ORR PERIODIC REVIEW 2013: FIRST CONSULTATION RESPONSE

CONSULTATION RESPONSE FROM DIRECTLY OPERATED RAILWAYS GROUP

This response is provided on behalf of Directly Operated Railways and East Coast. We have no objection to its publication.

Consultation question	**Directly Operated Railways response**
Chapter 3 (our objective for PR13)	
Q1 Do you agree with our proposed objective for the review? If not, what issues would you add or subtract?	Yes, Directly Operated Railways (DOR) agrees in principle with the stated objective. However, we do not agree with your claim that the industry will deliver or exceed performance compared to "the best railways in the world". Is the ORR confident that the necessary benchmarking has been performed to be able to make this claim?
Chapter 5 (high level timetable)	
Q2 Do you have any views on our proposed timetable for the review? Do you need further information to plan your involvement with PR13?	The timetable appears reasonable. At this stage there is nothing further we need to plan our involvement with PR13.
Chapter 6 and annex B *Price control separation and Network Rail devolution*	
Q3 Do you think that our approach to the disaggregation of Network Rail financial (and other) data to operating route is appropriate? Is the information we are requiring Network Rail to produce set at the right level? Do you have views on the information train operators should produce?	We consider that disaggregation of financial and other data to operating route is essential to achieve the objectives of • Financial transparency • Reaching the "true" cost of the railway on each route • Ensuring accountability for all financial aspects of the route can be placed firmly on the individuals responsible for operating and controlling the route. We would consider that in formulating the split between controllable and non-controllable operating expenditure in Statement 7a, as much cost that route level management can be made directly accountable for is allocated to controllable costs by each route to ensure the greatest level of accountability at route level. In addition as far as possible all other costs should be apportioned to route level on an appropriate basis (passenger kilometres, train kilometres, number of services, staff numbers, etc). Given the commercially sensitive nature of train operators' financial information the rationale for operators providing financial information needs to be carefully considered. We would consider that train operator's financial information should only be provided if it adds value and improves accountability and decision making within the industry.

ORR PERIODIC REVIEW 2013: FIRST CONSULTATION RESPONSE

CONSULTATION RESPONSE FROM DIRECTLY OPERATED RAILWAYS GROUP

Consultation question	**Directly Operated Railways response**
	Where such information is deemed useful it should as far as possible be consistent in nature and detail with that due to be provided by Network Rail at route level ie that it matches the Network Rail routes geographically and uses similar methodology in allocating financial flows that cross route boundaries and the treatment of central or fixed costs. The current ORR, ATOC and train operator discussions should provide a reasonable solution to this.
Q4 Which aspects of the price control should be separated for England & Wales and Scotland, e.g. should the efficiency assumption be separate?	We consider that as far as possible the degree of separation of price control mechanisms should be commensurate with the level at which route performance (financial, KPI's, outputs and outcomes) will be controlled, monitored and measured. Hence we would expect all aspects of the price control, mechanism be separated for England & Wakes and Scotland.
Q5 Do you think there should be further separation of the price control for Network Rail's operating routes and, if so, which aspects of the price control should be separated?	As stated in Q4 above we consider that as far as possible the degree of separation of price control mechanisms should be commensurate with the level at which route performance (financial, KPI's, outputs and outcomes) will be controlled, monitored and measured. We would consider the route should be held accountable for delivering efficient expenditure targets. We would also like to see the route held accountable as far as possible for the asset base of the route (ie constituent parts of the RAB that are route specific) and for the delivering asset renewal and enhancements in line with agreed route plans. Hence we would advocate that the efficiency assumption and RAB and debt aspects of the price control mechanism be separated to route level. If this were to be the case consideration will need to be made to as to how to treat the cost impact of major infrastructure upgrades and the potential impact of catastrophic events or cost shocks which may have cross-route cross industry implications. In relation to risk sharing and incentives, we recognise that Network Rail is and will continue to be largely a single entity. Therefore it is appropriate that financing is secured on the basis of a single balance sheet with the risk scoring that provides. However devolution and its objectives would advocate treating each route as separate entities with separate risk profiles and efficiency targets. Additionally we do not understand the rationale for wanting to 'trade' out/under performance between operating routes whether before or after efficiency benefit sharing. Therefore from a route performance and management performance perspective we would consider that each route should be "ring-fenced" to provide accountability and to provide comparison

