Responses to PR18 consultation on changes to charges and contractual incentives - contents list

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Introduction

These comments respond to the ORR's consultation on proposed changes to charges and contractual incentives for Control Period 6. The response is provided on behalf of Arriva plc, its subsidiary Arriva UK Trains Limited and its wholly owned train operating companies (TOCs), Arriva Rail London Limited, Arriva Rail North Limited, Arriva Trains Wales/Trenau Arriva Cymru Limited (ATW), DB Regio Tyne & Wear Limited (DBTW), Grand Central Rail Company Limited, The Chiltern Railway Company Limited (CR) and XC Trains Limited (XC). Arriva is a wholly owned subsidiary of Deutsche Bahn AG (DB AG).

Arriva views the Periodic Review (PR18) process as an important element of a coordinated series of activities necessary to ensure that all elements of the Rail Industry structure work together to support the delivery of the vital contribution that rail needs to make to society in the UK.

Therefore, Arriva has played an active part in the Periodic Review process to date and intends to do so going forward. In particular, Arriva is supporting the coordinated industry activity being undertaken by the Rail Delivery Group (RDG).

On this basis, Arriva endorses the responses provided to ORR by RDG relating to the consultation documents issued by ORR to date and confirms that Arriva's views are firmly reflected in the RDG response.

Regardless, Arriva would like to take this opportunity to emphasis a few key points that have emerged through the work undertaken to date.

In reviewing the ORR's proposals, we were struck that it was not always clear whether ORR saw a particular aspect of the overall regime as a Charge linked to a Network Rail cost or as an Incentive linked to motivating a particular behaviour from the parties involved. Clearly, while avoiding cost through a reduction in the level of Charges that are due has an incentive property, this would appear to be a secondary purpose. It would aid understanding of how the structure of charges and incentives is intended to work if the primary purpose of each element was made clearer by ORR.

In responding to this Consultation, a recurring issue has been that it is difficult to reach a firm view on the individual elements of the proposed structure of Charges and Incentives by considering the element in question in isolation. In this context, there are several areas where key elements are currently missing with future work to be undertaken by ORR or with no specific proposals being made by ORR.

Further to this, while we are looking at the principles associated with each of the proposed changes to the structure of Charges and Incentives, it will only be possible to assess the impact of these taken together when the overall financial impact is assessed which is also subject to future work.

Overall, has been very supportive of ORR's stated intention to focus the PR18 process on a number of key elements such as:

- Introducing Route Based Regulation
- Separate Regulation of Network Rail's National System Operator function
- Ensuring clarity as to the Outputs that Network Rail is expected to deliver
- Ensuring that Network Rail is funded to deliver these Outputs efficiently.

However, Arriva is concerned that ORR is proposing a number of significant changes targeting areas which have previously not been seen as priorities and where the expected benefits are of smaller scale. In particular, the proposed structural changes to the Operator Schedule 8 regime are a matter of significant concern at a time when the workload associated with the priority areas is already stretching the resources available.

Infrastructure Costs

Arriva welcomes the focus on improving transparency around costs and the drivers of costs and how these link to the associated Charges. Specifically, Arriva supports the objective of making Charges more cost reflective. However, if the benefits of this approach are to be unlocked, it is vital that the process of assessing cost drivers and cost allocation needs to be robust. Otherwise, we could expose Operators to the wrong price signals and potentially leave Network Rail with incorrect funding levels.

Arriva notes that the ORR links the changes proposed in this area to promoting further competition in the provision of passenger services. Arriva believes that enabling competition in the provision of commercial passenger services has the potential to lead towards greater diversity of service provision providing passengers with real choice driving increased passenger satisfaction and faster market growth. Arriva sees that growth in the markets served by commercial train services has been such that these markets could now be served in a sustainable way by multiple operators operating financially and operationally viable businesses – provided an appropriate contractual framework can be put in place. In this context, changes to the Charging structure is a necessary enabling step but it is not in itself sufficient as parallel reforms of the Franchising arrangements will also be needed. In addition, the role to be played by DfT's proposed Public Service Obligation (PSO) Levy needs to be considered as part of the overall contractual and financial framework.

Long Run Incremental Cost Charges

Of the 4 Options outlined for the deployment of changes to the overall framework for Long Run Incremental Cost charges, Arriva cannot support Options 3 or 4. Option 3 seems undeliverable in the absence of a capacity utilisation measurement methodology while Option 4 could lead to an artificial distinction between Operators who operate in the same downstream market but hold different duration of Access Rights. The different cost-base of the two type of operators could lead to significant downstream market distortions.

Arriva will only be able to take an informed view on Option 2 once the detail of other aspects of the overall structure of Charges and incentives are clear. In particular,

- Ability to bear tests
- Capacity Charge
- Process for gaining access to the Network including revisions to the Not Primarily Abstractive test.

In the absence of this necessary clarity, at this stage Arriva can only support Option 1.

If the issues highlighted below can be satisfactorily addressed, Arriva can see benefits of progressing Option 2.

In reviewing ORR's draft Impact Assessment in this area, Arriva would observe that the current expression of the "problem under consideration" does not take sufficient account of the conclusions reached by the High Court in 2006. These included that:

- the nature of the Open Access market segment and the contrasts with the Franchised Operator market segment fully justified services in the Open Access market segment not paying the artificially constructed Fixed Track Access Charge
- services which "…are able to pay for the costs that will be directly incurred as a result of their operations should be encouraged to use railway infrastructure…".

Ability to Bear tests

While Arriva notes that ORR intend to undertake work in this area early in 2017, we have some initial observations.

- It is essential that these tests should be applied to appropriate market segments. In particular:
    - The approach to non-commercial PSO services operated under Public Service Contracts (PSC) needs to be made clear. It seems inappropriate to treat these are having an unlimited ability to bear Charges associated with infrastructure long run incremental costs just because they are funded through a PSC. However, it is appropriate that there should be transparent attribution of the infrastructure long run incremental costs associated with these services to ensure that funders can make appropriate decisions with regard to the cost effectiveness of such services. This may become increasingly important as funding of PSO services is evolved to local transport authorities
    - For commercial services, whether they are operated under PSCs or not, the granularity of the market segmentation needs to reflect the very wide variation of the ability to bear Charges associated with infrastructure long run incremental costs between individual services. This granularity needs to reflect differences in revenue earning capability between for example:
        - Peak v off-peak
        - Different origin/destination pairs
    - Services that are subject to constraints on their revenue earning capability as a result of restrictions placed on their Access Rights as result of the application of previous processes for gaining access to the Network, including the current Not Primarily Abstractive (NPA) test, need to be considered as a specific market segment separate from services which face no such restrictions. This matter was extensively addressed by the High Court in 2006 where the markedly different nature of these two types of services was highlighted in the judgement. The business model for such services did not include the expectation that they would have to bear Charges associated with infrastructure long run incremental costs having commenced operations on the basis of covering their full short run marginal costs – this should be taken into account when considering the ability of such services to bear additional Charges.
    - The additional protections and risk mitigations enjoyed by Operators of services covered by a PSC should be considered when determining market segmentation. Such services should continue to be considered as being in a separate Market Segment to services not covered by a PSC. This matter too was extensively addressed by the High Court in 2006 where the markedly different nature of these two types of services was highlighted in the judgement. ORR should also give particular attention to the treatment of services which are not covered by a PSC but are nonetheless operated by an Operator who holds a PSC. Legislation already requires separate accounting for such services to ensure that no cross-subsidisation occurs.
- The ability to bear test should not be applied as a single test at a single point in time but should consider:
    - Past losses associated with previous service build up
    - Future revenue earning capability which may be affected by changes in market conditions including the start-up of additional potentially competing services

- Close consideration should be given to the specific parameters to be assessed in applying the ability to bear test. Different options seem viable:
    - Profitability
    - Return on Capital employed
- Consideration should be given to options to make the application of the ability to bear test dynamic so that the impact during a Control Period on a market segment's revenue earning capability from exogenous factors are adjusted for automatically. In particular, transitional arrangements may be necessary.

ORR highlight the potential interaction between the Ability to Bear test associated with cost reflective Long Run Incremental Track Access Charges and the DfT's proposed PSO Levy which is suggested to have a parallel Ability to Bear test. It is imperative that ORR and DfT coordinate their work on these two proposals given their inevitable interplay. In particular, it would be important to determine the order in which the two tests and associated Charge and Levy are applied. Arriva's expectation is that Charges Mark Ups would be applied first and then any PSO Levy. In addition, it is important that two proposed tests are congruent and test the same parameters in the same way with similar thresholds.

Capacity Charge

The current structure of the Capacity Charge whereby significant Charges are raised on existing "baseline" services before any additional services operate seems wholly incompatible with the application of fully cost reflective Long Run Incremental Cost Charges as proposed in Option 2. On that basis, if ORR were to take Option 2 forward, the option to abolish the Capacity Charge should be adopted.

In this context, the incentive for Network Rail to encourage the operation of additional services in a Control Period could be provided by the recovery of additional Long Run Incremental Cost Charges from these additional services even though no additional Long Run Incremental Costs would be incurred by Network Rail. Alternatively, such additional services could pay an appropriate Capacity Charge reflecting the additional Schedule 8 costs they generate for Network Rail and not pay Long Run Incremental Cost Charges.

Arriva notes that ORR might be considering the "variablisation" of the Long Run Incremental Cost Charges. Notwithstanding the proposal for additional services to pay additional Long Run Incremental Cost Charges as an interim step to address the additional Schedule 8 costs that would fall to Network Rail as a result of the operation of these additional services, Arriva would not be supportive of general "variablisation" of the Long Run Incremental Cost Charges as this runs the risk of underfunding Network Rail as a result of traffic volumes falling either on a planned or unplanned basis.

However, if ORR were not to take forward Option 2 to introduce fully cost reflective Long Run Incremental Cost Charges, then the need to address the anomalous structure of the Capacity Charge remains. As the purpose of the Capacity Charge is to recover additional Schedule 8 costs falling to Network Rail associated with additional traffic, the way that the current structure of the Capacity Charge operates whereby significant Charges are raised on existing "baseline" services before any additional services operate or additional costs are incurred by Network Rail highlights that most of the income that Network Rail receives from the Capacity Charge does not reflect a cost directly incurred. On that basis, despite the ORR's concerns, Arriva believes that the only viable option that has been identified to date remains Option 2.

With regard to Option 1, Arriva does not believe that the ORR's argument that there is a legislative barrier to removing the existing Capacity Charge caps is valid. The Capacity Charge does not form part of the "minimum access package" of Charges and is not related to a cost directly incurred as a result of the operation of "baselines" services. In which case, ORR does have the freedom to phase or cap the application of a Capacity Charge constructed in this way on Baseline services.

Process for gaining access to the Network

The application of fully cost reflective Long Run Incremental Cost Charges as proposed in Option 2 will require significant amendments to the process by which Operators gain access to the Network including to the current NPA test. The exact nature of these necessary changes will be strongly influenced by the approach taken to the definition of Market Segments. However, it would be inappropriate for a service provided by an Operator whose ability to bear fully cost reflective Long Run Incremental Cost Charges as proposed in Option 2 was reduced by the restrictions on its Access Rights to be placed in the same Market Segment as a service provided by an Operator who did not face such restrictions. Arriva suggests that a service paying Long Run Incremental Cost Charges should suffer no further restrictions on its access to the Network other than those arising from the proposed Economic Equilibrium test to ensure no impact on the viability of a PSC.

As the High Court concluded in 2006, the process by which Operators gain access to the Network and the protections from funders they do or do not enjoy, have significant bearing on the nature of the Market Segment that particular services fall into.

Station Charges

It does not appear that the current station long term charge (LTC) arrangement has been successful in enabling Network Rail to renew key station assets in a sustainable way to the extent that the station asset condition is falling behind the needs of passengers and Operators. For example, station Customer Information Systems are of widely differing quality across the Network with an increasing reduction in system integration and in addition, in contrast to the rapidly improving situation for rolling stock, the low level of station accessibility represents a major concern to Operators and Stakeholders.

Arriva supports the proposals that ORR are making but do not feel that they go far enough to address these issues. In addition, the forward look on future costs should take account of cost reductions that should be delivered by the replacement of old, costly to maintain systems with modern equivalent solutions.

Short-run variable charges

Arriva recognises that short-run variable charges are important in encouraging appropriate behaviour on the Network and in ensuring that Network Rail is properly funded by the right party for the costs directly incurred by services operating. However, for these objectives to be delivered, the charges need to be properly cost reflective and related to the cost directly incurred. In that context, Arriva continues to have significant concerns with regard to the current structure for the Capacity Charge. The declared purpose of the existing Capacity Charge is to recover the additional Schedule 8 costs that Network Rail would incur if additional traffic were to be operated on the Network. However, as the Capacity Charge is levied on “baseline” traffic before any additional services operate, its application to “baseline” services cannot be seen as cost reflective or related to a cost directly incurred.

Caps on Charges

ORR highlights restrictions that flow from recent new legislation on its ability to cap Charges. As Arriva understands this legislation, the restriction only applies to Charges that relate to the minimum access package. However, as the Capacity Charge is not part of the minimum access package and when applied to “baseline” traffic does not reflect a cost directly incurred by Network Rail, Arriva understands that ORR do still have the ability to cap or phase in the application of the Capacity Charge.

Variable Usage Charge

Arriva agrees that the Variable Usage Charge (VUC) is not a priority area for structural review in PR18 – this conclusion is in line with the RDG Review of Charges work. However, Arriva does believe that taking the opportunity to refine the calibration of the VUC has benefits having highlighted issues related to the use of a single operating speed for each Class of rolling stock. Such refinements need to be undertaken carefully so that changes to the deployment of rolling stock within a Control Period are reflected in changes in the VUC calibration parameters if necessary.

Capacity Charge

In addition to the previous observations made earlier with regard to the Capacity Charge, Arriva’s view is that the current construction of the Capacity Charge is an overly complex approach to delivering a relatively simple objective – the main flaw being its application prior to any additional traffic operating. Given the limited extent to which the situation where additional traffic above that which was anticipated at the time of the calibration of

Schedule 8 arises, Arriva suggests that significantly simpler approaches to achieving its purpose are available. In particular, Arriva does not share ORR's concerns with regard to the recalibration of the Schedule 8 Benchmarks as and when traffic not considered at the original calibration joins the Network. However, Arriva's preferred option would be the removal of the Capacity Charge.

Schedule 8

Arriva is concerned by the revisions that ORR are proposing to the expressed purpose of the passenger operator Schedule 8 regime as these have the potential to complicate its central role as a simple liquidated damages mechanism to reflect the long-term revenue changes affecting an Operator driven by under or over delivery of the targeted Performance trajectory for reasons other than their own delivery. ORR correctly set this out in the Box 4.1 and in the "Do Nothing" section of its draft Impact Assessment on Schedule 8 and passenger compensation.

However, Arriva is also surprised that ORR is proposing significant structural changes to the passenger operator Schedule 8 regime which cuts across the core principle identified by ORR in Box 4.1 that "Schedule 8 helps operators manage risks they cannot control" despite the consensus that the regime is broadly fit for purpose. In addition, ORR's proposals seem to be targeting small benefits but would require significant effort to implement at a time when resources are stretched.

Reflecting passenger compensation in Schedule 8

Given the existing confusion with regard to the purpose of Schedule 8 with regard to passenger compensation, Arriva believes that it is important that passenger compensation should not be directly reflected in Schedule 8 payments – as ORR correctly highlight in Box 4.1 of their consultation document, Schedule 8 "payments are not meant for the purpose of funding passenger compensation".

However, as passenger compensation becomes an increasingly central part of the rail industry's customer promise, it is important that clearer linkages are made to address the costs that currently fall to operators associated with the sort of "risks they cannot control" highlighted in Box 4.1 including from Network Rail and other Operator caused disruption.

Given the increasingly formulaic nature of passenger compensation, it seems most efficient that each operator should present Network Rail with an account for each Period for all Passenger Compensation paid out in accordance with the industry standard published Compensation Policies. Discretionary compensation above these levels that an Operator chooses to pay to passengers should not be included.

As with other aspects of Schedule 8, this new Passenger Compensation funding mechanism should reflect Passenger Compensation associated with "risks they cannot control" including those associated with Network Rail, external factors and other Operators. However, Arriva can foresee a number of challenges in linking the level of Passenger Compensation due to the attribution of delay cause given that it may not always be clear which of several factors caused a specific train to trip the compensation thresholds.

Setting of Benchmarks

Arriva is puzzled by ORR's description of the Schedule 8 Benchmarks as not representing targets. Regardless, it remains important that the Schedule 8 Benchmarks reflect the Performance levels associated with "risks they cannot control" that an Operator can expect to see delivered. In particular, Network Rail's Benchmarks should be aligned to the regulated outputs as highlighted in paragraph 4.25. This ensure that an Operator's revenue forecasts are aligned to the Liquidated Damages mechanism in Schedule 8.

With regard to Operator Benchmarks, in the absence of any regulated outputs, the use of historic performance levels to set Operator Benchmarks seems to be an appropriately objective approach. Arriva does not recognise the ORR's concern that using historic performance would motivate an Operator to under deliver with regard to TOC on Self performance give the strong revenue and cost incentives that Operators face in this area. An alternative approach involving grouping Operators run the risk of exposing an individual Operator to a Benchmark unrelated to the nature of their operation.

If ORR were to change the structure of the Schedule 8 Operator regime to one based on TOC on TOC delay minutes, then a benchmarking process based on historic performance seems the only viable approach given the absence of any target setting process in this area at present.

Improving the measure of passenger operator performance

As highlighted above, Arriva is most concerned that ORR is proposing significant structural changes to the passenger operator Schedule 8 regime which cuts across the core principle identified by ORR in Box 4.1 that “Schedule 8 helps operators manage risks they cannot control” despite the consensus that the regime is broadly fit for purpose.

The description of Operator Schedule 8 payments as being based on a “proxy” for the impact of any delay an operator causes to other operators does not properly reflect the full nature of the Operator regime with the Operator Payment rate actually being set to reflect exactly this impact using historic data. This historic correlation between TOC on Self delay and long-term revenue impact caused to other operators and is therefore not in fact an “empirically derived assumption” as stated in paragraph 4.37. It is also not limitations in the PEARS data system that lead to the current structure of the Operator Schedule 8 regime as stated – rather, as detailed below, the current arrangement reflects correctly the relative roles of Operators and Network Rail and PEARS was constructed to deliver the outputs required by the structure of Schedule 8.

The separate observation in paragraph 4.38 that the inclusion of a pre-determined amount of TOC on Self delay whenever an operator cancels one of its own services may indeed lead to perverse consequences. This observation was made in the previous RDG Review of Charges work in this area. However, this quirk could be most simply corrected by excluding TOC on Self “deemed minutes” from both the Benchmark setting and from the Delay Attribution processes.

Arriva has significant concerns with ORR’s proposal to switch the Schedule 8 Operator regime from a TOC on Self Regime to a TOC on TOC regime. As noted above, the current structure of Schedule 8 has extensively reviewed over the last 2 years and found to be broadly fit for purpose with no pressing need for significant or structural change. The proposal that ORR is making runs the risk of disconnecting the incentive arrangements created by Schedule 8 from the roles that industry parties play in managing Operations on the Network. As ORR say, a core purpose of Schedule 8 is to help “operators to manage risks they cannot control” – in this context, Operators can control delays they cause to themselves and are highly motivated to do so by Schedule 8 and other arrangements such as those associated with the Franchise Contract, passenger revenue and compensation, their own direct costs and reputational impact. However, Operators are not tasked with the management of services on the Network and therefore cannot control the broader impact that delays they cause to themselves might have on others. This role is vested in Network Rail and Network Rail is provided with significant tools through Access Contracts and the Railway Operating Code by which can it discharge this core System Operation role. Network Rail is able to take direct and immediate action to manage services on the Network in order to “minimise overall delay” - for example through the deployment of “Incident Officers” who act a single guiding mind for the whole industry in managing an incident and through the enactment of agreed Contingency Plans and Regulating Policies. Further, Network Rail is funded to undertake this role through its Control Room teams.

