1 Prospect Place
Millennium Way, Pride Park
Derby
DE24 8HG

Joanna Whittington
Director – Railway Markets & Economics
Office of Rail and Road
One Kemble Street
London
WC2B 4AN

Copy to: EMT Exec

Ref: ORR PR18\Schs4_8 Reviews

29 January 2016

Dear Joanna,

PR18 Reviews of Schedules 4 and 8 of track access contracts

Many thanks for the opportunity to respond to the recent consultation letter on Schedules 4 (the Possessions) and 8 (the Performance) regimes for the 2018 Periodic Review of Network Rail (PR18).

The comments below are based on the consultation letter and recent studies carried out by the Rail Delivery Group (RDG) on the review of charges and incentive regimes. This response does not seek to address all the headings outlined in Annex 2 and Annex 3 but tries to cover a number of key issues from an EMT's perspective.

Schedules 4 and 8 as liquidated sums regimes have been around for some time and whilst not perfect, they do provide a consistent approach to incentivising and compensating TOCs without costly administration and litigation. Over the last two Control Periods, Schedule 4 and Schedule 8 regimes have been amended and updated to ensure they function effectively. Nevertheless, both regimes perform an important function within the rail industry's regulatory framework and that there is significant scope for improvement.

Schedules 4 and 8 Overall

Purpose

One of the key objectives of both the possessions and performance regimes is to help align financial incentives between Network Rail and train operators so that train operators receive an appropriate level of compensation for planned and unplanned service disruption attributable to Network Rail's restrictions of use of their routes. Also, they help Network Rail understand the impact of service disruption on TOCs' costs and revenues to help drive its decision making such as its possession planning at a local level.

Generally, both regimes on average should compensate train operators for the impact of service disruption and be cost reflective for all possible circumstances that affect train operators' costs and revenue.

Schedule 4 – the Possessions Regime

The level of compensation received by operators

In relation to costs incurred when Network Rail takes a possession, the current regime does not account for costs incurred by a TOC who is not directly affected by the possession whereas there is an industry need to provide additional capacity on train services on parallel routes for passenger diversions.

The ACS

Franchised operators pay Network Rail a predetermined access charge supplement (ACS) in return for receiving Schedule 4 compensation for planned possessions. The ACS covers the estimated cost based on assumed maintenance and renewals volumes and Schedule 4 unit costs for each asset type and is forecasted for the full 5 years.

In theory, it should reflect the amount Network Rail is expected to pay out in Schedule 4 compensation over the control period and therefore financially neutral if Network Rail delivers all possession activities in its base plans efficiently. However, Network Rail's planned possessions are subject to constant reviews during the control period to ensure effective delivery of activities at a cost efficient way. There is likely to be over-recovery of Schedule 4 costs when the workplan used to set the ACS at the periodic review subsequently changes resulting in a lower number of actual possessions taken. For example, the recent review of Network Rail's affordability and deliverability on their CP5 delivery plan has led to a significant reduction in possessions planned in the base plan for CP5. It is worth sense checking whether the ACS which is forecasted for the full 5-year period is appropriate, and to have a rebate mechanism in place to adjust the difference back to the TOCs.

The Sustained Planned Disruption mechanism (SPD)

The current contractual wording is subject to differing interpretations of the provisions between train operators and Network Rail which make it difficult to process than it ought to be. With regard to protecting TOCs from circumstances where there is severe disruption caused by possessions, there is a considerable gap between a Type 3 possession i.e. 5 consecutive days, and a SPD i.e. 84 consecutive days. The current Schedule 4 mechanism is not well equipped to protect TOCs from instances where the prolonged disruption falls within this gap.

Possessions that are planned for over a period would cause a significant impact on passenger revenue as well as increasing costs in connection with managing the disruption. The impact of technology and the increasing use of alternatives to travel are likely to magnify customers' responses to disruption in future compared to any observed impact now or in the past. It is also worth mentioning that costs on TOCs' management resource have often been overlooked when the management team is required to spend extra time on managing the major disruption.

