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R. Owen
Office of Rail Regulation
1 Kemble Street
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8th February 2012

Ref: WC/ORR/RH063b

Dear Mr. Owen,

West Coast Trains – Response to the Office of Rail Regulation's
Periodic Review 13 – <u>Incentives</u>

West Coast Trains Ltd [WCTL] welcomes this opportunity to respond to the Incentives Consultation exercise in relation to the forthcoming Periodic Review 2013 (PR13).

1. <u>Foreword</u>

1.1 WCTL is responding to this consultation exercise in its current capacity, as the incumbent West Coast Main Line Franchised Passenger Train Operator, mindful of the fact that it is also one of the short-listed bidders for the impending ICWC franchise competition. We have therefore approached this consultation taking cognisance of our current position, commenting only on those specific components raised within the consultation where we feel able to do so.

2. <u>WCTL Overview</u>

2.1 We stated in our response to the first consultation, that the whole issue around incentivising any industry, was centred upon whether those incentives do actually provide an effective and efficient ability to change its outputs. Our view has not changed. It is essential that any incentives are sufficiently robust, to make such explicit change, in this case, ensuring <u>both</u> Network Rail & Operator deliver improved performance and capability, in parallel with reducing cost and improving efficiency.

2.2. Our initial views on the financial framework and outputs generated through having Route business units in place (Network Rail Devolution), noted that components such as the proposed Route-level Efficiency Benefit Sharing mechanisms (REBS), changes to access charging (e.g. scarcity charges), the introduction of Alliances alongside Concessions, (all at either a route and/or national level), appeared to be very worthy of further consideration, particularly in areas where you suggested benefits are retained by the Operator as a means of encouraging future initiatives & efficiencies. We note that, whilst the ITT for the new ICWC franchise does mention Alliancing in terms of future franchising, as *"...one of a number of a potential mechanisms for reducing industry costs..."*, it goes on to say that there are *"...opportunities within the existing franchising structure for NR and the franchisees to cooperate to reduce industry costs."*

2.3 We agree with ORR's ongoing aspiration in wanting to specify those outputs of Network Rail, (rather than its inputs). This needs to take full account of both taxpayers and funders requirements, alongside the development of stronger incentives for Network Rail and Operators. Working together to reduce costs should be**,** alongside Industry Reform, a key component to the overall objective of PR13.

2.4 For example, we also considered that existing financial incentives appear to be working moderately well regarding the Schedule 8 Performance regime. However we have previously suggested a possible review of the Schedule 4 regime, in particular, improving those incentives on Network Rail (especially with them devolving to a Route level) to reduce both the length of the possession planning process and the number of possessions required. We feel, this approach should culminate in greater accuracy within compensation payments relevant to each event.

2.5 It is vital that in seeking to fulfil its statutory duties in conjunction with this next Control Period, the ORR aligns those efficiencies & cost savings primarily alongside those expectations sought across the Industry through the *Rvfm* report. This would need to be sufficiently balanced to support and enhance those outcomes required from both Customer *and* Funder.

2.6 WCTL therefore sets out below, its thoughts and considerations regarding this consultation:

3. <u>Understanding of the PR13 Objective (Part A, Chapter 3)</u>

3.1 We agree that such outcomes as Passenger Satisfaction, Connectivity and Economic Growth are the key indicators for Network Rail to deliver against.

3.2 In the main, we accept that the PDFH, NPS and Passenger Focus research results do tend to generate reasonably acceptable trends & priorities with which the ORR should set such value on those outputs of Network Rail. However this is not totally conclusive; the very fact that it appears to suggest that Passengers primarily place most importance on 'price & value for money', alongside 'seating availability & information dissemination' above 'Journey time', is not essentially true for long distance TOCs like ourselves. To our customers, Journey times remain as of much value as punctuality and service delivery, in terms of their 'value for money' experience.

3.3 Therefore, in terms of setting Network Rail's outputs, 'Network Availability' should also be considered of high importance, particularly where long distance flows are competing against road and air competition. For example, the current measure of network availability (i.e. measuring against LTP timetables rather than actual 'on the day' STP timetables), calls for review and re-evaluation.

3.4 Whilst we acknowledge like the ORR, that the trade-offs between customers, funders & society are, in certain respects, common and complementary to each other, differing interests & outcomes also create a problem in obtaining the right balance. For example, optimising resource against timetable capacity and Network Availability, particularly alongside considerable Industry investment (e.g. the WCML), will undeniably have an impact on fare availability and cost.

