

GTR Response to ORR:

PR18 – Reviews of Schedules 4 and 8 of the TAC

This document represents GTR's response to the letter from the ORR to the industry, dated 13th November 2015, and subsequently discussed at the stakeholder event on Friday 27th November 2015. The key question posed by the ORR in this consultation and which this document addresses is as follows:

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

High Level Description – Performance Regimes

We broadly agree with the basis of definition put forward by the ORR in the high-level description, with the following clarifications:

- Clarify the first bullet that Schedule 4 relates to possessions and planned disruption; and Schedule 8 relates to performance (ie unplanned disruption). Only NR is responsible for planned service disruption (not 'other train operators')
- Schedule 8 is both a fare-box reward, rather than just a penalty mechanism, for NR.
- The third bullet point could be further clarified:

“provide appropriate **economic** signals so as to drive the decision-making in relation to performance and possession management, for example, in relation to **network** investments, or to give an indication to Network Rail on whether it is better to have a short possession but with higher engineering costs or take a longer possession. **The purpose therefore is to improve the value-for-money of the national railway.**”

Part 1 – Schedule 8

Looking at the ORR’s suggested structure in turn:

1) The purpose of Schedule 8

As this is an imputed calculation using parameters derived from econometric research, it should not attempt to draw in delay-repay costs into this mechanism (as done previously with Passenger Charter refunds), and remain one linked to the long-term impact of performance on revenue. Although there are benefits in passing NR its share of these refund costs these can be on the basis of the actual costs of the compensation regime (perhaps over a threshold linked to the NR benchmarks). However if this was done, further research would be needed on how this compensation impacts on passengers’ propensity to travel again within Schedule 8 (as they have effectively now paid less).

However it is the way the regime delivers this in practice that needs to be understood and improved, particularly as the TAC is now essentially unchanged for over 25 years old and should be reviewed to make sure it is still relevant for the changes to the railway occurring early in CP6 (eg Crossrail, Thameslink, ETCS) to make sure it is future-proofed. We would highlight the following areas that need review:

- The close-out of attribution – there is little pressure (despite the Track Access timeline) for NR to close out the attribution dispute process with large backlogs of incidents needing discussion. This causes both financial uncertainty and affects Schedule 8’s role as a liquidated damages regime. The ORR need to ensure NR improves its processes and monitor NR on its level of long-term incident disputes, reducing the transaction costs associated with this regime;
- The attribution of station-based incidents, as opposed to track-based, is to the impacted train operator alone, no matter who operates the station. Particularly for the large Network Rail stations this means that large infrastructure based issues (eg fire alarms, power failures etc) are attributed to the TOC. This is therefore contrary to the first two bullets set out in the definition and should be addressed to better incentivise NR; and
- Is it not clear how Schedule 8 will operate in future with an increasing amount of non-NR pieces of infrastructure (eg ELL and Crossrail) and stations operated by TfL (particularly Farringdon; but also much of the NCL to Moorgate). How will TOCs receive full revenue compensation (they currently often end up paying for LUL station closures) in future?

The underlying workings of the current regime therefore need to be reviewed to improve its future relevance and effectiveness to fulfil the high-level description.

2) NR Payment Rates

These should reflect the best-available research into the long-term impact of poor performance on operator revenue: again not just in theory but in practice. At the moment, following the decisions made prior to CP5, there is little reassurance that the correct delay multipliers, demand elasticities and other key inputs into the calculation are correct. Getting this right is important, ensuring that :

- Schedule 8 is providing the right level of compensation, so will prevent any issues around TOCs (or NR) using the regime perversely (RDG letter p15 Para 10); and
- NR has the most accurate possible level of economic benefit driving their business investment decisions.

We would ask the ORR to commission two pieces of work. The first is to use actual TOC revenue and performance data to see if the regime is working effectively and to confirm what the correct inputs into the regime are, re-establishing its economic soundness.

At the moment, the regime works on the basis that train lateness is a proxy for passenger lateness. The RDG response (p7) identifies an issue with passengers making interchanges. But the issue, in London at least appears to be much wider than that: in the last couple of decades considerable changes have happened in ticketing (ie Oyster/contactless) and ticket inter-availability; other transport (trams, London Overground, buses and even bikes); and passenger information; allowing passengers to manage their own journeys, using alternative arrangements when disruption occurs. The second piece of work, therefore, is the extent to which train lateness is still an effective proxy for passenger lateness in London and the South-East (and maybe contrasted nationally) to ensure Schedule 8 is properly compensating TOCs for revenue loss. Any study could possibly use gateline entry/exit data to look at passenger journey duration impacts.