The current structure of the Schedule 8 Operator regime is calibrated to ensure that Operators who cause delay to other Operators pay the full long-term financial impact caused by those delays on the basis that Network Rail continue to manage such incidents at least as well as was the case historically. This arrangement also ensures that Network Rail remains incentivised to manage the impact of all incidents occurring on the Network whether they be associated with Network Rail’s other activities, external factors or Operator incidents. In this regard, the current Schedule 8 Operator regime is broadly fit for purpose. It could be improved by the exclusion of TOC on Self cancellations, as noted above, and by improvements in the dataset used for setting Operator Payments Rates to ensure that these are as up to date as possible.

While in their proposed change to the structure of the Schedule 8 Operator regime, ORR have focused on the delay caused to “victim” Operators. It is less clear what the proposal includes with regard to determining the relevant Payment Rates for “victim” Operators. Both parameters are required to calculate the long-term financial impact caused to “victim” Operators.

If ORR were to progress their proposal to change the structure of the Schedule 8 Operator regime then it will be necessary to increase the powers of Operators to develop and to implement Contingency and Train Regulation Policies affecting other Operators in reflection of the new System Operation role that the revised incentives has created. While this is necessary, Arriva sees it as unfortunate that moving in this direction cuts across the current industry Performance improvement strategy which focuses on Network Rail providing an authoritive “single guiding” mind to directly manage the reactionary delay impact of incident regardless of the primary cause. In addition, Arriva sees this change of direction in System Operator role as contrary to the positive moves currently being made to develop effective Alliance arrangements between Operators and Network Rail.

The draft impact assessment in this area does not properly reflect these concerns. In particular, the incentive properties of Schedule 8 on Network Rail in its System Operator role to the manage performance impact incidents occurring on the Network would be significantly reduced as there would be no incentive associated with Operator caused incidents. At the same time, this System Operator related incentive would be transferred to Operators who are not vested with a System Operator role in this area. As a result, it could be expected that overall Performance would be worsened at a time when Performance improvement is correctly identified as a key stakeholder requirements and when the industry is currently not delivering the required Outputs. Further, it could be expected that Operators would invest in additional incident management and delay attribution resources to oversee the System Operator activity undertaken by Network Rail in managing Operator caused incidents. These resources would duplicate existing Network Rail resources leading to higher industry costs at a time when cost pressures are already evident.

The draft Impact Assessment does not properly reflect that the proposed change to the structure of the Schedule 8 Operator regime does not create a totally new incentive on Operators. The current structure of the Schedule 8 Operator regime is calibrated to ensure that Operators who cause delay to other Operators pay the full long-term financial impact caused by those delays on the basis that Network Rail continue to manage such incidents at least as well as was the case historically. It would appear that the ORR’s proposal is primarily focused on making these payments for specifically linked to individual incidents rather than based on a longer run correlation. It is not clear what benefits this change in calibration will in itself deliver despite the significant effort that would be required to deliver the proposed structural change to the Schedule 8 Operator regime.

Sustained Poor Performance provisions

Arriva would welcome changes which would streamline the application of the Sustained Poor Performance provisions. However, it seems perverse to exclude claims associated with revenue loss on the grounds that problems reaching agreement in this area are currently experienced. This is a proposal to address the symptoms but not the cause. Instead, as revenue loss is the principal effect of sustained poor performance, more work needs to be done to understand what is causing the difficulties currently being experienced and address these.

Schedule 4

As with Schedule 8, extensive review of the Schedule 4 regime has found it to be broadly fit for purpose without the need to structural amendment. However, it was also found that refinements in a few areas could have significant benefit – the ORR proposals address these areas and are welcome.

Notification Discount Factors

Arriva welcomes the retention of Schedule 4 Notification Discount Factors and agrees that these should be reflective of the very best evidence available and is therefore keen to support ORR’s market research in this area.

ORR should also consider the additional costs falling on Operators generated by Network Rail providing late advice or making late changes to Possession Plans.

Access Charge Supplement Calculation

It is clear that the calculation of the Access Charge Supplement is difficult for Network Rail with Arriva being unable to obtain quotes from Network Rail within a meaningful timescale. In that context, Arriva would have liked to have seen consideration given to alternative approaches in this area which could have reduced the scale of the task.

However, in the absence of such options, Arriva welcome approaches which would bring the level of the calculated Access Charge Supplement more in line with the actual Possessions Network Rail take. The option to recalculate the Access Charge Supplement annually in line with the emerging actual Possessions plan seems to achieve this most closely.

Bespoke Compensation for Major Disruptions

Arriva's experience of Sustained Planned Disruption has indeed been that the current thresholds are too high given the commercial profile of Operators and their exposure to financial flows under Franchise Contracts. A review of these thresholds would be welcome and should take account of the overall financial profile of Operators and their ability to mitigate the effect of Sustained Planned Disruption.

Operator Bus Costs

The recalibration of Schedule 4 should review the actual costs incurred by Operators in operating buses when the Network is disrupted for planned work. This should be associated with amendments to the Access Contract to allow these recalibrated costs to be paid to Operators.

Recalibration of Schedules 4 & 8

While a greater degree of industry leadership in this area could be beneficial, it is important that the industry is given a clear picture as to the parameters of the recalibration and the level of authority to be delegated to the industry. In particular, the recalibration should not be allowed to become a negotiation between Operators and Network Rail as to the level of the underpinning Regulated Outputs or become subject to a pattern "asymmetric warfare" with the technical competence sitting solely with Network Rail.

For these reasons, Arriva has previously valued to the central role played by ORR and would welcome that this were continued if only in the form of a strong oversight function.

Aligning Network Rail and Operator Incentives

While the majority of Operators are not directly exposed to the level of Network Rail costs, it is also the case that Operators have extremely limited ability to influence those cost levels. At the same time, Operators are not disinterested in Network Rail's cost levels as there continues to be only two sources for income for the industry – end users and the taxpayer. The more of these income streams that Network Rail consumes, the less that is available to support improvements for end users delivered through Operators. In addition, Operators are very focused on stakeholder perceptions of overall rail industry finances and strongly desire to be part of an industry that is well regarded by stakeholders for its cost effective delivery of good customer service.

With this background, the important first step should be to establish suitable means by which Operators can meaningfully influence Network Rail's costs as without the means to exert influence any incentives will simply expose Operators to risks they cannot control. Establishing this vital enabling framework should be the priority for PR18 with detailed financial incentive regimes considered once this is clear. ORR's focus on introducing direct Route Based and National System Operator Regulation will be pivotal in this area. Clearly, on this basis, any incentive regime should be limited in its scope to the cost elements where Operators are enabled to have influence and not the totality of Network Rail's cost base.

In order to achieve these objectives, any Operator incentive regime in this area should be:

- Financially limited to reflect areas where the Operator is enabled to exert influence
- Geographically limited to reflect the Operator's physical scope of influence

- Time bound to reflect the impact of the Operator's influence with baselines reset accordingly– impact could be assessed annually
- Upside only to reflect that Operators and Network Rail will be working together on cost improvement projects and not expose Operators to failures of Network Rail's own cost control processes which Operators cannot affect.

Arriva is of the view that the most effective approach to industry joint working in this and in other areas is likely to be in the establishment of formal Alliances targeting specific agreed areas of activity. Such Alliances need not be limited to being bilateral – multi-lateral Alliances with appropriate focus should be entertained. In that context, participation in a formal incentive regime should remain as an option for Operators to take on as appropriate.

In addition, the developing approach to Route Governance through Route Supervisory Boards can be expected to be complementary to an Alliancing approach.

Yours sincerely

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Arriva Rail North's response to ORR's Consultation on changes to charges and contractual incentives

Introduction

The Northern franchise is driving a transformation of rail travel in the North of England. Through delivering £1billion worth of investment, major service enhancements will drive economic growth across the regions we serve. By December 2019, we will have implemented new trains and faster journey times, supporting a 37% increase in capacity and over 2,000 additional services each week.

ARN views the PR18 process as crucial to ensuring that the structure of the rail industry in CP6 is aligned towards the delivery of shared objectives; notably efficiency, growth and strong performance. We welcome the opportunity to respond to this consultation relating to charges and contractual incentives, and are pleased to engage in wider industry dialogue to help develop efficient customer-led incentives regimes for CP6. We also endorse the response provided by our parent company Arriva.

Whilst recognising that financial incentives are important, ARN is eager to see behavioural incentives incorporated into the regimes. In order for the industry to become more integrated and customer focused a robust programme of cultural change is required. Network Raul must be incentivised to be driven by an understanding of its impacts on direct customers and end users. We view the introduction of greater behavioural incentives as a vital precursor to achieving this, driven by collaborative Alliancing between operators and Network Rail.

Infrastructure costs

ARN supports the ORR's recommendation for greater transparency and reflectivity of costs, as this sends clear signals to the industry in relation to Network Rail's cost base. A clearer understanding of Network Rail's cost base is required to ensure that costs to operators are fully reflective, and to inform the further development of fixed cost charges.

We also support the concept of Open Access Operators (OAOs) paying an increased fixed cost charge in order for greater access to the network. This must be based on a detailed assessment of their ability to bear such charges. We agree that the current NPA test will not be fit for this purpose in its present form if this regime is altered as recommended by Option 2. Furthermore, if OAOs are expected to pay additional fixed costs there must be a clear process to assess their ability to pay, which must not undermine their business model. This process must be developed with cognisance to franchised services and the impact on the funds available to the DfT and the franchising process.

Short-run variable charges

ARN is content for no major changes to the VUC to be prioritised for CP6.

Capacity charge

The Capacity charge is not well understood, largely deriving from its complexity coupled with a lack of transparency in how it is calculated. ARN questions whether it currently provides the correct incentives to Network Rail. ARN supports ORR's recommendation not to replace the Capacity Charge with adjustments to Schedule 8 benchmarks. We are of the position that this would promote a lack of transparency and cut across the principle of having clear visibility of Network Rail's cost base.

ARN would support the current caps on the Capacity charge being removed, subject to the application of an accurate ability to bear test. We also support the further development of the charge as a variable charge based on actual train mileage. This would enable it to more accurately reflect changes to the level of traffic on the Network during CP6 and hence act as a greater incentive for operators to better use capacity, as well as protecting Network Rail from additional Schedule 8 impact as intended.

Schedule 8

Passenger compensation

ARN does not think it is appropriate to include passenger compensation within the existing Schedule 8 regime. The associated recalibration of the Schedule 8 regime would be prohibitively complex. As well as requiring detailed yield information from operators, there is a risk the current delay attribution principles applied to the Schedule 8 regime will not align with the causes of passenger compensation claims. ARN would support an actual sums recovery regime. This would need to be simple to administer so any additional burden on operators in submitting these claims is limited and manageable.

ARN would endorse a more transparent approach to passenger compensation levels, in particular the spilt between Network Rail/Operator caused delays. This could drive behavioural incentives for Network Rail to manage any potential reputational risk amongst end users. Notwithstanding the potential administrative costs to operators of providing the information, it may also be a more efficient and value for money alternative to the other options considered within the consultation document.

The approach to setting benchmarks

ARN is highly concerned by the ORR recommendation to move away from setting benchmarks based on past performance and seeks clarity on the methodology that ORR is proposing as an alternative. We do not feel ORR has provided a compelling case to alter this element of regime. Until we have further information on ORR's proposed approach are unable to further develop our view on this recommendation.

Making assumptions on future performance risks the potential misalignment of benchmarks with actual performance trends. By allowing Network Rail to determine its own trajectory for CP6 there is a real risk that there will be a disconnect between Network Rail's targets and what operators have committed to delivering as part of the franchise bidding processes. Network Rail is already behind its CP5 performance trajectory and allowing benchmarks to be agreed without taking into account past performance risks weakening incentives to improve performance.

Improving the measure of passenger operator performance

ARN does not support in any way ORR's recommendation to change the measure of passenger operator performance within Schedule 8 to one based on delay caused to other operators (TOC on TOC). The industry has agreed that the current Schedule 8 regime is fit for purpose and does not require a radical overhaul for CP6. We are thus perplexed by this proposal, and do not believe it should be a priority area for PR18. ARN does not have full control over service recovery and we feel as system operator this responsibility should sit with Network Rail. This change would create significant administrative burden on operators, which are not currently resourced to attribute delay beyond its route cause. We also believe that this approach will act as a perverse incentive to Network Rail in mitigating the effects of any disruption, ultimately disadvantaging the passenger.

ARN would like to understand why ORR believes this is a priority area and is recommending this approach, and seeks clarity on how this would be implemented in practice. ARN is keen to work with the industry to further understand the key issues driving this shift and to identify a solution that provides the correct incentives to all parties to reduce TOC on TOC delay.

Sustained Poor Performance

ARN would support ORR's recommendation to simplify the contractual mechanisms associated with SPP provisions, in consideration of the administrative burden of assessing, preparing and successfully submitting a claim. We are also of the view that this contractual mechanism should allow for both cost and revenue recovery. Formulaic revenue loss under Schedule 8 is a proxy and not designed to take into account prolonged poor performance, which can have a significant detrimental effect on the fare box. The ability to claim revenue loss compensation via the SPP framework should therefore be retained for CP6 as a mutual incentive for performance improvement.

Schedule 4

Notification Discount Factors

ARN welcomes a review of the NDF and how this links with Network Rail planning processes. This element of the regime must provide the appropriate incentives for Network Rail to plan possessions effectively and successful first time. In our experience there is currently a perverse incentive that encourages Network Rail to book more possessions than are required, without understanding the work content in order to get possessions 'cheaply'. We are pleased to see that ORR is carrying out some market research into this area.

Bespoke compensation for major disruptions

ARN would support a review of the SPD thresholds, noting that no claims have been successful in CP5 to date. We believe that the thresholds are set at an unrealistic level. Given the nature of our operation, the current mechanism makes it virtually impossible to make a robust claim at Service Group level. We believe that this mechanism is overly complicated and would wish to see it simplified via a formal workstream for CP6. The North of England is currently seeing unprecedented levels of disruption which does not fall distinctly into a Type 2/3 category. The current contractual provision does not provide any opportunity to recover our costs and losses as a result of prolonged disruption.

Recalibration of Schedules 4 and 8

ARN does not support the ORR's recommendation to extend Network Rail's responsibility for most aspects of recalibration of charges and incentives to recalibration of the passenger regime's payment rates. An independent party is required to control the calculations and auditing behind the recalibration of regimes.

Aligning Network Rail and operator incentives

ARN believes that the establishment of Alliances can address the issue of financial exposure and efficiency over Network Rail's costs. It is our view that this provides a greater incentive for close bilateral and multilateral collaborative work between operators and Network Rail than the current REBS mechanism. In line with this, we do not believe REBS in its current form provides an effective incentive for Network Rail and operators to work together more closely.

Conclusion

In light of the points raised by this response, ARN looks forward to actively engaging in the further development of charges and contractual incentives for CP6. Greater clarity on the detailed design and impact of the proposed changes is essential for productive dialogue to ensure customer-led decisions are made that ultimately benefit the end user.

Yours Sincerely

Georgia Ehrmann

Georgia Ehrmann
Track Access Manager

Improving incentives on Network Rail and train operators: A consultation on changes to charges and contractual incentives – March 2017

1. The Associated Society of Locomotive Engineers and Firemen (ASLEF) is the UK's largest train driver's union representing approximately 20,000 members in train operating companies and freight companies as well as London Underground and light rail systems.

2. ASLEF's main area of concern regarding access charges is around the matter of rail freight. ASLEF clearly has an interest in growing our industry and protecting it from any potential decline. The nature of the franchising system means that services are not likely to be put at risk by changes in charges. Rail freight services, are however far more exposed to the free market and have very tight margins. Any changes to charges for them could risk transferring freight from rail to the road, and losing the multitude of rail freight benefits. It was for this reason that the union strongly opposed the introduction of a freight-specific charge in 2012.

3. The charge on trains carrying coal for the electricity supply industry has caused huge problems for the industry and has contributed to coal volumes falling far quicker than had been forecast. This just goes to demonstrate the sensitivities of the market to any changes in access charges.

4. The benefits in supporting rail freight growth are clear. Road congestion is estimated to cost businesses £17 billion a year and the Department for Transport estimate the cost of congestion being 99 pence per lorry miles on the most congested roads. In addition the UK has signed up to legally

binding Climate Change targets making the growth of rail freight even more important. The sector produces 76% less CO2 emissions than the equivalent HGV journey. In 2014 carbon dioxide emissions from transport went up from 25 per cent to 28 per cent of which surface transport emissions account for the 94% of that with HGVs contributing 17 per cent, despite making up only 5 per cent of road vehicles. Both passenger and freight rail together are less than 2 per cent. All of these factors as well as the fact that the ORR states that rail transport is 20 times safer than road transport demonstrates that we must support industry growth.

5. It must also be remembered that it is freight operators who do ballast and infrastructure work on our rail network. If they are forced into decline, maintenance of the whole network becomes threatened.

6. Network Rail can be less than efficient when it comes to the cost of infrastructure work. ASLEF believes that the ORR must base future freight charges on an efficient level of cost rather than Network Rail's excessive costs.

7. HGVs are already heavily subsidised and pay less than a third of the costs associated with their activities. This makes it difficult for rail to compete, especially in the consumer market. For this reason the Government needs to recognise road costs, such as road congestion, road collisions, road damage and pollution in any discussion about rail freight costs. The latest research commissioned by Campaign for Better Transport, which used DfT Mode Shift Benefit values, found a high level of distortion of the market across modes, which equates to an annual subsidy of around £6.5 billion. Any increases in charges to rail, would therefore effectively increase this subsidy to road haulage.

8. ASLEF recognises that the rail freight industry must contribute to the cost of rail maintenance, but any charges that move freight off of rail and on to

the road will simply add to the maintenance of our roads whilst simultaneously increasing CO_2 emissions and reducing road safety. We need to look at this matter holistically to ensure we have the safest and greenest transportation of goods around the UK.

Mick Whelan
General Secretary
ASLEF
77 St John Street
London
EC1M 4NN

Response to ORR's December 2016 Charges and Incentives Consultation

This pro-forma is available to those that wish to use it to respond to our consultation. Other forms of response (e.g. letter format) are equally welcome.

Please send your response to pr18@orr.gsi.gov.uk by **9 March 2017**.

Full name	Daniel Parker-Klein
Job title	Head of Policy
Organisation	The Chartered Institute of Logistics and Transport **(response prepared by CILT's Rail Freight Forum)**
Email*	
Telephone number*	

*This information will not be published on our website.

Please make any comments regarding the questions in the accompanying text box. We welcome comments in relation to the information outlined in both the consultation document and supporting documents, or regarding the policy areas more generally.

Chapter 2: Infrastructure Costs

Fixed cost charges:

1. Do you support our proposal to levy fixed cost charges on all operators, including open access operators, to the extent that they can bear them (option 2)?

No. Whilst we can see the argument for equality of treatment between Franchised and Open Access Passenger Operators, we believe that levying fixed cost charges on Freight Operators would have a very serious effect on freight volumes, even with an 'ability to pay' test. We understand that, in parallel with this proposal, ORR is considering extending the 'ability to pay' category from the current electricity coal, nuclear and iron ore sectors to include commodities such as aggregates, semi finished steel and deep sea containers from Felixstowe and Southampton to the M62 corridor. Margins in rail freight – especially in intermodal - are very tight, due to competition from a very efficient road haulage sector as well as competition between FOC's. An increased infrastructure burden for these additional commodities would almost certainly result in flows being lost to road, increasing carbon emissions substantially in the process, completely contrary to Government policy on modal shift.

