6 February 2012

Richard Owen
Office of Rail Regulation
1 Kemble Street
London WC2B 4AN

Dear Richard,

PR13 Consultation on Incentives

This letter sets out TfL's response to the consultation. TfL is content for the response to be published.

2. Background and context

2.27 TfL supports ORR's comments in favour of localism and greater local involvement in procurement and funding of rail services. Transparency of costs at local level is important to enable this to happen. ORR has published financial data at Network Rail route level and this is an important first step. However ORR notes that local networks often share a mix of traffic and in addition, local services run on several Network Rail routes. This should be taken into account in deciding what information should be published in future to ensure that financial information is of real use to potential funders.

2.34 ORR states that it is important that alliances between Network Rail and train operators 'do not result in undue preference or discrimination'. This is essential to protecting the interests of operators that are not involved in alliances because of the geography of the networks they serve. In the L&SE region, Network Rail recently announced a deep alliance with South West Trains and other alliances with the Anglia, c2c and Southeastern franchisees. These franchises have a close geographic fit with Network Rail routes but other operators also operate on the routes in question. London Overground and Crossrail will both operate on Anglia routes in CP5, as well as a number of other operators. Alliancing agreements and bespoke arrangements should be reviewed by ORR to ensure that they do not result in discrimination.

3. Understanding the PR13 objective

3.27 TfL supports ORR's use of PDFH to determine outcomes from interventions. However ORR quotes fares elasticities for conurbations outside London of 6% for commuting, 5% for business and 9% for leisure taken from PDFH version 5. These elasticities have not been fully accepted by the industry and DfT's current WebTAG consultation (TAG unit 3.15.4)

Doc # 439685.01

proposes use of PDFH version 4.0 for fares elasticities. ORR and DfT should use consistent assumptions on fares elasticities.

4. Aligning Network Rail and train operators' incentives to increase efficiency

4.8 TfL supports the principle that train operators should be exposed to the costs they generate and so be incentivised to challenge costs, quality of service provision and behaviour. Network Rail should be incentivised to provide appropriate standards of service to train operators including an adequate level of resourcing to meet the needs of intensive metro type services in London. TfL expects Network Rail to improve the quality of service provided to its concessions. This may result in higher costs but could still represent efficient operation.

It is important that an incentive mechanism rewards genuine efficiencies rather than reductions in costs at the end of a franchise or control period. ORR will need to ensure that if Network Rail and a primary operator on a route are working together to reduce costs, this does not affect the quality of service offered to other operators.

4.16 Exposing operators to changes in Network Rail's costs at periodic review is worth further exploration. TfL supports the objective of exposing operators to a greater share of Network Rail costs over time but the risk should lie with the party who can best manage that risk. It is unclear whether operators have significant influence over Network Rail's costs for such an incentive to result in behavioural changes. ORR should set out the proportion of Network Rail's costs it believes to be within operators' control.

4.27 A route level efficiency benefits mechanism (REBS) is best targeted at train operators whose routes align well with Network Rail routes and who can have a material influence over Network Rail costs. ORR notes that national operators will face weaker incentives. The same applies to operators such as London Overground whose routes map poorly to the Network Rail route structure.

If REBS is to be implemented, TfL believes an asymmetrical benefit share is appropriate with train operators receiving a higher share of upside performance than they lose for underperformance. However the point remains that operators may have little or no control over such performance in which case the incentive effect is negligible. It is important to have transparency of the share of train operators on each route if this is to drive benefits sharing apportionment.

A minimum threshold is proposed for participation in benefit sharing, above which it would be compulsory. LEK's work for the McNulty study shows that at least eight operators including London Overground each operate less than 5% train kilometres on the Anglia route although they may have a higher share of passenger journeys. It is questionable how much influence they would have over Network Rail costs.

5. Possessions and performance regimes

5.5 Payments under schedules 4 and 8 are intended to compensate train operators for the financial impact of service disruption. As concession operators such as LOROL do not take revenue risk, performance rates need to be set at a level that will incentivise good performance. Payment rates do not currently take account of the increase in passenger volumes that have taken place in recent years. Even without the East London Line, volumes have doubled on the Overground since TfL took over in 2007.