3.5 The expectation that the Devolution of Network Rail will bring closer working relationships provides a real opportunity to introduce (where not so already), more comparative metrics, sufficient to warrant those benefits gained through such affiliation. We do however consider, that in most areas the metrics currently applied, would suffice at a more detailed Route level, although as mentioned above with Network Availability, there are certain aspects that continue to require improved lucidity. It is also important through the proposed introduction of the REBS, to incentivise each Alliance (and between the differing Routes), whether it be on a 'Risk Bearing' or preferred 'Risk Sharing' basis, that such measures provide sufficient clarity and detail to drive forward positive change.

3.6 One of the critical facets being driven through from the *Rvfm* study is that Devolution should bring greater contestability and transparency between both TOC and the Routes themselves, thereby improving both efficiencies with the obvious incentive to change for the better. There is a critical need to ensure that Network Rail's current priorities (e.g. Operations, Asset management etc.) feature more prominently at a Route level as we head into CP5, addressing those Key Enablers described, through the requirement to fulfil those *current* outputs outlined under Table 3.7. To do this, such metrics must be commensurate in providing the appropriate data, analysis and reportage, necessary to give the intended '*closer working relationships*', improved direction and responsiveness to excel in an efficient and customer focussed manner.

3.7 The Key enablers themselves (part 3.48) should provide the sufficiency of giving direction to Network Rail and ultimately any *Alliances* formed. However, as the *Rvfm* study alludes to, there needs to be an outcome that also provides '*effective <u>Access</u> management*', which, through healthier transparency and collaboration, should go some way to robustly developing improvements in both Capacity management, in parallel with Network Availability requirements; such improvements being considered through the parallel Industry Reform Project workstream.

3.8 The '*transmission mechanism*' drives the approach as to how Network Rail (currently) responds to any incentives that it is set. In CP5, through the emergence of closer ties between TOCs and Network Rail, there will be an even greater obligation on the requirement to be more responsive than now. However, in view of our current *Company* position, we are unable to consider the virtues of whether the abolition of the Network Grant in order to improve Network Rail's customer focus, alongside other governance and financial re-structuring initiatives, would be realistic propositions or not, particularly in respect to the fact that such changes have an affect on Franchise Agreements.

4. <u>Aligning NR and TOC Incentives to increase Efficiency (Part B, Chapter 4)</u>

4.1 As we have outlined above and in our previous response, we feel the move towards a greater alignment of dual responsibility and purpose between Network Rail and TOCs is a far more effective way to deliver positive output with increased efficiency within the Railway Industry than now; and one that will ultimately achieve purposeful Customer & Funder outcomes. This is the view similarly shared by the DfT in principle, and (as you highlight), has been set out in the recently published 'Invitation to Tender' (ITT) documentation for the new ICWC Franchise.

4.2 Our current Franchise Agreement does not contain the EBSM mechanism, so this is a relatively new set of efficiency principles to consider, even more so when taken in the concept of the expected introduction of the perceived improved REBS mechanism. We are also mindful that for all Franchise Operators, any such change or introduction, would necessitate DfT agreement subject to compatibility and '*consistency with legislation*' requirements, whether this be part of the re-franchising process or not. Whilst weighing up the ORR's approach to the formulaic and baseline requirements of REBS, we would question whether the mechanism is powerful enough, given that the maximum upside across GB is likely to be £80m per annum and maximum downside £32m per annum (1% of OMR).

4.3 Obviously we remain unsighted as to whether any bespoke (or part thereof) arrangement under the closer association of *Alliances*, would be sufficient to complement, *carve-out*s or eventually replace any REBS default mechanism. This would equally apply to the specificity and values of those efficiencies likely to be shared or not. In view of our previous response highlighting our initial concerns about the ability of Network Rail to deliver such efficiencies, the ability to be able to negotiate such bespoke arrangements is a viable alternative to any default mechanism, particularly if on certain Routes there are large volumes of work to carry out, or where geographical and / or infrastructure constraints create undue risk to the ability to reduce cost.

4.4 We would question however one specific element; if the ORR's perceived view, is that enhancement expenditure within the REBS mechanism, (whilst excluded from the current EBSM model), might only support the larger enhancement projects under / through bespoke arrangements, we would be concerned about the view that smaller enhancements would not be otherwise captured, due to the perception that administrative costs would outweigh any potential gains.