Consultation question	**Directly Operated Railways response**
	between routes but that a funding mechanism is put in place to allow for additional funds to be made available in the event cash deficits or needs arise.
Chapter 6 and annex C *Outputs*	
Q6 Is the current approach to defining obligations in terms of outputs the best approach? What outputs should be defined? Should there be a move to more use of outcome based obligations? Would another approach be appropriate such as specifying inputs or intermediate measures?	We would advocate a move to putting in place outcome obligations as they are more encompassing. However a number of outputs measures would be needed to deliver the stated outcomes but that these may not be the subject of obligations. The validity of measures such as PPM or Network Capability on a long distance route where customers tend to make only a few journeys a year is weak. Hence DOR would welcome a refinement of output measures to address or include the specific characteristics of different parts of the railway. We would also welcome the introduction of a customer satisfaction outcome being included as part of Network Rail's obligations.
Q7 What are your views on how we should compile and present 'scorecards' of Network Rail's performance in CP5?	DOR would recommend the use of a balanced scorecard where passenger satisfaction is an over arching measure. The balanced scorecard could include a number of elements such as safety, people, commercial and value for money, asset management, customer (including PIDD and managed stations) and performance. Ideally given the whole industry focus this scorecard could initially be drawn up as an 'industry' scorecard and then disaggregated to include elements that Network Rail lead or are responsible/accountable for. This information should be available by route and published quarterly.
Q8 Should we make more use of 'whole system' outputs over which Network Rail does not have full control, or focus on more narrowly defined outputs which the company is fully responsible for?	We recommend the use of whole system outputs as it is these that affect the final customer. TOC's are already held to account for issues such as performance despite only having control of around 20% of delays. This would support the approach put forward in Q7 relating to scorecards.

ORR PERIODIC REVIEW 2013: FIRST CONSULTATION RESPONSE

CONSULTATION RESPONSE FROM DIRECTLY OPERATED RAILWAYS GROUP

Consultation question	**Directly Operated Railways response**
Q9 How should output obligations be defined in the context of devolved Network Rail routes with separate price controls?	The outputs should be disaggregated by route. This will also result in the obligations being more relevant to customers than the current national outputs.
Q10 How should the balance between the number of output obligations and their individual significance be struck?	It should be for the ORR and DfT to conclude on what Network Rail's priorities should be. However we suggest that an over arching obligation on customer satisfaction and the balanced between elements that deliver this will resolve any conflict or prioritisation issues.
Q11 Should Network Rail's output obligations include a specific safety requirement, different from its legal obligations?	We support the continuation of the CP4 requirement to reduce industry safety risk by a pre determined level. In addition we would expect appropriate KPI's on specific safety risks such as level crossing incidents, possession irregularities and track defects.
Chapter 6 and annex D *Incentives*	
Q12 Do you have views on how the effectiveness of the existing financial incentives can be improved?	We agree with the incentive objectives noted in Annex D.5 of the Consultation document. We consider the incentive regimes in place meet the stated objectives with the exception of the following: Schedule 8 regime We agree that there is significant benefit to the industry in having a mechanism that seeks to identify and attribute the root cause of delays. In addition we consider there to be a need have a mechanism to compensate train operators for revenue loss experienced through delays caused to trains outside of their control. However we believe the regime is flawed in the following respects: • The regime does not provide incentive to address the root cause of delay • The level of compensation provided to train operators under the schedule 8 regime is working to compensate for poor performance of Network Rail, however we believe this is not sufficient to provide the incentive on Network Rail to make changes to the network that lead to an improvement in performance, ie it is insufficient to change behaviour and indeed in our experience Network Rail has failed to build a case

Consultation question	Directly Operated Railways response
	for investment in the past • Does not differentiate the impact of revenue loss on different passenger groups. For example the regime is based on delay minutes on the assumption that there is an equal value (through the marginal revenue effect (MRE)) placed on each delay minute above benchmark. Where this may be appropriate for commuter train operators (where each minute beyond right time is critical) , this may not be the case for a long distance operator (where passengers are less concerned with small delays but are more concerned with cancellations and trains that are seriously late) • Creates an adversarial approach between operators and Network Rail in root cause delay attribution which is not consistent with the objectives of closer joint working relationships to reduce industry costs. While we would consider a wholesale redesign of a compensation mechanism that incentivises Network Rail to address the root cause of delays or pays the equivalent level of revenue loss to be the most appropriate cause of action we recognise that this is unlikely to happen at this stage. However we would therefore recommend that the constituent elements of the schedule 8 regime be recalibrated and reset at a level that is sufficient to incentivise the necessary change in behaviour and to properly address the root cause of delay. Examples of this could be that the MRE is reset or an additional factor is introduced into the calculation that would provide incentive for Network Rail to invest in the infrastructure to eliminate or mitigate the significant causes of delay rather than accept the financial consequences. In addition the benchmarks should be recalibrated to end of CP4 target performance levels. Addressing the broader issues highlighted in the Consultation document: • We believe that for joint ventures and vertically integrated entities operating a route from within a single entity no schedule 8 regime would be necessary between the two participating parties. However a regime would be required where there are minority operators on the route or where operators might be impacted by disruption on adjacent routes. However the incentive to analyse and attribute root cause of delays should be retained within the single entity. • We agree that a reduction in the bonus payments within the Network Rail regime would allow both parties to benefit from better than benchmark performance. In addition we consider that the financial impact and management of risk and accountability for the schedule 8 regime should be devolved to route level.

