to undertaking these economically necessary works, because the Alliance mechanism allows us to (a) manage the end to end project without complex contractual boundaries and (b) incentivises the Alliance to take long term widely maximising decisions rather than focus on narrow self-interest.

However, even within the context of Alliance, Network Rail needs to be allowed to become more radical and creative about how it creates access opportunities to undertake the work, and we are determined to work with them to do that. In turn, though, we are keen that more flexibility is given by the Regulator in relation to how the formal contractual access arrangements are applied for disruptive possessions.

Next steps

We have seen in our Alliance how committed our Network Rail colleagues are to running an excellent railway for passenger and freight customers. The amount of effort that is put in by frontline colleagues to make our railway work – often despite everything – is inspiring. By putting in place the right level of funding combined with the right regulatory and industrial structure, we can give that commitment and hard work the framework to succeed. There is great benefit to be had here for taxpayers and passengers. We look forward to continuing to work with you and Network Rail to secure them.

Yours sincerely

pp Tim Shoveller