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Dear Joanna,

<u>GB Railfreight response to ORR PR18 Review of Schedule 4 & 8 of Track Access Contract</u>

GB Railfreight Limited was pleased to attend and contribute to ORR's PR18 Schedule 4 & 8 workshop on 27th November 2015 and is also happy to outline, in more detail, its views on:

"The effectiveness of the current regime, including aspects that are working well, the scale of any potential problem, and what the priority areas for improvement should be".

<u>The Purpose of Schedule 4</u>:

The Schedule 4 regime needs to adequately compensate freight operators for all financial losses associated with alterations to their WTT paths caused by planned possessions. The word adequate is all important as it is essential to ensure that Freight Operating Companies (FOCs) are held cost-neutral so they are able to manage their businesses with reasonable financial certainly.

Prior to 1st April 2009, when Freight Operators received absolutely no compensation for services affected by possessions planned greater than 12 weeks out, they fought very hard to ensure as few possessions as possible affected their businesses, with little thought for any industry-wide efficiencies that might be desirable. There was no incentive for FOCs to co-operate if their services were to be cancelled or heavily diverted as they would just lose revenue and profit.

In GBRf's view, the introduction of the Schedule 4 regime, in 2009, has definitely incentivised FOCs to engage more and negotiate the many types of possessions with Network Rail. From that point of view, it works and the basic structure of it should remain.

GB Railfreight would like any CP6 Schedule 4 regime to be easy to administer and not subject to numerous Network Rail claims panel hearings which delays the payment of compensation due. As well as something being not quite right with Network Rail chairing its own claims panel for claims against it, there have been some examples of the Schedule 4 Category 3 claim being long, drawn out and unwieldy, with additional queries and pieces of evidence being requested depending on who is administering the claim. This does not incentivise freight operators to look at possession requests differently, knowing that the whole compensation issue might take many months.
The whole regime must be quick and easy to administer and operators have confidence they will be paid any compensation due straight away. There is definitely still a requirement for a Category 3 all-encompassing claim mechanism for additional costs and lost revenue for possessions.

The Level of Compensation Received by Operators

GB Railfreight believes that the current Schedule 4 regime does not always compensate FOCs for the additional costs they incur when Network Rail takes possessions. There are also some additional triggers required for Schedule 4 Categories 1 and 2 claims to ensure that FOCs receive adequate compensation when it is due. Actual amounts are not suggested here but triggers and the relative levels of compensation are.

The Schedule 4 regime should always cover any additional costs to operators and also needs to take account of the long-term impact of operators' businesses, especially when there are similar possessions across a number of weeks.

An example of where the current Schedule 4 regime (for possessions >12 weeks out) does not compensate is when purely additional traincrew are needed for route-conducting a train over a diversionary route or if a member of ground-staff is needed for a run-round. In these cases, no Schedule 4 compensation is due. Indeed, to avoid unnecessary confusion, the triggers that set off compensation for possessions <12 weeks out ought to be similar to possessions >12 weeks out.

Additional Category 1 and Category 2 triggers that need to included for CP6

Possessions >12 weeks out

- Category 1 trigger to be altered from an extra 10 miles distance to an extra 5 mile distance (as per possessions <12 weeks out).

- Category 1 trigger to be altered from "planned departure or arrival differs by 60 mins." to "planned departure or arrival differs by 30 mins." (as per possessions <12 weeks out).

- New Category 1 trigger – the use of an additional driver for diverted service.

- New Category 1 trigger – additional reversal or run-round (as per possessions <12 weeks out).

- New Category 2 trigger - existing Category 1 trigger of "more demanding length or weight restrictions" should be a Category 2 claim to be more reflective of the amount of business lost when shortening a train or part-loading it. This also needs to include a diversion over routes that have a lower designated Route Availability (RA). In the case of several commodities, the last few wagons can tip the train into profit so their removal needs to be adequately compensated.