Furthermore, the perilous state of the UK steel industry means that increased transport costs could be a significant factor in the decision to close plants, resulting in thousands of redundancies and an increased burden on Government social service costs. Conversely, the construction sector is looking to increase use of rail and is investing substantial sums in new facilities and wagons. Are these private sector investments in rail (the like of which Government is keen to encourage) to be rewarded with additional, unbudgeted, infrastructure costs? Such a penalty would almost certainly cause these companies to review their strategy for, and investment in, rail, choking off the predicted growth in demand from the only bulk sector not already in decline. Once again, Government policy for modal shift would be frustrated.

As well as our concern about the outcome of levying fixed costs on Freight, we believe that the Brockley Consulting report for Network Rail is a fundamentally flawed basis for assessing the avoidability of costs - as the author states, it is only a theoretical model for assessing cost and does not reflect reality in any meaningful way. It is a crude analytical structure and there is no assurance that NR would escape costs to any significant degree from the cessation of a particular flow, let alone the substantial sums that the model allocates to freight. It is crucial to understand that the model is simply a way of allocating fixed costs and is not a robust predictor of cost avoidability, which is a fundamentally different number.

We fail to see that the new method based on the Brockley Consulting Report improves transparency, rather it creates an impression of spurious accuracy which is very far from the reality of infrastructure management, cost causation and cost avoidability. We would welcome a better understanding of true cost causation and avoidability, but consider that there is considerably more analytical work to be done before this is achieved. The Brockley Consulting Report can best be considered as an initial exercise to inform further detailed research, which we believe would be far better undertaken under the aegis of ORR, since Network Rail have a vested interest in the matter. The issue is fundamental to rail and transport policy and implementation based on very early modelling would be a serious error of judgment and could have far-reaching implications.

Given that EU Transport Policy is that freight should only bear avoidable costs, explicitly ruling out the allocation of fixed costs to the sector (other than in exceptional circumstances), it follows that the Brockley Consulting model cannot logically be used as a basis for calculating freight infrastructure costs. To do so would very probably produce the perverse outcome of reducing freight volumes and thereby NR track access income which, in the absence of NR's ability to make any significant compensatory cost savings, would leave the remaining operators, both passenger and freight, to bear an increased allocation of fixed cost and run the risk of creating a downward spiral.

We can see no merit in the proposal to allocate fixed costs (other than FOL and FSC costs) to Freight. If the objective is a level playing field between FPO's and OAPO's then action should be taken to address this specific issue and not risk the substantial collateral damage to railfreight that would result from this proposal.

Fixed cost freight charges:

2. Do you support our proposal to simplify the current charging regime by having a single freight mark-up charge?

We have no objection to combining the current FOL and FSC charges into a single freight mark up but are concerned about the removal of the caps that currently apply and, as outlined above, would strongly oppose the inclusion of allocated fixed costs in the freight mark-up charge.

Fixed cost freight charges:

3. Do you support the recommendation to apply Network Rail's cost allocation methodology

(discussed in this chapter) to freight mark-up charges?
No – as outlined above, we believe that NR's understanding of cost causation and cost avoidability at differing levels of traffic is far from complete and that the Brockley Consulting report is only an initial exercise which can inform further analysis, but no more. The use of allocated shares of fixed costs is a misleading representation of cost transparency and avoidability – unless and until NR sign up to cost reduction equal to the allocated cost of a flow that ceases, the notion of avoidability is a mirage.
Station charges: 4. **Long term charge (LTC):** Do you support our recommendation that the methodology for the LTC at managed stations be recalibrated?
Station charges: 5. **Qualifying expenditure (QX):** Do you agree with our recommendation that we support the work to make total QX charges more transparent at both managed and franchised stations?

Chapter 3: Short-run variable charges package

Variable usage charge (VUC): 6. Do you support our recommendation not to make fundamental changes to the VUC for PR18?
Yes, but we are concerned about the impact of the elimination of caps on Freight which, unlike passenger, operates in a real, highly competitive market. We consider that the freight VUC should be based on the costs of an efficient infrastructure provider using international best practice and delivering lower unit costs via such methods.

Variable usage charge: 7. Do you have any suggestions for ‘recalibration’ style changes to the VUC you would like to see considered for PR18 implementation?
We have no objections to the sort of changes discussed, but would see them as 'tinkering at the edges' rather than the fundamental review advocated above.
Capacity charge (CC): 8. Do you support our recommendation not to replace the CC with adjustments to Schedule 8 benchmarks?
We consider CC is a muddle and needs a fundamental rethink. For the reasons set out above we do not favour either the continuation of the existing CC with caps removed or recovery through fixed charges. Pending a fundamental rethink, we favour the RDG solution of adjusting Schedule 8 benchmarks.
Capacity charge: 9. Do you think we should: (a) retain the existing CC (but remove the caps on open access, freight and charter operators); (b) remove the existing CC and recover lost revenue through fixed cost charges; or (c) do you have any alternative proposals?
Traction electricity charge: 10. Do you support our recommendation to keep the loss incentive mechanism?
No. It cannot be right to perpetuate a mechanism that penalises Operators due to inefficiencies by others.
Electricity asset usage charge (EAUC): 11. Do you support our recommendation that the EAUC not be altered, beyond recalibration, in PR18?

Yes
Coal spillage charge (CSC): 12. Do you support our recommendation to abolish the CSC?
Yes

Chapter 4: Contractual Incentives Regime

Schedule 8: 13. **Passenger compensation:** What are your views on the options of passenger compensation recovery and improving the transparency of compensation relating to Network Rail's actions?
Schedule 8: 14. **Approach to setting benchmarks:** Do you support our recommendation to only make changes to delink passenger operator benchmarks and Network Rail benchmarks for freight operators from past performance (but to leave the approach to the other benchmarks unchanged)?
We consider this is worth exploring but that the views of the FOC's should prevail re Freight benchmarks

Schedule 8: 15. **Measure of passenger operator performance:** Do you support our recommendation to change the measure of passenger operator performance to one based on the delay caused to other operators?
Schedule 8: 16. **Sustained poor performance (SPP) provisions:** Do you support our recommendation to limit SPP to costs compensation only?
No – revenue loss can be an important issue for an Operator
Schedule 4: 17. Do you support our recommended prioritisation of schedule 4 issues? If you think we should reconsider any of the areas we have de-prioritised please submit supporting evidence.
Schedule 4: 18. Do you wish to submit relevant evidence regarding: (a) processes associated with planning possessions; and/or (b) planning alternative arrangements to deal with planned disruption (e.g. the notification that is needed to arrange bus replacement services)?

Aligning operator and network rail incentives: 19. Do you have any views on how financial incentives could be improved to encourage collaboration between Network Rail and operators to reduce industry costs?
We support the principle of encouraging NR and Operators to work together to improve efficiency and drive down industry costs . However, the current REBS system has produced the perverse effect of penalising Operators for NR inefficiency – this cannot be right and any replacement system should be loaded to prevent this happening. In the meantime, with the creation of devolved routes with SBP's and Stakeholder Boards, we consider REBS should be suspended for CP6 and discussions take place re CP7 in the light of emerging devolved route relationships and performance.
Aligning operator and network rail incentives: 20. Do you have any views on the cost categories you think could be controlled by operators and whether these costs would be suitable as the basis of a potential future mechanism?

Any other points that you would like to make
We consider that consumer protection of those Operators and end users who exist outside the somewhat artificial world of Franchised Passenger services and who operate in a highly competitive environment should be a priority going forward. Theoretical economic analysis has its place but the impact on real businesses in the real world seems to be taking second place and needs to be revisited at regular intervals.

Thank you for taking the time to respond.

Chiltern Railways
If you think our way, travel our way.

Great Central House
Marylebone Station
Melcombe Place
London
NW1 6JJ

8th March 2017

ORR's consultation on changes to charges and contractual incentives: Chiltern's Position

Q1: Do you support our proposal to levy fixed cost charges on all operators, including open access operators, to the extent that they can bear them (option 2)?

- Chiltern supports the principle of an approach to recover fixed costs from all operators, however this must be based on a detailed assessment of operators' ability to bear such charges. It is important, particularly in the case of OAOs, that additional costs do not impact profitability to the extent they disincentivise business growth. Operators must be provided with detail of Network Rail's cost base to inform further dialogue on fixed charges for CP6.

Q4: Long term charge: Do you support our recommendation that the methodology for the LTC at managed stations be recalibrated?

- Chiltern supports the recalibration of the methodology for calculating the LTC at managed stations through basing CP6 charges on a more representative MRR schedule. In calculating LTC for CP6, the ORR should consider MRR savings delivered through station investments. This should incentivise NR to invest in more sustainable componentry with a lower full life cost, rather than less expensive equipment that may fail more often and drive greater MRR costs over the longer term.

Q5: Qualifying expenditure: Do you agree with our recommendation that we support the work to make total QX charges more transparent at both managed and franchised stations?

- Chiltern supports this recommendation, noting that the QX charge is unregulated.

Q6: Do you support our recommendation not to make fundamental changes to the VUC for PR18?

- Yes, Chiltern does not believe reform of the VUC to be a priority for CP6.

Q8: Do you support our recommendation not to replace the CC with adjustments to Schedule 8 benchmarks?

- Chiltern supports this recommendation, if it were replaced it would add further complexity to CP6 Schedule 8 recalibration and the application of 'no net loss no net gain' arrangements within Franchise Agreements.

Q9: Do you think we should: (a) retain the existing CC (but remove the caps on open access, freight and charter operators); (b) remove the existing CC and recover lost revenue through fixed cost charges; or (c) do you have any alternative proposals?

a) Chiltern would challenge the effectiveness of retaining the CC in its current form in CP6.
b) The CC derives from variable train mileage. Chiltern would therefore challenge its movement into a fixed charge mechanism.
c) Chiltern recommends that the principles of the CC as a variable charge based on train mileage are retained. Chiltern's concerns with the CC stem from the calculation of rates being not sufficiently transparent and thus difficult to understand and assess. There is furthermore no clear guidance on events that would trigger the need for a CC recalibration within a Control Period. On this basis Chiltern suggests that the rates informing the CC derived from train mileage require simplification, following the precedent set for example by the two sets of rates used to calculate Schedule 4 mileage savings.

Q13: Passenger compensation: What are your views on the options of passenger compensation recovery and improving the transparency of compensation relating to Network Rail's actions?

- Chiltern would not support the inclusion of passenger compensation within the formulaic Schedule 8 regime. Primarily, any recalibration of the Schedule 8 regime to include passenger compensation would require detailed information from operators. To account for different yields on the same flows, this would include journey numbers, ticket types and Delay Repay eligibility. These factors are highly variable and inconsistent with the methodology informing payment rates within the existing Schedule 8 regime. It is also likely that the current delay attribution principles applied to the Schedule 8 regime will not align with the causes of passenger compensation claims, generating a risk of inaccuracy. This approach would furthermore complicate the application of 'no net loss no net gain' arrangements within Franchise Agreements, to which elements of Schedule 8 and passenger compensation will apply.

- Chiltern prefers the option of passenger operators recovering passenger compensation through periodic claims to the previous option above, however believes that major advantages stem from such flows being automated where possible. Chiltern supports the principle of being entitled to claim compensation for passenger compensation allocated as a result of delays caused by Network Rail, however has concerns about the delay attribution methodology that would be applied to passenger compensation. In line with complexities stemming from use of a methodology inconsistent with that of Schedule 8, Chiltern would suggest applying the Schedule 8 delay attribution methodology to passenger compensation claims. Chiltern notes however that a number of operators are likely to be held neutral to the financial impacts of paying passenger compensation by the DfT. On this basis, Chiltern questions the incentive for operators to commit significant administrative effort towards periodic claims to recover passenger compensation.
- Chiltern supports the option of publishing passenger compensation levels and the attribution of costs between operators and Network Rail, agreeing it would promote transparency and provide reputational incentives. Chiltern is however concerned about the administrative costs that would arise from this approach. The administrative burden on operators would be compounded by the need to develop a stringent and auditable method for determining how passenger compensation is calculated and allocated to passengers.

Q14: Approach to setting benchmarks: Do you support our recommendation to only make changes to delink passenger operator benchmarks and Network Rail benchmarks for freight operators from past performance (but to leave the approach to the other benchmarks unchanged)?

- Chiltern would like to understand more about the methodology for delinking the above Schedule 8 benchmarks from past performance, and why passenger operator benchmarks and Network Rail benchmarks for freight operators have been selected for this approach. Chiltern is concerned about the process for reaching agreements between operators and Network Rail on benchmark trajectories for CP6. Past performance, for example during the 2017/18 year in CP5 provides a strong evidence base on which to determine future benchmarks. Making assumptions on future performance risks protracted debate and potential misalignment of benchmarks with actual performance trends. This approach therefore generates significant risks to the financial exposure of both operators and Network Rail across CP6 that are difficult to quantify.
- If the approach is taken to base benchmarks on future, aspirational performance targets, Chiltern seeks clarity on the ORR's strategy to align Network Rail and DfT performance targets for CP6. Whilst Network Rail's targets are implemented through Schedule 8 benchmarks, targets set by the DfT are implemented through financial regimes governed by Franchise Agreements. Chiltern also seeks to understand how this approach would maintain current levels of financial exposure to operators in line with 'no net loss no net gain' arrangements within Franchise Agreements.
- Chiltern notes the changes to performance measures in contention for CP6, such as a greater focus on Right Time. This will complicate the methodology for developing Schedule 8 benchmarks. There is a risk that the complexity of translating these new measures into CP6 benchmarks will be exacerbated by a lack of a historic performance baseline.

Q15: Measure of passenger operator performance: Do you support our recommendation to change the measure of passenger operator performance to one based on the delay caused to other operators?

- Chiltern does not support this recommendation this is because that operators do not have full control over service recovery and therefore the overall 'Delay Per Incident' (DPI). Network Rail play a key role in service recovery, through traffic regulation for example, as operators and managers of capacity on the network. Currently, operators and Network Rail do not have the resource on a day-to-day basis to attribute delay much beyond its initial route cause. If this recommendation were adopted it would require an operator to dispute the operation of services outside their own sphere of operation. It would therefore leave operators financially exposed to reactionary delay across the network that is beyond their control to manage and recover from. At the same time, the approach acts as a disincentive for Network Rail to expedite the recovery from incidents attributable to operators. This outcome would be likely to disadvantage passengers.
- A greater understanding is required of arrangements that would be implemented to maintain the incentive on Network Rail to effectively manage incidents, should TOC on TOC become the primary measure. It is Chiltern's view that scorecards lack sufficient rigour to perform this role. Regardless of route cause, the parties must be incentivised to collaborate to reduce wider performance impact.
- Chiltern seeks clarity on how this recommendation would be implemented in practise through amendments to benchmarks and payment rates, and how this approach would impact operators' financial exposure through the Schedule 8 regime.

Q16: Sustained poor performance provisions: Do you support our recommendation to limit SPP to costs compensation only?

- Chiltern supports the ORR's recommendation to simplify the contractual mechanisms associated with SPP provisions however objects to the approach of limiting it to costs compensation only. Chiltern believes SPP should continue to reflect regimes including Schedule 8 in compensating for revenue loss, which can dominate operators' financial exposure to prolonged poor performance. In Chiltern's experience, wider negotiations with Network Rail over revenue loss claims are becoming more straightforward as agreed methodologies are being implemented by the parties. On this basis, in the event that an SPP claim is made, Chiltern does not view the inclusion of revenue loss as an obstacle to resolution. In addition to simplifying the contractual mechanisms, the ability to claim revenue loss compensation via the SPP framework should be retained as a key incentive for operators to make SPP claims in CP6. This has implications for mutually incentivising performance improvement.

Q17: Do you support our recommended prioritisation of schedule 4 issues? If you think we should reconsider any of the areas we have de-prioritised please submit supporting evidence.

- Chiltern is interested to understand further detail about a review of the NDF approach. Chiltern is concerned that its current form, the NDF approach does not provide a sufficient incentive to promote earlier planning and notification of possessions by Network Rail or more efficient possessions. In addition to revenue loss, Chiltern feels that greater emphasis should be placed through the NDF framework on the costs to operators associated with amending train plans to account for late notice possessions. Chiltern notes that the associated MRE values are renewed for each Control Period, based on revenue during a base year within the previous Control Period. It is important that a consistent approach is adopted with re-calibrating performance regimes. If it is proposed for example that Schedule 8 benchmarks are in CP6 to be based on forecast performance, the ORR should focus on forecast MRE.
- Chiltern is concerned by the lack of visibility surrounding the ACS in its current form. It seeks clarity on how the ORR is proposing to simplify the charge and raise awareness of its purpose in CP6.
- Chiltern welcomes any initiatives to simplify the claiming of compensation by operators through the Schedule 4 mechanism (Types 2 and 3) and SPD and believes the thresholds should be evaluated. The relevant contractual wording is currently highly complex and often open to interpretation. This complicates the negotiation of claims between operators and Network Rail.

Q19: Do you have any views on how financial incentives could be improved to encourage collaboration between Network Rail and operators to reduce industry costs?

- Greater visibility is required of mechanisms such as REBS across operators. In line with Chiltern having opted out of REBS for example, there is currently limited understanding of within the business of the role the mechanism plays in incentivising efficiency gains. It is not clear how REBS links to other areas of collaboration with Network Rail. On this basis, financial incentives could be improved through the following:
    - Greater visibility and awareness amongst operators of Network Rail of the purpose of the incentive and how it operates.
    - The application of incentives should be consistent across operators.
    - Incentive needs to be straightforward and transparent, with simple contractual wording.
    - Where possible the associated financial flows should be automated to reduce administrative costs.
    - Financial incentives much be closely aligned with existing collaborative work streams to promote engagement from operators and Network Rail.
    - DfT must be involved with the establishment of such incentives where operators are held neutral through their Franchise Agreements.

General point:

Chiltern is held neutral to the financial impacts of changes to several charges and contractual incentives through its Franchise Agreement. It is important that any recalibration or adjustments to methodologies are transparent and maintain the current ease of allocation of costs between operators and the DfT. It is therefore important that DfT is involved with the associated work streams. Notwithstanding DfT Franchise Agreements, Chiltern seeks to engage closely with this element of the PR18 process as a key opportunity to reduce whole industry costs and incentivise strong performance.

Regards,

Richard Johnson
Interim Financial Controller

Response to ORR's December 2016 Charges and Incentives Consultation

This pro-forma is available to those that wish to use it to respond to our consultation. Other forms of response (e.g. letter format) are equally welcome.

Please send your response to pr18@orr.gsi.gov.uk by **9 March 2017**.

Full name	Gregory March
Job title	Performance & Policy Manager
Organisation	Colas Rail
Email*	
Telephone number*	

*This information will not be published on our website.

Please make any comments regarding the questions in the accompanying text box. We welcome comments in relation to the information outlined in both the consultation document and supporting documents, or regarding the policy areas more generally.

Chapter 2: Infrastructure Costs

Fixed cost charges:

1. Do you support our proposal to levy fixed cost charges on all operators, including open access operators, to the extent that they can bear them (option 2)?

YES; Broadly we support the further development and implementation of 'Option 2'. Given that under this option, the methodology for calculating freight fixed cost charges is not proposed to change, we are confident that this provides some long term certainty over fixed costs. Furthermore, we would welcome any move to improve the transparency of how fixed costs are calculated and allocated which in turn should provide greater accountability to Network Rail regarding the cost of operating, maintaining and enhancing the Network.

Fixed cost freight charges:

2. Do you support our proposal to simplify the current charging regime by having a single freight mark-up charge?

YES; the combining of the FOL and FSC charges into a single charge should simplify the administration associated with both charges which is to be welcomed.