4.5 Smaller enhancement projects are still important to improving performance, infrastructure capability and capacity management. We would therefore suggest that if this was to be the ORR's direction, then such smaller scale enhancements should be picked up under the JNAP process (or some other similar mechanism), itself a viable tool which would benefit from being contractualised, perhaps as part of any bespoke arrangements put in place.

5. Schedule 4 Possession and Schedule 8 Performance Regimes (Part B, Chapter 5)

Schedule 4

5.1 Like most others in this Industry, we broadly agree with the ORR's view that the current compensation mechanism generally aligns with the incentivisation of both Train Operator and Network Rail, in achieving the best outcome for the customer and funder. However, such discernment is becoming increasingly questionable (in certain locations to the extreme), as Network Rail seeks to balance its engineering access and planning requirements against the need to meet its national PDI-P target & trajectories. There still appears to be an ongoing Network Rail requirement to reduce train operating ability (particularly at weekends, and even more so on Bank Holiday weekends), which obviously vie against the need, especially by long distance operators such as ourselves, to run increasingly normal weekend timetables and offer attractive journey times compared to alternative modes.

5.2 In our first response to this CP5 consultation process, we acknowledged that Network Rail needs to reduce both the length of the Restriction of Use (ROU) planning process, and in terms of cost to Network Rail (and the Industry), the number of disruptive possessions. Indeed, as we never have prior visibility of those payments expected to be paid to TOCs on a *ROU by ROU* basis, it has always been difficult to understand whether any such ROU proposals are actually in the best interests of the end customer. We would hope that through Devolution and closer working initiatives that both the planning & optimisation of future engineering works will be improved. The initiation of an Industry working group under the auspices of Network Rail's IAPIP process is a tentative & untested start to an otherwise difficult area.

5.3 WCTL has tended, on numerous occasions, to be the principle advocator in promoting the imperative need (wherever feasibly possible) to operate train services as opposed to buses, irrespective of whether it is the least cost effective option (ORR Para 5.18 refers). We do however agree that through the lack of any real transparency in association with the optimisation of engineering works (see Para 5.2 above), combined with the long lead times in terms of engineering planning, we are otherwise placed in such a position that inevitably we unintentionally agree on occasion, to potentially unnecessary ROU's taking place.

5.4 Whilst we understand and support those reasons for an Industry review of Schedule 8 Payment Rates, (and by default Schedule 4 – ORR Para 5.21 refers), in order to reflect the modern day impact of disruption, we would strongly object to any move to reduce payment rates with either regime, in order to reduce the perceived risk that TOC's might be over compensated. This is primarily on the basis of those ORR's concerns expressed in their Para 5.23, as well as the important fact that it is not just '*on the day*' events, that can put people off from travelling, but also any pre-planned long term ROU affects, which for example, when customers see a route closed for a number of continual weekends[1], consequently deters them from travelling.

5.5 We would also consider that any request to amend Payment Rates under Para 17 of Schedule 8 to be only effected under ‘material’ timetable change as not viable. The benefit of being able to change Payment Rates at any time enables a Train Operator to react to changing economic drivers (e.g. affecting station calling patterns etc.) whenever justified (subject to approval), a situation that may well increase with the change to more *quantum based* Rights.

5.6 It could be that the ORR’s consideration of allowing a TOC to withhold Track Access Charges as a ploy for incentivising NR to reduce service disruption, might have been a possible way forward, (ORR Para 5.30 & Box 5.4 refer), but we agree this would be difficult to do as setting the correct thresholds and/or criteria would be both very complex and equally unchallengeable.

5.7 The other core reason is that Network Rail wouldn’t necessarily be incentivised through a payment rate reduction because the interfaces are set at an HQ level (National & Route), thus remote from the ‘*ground level*’ where the ability for change to take place, can actually occur.

5.8 Whilst Schedule 4 provides some protection to TOCs from such potential losses through its current formulaic payment structure, albeit an out of balance money-go-round of Schedule 4 ACS payments, such protection doesn’t necessarily fully extend to the long term lag affect of passengers being put off permanently from travelling by train, due to perceptions over the continual unavailability of weekend train services (despite the ability to utilise where feasible, the currently flawed Sustained Planned Disruption mechanism – see Paras 5.9 - 5.12 below).