- Multiple Category 1 or 2 triggers – currently a disrupted service is only liable for one claim even when multiple possessions cause a train to run later and with downgraded load/gauge, for example. For FOCs' costs to be adequately compensated, this needs to be revised so that more than a single Category 1 and 2 claim can be made against a service. Although, on the surface on it, multiple disruptions to a single train have the makings of a Category 3 claim, the lengthy time it can take for a FOC to be compensated means that the more formulaic Category 1 and 2 claims are preferred by FOCs. The use of multiple Category 1 and 2 claims for a single train means that the money paid out by FOCs to its traincrew and customers is recouped in a more appropriate timescale.

  It may be that there needs to be a measure for end-to-end disruption for freight journeys and possibly a new category of payment between Category 2 and 3.

Notification Discount Factors

GB Railfreight believes that, in negotiating the Engineering Access Statement early on (i.e. almost 1 year out), there should be financial incentives for Network Rail to have agreed diversionary routes confirmed as 'open for full service' along with any permissions already granted for heavier or longer diverted freight services. A sample of freight diversionary paths would also be needed so FOCs know what they might be expecting when bidding, along with the capability and capacity of the diversionary route.

On the opposite side, with the above detailed information already known, there should also be financial incentives for FOCs to agree to possessions far earlier on than now. There has got to be an all-round financial benefit for Network Rail and its contractors in knowing that engineering works, especially large complicated works, have been agreed many months out.

There will, however, need to be a change in behaviours and discipline at Network Rail in having this detailed information ready in good time for real incentivisation, on both sides, to be realised.

However, an important point to note for the FOC Schedule 4 regime is that, in many cases, no matter how many weeks' notice is given for a possession, the extra cost for an additional member of groundstaff (e.g. for an extra run-round) or the training of a driver over a new route, will be the same.

The Access Charge Supplement

FOCs do not currently pay an access charge supplement with respect to the funding of the Schedule 4 regime for freight. It is GB Railfreight's view that any increase in Schedule 4 payments should be funded by a far more efficient possession plan than, perhaps, has recently been the case. The regime is designed to be financially cost-neutral if possessions are planned and actually carried out efficiently.

Interaction with Regulated Outputs

For the beginning of CP5, the ORR regulatory output was that the Possession Disruption Index for Freight (PDI-F) should be "…..to ensure that freight services experience no increase from 2007/8 levels of disruptions resulting from engineering works".

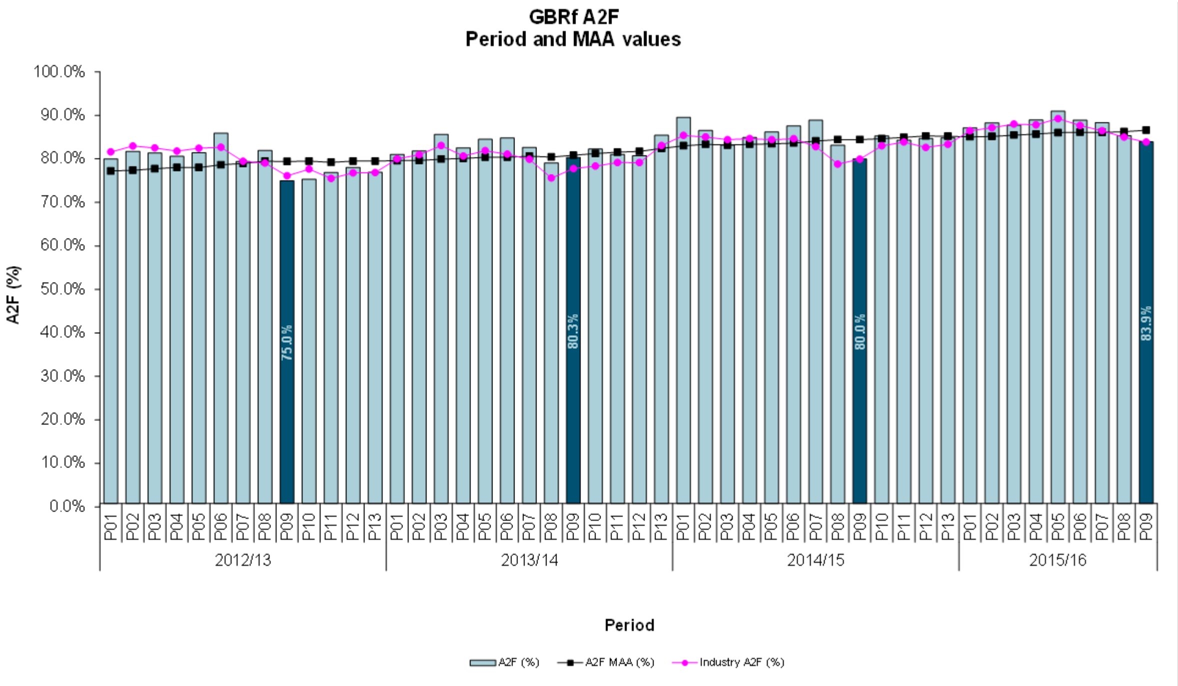
GB Railfreight and other FOCs were very unhappy that, at that time, although the regulatory output for passenger services was a reduction in levels of disruption, this was not the same for freight services. Whichever alternative measure to PDI-F is to be used for CP6, GBRf wants the Schedule 4 regime and freight disruption from possessions to be set to a clear reduction from the values at the end of CP5.