Fixed cost freight charges: 3. Do you support the recommendation to apply Network Rail's cost allocation methodology (discussed in this chapter) to freight mark-up charges?
PARTIAL; Whilst we support the general requirement to improve the transparency around Network Rail's costs associated with running the network, we are somewhat wary about approving a new methodology that includes, at present, vague definitions of additional costs, in this instance the inclusion of 'common costs' in the proposed new methodology. We would like to see more work undertaken on the proposed new methodology on the whole network so as to provide a more accurate understanding of the likely difference in costs between the existing and proposed new methodology. Whilst we are not at the time of speaking directly affected by either the FOL or FSC we are wary that any recalibration of the 'market can bear' tests may result in a change to this situation and as such are keen to see further work undertaken on any proposed new methodologies before supporting.
Station charges: 4. **Long term charge (LTC):** Do you support our recommendation that the methodology for the LTC at managed stations be recalibrated?
NO VIEW; We have no particular view on this subject at present.
Station charges: 5. **Qualifying expenditure (QX):** Do you agree with our recommendation that we support the work to make total QX charges more transparent at both managed and franchised stations?
NO VIEW; We have no particular view on this subject at present.

Chapter 3: Short-run variable charges package

Variable usage charge (VUC): 6. Do you support our recommendation not to make fundamental changes to the VUC for PR18?

YES; We broadly agree with the proposal not to make fundamental changes to the VUC for PR18.
Variable usage charge: 7. Do you have any suggestions for 'recalibration' style changes to the VUC you would like to see considered for PR18 implementation?
NO VIEW; We have no particular view on this subject at present.
Capacity charge (CC): 8. Do you support our recommendation not to replace the CC with adjustments to Schedule 8 benchmarks?
YES; We recognise the requirement, following changes to legislation, to review and update policy regarding the capacity charge (CC). In our view, the option to replace the CC with adjustments to Network Rails benchmarks could have resulted in perverse behaviours in terms of improving performance; i.e. with a less stringent baseline, Network Rail potentially would have less incentive to improve performance. Additionally, there is a risk that all FOC's could be adversely impacted financially by any change to a benchmark; i.e. FOC A increases traffic which triggers a lowering of the benchmark which results in FOC B, C, D, etc., being liable to greater financial risk.
Capacity charge: 9. Do you think we should: (a) retain the existing CC (but remove the caps on open access, freight and charter operators); (b) remove the existing CC and recover lost revenue through fixed cost charges; or (c) do you have any alternative proposals?
MIXED; We believe that both option (a) (Option 1) and (b) (Option 3) have merit and risk and would welcome their further development. With regard to Option 1, the financial risk associated with the removal of the CC cap and resultant increase in costs would, we believe benefit from additional focus to understand the likely risk. At a time when many freight commodities are at risk from rival modes of transport, keeping costs down is essential to retaining existing rail freight volumes in addition to attracting new rail freight flows. With regard to Option 3, whilst it would appear there is potentially greater security, in the form of known fixed costs, as a result of pursuing this option, it is not fully clear how this would apply to all FOC's. For instance, the current fixed charges only apply to operators who haul certain commodities that have been deemed as being able to bear the cost by the ORR. Under these

conditions there is a potential that some operators may essentially subsidise those who do not haul said commodities which could present an un-even playing field.

Traction electricity charge:

10. Do you support our recommendation to keep the loss incentive mechanism?

YES: We support this proposal.

Electricity asset usage charge (EAUC):

11. Do you support our recommendation that the EAUC not be altered, beyond recalibration, in PR18?

YES: We support this proposal.

Coal spillage charge (CSC):

12. Do you support our recommendation to abolish the CSC?

YES; given the recent and forecasted continued decline of the domestic and imported coal market the application of the charge seems largely irrelevant. Historically there has been much debate about the effectiveness of the CSC and its ability to reduce the amount of spillage seen.

Chapter 4: Contractual Incentives Regime

Schedule 8:

13. **Passenger compensation:** What are your views on the options of passenger compensation recovery and improving the transparency of compensation relating to Network Rail's actions?

NO VIEW; We have no particular view on this subject at present.

Schedule 8:

14. **Approach to setting benchmarks:** Do you support our recommendation to only make changes to delink passenger operator benchmarks and Network Rail benchmarks for freight operators from past performance (but to leave the approach to the other benchmarks unchanged)?

NO; Under current proposals the FOC benchmark would, as with PR13, be based on a small number of sample years in order to provide a benchmark figure. The risk with this approach is that the sample years chosen may not accurately reflect the wider Control Period performance. As an example, PR13 used years 2 (2.26) and 3 (2.42) of CP4 in order to calculate a benchmark of 2.39. The final two years of CP4, saw increased figures (year 4 = 2.54 and year 5 2.89) which essentially meant the CP5 benchmark was set significantly lower than current performance entering into CP5. Given CP5 has proven as volatile as CP4, we would like to see a greater range of data used in order to see an accurate and purposeful benchmark for CP6 agreed.

We also believe that the cancellation thresholds associated with Schedule 8 Service Variation & Cancellation need to be reviewed to accurately reflect the true commercial, reputational and logistical cost of Network Rail cancellations. Under the current regime the existing thresholds incentivise Network Rail to cancel a service rather than run it late. The cancellation rate on the lower threshold of £1,800 is significantly lower than the actual cost of cancelling a service and the value of the train. We would propose that the threshold is either removed completely so that all services are paid at the higher rate to reflect the true value of the service and incentivise Network Rail not to cancel, or to uplift the below threshold rate.

Finally we would like it noted that under the current performance regime, Network Rail is not incentivised to pro-actively manage incidents that have been attributed to a FOC. Once an incident has occurred, FOC's have little control over how an incident is managed and as such cannot efficiently control the amount of delay, and subsequent cost an incident may accrue. Increasingly TOC and Network Rail personnel are located in Joint Controls which enables the pro-active management of passenger delay incidents which include mitigating ongoing impact.

Schedule 8:

15. **Measure of passenger operator performance:** Do you support our recommendation to change the measure of passenger operator performance to one based on the delay caused to other operators?

YES; Given the level of scrutiny FOC performance and impact on other operators has received over recent years and the improvement this has contributed to, in the interest of balance and fairness it would be logical to also measure the impact of passenger operators on other operators too.

Schedule 8: 16. **Sustained poor performance (SPP) provisions:** Do you support our recommendation to limit SPP to costs compensation only?
NO VIEW; We have no particular view on this subject at present.
Schedule 4: 17. Do you support our recommended prioritisation of schedule 4 issues? If you think we should reconsider any of the areas we have de-prioritised please submit supporting evidence.
PARTIAL; We would like particular increased focus on the current FOC compensation rates as they are not currently reflective of the impact of possessions on FOCs and Freight End Users (FEU's) and the costs associated with this. In our view these reduced rates dis-incentivise Network Rail from developing a less disruptive possession strategy which in turn reduces network availability which can in turn impact the development of existing and new freight flows.
Schedule 4: 18. Do you wish to submit relevant evidence regarding: (a) processes associated with planning possessions; and/or (b) planning alternative arrangements to deal with planned disruption (e.g. the notification that is needed to arrange bus replacement services)?
YES; We are often pressured into accepting possessions that significantly impact the viability of services and have a considerable impact on our customers. In recent times this has often been as a direct result of poor project and possession planning which has resulted in the scope of work being unable to be delivered in the possession times resulting in the need for additional possessions. We are currently suffering as a result of the Edinburgh – Glasgow electrification project (EGIP) overrunning requiring a significant level of additional possessions due to the original work not being completed in the original agreed possessions. For this we are receiving minimal compensation which does not accurately reflect the financial and operational impact to us and our customer.

Aligning operator and network rail incentives: 19. Do you have any views on how financial incentives could be improved to encourage collaboration between Network Rail and operators to reduce industry costs?
YES; **Schedule 4;** as discussed previously, we believe accurate compensation rates relating to disruptive possession would focus both Network Rail and operator's minds to achieving the best result possible. An uplift in compensation rates to reflect the actual cost to FOCs of possessions could in turn foster greater collaboration and willingness to agree to preferred possession slots. **Schedule 8;** as discussed previously, we believe that Network Rail is not currently incentivised as part of Schedule 8 to pro-actively manage incidents caused by FOC's. We believe that a financial incentive to Network Rail to pro-actively manage all delay incidents would have a positive industry impact in terms of reducing key measures such as Delay Per Incident (DPI). We would also like to see a balanced performance regime. Under the current regime, if both Network Rail and the FOC outperform their benchmarks, the FOC makes a net payment to Network Rail, essentially being penalised for good performance for which the regime was not designed to promote. The scheme should be balanced so that if both NR and FOC hit or beat their benchmark the result is cost neutral. This in turn should promote greater collaboration between both parties to achieve this outcome.
Aligning operator and network rail incentives: 20. Do you have any views on the cost categories you think could be controlled by operators and whether these costs would be suitable as the basis of a potential future mechanism?
PARTIAL; Whilst there are undoubtedly some cost categories that are controlled by operators that could be considered as a suitable basis for a potential future mechanism we believe more thought is required to develop this concept. At present, a number of potential cost categories for consideration have a direct or in-direct relationship with Network Rail. For instance, our staff, rolling stock and fuel costs associated with running a service are directly linked to a number of Network Rail outputs such as the paths we are allocated and on the day management of said services. As such there is a risk that any mechanism developed around operator costs could be undermined by factors not within the operator's control (as previously articulated with Network Rails management of delay incidents caused by FOC's).

Any other points that you would like to make
We look forward to working with the ORR and wider industry on the PR18 process.

Thank you for taking the time to respond.

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IMPROVING INCENTIVES ON NETWORK RAIL AND TRAIN OPERATORS: A CONSULTATION ON CHANGES TO CHARGES AND CONTRACTUAL INCENTIVES

1. This letter contains the response by DB Cargo (UK) Limited ("DB Cargo") to the consultation document entitled "*Improving incentives on Network Rail and train operators: A consultation on changes to charges and contractual incentives"* issued by the Office of Rail and Road ("ORR") in December 2016.

2. DB Cargo is the largest rail freight operator ("FOC") in the UK and is a wholly owned subsidiary of Deutsche Bahn, the second largest mobility and logistics group in the world. DB Cargo operates around 4,500 trains per month in the UK conveying everything from cereals to coal, consumer products to biomass and petroleum to steel. DB Cargo employs a large workforce of around 2,900 providing freight, infrastructure, rail support and charter passenger services within the UK and freight services to and from continental Europe via the Channel Tunnel.

3. DB Cargo, in common with other FOCs, is a wholly private sector activity receiving no material direct government support in the UK. In this respect, rail freight is different to passenger rail as it has a very different, less direct, relationship with Governments, funders and other devolved bodies. In a heavily-capital intensive industry, DB Cargo owns and operates its own assets, including depots and rolling stock, and has invested heavily in new locomotives, wagons and facilities over the years since UK privatisation.

General Comments and Summary

4. The UK rail freight industry is a success story of the post-privatisation era, described by the former CEO of the ORR "*as the most transformed sector in the industry*". It has attracted private sector investment of c £2bn and in fifteen years has grown to account for a market share of surface transport of around 12% (up from 8% at privatisation).

5. Such growth has been achieved by a relentless pursuit of efficiency, striving towards customer satisfaction and strong control of costs.

6. Stability, certainty and confidence in the future is crucial for an industry that depends almost entirely on the private sector (whether in the form of shareholders, customers or debt providers) retaining confidence in the future. PR13 demonstrated that the process itself, as well as proposals and outcomes, can (and did) have immediate and serious impacts on the attitudes and confidence of customers (and potential customers) that directly affects the financial position of the sector.

7. The rail freight sector is highly competitive, with five main FOCs competing vigorously in all market segments. However, the rail freight industry's main competition is from road haulage and road based logistics services which set the price and service expectations in almost all market segments.

8. Key to maintaining growth and achieving further modal shift from road will be the ability to match the prices and flexibility/simplicity of road haulage. Maintaining a simple structure with a competitive level of freight charges or other costs/incentives is fundamental in helping to achieve this.

9. In almost all rail freight markets, and especially in the key growth markets for the future, customers have choices between rail and other modes, particularly road. Therefore, the entire regime, not solely the structure and level of access charges, has to allow, and incentivise, the use of rail to enable it to be competitive with road.

10. Customers, and potential customers, already find the rail access and access charging regime complex and difficult to understand. Injecting additional complexity or increasing the overall level of charges will;

    a. reinforce preconceptions that already inhibit rail growth;
    b. send negative and unhelpful signals to customers and potential customers as to the wider rail industry's interest and commitment in moving freight.

11. In this context, it is important to remember that rail freight is strategically important for GB PLC and provides an essential service to industry. The rail freight industry delivers £1.6bn per annum in benefits to the UK economy and conveys goods worth over £30bn per annum. Examples of this strategic importance include:

    a. From almost zero, rail has gained 10% market share of export automotive traffic in the last six years.
    b. Over 40% of London's raw materials (such as aggregates and cement) are delivered by rail and rail plays an equally key role in other major conurbations.
    c. Over 25% of all the deep sea containers that arrive or depart from the major UK deep sea ports are transported by rail.

12. Rail freight has a vital role to play in tackling transport-related carbon reduction, helping the UK Government to meet its climate change commitments and

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underpinning a greener economy. Transport currently contributes 21% of carbon emissions of which 7% originate from lorries. Given that rail freight produces 76% less carbon dioxide than road freight, it is clear that every tonne of cargo carried by rail rather than road makes a positive contribution towards reaching the targets.

13. FOCs generate very low margins. Even before the recent dramatic decline in coal volumes, the five year rolling average profit margin for FOCs was 2.6%. On 22 February 2017, ORR published its UK Rail Financial Information update for 2015/16 which showed that the combined FOC performance showed a deficit of income over expenditure in excess of £100m. Crucially no FOC paid a dividend. Understanding this is vital in assessing the ability of the sector, and its customers, to absorb the impact of increases in access charges.

14. The current structure of variable charges being based upon short-run marginal costs and fixed costs (including freight fixed costs) being recovered directly by network grant is a relatively close parallel to the situation faced by road freight - where the fixed costs of the national and local road network are funded directly by Government and road hauliers pay only VED and licensing costs. Although not an exact parallel, moving away from the current rail model (e.g. to one deemed to be more "cost reflective") risks rail freight being placed at a distinct competitive disadvantage.

15. Historically the wider benefits of rail freight (some of which are outside the railway balance sheet) have not been taken into account when assessing the structure and level of access charges. The problems this can cause were highlighted in PR13 and it is disappointing that ORR is not addressing this directly in PR18. If the result of PR18 ends up being regulatory proposals that damage the rail freight sector, with the onus as to how to counteract the effects being effectively passed to the DfT and Transport Scotland, this would be very disappointing. It is important that PR18 achieves outcomes that support rail freight (and rail freight growth) and thus obviate the need for any such mechanisms.

16. It is also disappointing that ORR has so far failed to take cognizance of other Government transport policy positions in order to ensure rail is not disadvantaged – for example, road costs remain highly competitive due in part to a long period where fuel duty rates have been frozen. Equally, DB Cargo strongly believes ORR must recognize and take account of macro-economic effects such as low oil prices.

Context

17. DB Cargo appreciates that the structural and political context of PR18 is challenging and an order of magnitude more fundamental than previous periodic reviews. As a result, ORR must ensure that the effect of its proposals align with and support other industry developments and changes. These include, but are not limited to, Network Rail Route devolution, the development of the Network System Operator and the impacts of Brexit.

18. Such alignment and support have to be major elements of the promised ORR holistic impact assessment of changes. Whilst DB Cargo awaits ORR's proposals in respect of how it will undertake this, it is concerned that the PR18 process is proceeding (with decisions beginning to be made) before being subject to such holistic assessment.

19. Implicit in most of the industry change agenda is the need for greater efficiency in the rail sector. DB Cargo is concerned that consideration of the potential for greater efficiency in Network Rail's activities is receiving insufficient attention when compared to the emphasis being placed on the quantum of those activities.

20. By way of comparison, it is useful to reflect on what the freight sector has already done to help drive efficiency. Achievements include:

    a. By running longer, heavier trains, more goods is transported using fewer freight trains resulting in increased efficiencies both in terms of resources and network capacity. Between 2001 and 2015 (i.e. before the decline in the transportation of coal), rail freight volumes increased by 15% but the number of trains reduced by 25%. Consequently, the payload per train increased by 40% over the same period.

    b. Freight operational performance is at historically very high levels with the Freight Delivery Metric averaging over 94% and "Arrivals to Fifteen" averaging over 86%.

    c. In the past four years, over 5,000 unused or spare paths have been relinquished by FOCs back to Network Rail either to increase general 'white space' or for reclassification as Strategic Paths.

    d. Continued private sector investment in new equipment, including reliable and more environmentally friendly locomotives and wagons with "track-friendly" suspension.

21. However it is difficult to see where, if at all, the freight sector and freight customers are receiving any recognition of, or benefit from, these achievements. This failure risks creating a perverse incentive which begs the question why should rail freight (almost uniquely in the rail sector) continue to strive for such efficiency if it is rewarded with cost increases, not decreases?

22. DB Cargo strongly supports the DfT's view (set out in Richard Carter's letter to Joanna Whittington dated 27th July 2016) that "*changes (in PR18) should only be made where they lead to a significant better outcome for users*". The letter goes on to make clear that "*we would be concerned at changes which increased complexity, and potentially costs, without clear evidence these would lead to improvements for users and taxpayers*".

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23. It is not clear to DB Cargo how the likely impact of some of the outcomes from the proposed and potential changes to charges and incentives will benefit, or lead to improved outcomes for, freight customers and we urge ORR to reflect on this and to set out the anticipated benefits as a matter of urgency.

Red Lines

24. DB Cargo is applying five “tests” to how PR18 will affect DB Cargo’s customers, DB Cargo’s business and the rail freight sector in general.

    These are that the process and outcomes must:

    a. Maintain user and investor confidence.
    b. Respect the open, fair and competitive market.
    c. Not lead to any price shocks.
    d. Only deliver change that is pragmatic and proportionate.
    e. Be subject to timely, holistic impact assessment.

25. We will review how the proposed and potential changes measure against these tests at the end of this consultation response.

26. The table below sets out a summary of the key points made by DB Cargo in respect of each charging topic in its detailed representations made in this response.

Topic	Key points
Variable Charge	• Welcome decision not to fundamentally review approach to variable charge calculation. • Significant concerns that the potential for capping any increase in the VUC will not be considered for CP6 leading to a substantial increase in variable charges regardless of any other increases. • Concerned that Network Rail’s OM&R costs may increase substantially in CP6 [redacted]. • Require ORR to set effective efficiency assumptions for CP6 (including a long term view for freight).

Fixed Charges, Ability to pay test and mark ups	• DB Cargo is unable to discern any realistic incentive (as opposed to potentially penal) qualities in ORR's preferred option (Option 2). • Ensure assessment of which market sectors can afford 'mark ups' is carried out effectively and takes account of potential for substantial increases in the VUC in CP6. • Urge ORR to reflect on the potential for unintended consequences that additional "mark ups" will discourage customers from using rail. • DB Cargo would strongly recommend that for every allocation of fixed cost to an operator there is a parallel piece of work setting out the realistic cost escapability prospects of the cost concerned. • Concerned to ensure any assessment is consulted upon and completed in sufficient time to ensure consequential changes to other aspects of PR18 can be considered if necessary.
Capacity Charge	• DB Cargo remains of the view that the Capacity Charge should be replaced with adjustments to benchmarks in the performance regime. • Alternatively, DB Cargo would support the Capacity Charge being levied as a "mark up" on an "afford to pay" basis.
Schedule 4	• DB Cargo considers that the metrics of the possession regime should be reviewed.
Schedule 8	• DB Cargo considers that the metrics of the performance regime should be reviewed.
Coal Spillage Charge	• DB Cargo agrees with ORR's proposal to abolish the Coal Spillage Charge. • ORR is also urged to confirm that the Coal Spillage Reduction Investment Charge will also be abolished (it was suspended for CP5 pending review in PR18).
Merger of FSC and FOL charges	• DB Cargo agrees with ORR's proposal to merge the Freight Specific and Freight Only Line charges.
Efficiency Benefit Sharing	• DB Cargo opted out of REBS for CP5 as it cannot influence a high proportion of Network Rail's cost base. • Merit in a freight scheme (FEBS) targeting specific areas worthy of development if actual cost savings can be established.