5.9 In consideration of the perceived closer working arrangements between TOCs and Network Rail in the future, there should nonetheless, in view of our comments above, be an opportunity (putting aside any outcomes pertaining to Bespoke Schedule 4 arrangements possibly being put in place as part of any future *Alliances’*), to re-evaluate the Sustained Planned Disruption (SPD) mechanism to reflect wider network availability issues.

5.10 Correspondence between WCTL and the ORR[2] during the second half of 2010 highlighted the fact that the current Schedule 4 SPD mechanism was both complex and unwieldy and not necessarily fit for purpose due to the contractual methodology and threshold values in place. We would therefore support a more measurable and robust mechanism, perhaps using some of those principles currently captured within the JNAP template. This should take cognisance of our concerns over those long term affects of habitually occurring ROUs not being captured under Type 1 & Type 2 possession regimes (as outlined above), but equally not meeting the extremely high thresholds contained under SPD.

5.11 Potentially there are a few ideas using those values contained within the JNAP process (a high-level hypothetical measure is set out below), that might otherwise enhance the SPD mechanism (by maybe introducing a separate layer) by bringing it in line with actuality alongside long term affect. As highlighted above, the realism of continuous / regular ROUs could have an acute affect on Revenue & Cost. Using defined parameters encapsulated within the JNAP, the SPD mechanism might be improved by:

5.10.1 A mechanism that is perhaps measured and thus triggered against, overall train journey time delay (inc. cancelled minutes) to any Service Group, defined in terms of total minutes/train over & above, for example, a 25% journey time increase threshold. For example, if over 3 periods, a total Service Group planned journey time was 10000 minutes, but the total, including delay & cancellation minutes was measured at 13000 minutes, then as the accidence?? was 30%, a Revenue claim could then be progressed under a SPD type mechanism. This ought to incentivise Network Rail to optimise ROU’s (inc. the reaching of any PDI-P type targets), as well as working closer in with TOC’s.

[1] ROU’s that would be otherwise categorised Type 1 or possibly Type 2, but not feasibly captured under the current SPD mechanism.
[2] See letters to/from E. Bulman (Our Ref VWC/ORR/RH060/SPD) dated 26/10/10 & 16/11/10

5.11 In summary we believe the SPD mechanism needs to be re-evaluated by introducing lower thresholds and clearer methodology, and potentially enhanced by more prescriptive reality ('*on the ground*') methods that reflect both the short term and long-term affect of Type 1 and Type 2 ROUs, that currently, when assessed against current thresholds, means SPD is never triggered.

Schedule 8

5.12 The benefits derived from establishing bespoke arrangements as a consequence of closer alignment and / or *Alliances* with Network Rail, would be essential to meeting those outcomes being driven through from the Rvfm study. Schedule 8 performance can play an important part in achieving such goals.

5.13 In order to play its part, it may under such circumstances, be necessary to maintain the important function that PPM currently plays in driving forward requisite compensation and change. It might also be suggested however, that whilst PPM outputs are retained, such a regime might need to equally draw away the measure of *delay minutes*. It is apparent through our experience gained over the last decade that *delay minutes* themselves do not necessarily become key enablers in driving change or conveying to Network Rail a TOC request for increased action in any particular area; PPM however does, as it is this affect that customers associate with Train Operator performance.

5.14 Bespoke arrangements might therefore benefit from a focus more upon PPM outputs / drivers, than *delay minutes*, but only so long as they are integrally linked into Joint Performance Improvement Plans (JPIP). The purpose of a JPIP is obviously to work together to achieve performance related targets which drive benefits for both industry parties and end users. Whilst delay minute attribution would need to remain to understand the causation affect of any such delay, an approach of this type, might not only seek to resolve problem areas but also reduce administration costs, so prevalent with today's Performance monitoring processes.

5.15 Irrespective of whether bespoke arrangements or a modified templated schedule 8 are introduced, the fact remains that the *Sustained Poor Performance* mechanism (SPP) needs to be retained either in its current form, or in positively modified form, inline with any general changes to the regime (as an output of the CP5 review). The mechanism provides an added incentive upon Network Rail to maintain & improve the *continuity of performance* rather than just being responsive to adhoc period improvements.

5.16 The Schedule 8 payment mechanism is, as the ORR and the Industry have suggested, adequate in so far as it incentivises Parties' to take account of the financial impact on each other, as well as reflecting the impact (where accurately calibrated) on each other's businesses. Any discussions around the practicalities associated with introducing a payment time lag (3 months has been suggested), would require some detailed consideration, due to the financial consequences on revenue streams and other contractual commitments.