CP6 – Going Forward

GB Railfreight asserts that, going forward to define the CP6 Freight Schedule 4 and 8 regime, regular freight sub-groups should quickly be established to discuss and refine the detail contained in this and other FOCs' responses.

The Purpose of Schedule 8:

The Schedule 8 regime has certainly focused GBRf's thinking in terms of performance. The financial performance of the regime means that GBRf is constantly looking at ways of performance improvement. The graph below shows the A2f performance of GBRf for the past 3 - 4 years.



It would be untrue to say the financial penalties for poor performance did not motivate GBRf to perform better. For example, the above graph demonstrates a 3.9% rise in A2F between 2014/15 and 2015/16 after a generally flat trend in performance over the previous two years.

<u>Payment Rates and Benchmarks</u>

Due to the way the payment rates and benchmarks are interlinked you cannot look at these elements individually. There was a significant swing in CP5 leading to increased payments by FOC's, this was mainly driven by the increase in the payment rate from FOC's to Network Rail, but also due to the higher Period benchmark set for Network Rail.

The Table below demonstrates a scenario analysing both CP4 and CP5 rates and benchmarks. In this scenario GBRf have run an average mileage of 250,000 in the Period. GBRf cause no delay to any other TOC/FOC and Network Rail and TOC/FOC's cause no delay to GBRf - essentially, it is a zero delay period. Under the CP5 benchmarks and payment rates GBRf would pay out £95k to Network Rail, during CP4 this was £12k. This equates to a significant annual 'free' payment to Network Rail.

		Network Rail						GBRf						
		Bench	Pd bench	NR Delay	Under/ Over		Total	Bench	Pd bench	GB Delay	Under/ Over		Total	Sch 8
Status	**Miles**	**mins**	**mins**	**mins**	Benchmark	**rate**	**payment**	**mins**	**mins**	**mins**	Benchmark	**rate**	**payment**	
CP5	**250000**	7.2	18000	0	-18000	20.81	-£374,580.00	2.37	5925	0	-5925	47.24	-£279,897.00	-£94,683.00
CP4	**250000**	6.39	15975	0	-15975	9.88	-£157,833.00	3.05	7625	0	-7625	19.15	-£146,018.75	-£11,814.25

Any further significant swing in the payment rates in CP6 will be effectively pricing FOC's off the railway network and will work directly against the strategy to encourage modal shift from road to rail. In particular this would become apparent on busy routes where risk and reward would be challenging to balance and justify.