Infrastructure costs

Q1 Do you support our proposal to levy fixed cost charges on all operators, including open access operators, to the extent that they can bear them?

27. Given that the Railways (Access, Management & Licensing of Railway Undertakings) Regulations 2016 ("the Regulations") allow additional charges above the cost directly incurred in the form of a "mark-up" if a market segment can bear them, it is quite hard to disagree with the principle of this other than to state the obvious that it places exceptional weight upon the evidence used to define both market definition and the assessment of what the market can bear.

...

28. DB Cargo would ask ORR to clarify if FOCs would continue to pay the fixed cost charges "*they currently pay*" (as set out in ORR Option 1) or not as Option 2 only refers to *"freight operators would continue to pay the fixed cost charges based on a market can bear test".*

29. DB Cargo notes that ORR is proposing to take option 2 forward and its comments are based on this proposal. DB Cargo has strong reservations on the practicability of option 3 and is strongly opposed to the principle of option 4. However, as ORR has discounted option 4, DB Cargo will not outline the reasons for its opposition of this option.

30. It is far from clear what the purpose and intended outcomes of this proposal are thought to be. DB Cargo understands that transparency, per se, is a "good thing" but there has to be some benefit from the process. It is hard to see how any allocation of fixed costs by one or other attribution or allocation mechanism will assist in infrastructure cost management, not least as FOCs such as DB Cargo do not possess the necessary skill sets to undertake this, nor would it likely be a cost-effective course of action.

31. Accordingly, it is hard for DB Cargo to discern any realistic incentive (as opposed to potentially penal) quality in the proposal.

32. The consultation document is silent on the point that the relevant EU legislation (from which the Regulations were transposed) sets out that at a minimum, track access charges "*shall be set at the cost that is directly incurred as a result of operating the train service*" but goes on to make it clear that total access charges may include in addition, a contribution to fixed costs (subject to affordability) with credits for externalities. DB Cargo awaits ORR's proposals in respect of an externality credit in order to achieve a balanced approach to implementation of the applicable legislation.

33. The processes of market definition and an assessment of ability to pay are both subjective and are not activities our competitors in road freight even have to take account of, let alone manage. As a result, the very processes themselves risk alarming or discouraging current and potential freight customers.

34. DB Cargo would urge ORR to reflect on the substantive risk of unintended consequences whereby the effect of such a mark-up might be to drive freight traffic from rail to road. Experience from PR13 showed clearly that the impact of a changed access regime is as much about the impact on customer and investor confidence as on the immediate financial impact of an additional or higher charge. DB Cargo was very struck by the clear concern that "*good traffic will be priced off*" voiced by Professor Chris Nash at the ORR stakeholder workshop on February 9th 2017.

35. If ORR decides to proceed with this, DB Cargo would strongly recommend that for every allocation of fixed cost to an operator there is a parallel piece of work setting out the realistic cost escapability prospects of the cost concerned.

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36. In addition, it would be important to have a clear and realistic starting point for such an assessment. It would not be correct for costs remaining because of the failure of Network Rail to achieve CP4 and/or CP5 efficiency plans (the targets for which were accepted by the company) to be included. A good example is the network costs associated with former coal traffic and whether Network Rail has stripped out (or even begun to strip out) the cost associated with the former transportation of substantial volumes of coal across the network? If not, why not and consequently why should Freight (and other) Operators be penalised for Network Rail's failure to address this?

37. In addition, the ORR should make clear that capability of the network as of 1.4.2014 as advertised in the Sectional Appendices and other relevant documentation (as subsequently amended by established Network Change proposals) should be the starting point for the consideration of Network Rail's costs.

38. It is hard to see what better outcomes will result for FOCs or their customers from ORR's proposals and as a result this would appear to fail a key Government "touchstone" at the first hurdle.

Q2 Do you support our proposal to simplify the current charging regime by having a single freight mark-up charge?

39. DB Cargo supports having only one freight mark-up charge to the extent that any 'mark-up' is deemed affordable. This is a good example of a proposed change that would "*lead to a significant better outcome for users"* by reducing complexity.

Q3 Do you support the recommendation to apply Network Rail's cost allocation methodology (discussed in this chapter) to freight mark-up charges?

40. DB Cargo is not convinced that the application of the methodology developed by Network Rail and Brockley Consulting is an advance on the methodology devised by LEK for PR13. Therefore, it does not support its use for the underpinning of any fixed-cost 'mark-ups' for freight traffic in CP6.

41. There has been extremely limited FOC and other operator involvement in the Brockley Consulting work, despite offers to participate more fully. This contrasts vividly with the much higher degree of operator involvement in the LEK work. Such limited involvement as there was in the Brockley case studies was on the understanding (outlined on numerous occasions by both Network Rail and Brockley Consulting) that the work was intended as an aide to improve transparency, but was not intended to affect charges as part of PR18. The fact that this now appears likely (albeit subject to an ability to pay test) is of concern. It is hard to escape the conclusion that Freight (and other) Operators have been misled, even if inadvertently, thereby setting an unfortunate precedent for regulatory policy.

...

42. It is not clear to DB Cargo from the consultation document whether the Brockley Consulting and Network Rail approach now involves either a long run incremental cost or long run marginal cost approach – rather than the short run marginal cost approach used by ORR and Network Rail hitherto. This needs clarifying; there then needs to be an open and honest exposition of what is intended, its implications and the uses to which it will be put, prior to a consultation where consultees have sufficient information to make an informed assessment.

43. The Brockley Consulting methodology essentially involves a "top-down" allocation of costs to constant traffic sections whereas the LEK work was an activity based approach which bore closer resemblance both to actions on the ground and a "bottom-up" approach.

44. The LEK work usefully highlighted the complexities of understanding fixed costs in the wide ranges it concluded for gross avoidable freight costs (on a 35-year average basis) between a low of £215m and a high of £428m.

45. It is hard to see how any high-level "top down" approach will result in more meaningful outcomes. The result may appear to have a lower range of uncertainty (or indeed be expressed as a single figure) but this is likely to be no more than the result of spurious accuracy and of little, if any, value to drive management action or cost reduction.

46. Alongside any such cost allocation there should be specific work undertaken to assess actual cost escapability prospects for the constant traffic sections or activities concerned, otherwise such fixed cost allocations should not be used as any basis for any charge.

47. If such an approach is to be introduced for rail freight, then a parallel regime for road freight is needed to avoid rail freight suffering modal disadvantage. It is of concern that the ORR makes no reference to any risk of modal disadvantage.

48. The Brockley Consulting work has not been widely shared or debated across the industry and many will be unsighted on it. DB Cargo would urge ORR to reflect on whether it is appropriate, or sensible, to use this work for the purposes of PR18.

Q4 Do you support our recommendation that the methodology for the LTC at managed stations be recalibrated?

49. As a FOC who does not regularly use managed stations, DB Cargo has no comments to offer on ORR's recommendation.

Q5 Do you agree with our recommendation that we support the work to make total QX charges more transparent at both managed and franchised stations?

50. As a FOC who does not regularly use managed or franchised stations, DB Cargo has no comments to offer on ORR's recommendation.

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Further general points

51. The increased importance attached by ORR to fixed cost mark-ups places an increasing and very great emphasis on the robustness of the assessment of what different market(s) can bear.

52. It would have been helpful to have greater understanding of ORR's intentions in this area as any responses to this consultation are essentially theoretical as it is not possible to estimate what the potential outcomes might be.

Market Definition

53. DB Cargo considers that the definition of Markets is a key factor. In the past, ORR has adopted the tendency over time to define markets increasingly narrowly. Traditionally this has been by commodity structure and ORR's current thinking is to continue with this approach. The strength of this is that it looks outwards to how customer activity is organized. However, the principal weakness is that it does not align well with how FOCs are organized and how they deliver services for customers.

54. FOCs do not manage their operations on a sector basis. Resources may be used to operate a coal train on one day and an intermodal train the next. FOC business models are company-wide and the impact of a new charge or an increased charge affecting one sector can have implications for other sectors.

55. DB Cargo would urge ORR to consider a simpler approach to market definition. The KPMG work on UK Rail Freight Economic Value and Investment has already been shared with ORR. This concluded that simpler market segmentation (e.g. into traditional, bulk and multi-customer segments) was more meaningful in assessing both rail operator and customer impacts. DB Cargo would urge ORR to consider a similar, simple segmentation in the forthcoming "market definition / market to bear test" analyses.

Market to bear test

56. The market to bear test has to comprise of a number of elements and DB Cargo would suggest that these include:

    a. Impact on the rail freight market and current traffic volumes;
    b. Impact on future growth;
    c. Impact on FOC profitability and hence FOC ability & willingness to invest;
    d. Impact on Network Rail;
    e. Impact on third-party involvement, and crucially the willingness and ability of third parties to invest in rail freight;
    f. The impact of exogenous factors such as the oil price and the freezing of fuel duty for road freight;

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g. The disparity between quinquennial Periodic Reviews and 30-year asset lives meaning that the view on access charges can potentially change five or six times over the life of an investment; and
h. Other impacts, such as those on the wider economy and environment.

57. The work on the “market to bear” test has to be sufficiently subtle to distinguish between an assessment of what the market could bear historically, what it can bear currently and what the impact might be on future investment.

58. It is critical that there is accepted and meaningful output from the work on the “market to bear” test in time to inform the holistic assessment process ORR has committed to and certainly before any conclusions are made on individual policy items.

Efficiency

59. The consultation document is silent on what ORR’s approach will be to assessing Network Rail efficiency going forward or indeed what the starting point will be for that assessment.

60. DB Cargo is aware that Network Rail has found CP5 exceptionally challenging. ORR’s current consultation on the PR18 financial framework makes this clear and highlights:

    a. *increasing costs and timescales for enhancement projects - the Hendy report in November 2015 identified a £2.5bn overspend forecast;*

    b. *underperformance and deferral of renewals – our 2015-16 Annual Efficiency and Finance Assessment (AEFA)17 highlighted a forecast by Network Rail of deferrals valued at £3.1bn by the end of CP5; and*

    c. *a forecast efficiency measure18 shortfall for operations, support, maintenance and renewals of £3.9bn for CP5 noted in our AEFA*.

61. DB Cargo’s strong view is that the capability of the network as at 1 April 2014 (as advertised in the Sectional Appendices and other relevant documentation and as subsequently amended by established Network Change proposals) should be the starting point for the consideration of Network Rail’s efficiency.

62. This is critical for the proper consideration of both fixed and variable infrastructure costs. DB Cargo is concerned that there might be unfortunate and inadvertent consequences of deciding policy positions on charges without clarity as to the make-up and quantum of the applicable costs.

63. DB Cargo’s strong view is that neither FOCs nor their customers should have to pay additional or higher access charges to offset the failure of Network Rail to achieve its efficiency targets.

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64. DB Cargo would welcome clarification as to how ORR proposes to handle future Network Rail efficiency targets and the impact that might have on the applicable cost base for the calculation of the VUCs and other access charges. DB Cargo recalls that for CP4, ORR adopted a 10-year view of efficiency that was "brought forward" for the purposes of calculating charges. This had the dual benefit of limiting access charges to affordable levels and incentivizing Network Rail to achieve the necessary efficiencies.

65. DB Cargo would also welcome clarification from ORR as to how the impact of the wagon fleet owned or contracted by Network Rail for infrastructure renewal, maintenance and enhancement has been treated. In general, these are intensively utilized wagons with older, less track-friendly suspension systems. ORR is asked to confirm that the assessment of freight costs being used for PR18 has specifically excluded or deducted the costs associated with the operation of these wagons.

Impact on Network Rail financing

66. A clear downside of increasingly linking fixed costs to activity according to a mechanism or convention that is essentially artificial is the risk to Network Rail's financing. Should the projected activity level not materialize for any reason (and the collapse in coal volumes in 2015 is a good example of what can happen) then Network Rail risks having a shortfall in its revenue to cover its fixed costs.

67. The proposal floated in supporting note 3 to the summary table on page 4 of the consultation document that "*FTAC may become a per-unit of traffic rate*" is a very minor reference to what is a point of fundamental significance. It is of concern that this is not set out in more detail or clarity within the body of the consultation document.

68. DB Cargo's view is that such a potentially major change should not just be mentioned in passing in a footnote if there is any serious intent to develop or introduce such a change. Instead, it should be presented in a way that is set out clearly and with supporting evidence. If the there is no serious intent to develop or introduce this in CP6, it should not have been mentioned at all.

Reliance on modelled allocations

69. DB Cargo has increasing concerns about the reliance being placed by ORR on modelled allocations. Whether through systems such as VTISM, the proposal to adopt the Brockley Consulting methodology or the increasingly important ability to pay test, the outcome of PR18 seems increasingly reliant on modelled outcomes either proposed by, or where the associated data is largely controlled by, Network Rail.

70. DB Cargo has long had a concern that the information and knowledge asymmetry between Network Rail and Freight (and other) Operators is a major hurdle to greater operator involvement. It is frequently not straightforward even to seek independent advice from consulting engineers because of both cost and the consulting engineers

other relationships with Network Rail and/or ORR.

71. The allocation models themselves are often highly complex and both the individual and cumulative impacts can be both very hard to predict and sometimes very considerable.

72. DB Cargo hopes that this reliance on modelling will not be at the expense of a greater understanding of infrastructure cost behaviour and holding Network Rail to account in the real world.

73. DB Cargo would welcome clarity and reassurance as to how ORR will manage this given that the effects have, both individually and cumulatively, major implications for Freight (and other) Operator profitability and sustainability.

Short-run variable charges

Q6 Do you support our recommendation not to make fundamental changes to the VUC for PR18?

74. DB Cargo supports ORR's recommendation not to make fundamental changes to the structure of the VUC for PR18. However, despite this, it remains very concerned that there is still likely to be a significant increase in the level of the VUC.

75. The ORR must take cognizance of how the application of the existing (or likely slightly modified) structure of charges to a different cost base will impact on FOCs and their customers.

76. DB Cargo is concerned and disappointed that the consultation document makes no reference to even the potential for this.

77. DB Cargo has had sight of the confidential "Initial Industry Advice to Governments" which makes clear that Network Rail aspires to [redacted] increase in OM&R expenditure across CP6. DB Cargo is not aware at this stage of any proposals from ORR or Network Rail to significantly vary the proportion of Network Rail's costs assessed as fixed and variable. In addition, DB Cargo is not aware of any proposals at this stage from ORR or Network Rail to significantly vary the proportion of Network Rail's assessed variable costs between passenger and freight. DB Cargo recalls that PR13 saw a significant switch in such costs from passenger to freight and DB Cargo fears that PR18 may continue that trend.

78. In the light of the above, and in the absence of any other data at this stage, DB Cargo has to assess that the applicable Network Rail variable costs to be recovered by the VUC may rise by at least [redacted]. Furthermore, it is not yet clear whether, given the reduction in coal volumes, there will be any consequential additional impact on VUCs for all commodities.

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79. The outcome of this level of increase on the economics of rail freight in many sectors could be very negative and DB Cargo urges ORR to urgently assess such potential impact before concluding on this recommendation.

Q7 Do you have any suggestions for "recalibration" style changes to the VUC you would like to see considered for PR18 implementation?

80. DB Cargo would welcome greater evaluation of the track damage impact of higher speed trains (greater than 75mph) and the interaction between frequency and high speed. DB Cargo is aware that there is some evidence that these effects have hitherto been understated.

81. DB Cargo asks ORR to consider any lessons that might applicable from High Speed One, where there is a clear correlation between high speed passenger trains and high infrastructure costs.

Q8 Do you support our recommendation not to replace the CC with adjustments to Schedule 8 benchmarks?

82. DB Cargo does not support ORR's recommendation not to replace the Capacity Charge with adjustments to Schedule 8 benchmarks and believes that the proposal should remain as an option for consideration for CP6.

83. DB Cargo understands that the Capacity Charge provides Network Rail with additional revenue to cover the increase in Schedule 8 payments that typically results from adding traffic associated with the increased difficulty of recovering from incidents of lateness as the network becomes more crowded. A secondary objective of the charge is to provide appropriate incentives and price signals to train operators and funders to make efficient use of network capacity.

84. However, DB Cargo considers that the current Capacity Charge meets neither objective effectively as far as freight is concerned. Firstly, it over recovers the marginal cost of additional traffic by way of applying the marginal cost to all traffic both above and below the baseline. This means that Network Rail would continue to receive significant sums of Capacity Charge even if there was no growth on the network and, therefore, no additional Schedule 8 payment costs to recover. DB Cargo recognises the consistent principle of a marginal rate being applied to all traffic, in-line with the VUC. However, this does not take into account that, unlike the VUC, the Capacity Charge should only recover additional costs above the baseline. The result is a substantial over recovery. Secondly, a freight service would pay the same Capacity Charge irrespective of what part of the network was being used and at what time.

85. This over-recovery is exacerbated because rather than having one baseline for freight activity as a whole, the Capacity Charge is applied separately to three commodity groupings (Coal, Intermodal & Other) in an 'end of year wash-up' process to assess whether any or all of these commodities has exceeded its baseline. This can lead to large sums of money flowing from FOCs to Network Rail for above baseline

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activity even if overall freight on the network (measured in train miles) has fallen considerably. For example, in 2014/15 Financial Year, FOCs were liable to an additional payment of £765,260 because of the significant increase in the 'Other' commodity grouping over its baseline whereas the additional payment would have only been £202,389 if the 'wash-up' was calculated on all freight train miles in aggregate.

86. DB Cargo is disappointed, therefore, that ORR has chosen to discount the option of replacing the Capacity Charge with adjustments to Schedule 8 benchmarks on the basis that the proposal is costly, complex and has no beneficial incentive effects. Given that the main reason for having the Capacity Charge is to enable Network Rail to recover additional Schedule 8 payments resulting from increased levels of trains on the network, it seems appropriate to DB Cargo that the best means of addressing this is through Schedule 8 itself and not as additional fixed or variable charges. DB Cargo set out a possible way of achieving this in Annex 1 of its response dated 2 February 2016 to ORR's consultation letter concerning the preparation for the reviews of Schedules 4 & 8 of track access contracts.

Q9 Do you think we should (a) retain the existing CC (but remove the caps on open access, freight and charter operators); (b) remove the existing CC and recover lost revenue through fixed cost charges; or (c) do you have any alternative proposals?

87. Notwithstanding DB Cargo's representations to Q8 above, if ORR maintains its position that it is not going to replace the Capacity Charge for FOCs with adjustments to the Schedule 8 benchmarks, then DB Cargo would support option (b) i.e. remove the existing Capacity Charge and recover lost revenue through fixed charges 'mark-ups' on an ability to pay basis.

88. DB Cargo would certainly not support option (a) i.e. retain the existing Capacity Charge for Freight Operators but remove the current caps. This would lead to a significant increase of Capacity Charges to FOCs which was assessed at the beginning of CP5 as adding around £15m - £20m to the level of charges. Such an increase could not be absorbed by FOCs even if all other charges remained the same for CP6.

Q10 Do you support our recommendation to keep the (Traction electricity) loss incentive mechanism

89. DB Cargo has participated in the cross-industry discussions on this matter through the auspices of the Traction Electricity Steering Group ("TESG"). These discussions concluded that the loss incentive mechanism has not been effective in its primary purpose of promoting reductions in system losses, or in incentivising increased levels of on-train metering.

...

90. DB Cargo notes that paragraph 3.43 of the consultation document states that ORR's proposed retention of the loss incentive mechanism is to provide *"incentives to ensure that the forecast losses are reflective of likely outturn"*. Whilst DB Cargo agrees that there are benefits to improving industry's understanding of EC4T, it is also important that any incentive mechanism is able to achieve its stated objectives. DB Cargo (together with other TESG members) is concerned that the loss incentive mechanism can result in the following perverse incentives:

- The ability to forecast losses in order to set an 'accurate' Distribution System Loss Factor (DSLF) is extremely complex. DB Cargo believes that at present, errors in modelled consumption rates contribute to a greater amount of the end of year EC4T wash-up than errors in the DSLF. There are also other possible contributing factors to the 'wash-up' including errors with grid supply point and on-train metered data. Therefore it is extremely difficult to begin to effectively analyse 'wash-up' data as a means of understanding losses until on-train metering levels are significantly higher than at present.