ORR PERIODIC REVIEW 2013: FIRST CONSULTATION RESPONSE

CONSULTATION RESPONSE FROM DIRECTLY OPERATED RAILWAYS GROUP

Consultation question	**Directly Operated Railways response**
	Schedule 4 We agree with the principle that operators should be compensated by Network Rail for loss of access to the network. The incentives here appear to provide sufficient incentive to undertake timely renewals and maintenance and provides. However this does not necessarily minimise disruption to operators and does not adequately deal with overrunning work, which falls to schedule 8. Addressing the key issues highlighted in the Consultation document: • We believe that for joint ventures and vertically integrated entities operating a route from within a single entity no schedule 4 regime would be necessary between the two participating parties. However a regime would be required where there are minority operators on the route or where operators might be impacted by disruption on adjacent routes. • We believe operators do not require any additional incentive to minimise disruption to their services and therefore would not advocate a reduction in the rates within the schedule 4 regime. • A free possession allowance would not provide Network Rail with the appropriate incentive to minimise disruption to operators services In addition to the above the current disconnect within Network Rail between accountability for the financial consequences of schedule 4 and schedule 8 should be addressed to ensure decisions are made in the full knowledge of their effect.
Q13 Do you have views on how the effectiveness of Network Rail's incentives to make best use of capacity could be improved?	Retaining some form of volume incentive regime on Network Rail is the right thing to do. However with a constraint on funds in any control period such a regime should be geared to provide additional capacity on truly capacity constrained routes and that Network Rail should be incentivised to work more closely with operators to identify these areas and to build industry business cases to prioritise. Open access operator's use of the network should also be taken into account when considering the capacity and use of the network. This could be done on the basis of a metric that measures train or passenger kilometres against the infrastructure capacity limit for each route section. This may be best facilitated by a central body with accountability to the industry but with input from the Network Rail routes and operators. On the issue of downside risk we believe that it would not be appropriate for Network Rail to be exposed to downside risk in relation to passenger services as the existing mechanisms to determine the provision of incremental capacity such as the HLOS, RUS and robust industry business case assessments should be sufficient to mitigate the provision of excessive or superfluous capacity. However we feel that measures should be put in place to mitigate the risk of overprovision of capacity in relation to freight travel. We consider also that the introduction of some form of scarcity or

Consultation question	Directly Operated Railways response
	reservation charges would complement the volume regime. This is explored later in answer to question 28.
Q14 Do you agree that we should include a regional efficiency benefit sharing mechanism calculated at the Network Rail route level? Are there further issues about how a regional efficiency benefit sharing mechanism should be introduced which you want to highlight?	We agree a regional efficiency benefit sharing mechanism at route level should be included. We would propose to amend the mechanism to allow for savings from bespoke arrangements between Network Rail route and operator to be shared before the remainder of the outperformance 'pot' is shared on the suggested formulaic basis.
Q15 What are your views on exposing franchised passenger train operators to changes in Network Rail's costs at a periodic review?	TOCs enter into franchise agreements on the basis of financial projections in their bids and are set for the length of the franchise. Currently TOCs are at risk for cost variations against their projections other than at a periodic review of Network Rail charges. On the basis of previous periodic reviews, removing this protection will significantly increase the risk to TOC finances which would be unacceptable. If such a step were to be taken a mechanism would need to be put in place to minimise the fluctuations in Network Rail recharges between control periods caused by either significant enhancement (lumpy) expenditure or changes in methodology. This could be done by fixing a proportion of Network Rail's costs for a period greater than the current 5 year period with significant enhancement expenditure dealt with via a smoothing mechanism to limit fluctuations between control periods and changes in methodology through an extension of franchise change process.
Q16 Do you believe that Network Rail should share in train operator revenue and/or costs? Are there further issues about introducing a revenue/cost sharing mechanism which you would	We agree that a form of revenue or cost sharing would incentivise both parties to reduce industry costs. However there are some structural obstacles that would need to be taken into account in working this through, namely: • Share ownership structure of operators may make operators reluctant to share either revenue or costs unless factored upfront into franchise bids • Form of incentives for risk sharing between train operators and DfT may already have taken a proportion of any excess revenue, cost or profit earned through franchise agreement mechanics We also feel the opportunity for Network Rail to influence the