Clarity and visibility of the costs incurred by passenger operators is also required. There is a belief by GBRf that the losses being claimed by the TOC's do not actually materialise. GBRf would like to see actual empirical evidence, both historic and current, of forecast losses through poor performance leading to the predicted downturn in revenue from the FOC's.

The way that benchmarks are calibrated at the end of control period seems counter-intuitive. Poor performance throughout the previous control period is rewarded with a higher benchmark - NR certainly benefited from this at the end of CP4 with a significant increase in their benchmark into CP5. However, improved performance is penalised with a reduction in benchmark. This is very much what the freight sector faced as a result of the CP5 settlement.

The Star Model

GBRf believe that the STAR model is the only realistic method of administrating the Schedule 8 performance regime, changing this to another method would mean individual contracts between all parties and would lead to unnecessarily high administration costs and significantly slow the resolution process down.

GBRf believes that having Network Rail as the party administering the regime is fundamentally flawed. So far this year GBRf have successfully disputed over £2 Million of incorrectly allocated TDA (See table below).

	Incidents		
2015/16	**Disputed**	**Changed**	**%**
P1	240	188	78.30%
P2	240	193	80.40%
P3	225	166	73.80%
P4	196	165	84.20%
P5	198	173	87.40%
P6	198	152	76.80%
P7	196	177	90.30%
P8	248	222	89.50%
P9	243	205	84.40%
P10 (As 4/1/16	165	150	90.90%
2015/16 to 4/1/2016	2149	1791	83.30%

There is no financial incentive for Network Rail to correctly attribute any TDA caused by Network Rail to their selves. If they allocate it incorrectly to the Train Operator and it is not noticed, then NR are financially better off. If they allocate it incorrectly to the Train Operator and it is successfully disputed, NR pay what they should have paid originally and are therefore no worse off.

In December 2015 GBRf felt it had no option other than employing additional staff (at significant cost to itself) to protect its financial position against this incorrectly allocated TDA by Network Rail.

GBRf see two possible ways of resolving this flaw:

1. Schedule 8 administration is carried out by a truly independent body with no financial interest in the outcome of allocated incidents.

2. A penalty charge is levied to Network Rail for all successfully disputed incidents, this would lead to more incidents being correctly allocated at Level 1.

Treatment of Cancellations and Service Variation

In relation to Late Notice SV&C, GBRf believe the current mechanism does not cover the costs incurred for that service. Within short timescales, almost all the costs have already gone in to running the service. The only saving would usually be track access and fuel (and even these are sometimes lost when we cancel services on the day). A more reflective figure needs to be discussed and agreed upon to ensure that the real cost of cancellations are clear and that a fair compensation figure can be established.

In addition, having a limitation on only one service variation claim per service will not fully compensate the operator for possible variations to that service.

> Example; If is service is diverted resulting in 2 additional run rounds and an arrival 2 hours later, using a diesel loco vice an electric, we can currently only claim 1 service variation payment. However this may result in GBRF having to employ, at short notice, 2 additional ground staff members as well as an additional driver (Possible 2 or 3 additional drivers if route knowledge issues and late running arise from the diversions). As well as an additional locomotive

or

Consideration to be given to an SV&C benchmark, working to a similar mechanism already in place for SV&C cancellations – in particular a higher payment rate once above the threshold.

<u>Liability Caps</u>

GBRf believe that an incident cap is a useful mechanism in the regime and as it is self-funding should be continued.

<u>Perverse Incentives</u>

If an operator reaches their annual Liability cap then there is limited financial incentive to focus on performance. In fact, the operator may actually choose to perform at a substandard level leading to a better benchmark in the next control period.

I trust that the comments made throughout this document are helpful in determining the position of GB Railfreight in reviewing the effectiveness of the existing contractual charging regimes. It should be clear throughout this response of the areas that GBRF believe work well under the current charging regimes. Nonetheless, GBRf have raised a number of challenges in reviewing aspects of the regimes that require urgent attention and should be treated as priority for the PR18 Charing Review.

Yours sincerely,

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