We are uncertain how practical this mechanism provides in relation to safeguarding the impact of a prolonged disruption on TOCs' long term revenue. This particular area needs to be reviewed and we welcome ORR's view on this situation.

Notification Discount Factors

The regime should strongly encourage NR to minimise movement of possessions at short notice. Network Rail receives a discount on the amount of Schedule 4 compensation it pays to TOCs. These discounts are calculated using notification factors and thresholds based on the timetable and Informed Travellers' timescales. This particular heading has been reviewed at the previous periodic review (PR13) and adjustments have been made to the notification factors to reflect the weighting of notice that is given of possessions at Service Group level. Therefore, we do not believe that this requires another major revision, but would benefit to have some attention on bridging the gap between T-12 and T-1 as currently Network Rail has no incentives or penalties to upload passenger information once it is past the T-12 deadline.

Other aspects of Schedule 4 regime – National Operational Disruption

We acknowledge that the pre-determined formulae is derived to broadly cover circumstances surrounding most 'typical' possessions and it remains appropriate so we should continue with the current formulae subject to an update of other elements in the formula.

However, we believe that the existing mechanism is not fit for purpose particularly in response to restrictions of use caused by major operational disruption e.g. the recent threat of industrial action by Network Rail staff in May & June 2015, which was cancelled subsequently. Although the strike was cancelled, we incurred significant losses associated with the proposed operational disruption because we were not entitled to revenue compensation as the working timetable was resumed.

East Midlands Trains relies upon advance bookings for a significant element of its revenue. Passengers book several days/weeks in advance and if they cannot buy a ticket in the right train at the right place, they will make alternative travel arrangements. Thus, threatened strikes would impose a significant financial effect on the business even though the strikes were subsequently cancelled.

There is likely to be a number of possible solutions to this incentive challenge. We would like the ORR to consider this inefficiency in the PR18 periodic review for Schedule 4.

Other aspects of Schedule 4 regime – Indexation of payment rates

Historically, the Schedule 4 and Schedule 8 payment rates have only been indexed for inflation. However, there has been a strong record in the industry of passenger revenue growth each year in excess of the rate of inflation. If Schedules 4 and 8 are to be effective mechanisms to compensate TOCs for passenger revenue effects, we believe there needs to be a mechanism to index the payment rates by an additional factor to reflect the real growth in industry revenue.

<u>Schedule 8 – the Performance Regime</u>

Network Rail Payment Rates

Schedule 8 payment rates have been recalibrated at the previous Control Period so there is no need to have a major overhaul. However, Schedule 8 payment rates are derived from the PDFH framework which only reflects the impact of service disruption on future revenue. There is not a direct or indirect link between Schedule 8 and end-user compensation mechanism, e.g. delay repay, and it does not account for customers' end to end journey experience.

Schedule 8 does not reflect any increasing costs caused by the changing environment, such as changes in legislation, changes in technology and pressure from political stakeholders. The introduction of automatic delay repay will mean that TOCs pay out to customers who would not otherwise be bothered to pursue a claim. It will be useful to have further consideration on the outcome if this incentive regime is linked to end-users.

Sustained Poor Performance (SPP)

The contractual wording and the criteria set in the contract is subject to interpretation. The current wording would benefit from clarification and the criteria could have been simpler so that it will become less contentious when claims are made to Network Rail. Also, there is no timescale to the entire process or to the resolution for disputes should any parties trigger the clause. Any claim under the SPP could potentially take many months and even years to settle and hence very costly to the industry. Therefore, it is worth having a look at simplifying the existing mechanism and criteria in the periodic review PR18.

I hope this input is useful. If you would like to discuss this in further detail, please feel free to contact me.

Yours sincerely,

Lanita Masi
Track Access & Network Change Manager

Tel: ✂
Mob: ✂
Email: ✂