Consultation question	**Directly Operated Railways response**
highlight?	controllable costs base of operators is limited with the most significant cost savings or revenue gains achievable through regulatory change or DfT enabled benefits with the scale of the remaining controllable operating costs small in comparison to those of a Network Rail route. An additional factor to take into account here is that operators are already incentivised to minimise their controllable cost base through the franchise bid process and the profit targets provided by owning groups. So in principle we would not support a generic mechanism that allows Network Rail to share in operator's costs or revenues. However there may be scope for a bespoke cost sharing mechanism based on sharing savings from individual schemes where Network Rail have supported operators in reducing industry or operators costs.
Q17 We would welcome your views on possible bespoke arrangements for enhancement efficiency benefit sharing and whether there is a need for additional measures to increase the contestability of expenditure?	We would advocate the introduction of bespoke arrangements.
Q18 Are there further new incentives which you believe should be introduced and what would the benefits be?	We do not have any further views in relation to incentives.
Q19 Are there other interactions between incentives (and the wider regulatory framework) which we need to take into account?	We feel the ORR need to consider the emerging plans for new franchise agreements and set the structure of incentives mindful of these developments, particularly in relation to the removal of protection from periodic review changes and the balance of risk and return in franchise agreements in relation to revenue.

ORR PERIODIC REVIEW 2013: FIRST CONSULTATION RESPONSE

CONSULTATION RESPONSE FROM DIRECTLY OPERATED RAILWAYS GROUP

Consultation question	**Directly Operated Railways response**
Chapter 6 and annex E *Financial framework*	
Q20 What are your views on the duration of the control period?	We recognise and would agree with the key factors sighted in the consultation document that would drive a change in the length of the control period, particularly the need to provide certainty to suppliers and hence to derive the best value out of the supply chain. We would also consider franchise length to be significant factor particularly in the event that the protection provided under the Clause 18.1/Schedule 9 arrangements were to be removed in relation to changes in Network Rail charges. If protection is retained then the train operator is not impacted by changes to costs from one control period to another. In this case we would advocate an arrangement where ongoing operating expenditure, expenditure on repairs and renewals and already planned enhancement expenditure ring-fenced from previous control period would be projected or held for a longer period than 5 years, thus providing certainty to suppliers. Expenditure on enhancements would continue to be assessed at each 5 year interval as for now. Any impact of this on train operator charges would be subject to the existing franchise protection clauses. If protection were removed there would be a greater need for train operators to have stability in charges levied by Network Rail for the length of their franchise. Hence before the start of a new franchise (or with a one off adjustment if franchise start is not coterminous with the beginning of a control period), Network Rail charges levied on that operator would need to be rebased on a “true railway cost” basis such that no material changes would take place from one control period to the next. This would ideally require a longer term planning horizon. However for practicality reasons the same approach to the above could be implemented. In the event of unforeseen cost shocks or changes in methodology at periodic review a mechanism would need to be introduced to protect operators from the financial effects of these.
Q21 Do you think that we should retain the single till approach rather than moving to a dual till approach?	We would advocate a similar approach to that applied in a private commercial entity, which would be that an organisation would manage its finances within the funding/profit envelope it is tasked with. Hence if a route is responsible for commercial property and income from it as well as the infrastructure then the route should be managed on the combined net position. Hence we would advocate a continuation of the current single till approach. This however would not prevent Network Rail as a whole and the route businesses being incentivised to grow income from commercial activities independently from the ‘railway’.