But having the most accurately derived NR payment rates is fundamental to the regime working effectively, with it also being the key driver of the capacity charge (which needs to reflect NR's marginal Schedule 8 costs) and Schedule 4 compensation. The ORR should look to improve the research and understanding in this area as a matter of priority and then properly realign any future Capacity Charge regime with the performance (Schedule 8) regime to ensure both work as intended.

3) NR Benchmarks

One feature of the regime is the large swings of period financial compensation across the year, due to seasonality effects. Notwithstanding the existing payment provisions, one further suggestion would be to adapt the regime to have periodic benchmarks still equating to the overall annual output, perhaps aligned to the PPRP period targets. But NR's systems (ie PEARS) would need to improve to allow this to happen to ensure transparency and minimal additional input time for this to be viable.

4) Sustained Poor Performance

The SPP mechanism appears to exist in principle, but appears to be incredibly difficult and time-consuming to activate in practice. The ORR should provide guidance as to the type and level of evidence required for a successful claim and be the final arbitrator, perhaps with the ORR putting together an archive of the circumstances of claims suitably redacted for commercial sensitivity.

In addition, given the sustained disruption that has been ongoing on the South-East network linked to TLP works the ORR has a unique opportunity to understand if the nature of any additional impact on passenger revenue over and above Schedule 8 payments. Given the conclusion of this research, there is the opportunity to simplify or remove this part of the regime.

5/6) Operator Regime

A disproportionate amount of time and effort goes into calibrating this part of the regime, which leads to relatively small financial transfers. If this regime could be simplified, or replaced with an alternative compensation mechanism for NR this could lead to an easier regime to manage, payments based on actual interaction and lower transaction costs.

One suggestion, requiring further investigation, would be to do an annual calculation of the actual financial impact an operator has had on NR (through TOC-on-TOC causation) and doing a straight wash-up.

7) Cancellations

Reliability events have fundamental impacts on passenger journeys, both in terms of lateness and crowding, so the current process for NR (with incidents caused by a denial of track access) should continue. For TOCs, who already bear revenue risk, it is questionable how much value this provides when a train cancellation (esp those around train crew and fleet provision) is likely to have a lesser impact on other operators.

9) Interaction with regulated outputs and franchise obligations

It is not clear why the RDG response believes the ongoing NTF work around train performance metrics needs to be reflected in the performance regime (Feature 8.1), particularly as these are primarily intended to improve information to customers rather than best reflect the actual delivery of the railway. PPM, for example, is a much better indicator than Right-time as a single descriptor of good/bad performance. Unfortunately, as a measure it is also harder to defend to the public but it should be clear whether a metric is inward or outward facing.

The performance regime should continue to be linked to the revenue/economic research that best links passenger lateness (ie performance) to future revenue effects, which means relating this to the value of passenger time and ultimately back into PDFH parameters. In terms of the trajectory for the Control Period the choice of metric is actually a moot point; it is the quality of the planning that goes into creating this trajectory that is paramount. And where NR have been found wanting on the South-East Route in CP5, so it is the creation and delivery of the trajectory itself, rather than the metric in which it is expressed, that most needs to improve.

10) Perverse Incentives

Perverse incentives would be much reduced if the performance regime:

- Properly reflected the performance impact of revenue loss based on research; and
- Better reflected passenger journey experience, rather than the train service performance continuing to be used as a proxy for this.

11) Other aspects of the Regime

One key area to improve the performance regimes in general is knowledge management:

- There is little understanding within the industry of how the regime works, not just in theory but also how the calculations work in practice;
- Misunderstanding of the regime is often the cause of perceived perversities that in reality don't exist but are then created;
- Ensure that data and processes make recalibration of the regime during a Control Period as easy as possible; and
- A more joined-up approach between the ORR and DfT is needed to improve the transfer of new Control Period benchmarks into TOC Franchise Financial Models and the consequent change in payments.

Part 2 – Schedule 4

Again, looking at the ORR's suggested structure in turn:

1) The purpose of Schedule 4

See general performance regime response. But GTR is broadly supportive of the structure of current regime, just the granularity and level of inputs could be improved.