- Losses are known to vary by year and by ESTA, which further inhibits the ability to 'accurately' forecast losses on a network-wide basis using 'wash-up' data or other methodologies. In any case, under the relevant provisions in the Traction Electricity Rules, DSLFs are set for the duration of the control period in order to provide certainty to metered operators. This would prevent any changes to DSLFs, even if industry was able to determine a more robust forecast for such losses.

- In the prevailing situation where the end of year EC4T 'wash-up' corrects an overcharge to operators, the loss incentive mechanism generates a net financial loss for modelled operators, and a net gain to Network Rail. Therefore, operators and Network Rail have *opposing* incentives to accurately forecast losses: if the DSLF is set too low there is a loss to Network Rail and a gain to modelled operators, and vice versa if the DSLF is set too high. This seems to strongly contradict ORR's intention to share risk, and the industry's general aim to better align incentives.

91. In conclusion, therefore, contrary to ORR's proposal to retain the loss incentive mechanism, DB Cargo considers that instead the mechanism should either be modified so that it can better achieve its objectives or, alternatively, removed altogether.

Q11 Do you support our recommendation that the EAUC not be altered, beyond recalibration, in PR18?

92. DB Cargo supports ORR's proposal not to alter the EAUC beyond recalibration in PR18.

Q12 Do you support our recommendation to abolish the CSC?

93. DB Cargo supports the recommendation to abolish the Coal Spillage Charge.

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94. DB Cargo also considers that ORR should confirm that the Coal Spillage Reduction Investment Charge will also be abolished (it was suspended for CP5 pending review in PR18).

Short-run variable charges – general points

Impact of ending of CP5 cap

95. Paragraph 3.10 of the consultation document references the ending of the CP5 cap on the average increase in the VUC for freight and the ending of any prospect of 'phasing-in' any increases over CP6 in a rather matter-of-fact way without drawing out the impact on freight customers or the markets concerned.

96. It is evident that the ending of the CP5 cap in itself will increase applicable access charges very considerably, over and above any general increase in the VUCs. Given the way the CP5 cap operates (i.e. on the average increase rather than on the VUCs collectively), DB Cargo acknowledges that it is hard to assess such impact, but given its significance the issue should have been clearly elucidated.

97. It is self-evident that such an increase will have a material impact. Neither aggregates nor steel were market sectors determined by ORR during PR13 (and previous periodic reviews) as being able to support higher total access charges. DB Cargo fears that the impact of these changes in these sectors will be to drive reverse modal shift (i.e. from rail to road).

98. Freight customers view rail in comparison with other modes. It is unhelpful, therefore, for ORR to reduce the ability of the sector to compete with road. It is unfortunately not apparent to DB Cargo or its customers that ORR understands the impact this element of the Periodic Review can have. The absence of detailed impact assessment and mitigation measures is disappointing.

Potential CP6 VUC increases

99. As already set out in this response, DB Cargo is deeply concerned that the application of the likely VUC structure to the potential Network Rail cost base for CP6 poses a fundamental threat to rail freight.

100. DB Cargo has assessed that the effect might well be to considerably increase applicable access charges. Assuming this increase was [redacted], the list below sets out the impact on a representative sample of wagons used by DB Cargo customers.

Coal ESI:	HTA £[redacted] to £[redacted] per kgtm
Aggregates:	JNA £[redacted] to £[redacted] per kgtm
Steel:	KVA £[redacted] to £[redacted] per kgtm
Intermodal:	FKA £[redacted] to £[redacted] per kgtm

...

Automotive: WIA £[redacted] to £[redacted] per kgtm

101. To further illustrate the potential impact of this, the table below sets out the impact (assuming a [redacted] increase in the VUC) on a representative sample of services used by DB Cargo customers.

[redacted]

102. These increases do not factor in any impact of the ending of the CP5 cap on VUCs, and therefore understate the position DB Cargo's customers may face.

Cumulative Impact of ending of CP5 cap and potential CP6 VUC increases

103. In the PR13 process, MDS Transmodal reviewed the impact of changes in track access charges on rail freight for ORR. As part of this, MDS Transmodal assessed the impact of (inter alia) a 50% increase in the VUC and a 100% increase in VUC. The conclusions, accepted by ORR, were:

Impact of % changes in VUC on Tonnes and Tonne kms by commodity

Commodity	**Tonnes**	**Tonnes**	**Tonne kms**	**Tonne kms**
% change in VUC	**+50%**	**+100%**	**+50%**	**+100%**
Other (Nuclear)	0.0%	0.0%	0.0%	0.0%
ESI Coal	-0.2%	-0.4%	-0.2%	-0.4%
Other Coal/Biomass	-0.3%	-0.7%	-0.5%	-1.0%
Iron Ore	0.0%	0.0%	0.0%	0.0%
Automotive	-6.3%	-12.1%	-5.1%	-10.1%
Metals	-2.0%	-3.9%	-2.1%	-4.2%
General Merchandise	-3.9%	-7.5%	-4.6%	-8.8%
Petro/Chem/Ind Min	-3.8%	-6.9%	-6.5%	-11.4%
Intermodal	-7.4%	-14.3%	-6.6%	-12.9%
Domestic waste	-7.4%	-14.3%	-6.3%	-12.3%
Construction	-8.7%	-16.1%	-7.7%	-14.8%
Total	**-4.0%**	**-7.6%**	**-4.6%**	**-8.9%**

(*source : MDS Transmodal Stage 1 report for ORR 12 February 2012*)

104. In the same report, MDS Transmodal also assessed the potential for modal shift

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from rail to road given such higher access charges. They concluded that

a. There was a HIGH risk of Intermodal, Automotive and Domestic waste traffic switching to road;
b. There was a MEDIUM risk of Construction, Petro/Chems/IndMin, General Merchandise, Metals, Iron Ore and Biomass traffic switching to road;
c. There was LOW risk ESI coal and Nuclear traffic switching to road.

105. MDS Transmodal also concluded in addition to the impact on FOC profitability, there would be an additional mode shift cost of £51m in HGV environmental external cost. This compared with c£53m of additional VUC revenue (of which £13.4m of this related to ESI coal traffic which has now mostly ceased due to Government energy policies). These were complex calculations, but MDS Transmodal suggested that, at a minimum, environmental external costs would exceed any increase in VUC revenue for Intermodal, Construction, Domestic waste and Petro/Chems/IndMin.

106. It is evident from the current situation with PR18 that, absent any changes in direction from those signaled in the consultation document and the Initial Industry Advice, the effects on FOCs and their customers may very well be similar to the situation assessed by MDS Transmodal in PR13 in looking at both a 50% and a 100% increase in the VUC. In other words:

a. Loss of current volume – up to 15/16% in key growth markets such as intermodal and construction;
b. Stunted growth prospects;
c. Modal shift to road and increased environmental external costs;
d. Deterioration in both FOCs and sector financial positions;
e. Loss of investor confidence.

107. In conclusion, DB Cargo considers that the impact of any such increases in the VUC for PR18 would have no less effect than it would have done in PR13. In fact, given the continued structural weakness in UK markets such as steel production, DB Cargo submits that the impact of such increases may very well be much greater. DB Cargo would urge the ORR to reflect very carefully on the potential effect any significant increases in the VUC would have on FOCs, their customers and general industry confidence.

Legal

108. It appears that ORR's position on ending the CP5 cap on the average increase in the VUC for freight together with discounting any possibility of 'phasing-in' any increases in the VUC over CP6 comes from its interpretation of the Regulations and supporting EU legislation.

109. Implementing Regulation EU 2015/909 specifies that "*given that railway undertakings need predictable charging systems and have reasonable expectations for the development of infrastructure charges, the infrastructure manager should*

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provide a phasing-in plan for railway undertakings operating the train services that may see their charges significantly increase following a review of the implementation of the existing calculation modalities, if such a phase-in plan is required by the regulatory body."

110. Having considered the Implementing Regulation, DB Cargo submits that the key things that have to have happened in order for a cap or phase-in plan to be considered by ORR are 1 that there has to have been a review of the implementation of the existing calculation modalities; and 2 that charges may significantly increase.

111. The Implementing Regulation does not require, as ORR's alternative interpretation seems to suggest, that any review has to result in changing the existing method for calculating direct costs, merely that there has been a review and that such a review may result in significantly increased charges. DB Cargo submits that it is beyond doubt that a review is being undertaken and as a result of that review, charges for FOCs may increase significantly. It would be perverse for ORR's interpretation of legislation designed to attract increased use of rail to prevail which will result in the complete opposite effect.

112. DB Cargo would hope, therefore, that ORR will review its position in this respect and adopt a more pragmatic approach to the interpretation of the requirements of the Implementing Regulation as DB Cargo has done. Furthermore, given the UK's forthcoming exit from the European Union and acknowledging that the terms of Brexit are still to be determined, some flexibility of approach ought now to be possible to avoid perverse or unintended consequences of a narrow interpretation of the legislation.

113. To support its views set out above, DB Cargo is seeking expert legal opinion which it will share with ORR when it has been received.

Contractual Incentives regime

Q13 What are your views on the options of passenger compensation recovery and improving the transparency of compensation relating to Network Rail's actions?

114. As a FOC who does not convey passengers, DB Cargo has no comments to offer on this matter. However, it would be concerned if an unintended consequence of taking forward such a proposal resulted in adverse effects on the FOC Performance Regime, for example an increase in payment rates.

Q14 Do you support our recommendation to only make changes to delink (Sch. 8) passenger operator benchmarks and NR benchmarks for freight operators from past performance (but to leave the approach to other benchmarks unchanged)?

115. The changes made to the various metrics in the freight Schedule 8 performance regime for PR13 (including the benchmarks) have had a significant and adverse effect on the financial risk faced by FOCs. Therefore, whilst DB Cargo would support ORR's recommendation to make changes to delink the Network Rail benchmark from past performance, it also considers that the way in which the FOC benchmark is derived should also be reviewed.

116. Whilst DB Cargo is not opposed in principle to setting the FOC benchmark on the basis of average industry performance, there are a number of possible changes to the FOC benchmark (and other aspects of the regime e.g. payment rates) that it believes should be explored for CP6.

117. Firstly, if the FOC benchmark is to continue to be based on average freight industry performance, then this should be measured across at least the first four years of CP5 and not just two years of data as has been the case in previous reviews. DB Cargo considers that larger calibration periods lead to greater and not lesser precision as fluctuations can be spread over a larger time period.

118. Since the start of CP4, FOC on-self delay has reduced by around 47%, FOC on third party delay has reduced by 4% (both as measured on minutes delay per 100 train miles) and FOC third party delay per incident ("DPI") has increased by 49%. Whilst an increase in DPI could be expected from the increase in network congestion, DB Cargo believes that such a significant increase could also point to the fact that the performance regime does not incentivise Network Rail enough to manage incidents that are attributed to FOCs.

119. The current performance regime includes an annual benchmark adjustment process that is intended to counter-act increased third party use of the network. Given the substantial increase in DPI, DB Cargo considers that this mechanism should also be reviewed for CP5.

120. DB Cargo welcomes the efforts by ORR to set up a Working Group to discuss the detail of possible changes for CP6 to both the Schedule 8 performance and Schedule 4 possessions regimes for FOCs. DB Cargo looks forward to participating in this Working Group.

Q15 Do you support our recommendation to change the measure of passenger operator performance to one based on delay to other operators?

121. As a FOC, it is not appropriate for DB Cargo to comment in detail on this, but it would be concerned if an unintended consequence of such a change in methodology resulted in adverse effects on the FOC Performance Regime and/or led to increases in conflict and debate between Network Rail and Train Operators about the management of incidents, particularly in real time.

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Q16 Do you support our recommendation to limit Sustained Poor Performance to cost compensation only?

122. DB Cargo has no comment on this.

Q17 Do you support our recommended prioritization of Schedule 4 issues? If you think we should reconsider any of the areas we have de-prioritised please submit supporting evidence.

123. DB Cargo strongly believes that Schedule 4 has to incentivise Network Rail to keep freight trains running on the network either by providing diversionary routes or by using methods of operation on the planned routes such as bi-directional working. In addition, Network Rail needs to be incentivised to provide diversionary routes that match the capability of the planned route. This is because it is not possible in the vast majority of cases to use replacement road transport for freight.

Q18 Do you wish to submit evidence regarding: (a) processes associated with planning possessions; and/or planning alternative arrangements to deal with planned disruption?

124. Whilst DB Cargo recognises that the formal processes associated with the consultation and planning of possessions are enshrined in Part D of the Network Code and associated documents, in its experience the effects of Major Projects have consistently undermined these processes. In particular, the electrification of the Western Route, North Western Route, Edinburgh to Glasgow and the Central Belt have driven the requests for many hundreds of hours of additional possessions. Many of these additional possessions come after T-12 (i.e. after revised timings and plans have been received and put in place by Operators for existing possessions that were advised in good time).

125. This continual change to the access regime has been driven by Network Rail's inability to deliver to DfT timescales due to an insufficient understanding of the work needed to be carried out and the time required to deliver to those timescales. This continual churn of access requirements has driven an increase in DB Cargo's costs, increased disruption to our customers' businesses and inefficient solutions in respect of the pathing of trains affected by these possessions. Whilst Schedule 4 provides some compensation, this tends to be far outweighed by the actual costs (including the significant amount of additional clerical and management time that would not be necessary if Network Rail had a better grip on its possession requirements and how these should be planned.

126. In addition, it is frequently seen that possessions are requested in advance before there is actually any work planned to use those possessions. It seems Network Rail's approach in such circumstances is just to hope that sufficient work will be forthcoming to fill the opportunity when in many cases work does not materialise. This results in possessions being published and agreed when it is known that such possessions will not be required. For example, the Crossrail West Project frequently requests

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possessions where no work is undertaken but remains insistent that these possessions are required to deliver to the DfT timescales and cannot be removed.

Q19 Do you have any view on how financial incentives could be improved to encourage collaboration between Network Rail and operators to reduce industry costs?

Q20 Do you have any views on the cost categories you think could be controlled by operators and whether these costs would be suitable as the basis of a potential future mechanism?

127. DB Cargo strongly supports putting in place financial incentives that encourage collaboration to promote efficiency and reduce cost.

128. As already set out in paragraph 20 of this response, DB Cargo and the freight sector in general has a strong track record in driving network efficiency. The CP4 efficiency benefit share mechanism provided some financial reward for adopting such efficiencies.

129. DB Cargo opted out of the Route-level Efficiency Benefit Sharing (REBS) scheme in CP5, primarily because of the risk of exposure to Network Rail cost "downside". However DB Cargo together with other FOCs and in conjunction with Network Rail developed an alternative mechanism i.e. the Freight Efficiency Benefit Share ("FEBS") which is based on LEK's PR13 work on freight avoidable costs.

130. The aim of FEBS was to help Network Rail realise efficiency gains. This was envisaged to potentially involve FOCs:

   a. accepting changes to their operations where that would help Network Rail reduce its costs;

   b. challenging Network Rail's assumptions about the capacity and capability that freight requires (for example in proposed renewals or enhancement schemes); and

   c. having a different balance of expertise and technical capabilities that might help Network Rail to realise efficiencies that might not otherwise have been identified.

131. [redacted]

132. The scope was seen to be [redacted] of freight-related OM&R expenditure plus enhancement schemes by mutual agreement, although there was no clarity at that point of any interrelationship between any FEBS scheme and the ECAM process then being introduced.

133. The scope of FEBS was largely built on the work undertaken in 2012 by LEK on freight avoidable costs. This was critical as this was practical work built on a focussed freight basis and was classified as;

   a. Freight-only line costs
   b. Redundant freight assets costs (e.g. property)
   c. Variable usage costs (using modified VTISM inputs)
   d. Redundant enhancement costs
   e. Consequential cost reductions (e.g. resulting from maintenance and renewals policies)
   f. Network Rail staff costs.

134. [redacted]

135. [redacted]

136. The scheme envisaged Network Rail and FOCs working collaboratively to identify and implement efficiencies and the FOCs would consequently share the benefits in proportion to each FOC's variable usage charges.

137. For efficiencies to be included in the scheme, FOCs would need to actively contribute to their identification and realisation - which would require resourcing and other commitment from FOCs.

138. For a number of reasons the scheme was not implemented although all parties were supportive in principle. DB Cargo believes the proposal still has merit and would be very willing to discuss the work in more detail with the ORR if that would be helpful.

139. A key concern of DB Cargo has always been that FOCs and other operators cannot influence a high proportion of Network Rail's cost base which is one of the reasons why DB Cargo opted out of REBS and why the freight approach to Network Rail efficiency has been (and remains) targeted on specific costs and activities where FOC experience and knowledge can be best utilised.

140. In addition to the scope of FEBs, DB Cargo would welcome specific incentives being placed on Network Rail to improve the impact on the track of the wagon fleet used for the maintenance and renewal of the network.

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Conclusion

141. In paragraph 24 above, DB Cargo set out the 5 “Red Line” tests being applied to PR18. Its conclusions as to how the proposals in this consultation relate to these are set out below:

a. *Maintain user and investor confidence.*

   There are clear risks to maintaining investor and operator confidence from PR18 and this consultation far from reducing that risk, will substantially increase it.

b. *Respect the open, fair and competitive market.*

   There is no evidence that the proposals in the Consultation Document will distort or affect competition within the rail freight market, but they will result in further modal disadvantage in comparison with road transport. Modal shift from rail to road is likely as a result of ORR’s proposals.

c. *Not lead to any price shocks.*

   As set out in this response, DB Cargo is apprehensive that there is a very high probability of price shocks as a result of:

   i. The ending of the capped VUC rates in CP5 – these will increase access charges for steel and aggregates customers in particular, but the effects will be felt by all customers;

   ii. The impact of a likely increase in Network Rail OM&R costs which was signalled in the Initial Industry Advice. Without any change in allocation or attribution methodologies, these would likely increase all variable access charges by some [redacted] in addition to the increases set out above.

d. Only deliver change that is pragmatic and proportionate.

   DB Cargo is concerned that the potential impacts on the VUC will not be proportionate and cannot see any beneficial effect for FOCs or their customers. DB Cargo would remind ORR of the clear statement from Richard Carter of DfT that “*changes (in PR18) should only be made where they lead to a significant better outcome for users*”.

e. Be subject to timely, holistic impact assessment.

   The absence of the framework for holistic, cumulative assessment is concerning. DB Cargo acknowledges that, as is evident in the consultation document, ORR is attempting to give impact assessments of individual

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elements. However it was the lack of a timely, holistic impact assessment that was a main failure in PR13 and DB Cargo is concerned that this may be repeated before key policy decisions are made in PR18.

Please contact me if you would like clarification or amplification of any of the points in this response. DB Cargo would wish to be given the opportunity to redact certain information in the response prior to it being made public.

Yours sincerely,

Nigel Jones
Strategic Advisor

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Response to ORR's December 2016 Charges and Incentives Consultation

This pro-forma is available to those that wish to use it to respond to our consultation. Other forms of response (e.g. letter format) are equally welcome.

Please send your response to pr18@orr.gsi.gov.uk by **9 March 2017**.

Full name	Emma Mons-White
Job title	Planning Manager
Organisation	Tyne and Wear Metro
Email*	
Telephone number*	

*This information will not be published on our website.

Please make any comments regarding the questions in the accompanying text box. We welcome comments in relation to the information outlined in both the consultation document and supporting documents, or regarding the policy areas more generally.

Chapter 2: Infrastructure Costs

Fixed cost charges:

1. Do you support our proposal to levy fixed cost charges on all operators, including open access operators, to the extent that they can bear them (option 2)?