5.17 We would again assert, that whilst those at a Network Rail headquarter and regional level, tend to understand intrinsically, the concept, metrics and impact of Schedule 8 on an Operator, (similarly for Schedule 4), those at *ground level*, whilst appreciative of the localised affect of *delay*, don't necessarily grasp / appreciate the wider and / or secondary impact on Performance of services, as a result of infrastructure causation that they control and/or manage. We would suggest that any change to the regime, in order to effect better incentivisation, takes cognisance of such current misalignment.

5.18 Discussions centred on whether current contractual provisions adequately give sufficient incentive upon both Network Rail and the Train Operator to treat '*extreme events*' in a more facilitative manner, thus expediting a timetable that provides a robust solution to the 'event' is challenging. WCTL always strives whether under normal or extreme conditions, to operate a '*full*' timetable. We pride ourselves on providing the confidence to our customers that (wherever feasible taking into consideration any severity of an event), we will get them to their destination. The practicalities of resourcing specific contingency plans at very short notice in any specific area is always difficult and cost hungry, with the effect on customers of indiscreet cancellations and further possible disruption.

5.19 Whilst we would not be averse to further work taking place in this area, we are mindful of the fact that a recent Industry approach to the Delay Attribution Board (DAB), relating to a request for a definition of what should be considered as a '*severe disruptive event*', alongside clarity over when such a stage would be triggered, resulted in a 'non agreement' across all Parties. Similarly, we would be unwilling to consider further the pros and cons of establishing of a set of principles for attributing delays between Network Rail and those Operators that partially operate infrastructure, but this would have to be kept simple to be effective.

6. Access Charges (Part B, Chapter 6)

6.1 No Comment

7. Capacity Utilisation Incentives (Part B, Chapter 7)

7.1 Since last May's initial consultation, taking into consideration our current position (Para 6.1 above) our views have not essentially changed, aside from noting the affect of possible bespoke arrangements replacing current national Industry mechanisms. WCTL considers that in the event of contractual disaggregation to Route Level, any variable charging regime must retain the capability to be transparent as well as effect change.

7.2 Although there is still no current visibility on how such charging regimes would be managed at a disaggregated Route Level (and thereby what specific capacity utilisation incentives are available), it is once more important to note that any eventual disaggregated charging regimes are again established on the basis of a bottom up approach. This would then provide the visibility of data at a route & *ground level* being sufficient to incentivise the balancing of actual '*wear & tear*' impact against both service level provision and Resource capability, all of which influences the allocation of capacity.

7.3 Acknowledging that the new West Coast ICWC Franchise has been directed to provide greater flexibility in its service specification outputs, thereby providing additional but untested service flexibility in response to changeable market forces, means that capacity allocation in the *new world* (post Rvfm), especially when set at such disaggregated levels, has to maintain some form of continuity using current charging methods.

7.4 Therefore aside from our concerns over the need for a 'bottom-up' approach, we also accept that the Capacity Charge needs to remain, primarily as the foundation, upon which other building blocks (Scarcity or Reservation charges) may be introduced later; thereby ensuring continuity in the management, availability & allocation of capacity on a fair and robust basis.

7.5 However it does remain unclear especially whether the Reservation and / or Scarcity charge could not be introduced for bespoke arrangements, where *Alliances* were established? As the ORR have intimated there are pros and cons to both of these charging regimes, but on specific routes, it might, through *Alliances*, provide some form of positive incentive to managing capacity on otherwise constrained routes?

8. Network Rail's Financial & Capital costing arrangements (Part B, Chapter 8)

8.1 No Comment.

9. <u>The Incentive properties of Opex & Capex cost recovery (Part B, Chapter 9)</u>

9.1 No Comment.

10. <u>Other Incentives (Part B, Chapter 10)</u>

10.1 WCTL has no real comment on the detail, however we do recognise the importance of this to the rail industry if it is to deliver the ‘value for money’ challenge set by the RVfM study. We also acknowledge, like others, that the aligning of incentives continues to provide some concern.

10.2 We would like the opportunity to comment further on these issues once further clarity becomes available as a result of the Devolution of Network Rail and any closer working relationships that transpire.

We trust that this response is helpful and provides you with some useful clarification and information.

Yours Sincerely

Robert Hodgkinson
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West Coast Trains Ltd.