2) The level of compensation received by operators

Revenue

There are a number of issues with the revenue compensation mechanism:

- Possession compensation is dependent on the missed monitoring points within Schedule 8, which doesn't incentivise operators to use diversionary routes if all monitoring point stations are still being served. A more granular geography (maybe aligned to the Capacity Charge sections) would prevent this, particularly with the funded plan within CP5 for NR to improve its capability in taking shorter DC isolations to reduce possession network impacts;
- Since Control Period 3.5 (or CP3a), the deemed minutes for Schedule 8 unplanned cancellations were uplifted by 50%. Unfortunately this factor was also carried through into Schedule 4 which looks at the revenue impact of planned possessions (so pre-planned train cancellations) and should therefore simply use the mean service interval (ie two-thirds the level used in Schedule 8); and
- Revenue compensation under Schedule 4 is based on the off-peak payment rate when most possessions occur at evenings and weekends (esp Sundays), when on many London suburban services usage would appear to be less than during the week day contra-peak. However the extent of any shortfall needs further analysis.

The revenue compensation mechanism is heavily reliant on the correct calculation of the NR payment rate and as previously discussed more work should be commissioned to confirm the relationships and the correct parameters. Getting this right isn't just about properly compensating TOCs, but also better reflecting the economic cost to NR of taking additional possessions and improved alignment between regimes.

Bus Costs

Our biggest issue with the current approach to bus costs is the formula fails to take account of the actual number of buses laid on to move passengers during engineering works. In any case having a formulaic approach is always going to be less accurate and, almost certainly more complex, than basing payments on the actual invoiced cost of laying on replacement buses, with suitable safeguards to prevent over-charging.

3) Notification factors

Consideration should be made as to the extent that reduced discount factors based on 'New Working Timetable' (55% discount) and 'Informed Traveller timetable' (70%) notification are appropriate to LSE operators, when customers appear to often plan their journeys on a more short-term basis.

Supported by suitable analysis, it would make sense to revisit the scale of this differential perhaps, for LSE operators at least, removing the 'New Working Timetable' discount to rebalance NR's incentive to plan early but without the appropriate level of detail. It may also be appropriate, following further investigation and resolution of other implications, to have an intermediate timeframe (say six weeks out with a suitable planning timeline). This would help incentivise NR to be able to address emerging issues sooner or refinements to pre-existing possessions, without picking up the maximum discount factor (ie 85% currently) but still giving most customers sufficient notice.

Any changes to notification factors should also take into account the issue about the level of deemed minutes for planned cancellations being 50% higher than that intended.

4) The Access Charge Supplement (ACS)

It is unclear as to how effective the linkage is between the ACS (planned at an NR Route level), Schedule 4 (paid to operators) and NR's possession arrangements actually works in practice. Put another way, if NR does deliver all its possession levels effectively, is this actually reflected in near-neutrality for a TOC between the ACS and Schedule 4 payments?

At the end of a Control Period unspent ACS monies appears to currently stay within NR? Although this may reflect an efficiency saving and therefore rightful benefit for NR, this may also represent a failure to plan or deliver effectively. Therefore this retention may well not be incentivising the appropriate importance between good planning and delivery on the railway.

These appears to be partly due to a historic lack of openness and transparency in how the calculations are made at the start of the Control Period, but there also needs to be a review and improvement mechanism, using better data, built in to improve this linkage if deficiencies are identified.

5) Sustained Planned Disruption (SPD) Mechanism

This mechanism appears to exist in principle, but is incredibly difficult to activate in practice like the SPP mechanism in Schedule 8. Again, The ORR should provide guidance as to the type and level of evidence required for a successful claim and be the final arbitrator, perhaps with the ORR putting together an archive of claims suitably redacted for commercial sensitivity.

This would improve transparency and future transaction costs and ensure that the industry better understood the circumstances and evidence required for such a claim. Otherwise, as this appears to essentially exist only on paper, it might be better to remove SPD and simplify the regime.

8) Other aspects of the regime

The current calculation of Schedule 4 payments is overly manual and therefore open to error, particularly around mileage figures, increasing the transaction time. The process and method for calculation needs to be overhauled to improve the accuracy and the calculation trail, and reduce the time spent recalculating and agreeing the correct payment for the period.