Tyne and Wear Metro have a bespoke Track Access Agreement under which we pay a fixed Operational and Maintenance Charge; we do not pay separate Fixed Cost Charges. We seek confirmation that Tyne & Wear Metro will not be affected by this proposal and any agreement to this would depend on the extent of the fixed costs and the methodology used to determine 'market can bear'.

Fixed cost freight charges:

2. Do you support our proposal to simplify the current charging regime by having a single freight mark-up charge?

N/A

Fixed cost freight charges: 3. Do you support the recommendation to apply Network Rail's cost allocation methodology (discussed in this chapter) to freight mark-up charges?
N/A
Station charges: 4. **Long term charge (LTC):** Do you support our recommendation that the methodology for the LTC at managed stations be recalibrated?
We are unsure as to whether this applies to managed and or franchised stations and seek clarification as to exactly which stations this applies to. We would want to know how these would be recalibrated and determine any financial impact before agreement.
Station charges: 5. **Qualifying expenditure (QX):** Do you agree with our recommendation that we support the work to make total QX charges more transparent at both managed and franchised stations?
Attempts to make charges more transparent would be welcomed. Sunderland Station is managed by Northern but Tyne & Wear Metro is the major user of the station, paying over 85% of QX charge. More transparency would therefore be welcome as it would allow more cost comparison and an assessment of value for money.

Chapter 3: Short-run variable charges package

Variable usage charge (VUC): 6. Do you support our recommendation not to make fundamental changes to the VUC for PR18?

Due to the nature of our bespoke Track Access Agreement, Metro pay a fixed Operational and Maintenance Charge; we do not pay a separate VUC. We seek confirmation that Tyne & Wear Metro will not be affected by this proposal.

Variable usage charge:

7. Do you have any suggestions for ‘recalibration’ style changes to the VUC you would like to see considered for PR18 implementation?

No

Capacity charge (CC):

8. Do you support our recommendation not to replace the CC with adjustments to Schedule 8 benchmarks?

As with previous questions, the bespoke nature of our Track Access Agreement means we do not pay a separate CC. Given this, we would seek assurance that that if the CC was replaced with adjustment to Schedule 8 benchmarks, Tyne and Wear Metro would not face an increase in overall costs through such an adjustment its Schedule 8 benchmarks.

Capacity charge:

9. Do you think we should: (a) retain the existing CC (but remove the caps on open access, freight and charter operators); (b) remove the existing CC and recover lost revenue through fixed cost charges; or (c) do you have any alternative proposals?

This depends on any potential financial impacts and as Tyne & Wear Metro does not currently pay a separate CC. We seek confirmation that Tyne & Wear Metro would not be affected by either of these proposals. Until these financial impacts are known we are not in a position to believe that any one option is better or worse than the other.

Traction electricity charge:

10. Do you support our recommendation to keep the loss incentive mechanism?

At the current time, Metro is the only electrified operator on the sections of track we operate on, so foresee no impact as a result of this.

Electricity asset usage charge (EAUC):

11. Do you support our recommendation that the EAUC not be altered, beyond recalibration, in PR18?

As in previous points, due to the bespoke Track Access Agreement, we do not currently pay this as this is covered under our fixed Operation and Maintenance Charge. We seek confirmation that Tyne & Wear Metro will not be affected by this proposal.

Coal spillage charge (CSC):

12. Do you support our recommendation to abolish the CSC?

N/A

Chapter 4: Contractual Incentives Regime

Schedule 8:

13. **Passenger compensation:** What are your views on the options of passenger compensation recovery and improving the transparency of compensation relating to Network Rail's actions?

We would welcome the option to claim back passenger compensation from Network Rail. However, we would seek clarity on if this will apply to Metro. Metro currently pay refund in full for a single trip if a journey is delayed by more than 15 minutes. This is set in the Concession Agreement let by Nexus and as such is not a DfT franchise obligation, although is comparable.

Schedule 8:

14. **Approach to setting benchmarks:** Do you support our recommendation to only make changes to delink passenger operator benchmarks and Network Rail benchmarks for freight operators from past performance (but to leave the approach to the other

benchmarks unchanged)?
We do not support the approach to have different methodologies for benchmark setting applied to TOCs and Network Rail. This lacks consistency. It may be that there are plans to otherwise ensure this, but in the absence of any further detail, this cannot be supported. We also do not support delinking benchmarks and past performance. By examining previous performance and applying uplifts we can identify what we want future benchmarks to look like. As above, it may be that there is an alternative way of doing this, but as there is no further information about how benchmarks would be calculated, this cannot be supported.
Schedule 8: 15. **Measure of passenger operator performance:** Do you support our recommendation to change the measure of passenger operator performance to one based on the delay caused to other operators?
We do not know what the impact of this will look like. Potentially this also disincentives TOCs from doing the right thing by customers, in order to avoid causing delay to other TOCs. What will this look like? How will it be measured? Does this disproportionately impact on operators where they have greater or lesser interactions with other TOCs? We have concerns about the level of resource that this would take to monitor, as rather than simply looking at the delay of Tyne & Wear Metro trains, the delay of other TOCs would also have to be analysed in order for Tyne & Wear Metro to manage the regime.
Schedule 8: 16. **Sustained poor performance (SPP) provisions:** Do you support our recommendation to limit SPP to costs compensation only?
This does not currently feature in our Schedule 8 regime. However we support the recommendation.
Schedule 4: 17. Do you support our recommended prioritisation of schedule 4 issues? If you think we should reconsider any of the areas we have de-prioritised please submit supporting evidence.
No issue with this proposal.

Schedule 4: 18. Do you wish to submit relevant evidence regarding: (a) processes associated with planning possessions; and/or (b) planning alternative arrangements to deal with planned disruption (e.g. the notification that is needed to arrange bus replacement services)?
No
Aligning operator and network rail incentives: 19. Do you have any views on how financial incentives could be improved to encourage collaboration between Network Rail and operators to reduce industry costs?
No
Aligning operator and network rail incentives: 20. Do you have any views on the cost categories you think could be controlled by operators and whether these costs would be suitable as the basis of a potential future mechanism?
No

Any other points that you would like to make
As highlighted in several parts of the response, Tyne and Wear Metro has a bespoke Track Access Agreement. Clarity is sought from the ORR that the Track Access Agreement will not be affected by the proposals.

Thank you for taking the time to respond.

Department
for Transport

Richard Carter
Director, Rail Strategy and Security
Department for Transport

Web Site: www.dft.gov.uk

17 March 2017

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Sent by e-mail

R Jh

Response to the ORR's PR18 consultation on charges and contractual incentives

Thank you for the opportunity to respond to the ORR's consultation document, *Improving incentives on Network Rail and train operators: A consultation on changes to charges and contractual incentives*. This work has the potential to be an important step in the right direction, and we welcome the overall direction of travel and the highly collaborative and pragmatic way in which the ORR has approached this issue. Before responding to the detailed points raised in the consultation, we wanted to set out our ambitions for the industry to put our consultation points in context.

The importance of customer centred joined-up approach

The Government's vision is for a railway that responds to its customers, giving them what they need and expect – a world-class future railway which achieves a gold standard of customer service. Among other things this means:

- **Joining up track and train**, so that all parties in the industry are working as a team, with shared objectives and incentives, resolutely focussing on customers, delivering what they want and need.
- **A clear focus on improving efficiency**, including improving the railway's competitiveness and delivering better value for taxpayers.
- Ensuring that our **railways continue to deliver for the economy**, including through supporting a vibrant rail freight market.

This will mean a new and different approach from all parties. It requires reconsideration of many aspects of how the railway has recently worked, and using all the levers to ensure it truly delivers for its users.

We are looking to the ORR to do all that it can to support this agenda, creating stronger incentives for a joined-up approach to track and train, and for a relentless focus on delivery for rail users. This should, in our view, include continuing your ambitious approach to route devolution, to joined-up customer-centred route strategic business plans and to support the continuous evolution of the scorecard process to create genuinely joint industry objectives; these could be a transformative tool in bringing track and train together in the future. This needs to be accompanied by relentless drive on efficiency in all parts of the rail industry. We are therefore also looking for the ORR to be ambitions in how it uses the levers which are the subject of this consultation – charging and efficiency incentives to create a railway centred on its customers.

We therefore welcome most of the proposals you have set out in the consultation document. However, we will be looking for the ORR to ensure the review process provides a strong push for industry to continue to improve including continuous development during each control period.

Our key observations are set out below, with the detail in Annex A.

Summary of key issues in the consultation

Joining up track and train

An important enabler to improving our railway is a genuinely joined up approach between track and train, with all parties committed to delivering what passengers want and need. It is vital the charging and financial incentive framework sends appropriate cost signals and incentivises alignment of industry objectives. The ORR's approach to charges and incentives has an important role to play here by increasing transparency of costs, by creating industry incentives to encourage greater joint working, and removing any disincentives. Such reform must ensure a regulatory framework that evolves beyond PR18 final determination to support future use of greater track-train alliancing.

Improving efficiency

Government remains committed to a rail industry in which competition for passenger services provides a modern, efficient railway, the best long-term value for the taxpayer, and a high quality of customer service. Increasing transparency of infrastructure costs will play an important role here, as well as creating joint incentives for efficiency.

On-rail competition can also play a role in delivering these outcomes, supporting our highly competitive franchising process. However, in order for this to work effectively, both franchised and open access operators need to operate on a level playing field. This includes protecting the resilience of the network and its ability to recover from delays, and ensuring that a more crowded railway does not lead to a decline in performance due to increased pressures on capacity. We therefore welcome the ORR's approach to charging reform, including its commitment to working with us to facilitate more competition in passenger services by ensuring ORR proposals on fixed charges and our work on the Public Service Obligation (PSO) levy[1] are fully joined up.

Delivering for the economy

An efficient, effective, joined up railway plays a key role in creating and expanding economic opportunities. The ORR's work in providing stronger efficiency incentives, and encouraging the industry to deliver for its customers is critical to this.

The Government's Rail Freight Strategy[2] published in September 2016 recognises the valuable contribution rail freight makes to the economy and to the environment. In this light, the level and future trajectory of track access charges has an impact on rail freight operators' ability to offer competitive prices to their customers and on their growth. It is therefore critical that the impacts of any changes to access charges upon the freight sector are weighed carefully prior to adoption, to

[1] See: https://www.gov.uk/government/consultations/the-passenger-rail-public-service-obligation-levy

[2] See: https://www.gov.uk/government/publications/rail-freight-transport

avoid unintended adverse consequences. A view from the ORR as soon as possible would also give as much certainty as possible to the freight industry.

How we work together to support users

We welcome the principles and approach the ORR adopts throughout the consultation document to improve charges and incentives. However, to maximise their effectiveness for users it will be important for both the DfT and the ORR to continue to closely work together through PR18, to help ensure that the regulatory reforms agenda complements the broader programme of rail reform which the Government is taking forward. We would also continue to encourage the ORR to ensure its approach to working with NR puts the interests of the user first, including ambitious route devolution and the continued development of joined up working between track and train. It is important this principle remains at the heart of PR18, given their importance in facilitating many of the measures discussed in the consultation document.

Richard Carter
Director, Rail Strategy and Security

Annex A - Specific comments on aspects of the consultation document

We have structured our detailed response by reference to the following themes:

- Transparency of fixed infrastructure costs
- Charging reform
- Regulatory incentives

Transparency of fixed infrastructure costs

Further improving the efficiency of Network Rail (NR) is a significant priority for NR and for Government, helping to ensure that NR delivers its customers.

A key component of this is to better understand NR's fixed costs, helping to provide an even greater focus on efforts to reduce costs. We therefore welcome the pilot study that has been completed for the Wales route to better understand these fixed costs. We strongly support its extension, with suitable refinements, to other routes.

Charging reform

In undertaking charging reforms, we consider that the ORR should focus on ensuring that charges are fair, reasonable, as simple as possible, and provide clear incentives to encourage efficiency and economic development.

Our views in relation to specific charges are discussed below.

Fixed charges

We support reforms to fixed charges which help facilitate a more competitive railway, whilst safeguarding the critical contribution made by rail freight.

In that light, we support the ORR's proposal to levy fixed costs on all operators subject to the market can bear test (Page 13, Option 2). This will allow all operators to make a fair and appropriate contribution to the fixed costs of the network. Combined with our own work on developing options for a PSO levy, this could provide a more level playing field helping to facilitate fair on-rail competition for passenger services, stimulating even greater innovation for the benefit of passengers.

With respect to the details of the market can bear test, we would welcome the opportunity to engage fully in ORR's work, which we consider should be further developed as a matter of priority. For example, a more disaggregated approach to market segmentation may be the best way to account for the different markets and circumstances that different types of operator face.

Freight considerations

The level and trajectory of freight charges will be critical to the success of the rail freight strategy. We welcome ORR's early and proactive engagement with the industry as part of this review process. However, it is important that the ORR is as clear as possible on its freight charging proposals, as soon as possible to minimise uncertainty.

More specifically:

- We note the ORR's plans for updating the analysis underpinning the market can bear test as applied to freight operators. In carrying out a review of the market can bear tests by commodity, as proposed, it is important for the ORR to carefully consider the implications on the potential growth of the freight sector in line with DfT's Rail Freight Strategy. DfT will work with the ORR and industry to understand how the market can bear test by commodity will impact on the freight sector. More generally, we consider it would be beneficial for the ORR to explore options for providing a mechanism for reviewing the market can bear test during a control period when, for example, there are significant shifts in commodities markets that disproportionately affect the freight sector. We recognise such an approach would need to be carefully considered to understand the risks associated with the potential uncertainty it could introduce.

- We also support the recommendation to apply NR's updated cost allocation methodology to freight mark-up charges as part of the review of charges. In considering revisions to the market can bear test by looking at how ability to pay might vary by location, ORR will need to take into account cost directly incurred charges and the overall impact on the freight sector.
- Furthermore, we support the simplification of the charging regime by having a single freight mark-up charge, rather than allowing Network Rail to recover fixed costs through two separate charges (Freight Only Line Charge and Freight Specific Charge). We also support abolition of the Coal Spillage Charge.

Station charges

The success of Britain's railways depends on every aspect working effectively and efficiently. Stations are the means by which passengers enter and exit the rail network – every journey taken will involve at least two stations, and the importance of effective regulation in managing stations and impacting on the passenger experience cannot be underestimated

In 2015 the RDG review of station charges found improvements could be made. While we share the RDG view that improvements to station charging in isolation will not resolve some of the more significant barriers to delivering new station management and operation models, we think that important changes can and should be made.

We agree that improving the methodology and application and allocation of Long Term Charge (LTC) and Qualifying expenditure (QX) at NR Managed Stations is a welcome first step to delivering better station management models. In particular:

- **LTC**: We welcome the proposed changes to the LTC methodology, and support the principle of improving cost-reflectivity. We recognise it would be difficult for each individual station to levy its charges calculated individually. However, the current system of LTC allocation decreases certainty, cost transparency and accountability, and does not provide a true picture of the cost of the railway (or a station). It could lead to investment being diverted from stations where it is needed. It should not be unduly onerous to calculate individual LTCs for 18 stations to arrive at a more accurate settlement; this would also provide train operators with a greater degree of certainty over charging at some of Britain's largest and busiest stations, allowing charges to be focused where they are most needed. Building up individual asset management plans will also support the consideration of alternative management models at Network Rail-managed stations.
- **QX**: We fully support the principle of making QX charges more transparent at both managed and franchised stations. Publishing QX figures for individual stations would allow for comparisons and benchmarking, and for challenging whether costs are being efficiently incurred at all stations and DfT will require those operating under franchise agreements to ensure that this is in place for the start of CP6. Publishing this data might then allow, for example, third parties to use the data to pioneer technological solutions which could be applied to reduce costs further, and DfT would welcome any such commercial arrangements.

We note ORR's commitment to consider appropriate charging arrangements across an increasingly diverse range of management and operational models. However, charging arrangements are just one of the limbs that support this work and we therefore look to continue to work with ORR on asset management, a review of access documentation, station capacity and passenger experience

More generally, we will continue to work with ORR and others to review station charging in the context of a wider review of the suite of station regulatory tools, including the Station Stewardship Measure, and station regulatory documentation (Station Access Agreements, Station Specific Annexes and Station Access Conditions), where we believe there is scope to make significant difference to the way in which stations benefit the passenger and wider industry.

Capacity charge

We also recognise the industry concern that the capacity charge does not provide a meaningful incentive on Network Rail to grow traffic on the network and that it represents a significant administrative burden due to its complexity and design. We also consider that it is important to recognise that there are trade-offs from increasing traffic and that this should not be incentivised at the cost of major impacts on performance. In light of this we believe that of the three options considered the removal of the charge and subsequent recovery of lost revenue through fixed charges represents the best option, removing complexity and improving efficiency in the industry.

A pre-condition for this, however, are the ORR's proposals for reform to fixed charges as we have discussed above. We would be likely to take a different view without proposed reforms.

Variable usage charge (VUC)

We understand the ORR's decision not to prioritise any fundamental changes to the VUC for PR18, given the broad ranging agenda included in PR18 for significant change to the regulatory landscape, particularly the promotion of ambitious route regulation and effective system operation. However, to ensure that the benefits of alternative approaches are fully considered in the future, we would strongly encourage the ORR to set out a clear programme of work, working closely with the industry, after PR18 to enable appropriate decisions to be considered well in advance of PR23.

In the meantime, we welcome ORR's commitment to continue to work with stakeholders throughout CP6 to explore issues relating to the charge - including alignment with route-level regulation and investigating methodological issues (as discussed at paragraph 3.15 of the consultation document).

Regulatory incentives

As we discuss above, Government is strongly committed to achieving a more joined–up railway, with a much stronger alignment between track and train. This includes alignment of objectives throughout the industry, supported by a full range of aligned and common incentives and metrics – franchising, management and regulatory incentives - to help ensure the railway delivers for its users. While integrated management teams and alliances will play an important role, regulatory incentives will also play a key role in facilitating industry wide change. It is therefore important that changes to regulatory incentives simplifies, rather than adds complexity.

We consider individual incentive regimes below.

REBS

As reflected in stakeholder views already provided to the ORR, the current Route Efficiency Benefits Scheme has not been effective in creating genuine, joined up efficiency incentives. However, we do consider an appropriate shared risk and reward regime can still play an important role, particularly outside the framework of a formal structural arrangements between parties (such as in an alliance). We would encourage ORR to consider how a future joint financial incentive regime could be designed to in bring track and train together, consistent with the Secretary of State's rail reform agenda that includes structural approaches to encouraging industry collaboration (such as alliances).

The principles at para 4.90 of the document should be at the forefront of discussions when considering the scope of any future joint incentive mechanism. We also consider that, in practice, and given the wide variety of circumstances in the network, flexibility and alignment of the arrangements to a more devolved NR will be very important, and that this is complementary to the formation of alliances.

Potential approaches to explore when considering the design of a new regime may include:

1. Requiring the parties themselves to enter into a joint commercial efficiency sharing arrangement, with incentives and metrics agreed following effective engagement between both parties. This would require further detailed development work, and we would welcome the opportunity to work with ORR on this.
2. Additionally, or as an alternative, a financial fund focussed on providing specific incentives for joint performance. This would be subject to appropriate financial resources and governance arrangements being in place, and possible perverse incentives being fully considered. This could incentivise joint actions which would otherwise not be viable in the absence of the fund. Again, this would require further detailed development work.

Schedule 8

We recognise the important role that Schedule 8 plays in improving performance on the railway by incentivising Network Rail and operators to reduce the impacts of disruption, and ensuring value for the taxpayer by reducing risk for operators. We also note industry stakeholder views that the existing regime is broadly effective at delivering these incentives. Therefore, we support ORR's focus on improving the transparency and accuracy of the existing unplanned disruption compensation regime, rather than overhauling it in its entirety. We would therefore expect a joined-up, whole industry approach to delivering these improvements.