The regimes should be recalibrated to take account of increasing passenger numbers and the impact on the economy of delays. TfL proposes higher bespoke incentive rates for London services. Because of higher income and GDP per capita in London, the value of a minute's delay should be higher than in other parts of the country. TfL uses a London weighted value of time which applies an uplift to the national value of time to take account of income differentials. TfL's own performance regime incentivises LOROL to reduce delay minutes and compensates TfL for economic and financial losses from poor performance. A review of delay attribution for London Overground shows reduced TOC on self minutes driven by TfL's own performance regime, but continuing high Network Rail delay minutes.

5.29 Payment rates under schedule 4 should be an accurate reflection of loss arising from poor performance and be structured to provide a proper incentive. Schedule 4 does not sufficiently incentivise Network Rail to minimise the number of possessions as Schedule 4 costs can be rolled into the costs of a project. TfL would support a punitive element to the payments.

5.37 TfL does not support the removal of Network Rail's liability for Schedule 4 payments if it declares a restriction of use due to extreme weather. Network Rail should be incentivised to provide to operators the maximum possible network availability. A penalty should be maintained so that there remains an incentive to for Network Rail to commit an efficient level of resources to ensuring network availability. A joint RoU between operator and Network Rail may be appropriate.

5.42 TfL supports the proposal that there should be a set of principles for attributing delays between Network Rail and train operators that operate partially off the Network Rail infrastructure, as will be the case for Crossrail. The process for tracking how delay is imported from one part of the network to another should be clearly set out e.g. from east to west on the Crossrail route.

5.53 Bespoke regimes are appropriate where other operators are not impacted by a failure. A removal or reduction in value of TOC on self payments is appropriate where there is no impact on other operators where, as is the case with Crossrail, TfL has its own performance incentive. Schedule 8 may not incentivise best performance on a route such as Crossrail where Central section performance is critical rather than right time arrival at destination. TfL believes that a national framework of performance regimes should be retained even if bespoke arrangements are introduced for some operators.

6. Access charges
ORR is considering allowing bespoke variable access charges to be negotiated between Network Rail and train operators alongside price lists. As with benefit sharing agreements it is essential that other operators would be protected from disadvantage as a result of bespoke arrangements being implemented.

7. Capacity utilisation incentives

7.52 TfL is pleased that ORR is not progressing Network Rail sharing of train operator revenue as part of PR13.

7.55 TfL supports ORR's plan to undertake research into the extent of unused paths and to monitor capacity utilisation. This will show the extent of unused freight paths on the network and highlight areas where such paths could better be used by passenger services. TfL does not consider reputation to be a sufficient incentive to enable better use of capacity.

7.64 TfL supports the plan to investigate the case for a charge that makes better use of existing capacity and continues to support the case for a reservation charge.

8. Network Rail's financing arrangements
8.72 TfL agrees that ORR should use a cost of capital that reflects Network Rail's financing costs. The option for Network Rail to issue unsupported debt should be kept open. ORR should take into account the impacts in future control periods in determining the most appropriate financing option. Although reducing the net revenue requirement in CP5 is to be welcomed, this should not be at the cost of an unsustainable future net revenue requirement.

9. The incentive properties of opex and capex recovery
9.10 TfL agrees that there is currently a capex bias at Network Rail, driven by incentives. Costs tend to be added to large scale infrastructure schemes where in some cases they should be treated as maintenance or other opex.

Q9.2 In assessing support, operations and maintenance costs using a base year, ORR needs to ensure that the base year is robust and that it provides a good starting point for future years' expenditure. At a time of structural change as a result of Network Rail devolution and changes in industry relationships, it may be more appropriate to use forecast costs rather than actual costs before applying efficiency targets.

10. Other incentives
10.72 TfL supports the aim of incentivising energy efficiency and development of incentives for Network Rail to reduce transmission losses.

However it believes that reputation incentives will be insufficient to incentivise changes in behaviour. TfL favours financial incentives for continuous improvement in energy efficiency but recognises that the route to delivery may be through franchise agreements rather than through regulation.

Yours sincerely

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