27 August 2010

Ekta Sareen
Economist
Office of Rail Regulation
1 Kemble Street
London, WC2B 4AN

Dear Ekta,

<u>High Level Review Of Access Charges</u>

Thank you for the opportunity to comment upon the review of Access Charges. This letter draws together the response of all FirstGroup's rail operations, including First ScotRail, First TransPennine Express, First Capital Connect, First Great Western, and Hull Trains.

Firstly thank you for arranging the workshop and supplying us with the work carried out by CEPA.

We would like to set out our principle concerns about access charges changes. They create a considerable amount of business uncertainty, create a huge administrative burden, particularly in Franchised TOCs. The implementation of the 18.1 provisions also has a significant opportunity cost; it takes up a considerable amount of time of key staff in both the funding organisations and the TOCs. Thus if the charges are to be changed it has to justify the problems and costs that such changes create. While the CEPA report mentions these problems of implementing 18.1 it does not attempt to quantify them, it is thus unclear what weight has been given to these effects in their report. We would like there to be a bias towards the status quo, with changes only made where there is a significant proven benefit.

Under the current charges structure 65% of Network Rail's income comes directly from Government bodies, if the Fixed Track Access Charges are included as indirect Government funding it comes to over 80% of Network Rail's funding. With less than 12% of Network Rail income coming from variable access charges dependent on operators usage of the Network, and most TOCs subject to 18.1, the opportunity to influence behaviours by varying charges is inevitably limited.

The vast majority of the Government and fixed access charge money covers the underlying cost of the Network. The principle purposes of the current structure of charges to train operators are to reflect only the marginal cost of changes to the timetable and incentivise improving performance in delivering that timetable. The basic economics of the industry, reliant as it is on Government funding for the basic costs of the Network, generally prevents the infrastructure growing to meet the needs of customers in response to need without additional Government funding. No change to the structure of the charges will overcome this restriction.

Currently access to available capacity is governed largely by the access rights in Schedule 5 of the Track Access Agreements and operators have made clear their opposition to changes in the way they are specified, because of the value they add to their businesses. New access rights have largely been created by the identification of and inventive use of "White Space" in existing timetables coupled with Flexing of Franchised TOC services. Where more than one operator has been competing for a particular slot in the timetable these disputes have been resolved by ORR through the approval process for access agreements. It is seems unlikely that charges as a method of determining the allocation of scarce paths, or persuading access rights holders to give up rights will have a significant or beneficial effect.

Transfer of rights has largely been a freight issue driven by changes in the haulier of a particular flow of goods. This transfer has been fraught with difficulty. The difficulties have largely arisen because, where capacity is constrained, FOCs have been inventive about using the spare capacity within their existing timetable to serve new opportunities. This has meant that due to the contractual obligations to meet the needs of these additional flows, they have not been able to fully relinquish paths used to supply a particular flow when they lose the contract. The problem is a physical not and economic one.

We believe the desire of customers to either travel when they want or have their goods moved when they want has had a much greater effect on the timing of services than the capacity allocation charge. The vast majority of trains are operated to meet the requirements of Franchise Agreements and operators often have little room for change. The other significant constraint on changing the timetable is the resources available to the train operators, particularly those operators using high cost modern leased Rolling Stock. Train operators are dependent on efficient use of resources to make their operation profitable and they can only make very limited changes to their timetable and changes to the charging structure would need to be very significant to justify less efficient use of rolling stock. Because of these constraints we do not believe that a Scarcity Charge is likely to lead to the release of more capacity.

It is unclear that past changes to the structure of charges in previous Control Periods has had a significant effect on behaviours in capacity allocation or investment issues. Changes at each Control Period have been successful in more accurately reflecting Network Rail's marginal costs from service changes and ensuring that changes in Operator revenue from customers are reflected in the performance payments. Problems experienced in negotiating charges for additional paths has been greatly simplified by the introduction of the Capacity Charge.

It is notable that a number of the capacity and investment issues which the CEPA report seeks to address through charges are also under consideration under the parallel reviews of access planning and the specification of access rights. We believe the physical rules based approach to allocating capacity will be more effective than the use of economic signals.

We believe that such changes as are made to the structure of charges should concentrate on making changes which will clearly and directly influence behaviours in a desirable way. One area where we believe that the biggest opportunities exist to improve behaviours is in the area of reducing the impact of the rail industry on the environment. The generally positive environmental position of rail should not lead to complacency. Rolling stock that delivers lower emissions, better accessibility, reduces the wear and tear on the network and has higher levels of safety should be encouraged through differential access charges. The differential needs to be sufficient to justify the additional costs of better rolling stock.

The one area where there is a general desire to see the spare capacity of the Network made available to operators is on Sundays. Charges will need to incentivise Network Rail generally to reduce the amount of engineering access time it requires to meet the end users needs. However as we have already identified the basic economics of the industry, where operators can normally meet little more than the marginal costs of the paths from their revenues, means that this release of Sunday capacity will not be generally self funding. If the seven day railway is to become a general reality Government will need to believe that the investment required will bring a return in the wider economy and environment. If this is achieved Network Rail's fixed funding arrangements should change to require them to deliver this capacity.

We are also concerned that Network Rail has no incentive to make changes to the Network which will reduce the losses in the electricity supply system. Network Rail must be incentivised to reduce electricity losses, particularly on the DC system. We note that ORR has appointed a reporter to look at the opportunities to improve the efficiency of electric traction and we welcome this. We believe that reducing electricity losses will be self funding and the structure of charges needs to change to transfer the risks and opportunities of network inefficiencies to the body that is best placed to make the improvements. The body best placed to invest in a network with lower losses is Network Rail, yet at the moment the costs of the inefficiencies are passed to the Operators.

Conclusions

In an industry where over 80% of the funding is derived from Government and only 12% is dependent on the behaviours of the customer or the supplier, there is clearly limited scope for influencing behaviours through changes to those charges. This is particularly true where capacity is constrained. The majority of capacity in constrained areas is already committed to meeting the requirements of Franchise Agreements.

The costs and risks of changing the charging mechanisms are significant. While CEPA appear to have recognised the economic effects of the 18.1 provisions they have not looked at the administrative burden and opportunity cost of implementing it. We believe that these must form part of any future evaluation.

Changing charges poses a considerable risk to all operators. Any increase in the proportion of costs funded through the Variable charges will have a significant adverse effect on open access and freight operators which may well be unsustainable. Any reduction in the variable charges will prevent Network Rail recovering its marginal costs if services expand and, because of the operation of 18.1 will, in the short term, reduce the competitiveness of Franchised TOCs compared to open access operators.

We believe that any review of charges should have a natural bias to wards the status quo and any changes should seek to incentivise changes in behaviours only where there is clear evidence of that a change is desirable and that the new charges will be an effective way of promoting change.

Yours sincerely

Hugh Clancy
Commercial Director, Rail