ORR PERIODIC REVIEW 2013: FIRST CONSULTATION RESPONSE

CONSULTATION RESPONSE FROM DIRECTLY OPERATED RAILWAYS GROUP

Consultation question	**Directly Operated Railways response**
Q22 Do you think that our overall approach to risk and uncertainty in PR08 was appropriate and are there any improvements that could be made for PR13?	A continuation of the approach taken to risk in PR08 seems reasonable and we would concur that risk should be borne by the party best able to manage it. This would include devolving risk and the management of risk of controllable and accountable costs to route level. However in this instance it would be prudent to retain any 'risk buffer' at the centre. In addition given the possible removal of protection from Franchise Agreements the balance between the level of risk built into Network Rail costs and the potential for re-openers to cause significant swings in TOC recharges needs to be examined and both should be set to provide stability in TOC recharges both within and between control periods.
Q23 Network Rail faces a number or risks. At this stage, do you have any views on how general inflation risk and input price risk should be addressed?	Firstly we would expect Network Rail's costs to include an element of inflation that best fits the categories of input costs and that Network Rail manage this at route level. The approach taken in PR08 to include these as part of the efficiency assumption is a reasonable one. In addition disaggregating and devolving the efficiency assumption to route level would make route management accountable for input price and it would be for them to manage the inflation risk. This would be consistent with the devolution objectives. Secondly we have no firm views at this stage on the different risk sharing options as it is difficult from the Consultation document to get a feel for the size and impact each has on TOC recharges. However we consider that an approach that aims to limit or avoid any cost 'shocks' on TOCs within and between control periods would be preferential. Particularly if the elements of financial protection within TOC's Franchise Agreements are removed.
Q24 We plan to retain the same high-level approach to amortisation in CP5 that we introduced in CP4. What are your views?	DOR agrees with the continuation of current high level approach to amortisation in CP5. However we would advocate a change from the capitalisation of reactive maintenance expenditure to charging reactive maintenance costs to operating expenditure in the year incurred. This would be a more transparent approach and would make route management more accountable for incurring the expenditure.
Chapter 6 and annex F *Structure of charges*	
Q25 Do you consider that our charging objectives remain appropriate?	DOR agrees that Network Rail's charges should be set to enable Network Rail to recover its efficient costs and also to incentivise train operators to use the Network efficiently. To facilitate this we suggest that the Variable Charge should consist of a range of cost inputs which reflect:

CONSULTATION RESPONSE FROM DIRECTLY OPERATED RAILWAYS GROUP

Consultation question	**Directly Operated Railways response**
	• The marginal wear and tear on the track and other assets • A scarcity charge for a path, by type of route, economic value, time of day and day of week to incentivise economic use of less congested parts of the network and less congested periods of time. Specifically we wish to see a charging structure which incentivises the use of parallel secondary routes taking into account the whole cost of train operation. We would support a volume incentive.
Q26 What are your views on the geographical disaggregation of variable usage charges?	DOR would welcome a charging structure that incentivised the use of lightly used routes with a premium for routes approaching capacity.
Q27 What are your views on introducing a charge levied to reflect network scarcity?	We would support such an approach.
Q28 What are your views on a reservation charge (assuming it would be set to be financially neutral for freight operators)?	We support the use of a reservation charge but question the need for it to be financially neutral for freight operators as this would dilute the incentive to use the Network efficiently. However we recognise that such a change may have to be phased.
Q29 Should passenger open access operators pay charges that exceed variable costs. How should charges be calculated?	As in our answer to Q25, we would expect an Open Access operator to pay a usage charge based upon: • The marginal wear and tear on the track and other assets • A scarcity charge for a path, by type of route, economic value, time of day and day of week to incentivise economic use of less congested parts of the network and less congested periods of time. We also consider that open access operators should pay an element of a fixed charge to reflect the administrative costs that they impose on Network Rail which are not recovered through the variable charge. Further should the not primarily abstractive test be relaxed we would expect open access operators to pay equivalent access charges to those experienced by franchised operators.

ORR PERIODIC REVIEW 2013: FIRST CONSULTATION RESPONSE

CONSULTATION RESPONSE FROM DIRECTLY OPERATED RAILWAYS GROUP

Consultation question	**Directly Operated Railways response**
Q30 What are your views on the proposals to improve incentives to reduce traction electricity consumption?	We welcome this approach. However we also wish to draw to ORR's attention that Network Rail currently has no incentive to minimise inefficient use of fuel (and resultant increased CO2 emissions) caused by adverse signal aspects and speed restrictions).
Q31 Should we put a cap on certain freight charges in advance of our determination and should these be linked to other changes?	We do not understand how this facilitates the achievement of the charging objective. Charges should reflect the efficient cost of the operation including opportunity cost. We do however consider there is considerable scope for a reduction in costs on lightly used lines. To illustrate this, once the CP4 works are complete on the Joint Line we would welcome a reduction in charges that facilitated the operation of freight trains on this lightly used route taking into account all operational costs.
Q32 Do you have views on the interactions between these possible changes and when they should be implemented – for example whether some changes should only be introduced after other changes have 'bedded in'?	We consider that the VTAC should be built up using the inputs of geography, time of day and week (as with EC4T) network scarcity and a reservation charge to achieve the charging objective. We agree that clause 18.1/Schedule 9 has prevented some of the incentives from previous access charge reviews from being achieved. To give certainty we suggest that any radical change to the charges structure takes place at change of franchise for franchised operators and new or amended access contracts for open access and freight. To remove uncertainty we suggest that the variable charges structure is then unchanged (except for RPI+/- x) for a period of 15 years.