It is important that ORR carefully considers the impacts of changing benchmarks to ensure it does not inadvertently create perverse incentives or discourage operators and Network Rail to work together in the interests of passengers and freight customers. We therefore welcome ORR's commitment to continue to work with the industry in 2017 to establish a new methodology for setting these benchmarks. We would also welcome the opportunity to discuss with ORR the impact these proposals could have as a result of the franchise Change mechanism.

Any changes to passenger operator performance measures must retain and improve the incentive on TOCs and NR to work collaboratively to recover from an incident as efficiently as possible and in the best interests of the passenger. We therefore welcome the ORRs consideration of the move to TOC-on-TOC delay attribution as a means of both improving decision making (for example train cancellations) and the incentive of the industry to work together to limit the impact of reactionary delay.

We also recognise Schedule 8 and passenger compensation are separate regimes that serve different purposes. The department and the industry continue to take steps to improve the effectiveness of the passenger compensation regime though the Delay Repay 15 initiative and increasing the accessibility of compensation to increase passenger uptake. Despite this the perception of the public that operators are unfairly compensated, as a result of the disparity in payments made under each of these regimes, remains. We are therefore keen to work with the ORR to explore options for addressing this perception of unfairness over time, particularly through greater transparency in the arrangements.

We also welcome steps, such as those set out in the consultation document to increase further Network Rail's focus on restricting passenger disruption, including through increasing its direct financial incentives to effectively manage this; putting the interests of the passenger first. While the implications of such steps must be carefully considered, this could significantly increase the transparency of the regime, helping it to work more effectively to deliver what users need.

We would also caution that any structural changes to the regime such as this, or indeed potential links between the regime and passenger compensation, may introduce additional financial risk to operators. The impact would therefore need to be carefully considered, recognising that this would impact on bid value for money and ultimately risk reducing value for the passenger and taxpayer. We welcome to opportunity to work closely with the ORR on this as the PR18 process continues.

Sustained poor performance (SPP)

In instances of sustained poor performance, the existing provisions within Schedule 8 does not appear to have provided a meaningful incentive on NR performance, and the burdensome resolution process has proved a barrier blocking the development of co-operative industry relationships to benefit passengers. We therefore support the ORRs recommendation to limit SPP to costs incurred by operators only.

However, we remain unsure whether the SPP regime in its current, or proposed future form, will have any meaningful incentive upon Network Rail beyond that incurred by Schedule 8. Whilst we strongly support placing incentives on Network Rail to improve their performance, we feel the ORR should consider if the SPP regime can fulfil this role. If not, we would both encourage and be happy to support the ORR in undertaking further work, for example revisiting the circumstances surrounding eligibility criteria, and when compensation is paid.

To deliver any meaningful incentive to ultimately benefit passengers, any future process should respond more quickly to poor performance, with the incidental benefit of reducing the administrative burden on the industry.

Schedule 4

We support ORR's proposals for incremental reform and update of the planned disruption compensation regime, to reduce disruption by improving the incentive on NR to cooperate with operators and plan possessions in the passenger and freight user interest. In particular we welcome the ongoing work to update the notification discount factors as a means of addressing the possible perverse incentive on NR to plan speculative possessions, which can result in unnecessary impact on passengers and train operators.

We also recognise the risk of estimating the access charge supplement based on NR Strategic Business Plan and therefore welcome the consideration to use NR's delivery plan. However, we also note that although an annual re-benchmarking based on delivery plans would improve accuracy, associated annual run of the financial model for Schedule 4 changes could present a significant, and costly, administrative burden. We would therefore welcome the opportunity to work closely with the ORR as they develop proposals in this area, particularly consideration of the impacts of implementation versus the benefits being delivered.

Devon & Cornwall
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Paul Cornick
Office of Rail and Road

7 March 2017

Dear Mr Cornick,

Consultation on changes to charges and contractual incentives

We are a non-profit partnership between the rail industry, local authorities and Plymouth University which works to promote use of branch line services in Devon and Cornwall. We would like to comment on one aspect of the current consultation

Changes to the Fixed Track Access Charge

With reference to Brockley Consulting's report for Network Rail, we are concerned at what the approach they outline could mean regarding costs allocated to rural railways across the country.

The consultation document makes mention that Network Rail are shortly to complete a study of the whole network in the spirit of the Brockley Consulting report. We will be taking a keen interest in the findings.

Our view is that the Brockley Consulting methodology and analysis should be subject to peer scrutiny and we request that ORR arrange this alongside the Network Rail work on applying the Welsh pilot study Britain -wide.

We urge ORR to hold a further consultation on the Britain-wide application of the Brockley Consulting approach and the results of the peer scrutiny and not to adopt the Network Rail proposed allocation of fixed access charges across train service categories until this process is completed.

We too support the attempt to get greater clarity but, above all, we believe that the costs allocated to rural railways must be fair and, as far as possible, real.

Yours sincerely,

Richard Burningham
Manager

Jerry Swift
Esk Valley Railway Development Company
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North Yorkshire
YO17 6UZ

Office of Rail and Road
One Kemble Street
London
WC2B 4AN

4th March 2017

Dear Sirs,

ORR CONSULTATION ON STRUCTURE OF CHARGES

Following a recent media comment on Network Rail's consideration of cost allocations by route section (Cost Allocation Project) we reviewed material on the ORR website and identified the ORR Consultation "Network Charges A consultation on how charges can improve efficiency" which was pertinent to the piece.

We note the closure date for this consultation but believe that it is still worthwhile putting our views in as we are aware that this work is ongoing: we can only apologise that we were not aware of this important consultation in a timelier manner.

We will now look to respond to the ORR Consultation on the financial framework for PR18. We realise that it is too late for our views on the closed consultation to be formally taken into account but hope that they prove useful in the ongoing discussions around PR18.

Yours faithfully

[by email]

Jerry Swift for Esk Valley Railway Development Company

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Introductory comments

This response is viewed from the perspective of the Esk Valley Railway Development Company (EVRDC), a "community rail partnership" (CRP), one of only two CRPs structured as development companies. This approach was followed in the early days of the DfT Community Rail Strategy to allow the CRP to 'trade'.

EVRDC works with a number of stakeholders including train operators (both Northern and The North Yorkshire Moors Railway), Network Rail, local and regional government, the NHS, local tourism interests and community groups including station adopters, to promote services on the line between Whitby and Middlesbrough.

Our experience suggests that commitment or otherwise to the line is generally based on the availability of funding and political considerations rather than any understanding of the economic case for the railway.

As local authorities have seen their finances squeezed, we have seen our funding increasingly transfer to being a pass through from central government via the train operator (Northern) to us as an annual grant. Local authorities have also found it more difficult to commit other resources but we do believe that underlying these difficulties there is still wide support for the line.

We have a franchise commitment to an additional daily train service and working with Sirius Minerals (who are developing a major new potash mine just outside Whitby) we are looking at further service enhancements.

Government policy of centralising specialist healthcare facilities and further education along with increased regional tourism and major industrial development is driving demand and we fully expect a more effective service to more than justify its existence in additional ridership across the day.

Charges may be somewhat peripheral to considerations of the line, unless they start to drive perverse behaviours on the part of the TOC or Network Rail: we do not believe they will drive decision making by other stakeholders unless they were changed to the point where Network Rail and the TOC were both falling over themselves to provide additional capacity, and we do not believe that situation is likely to exist.

Chapter 1 - Introduction

1. How much does Network Rail's structure of charges matter today?

   We recognise that for train operators and therefore for some passengers (to the extent that charges feed through into fares), charges can be a significant consideration. We undertook some work with Network Rail in 2005 that suggested the costs of running the Whitby to Middlesbrough line were not necessarily as great as might be believed. But that work also made clear that when renewals were required costs jumped up substantially. That work led us to believe that investment in the railway could lead to longer term savings, but that producing a business case for such investment was anything but easy.

2. What issues could a new structure address?

   As the work that Network Rail and ORR have commissioned so far seems to suggest an increase in charges for rural lines might be called for, we think it unlikely that this would support the very clear need to increase capacity on the Esk Valley line, to allow NYMR to continue to run and develop their services whilst achieving a Middlesbrough Whitby service that more closely meets the needs of local people, encourages tourism into the area, reduces car use, particularly in the National Park and supports Government policy in respect of (inter alia) health and education.

3. Can you provide examples of behaviours that would change within your organisation or elsewhere in the rail industry with an improved structure of charges?

   If there was greater transparency of charges it could enable CRPs to be more constructive and proactive in suggesting opportunities to improve efficiency in the industry.

   Network Rail's cost attribution project

   Whilst you have not asked a question on this, we have reviewed this document as we have some knowledge in this area. As noted above, in 2005 we worked with Network Rail on the development of a cost model for the Esk Valley Railway. It was one of five pilot lines that they looked at but our understanding is that our line produced much more comprehensive data at that time.

   The research at the time clearly showed that the allocations of costs are fairly arbitrary as many resources are shared across a number of route sections. The following key points were identified:

   I. *Allocated costs are quite different from actual costs incurred on any route section. We suggest that In view of that, they should never be used as a basis for making decisions about the future of individual lines, and we welcome ORR comments that seem to give us some comfort on this point, referring to costs being charged based on what the market will bear.*
   II. *A significant proportion of the costs allocated to rural lines are fixed overheads, so the more you chip away at these, the higher the overheads on the rest of the network. Closing the lines does not help since the residual liabilities on the closed lines remain which themselves add to the cost of the overheads and any social benefits (pollution, mobility, health, education etc.) are eroded.*
   III. *The railway is a network and completely interconnected with shared costs and traffic. That is why it is so fiendishly difficult to separate out costs and income in a way which allows a 'balance sheet' to be produced for individual branches or route sections. Over 50 years, BR never achieved it .*
   IV. *We believe that there are some unsupported assertions and some inconsistencies in the explanations attributed to Brockley. It is true that some rural lines run through challenging terrain with significant structures incurring costs, but this is not a feature that distinguishes them. The West Coast Main Line from Preston to Glasgow has similar features, as does the East Coast Main Line with structures like the Royal Border bridge, the King Edward Bridge, and the viaduct at Durham for example. By contrast, we know*

that this same piece of work showed that the St Ives branch was at that time very cheap to maintain, and it is hardly lacking in hills.

V. *Furthermore, we believe Brockley is applying science to what is a fairly arbitrary number, which then remains an arbitrary number. As we discuss elsewhere, the approach to date has been to build a plan that is predicted to deliver outputs rather than specific interventions (with the general exception of enhancement schemes). The funding is then used by Network Rail to deliver what it believes is the optimal arrangement of interventions (maintenance and renewal) to deliver the outputs within the planned cost. The allocation below route level is thus somewhat arbitrary. For such an approach to work we suggest a bottom up build on individual route sections, and commitment to then deliver those plans, would be essential.*

VI. *We think there is some blurring of the distinction between actual costs and unit costs. Clearly fixed costs on rural lines are likely to produce a higher unit cost because of the relatively small number of trains. Conversely, fewer trains with light axle loads will tend to reduce the impact on the infrastructure (and the cost of maintaining it.) Whichever approach you adopt, it is clear that a two-car Sprinter on the Esk Valley line is going to produce less wear or damage to track and structures than 100 tonne wagons or frequent and longer trains between Middlesbrough and Northallerton, for example.*

Chapter 2 – Background and approach

4. Are the high-level gaps (in Figure 4) a good starting point for developing solutions? Would you have expected to see any other high-level gaps and, if so, what are they?

We note that disappointingly it is difficult to identify end users and local communities' needs for accessibility to effective transport in any of these gaps. That might be taken to imply that the railway network currently meets all their needs, and clearly it doesn't in a number of dimensions. It is not the role of this review to address those issues, but the review has stated that it aims to consider a charging regime that does incentivise the industry to deliver better value for money. The DfT has written to ORR to explain the UK government's thoughts on how financial incentives can improve outcomes for passengers, freight and taxpayers. In its letter DfT makes the strategic context clear and we think this should be reflected in your gap analysis.

We do not believe that charges can necessarily drive down Network Rail's costs. The relationship between Network Rail's charges to TOCs and the TOCs behaviour is reasonably easy to see (consider the move towards lower impact rail vehicles etc), but may require substantial investment in order to deliver benefit.

Network Rail can reduce its costs through more effective processes (for example it takes for ever to get projects undertaken, and all that time is money), it can reduce its requirement for signallers but that requires substantial investment and rural lines are low on the list because their signalling is generally minimal, and it can reduce the costs of maintenance. Maintenance is a function of time passing (bridges need inspecting and maintaining to a degree irrespective of use) and network use. Charges that encourage more track friendly vehicles are therefore to be welcomed but care needs to be taken not to encourage TOCs and Network Rail to reduce network availability in order to reduce use-related maintenance.

5. Do the assessment criteria accurately reflect the main factors we should consider for assessing the impact of options?

   As noted under 4 above, we do not see the passenger or local communities sufficiently central to this work. It appears as a slightly dry exercise in shuffling the money.

6. To what extent does the use of scenarios, in the form of the RDG 'states of the world', help to understand the likely effectiveness of future charging structures?

   This seems a sensible approach but we would like to see greater consideration of the passenger and the benefits (or otherwise) to local communities.

Chapter 3 – Options and proposal

7. To what extent do the packages of options represent the key strategic choices available to improve the existing charging structure?

   The three packages (and variations on those themes) appear to cover the principal options, with one possible but radical exception. We suspect that this is not the review to consider a radical departure from the principals established at privatisation, but at some stage we would urge some consideration to a 'road' model. By this we mean that road users generally (tolls aside) pay a flat contribution towards all parts of the network through taxation and licencing. It is then up to the operator to make profit on their operations. Where such operations are profitable the transport authority would consider some form of franchise agreement to recover profits which can then support network provisions. Where the services cannot be provided profitably it is for the transport authority to consider whether to support the provision of services through subsidy.

   This approach would be beneficial in terms of encouraging new market entrants but has one huge drawback. Current processes can be used to manage the supply of that most scarce of commodities, capacity. However, such an approach might encourage market entrants to contribute to capacity creation.

8. Would you expect the infrastructure costs package to deliver more (or fewer) benefits than the value-based capacity package at this stage and, if so, why?

   Both approaches have positive and negative aspects. The infrastructure costs package would benefit EVRDC services on a day-today basis (we believe it would probably reduce costs to Northern) but could transform radically where major renewals are required. For all rural lines such an approach could lead to a very lumpy profile of charges, which would be less likely on principal routes where plans are more likely to average out across the route.

   The more such peaking is smoothed by averaging across a number of routes, the less cost reflective the charge becomes, so there is an inherent contradiction in the approach.

   The value-based package sounds attractive since it is assumed to reflect the value to communities and passengers. But EVRDC does suffer a lack of capacity in terms of train paths and train capacity. The approach suggested might then suggest higher charges to reflect these capacity constraints which would clearly be counter-productive, and we suggest counter-intuitive.

We note the point made at your workshop about the distinction between increasing understanding of costs and passing this improved information into charges. We agree that an improvement in understanding of costs is to be welcomed but we suggest this has to be bottom up. We are reasonably certain that many of the 'costs' are actually allocations of predicted expenditure and that these 'costs' have over many years been massaged for a variety of reasons, not the least of which is the point the ORR have noted about the ability of the market to bear the charge. We would strongly caution about applying too much detailed science to what is a rather suspect base number: it doesn't matter what colour you paint a pig, it is still a pig.

This does bring up a fundamental reservation about this method which we discuss in response to Chapter 4.

Chapter 4 - Infrastructure costs package

9. We would welcome your views on our proposal to prioritise further development of the infrastructure costs package.

We note your paragraphs under 'Challenges' and suggest that those challenges may be underestimated. We also wonder how the industry believes a better understanding of cost is likely to reduce those costs. The only mechanism we can see is where comparison between routes might highlight excessive cost on one or more of them, but we think in a constrained market Network Rail's ability to then influence those costs may be limited. We also suggest that it may indeed have the counter effect: the evidence would suggest that the supply side has tended to ratchet up costs, not be truly competitive.

We also reiterate the point we made earlier. These are not costs incurred, they are costs predicted, and Network Rail has been measured on the basis of outputs such as PPM, track delivered, signalling equivalent units delivered, structures delivered and capacity.

With the exception of either grand schemes such as Western electrification or Kings Cross enhancements or specific capacity enhancements (which themselves are often fairly grand), it is not measured on the delivery of individual schemes and indeed it might be argued that it should not be: passengers care about clean, safe, on time train services, not whether the single line track between Sleights and Grosmont has been replaced.

Network Rail produces a plan based on what it expects to do by way of maintenance and renewal but that plan must perforce change in light of emerging issues, and we would suggest what is usually at the bottom of the pile is the rural railway.

Thus, considering infrastructure costs on the Esk Valley line, except where there is a committed enhancement, is a cost based on a prediction which might not occur.

If a TOC or funder is basing their willingness to pay based on an expectation of likely work and likely impacts in the next and subsequent control periods, that may be a fairly seriously flawed assumption unless Network Rail is committed at the level of that individual route section to carry out the work on which the plan was based.

If that happens that will remove much of the current scope for what, we suggest, Network Rail euphemistically calls 'efficiencies', in our experience often scope reductions that can be justified as the outputs are not obviously impacted in the short term.

10. What costs and benefits do you see with the infrastructure costs package? Do you think our draft impact assessment is missing any significant impacts or has misrepresented any impacts?

    We would broadly agree with the scope of your draft impact assessment. However, we think the benefits may be optimistic for the reasons outlined above and we think the costs of implementation may be understated. We believe that this may generate something of a cottage industry in chasing down whether what was being charged for is actually being delivered in an efficient way.

    Network Rail is learning that contractor early engagement tends to bring benefit in terms of costs and efficient project delivery. If it now has ORR and its customer TOC sitting on its shoulder suggesting alternative strategies that they believe may be more efficient, at a project level that could slow an already cumbersome process down even more.

    Clearly we are not suggesting that Network Rail should be given carte blanche, but we do think there is the need for a careful balance to be struck and we think that balance is not without its pitfalls or ongoing costs, and for our railway that could be a significant impact at the very time when we are working with Network Rail, Northern and funders to look at enhancements which will deliver a step change in services, funded through a section 106 agreement and required in order to support the significant mine development just outside Whitby.

    We note the mention of Station Long Term Charge (SLTC) which you say "covers the costs of long term maintenance, repairs and renewal (MRR) costs at stations. It is charged by the station facility owner to train operators that call at the station. It is based on the calculated efficient MRR expenditure over 35 years (franchised stations) or 100 years (for managed stations)."

    Our belief is that this was the way in which SLTC was developed at privatisation, but that just before it 'went live' there was considerable 'massaging' as the costs for some stations were deemed excessive. We have no evidence that this has ever been addressed so would urge extreme caution about assuming that SLTC is in any way cost reflective.

11. To what extent do you think the benefits of this package can be realised through more information, rather than through the use of charges?

    Your draft impact assessment identifies that the change in charges may In fact be small, due to the effects of Network Grant, and that in any event franchised TOCs are held harmless for cost changes through their franchise. We therefore feel that even if this work is undertaken, passing it through to actual charges in this Control Period may have little value.

Chapter 5 - Value-based capacity package

12. We would welcome your views on our proposal not to prioritise further development of charging options based on the value of capacity.

We would agree at this stage. Taking work forward on two fronts would deflect too much from effective an efficient delivery and could cause conflicting demands on the industry. If the infrastructure costs package approach is taken, the greater granularity of data that will be developed will assist in any subsequent work on the value of capacity.

13. What costs and benefits do you see with the value-based capacity package? Do you think our draft impact assessment is missing any significant impacts, or has misrepresented any impacts?

    We did not locate your draft impact assessment to review. However we broadly agree with your comments in the consultation document. For community and rural rail services, long the Cinderella of rail provision, we think that this methodology could have real merit but we recognise the challenges.

    We agree the commercial benefits of capacity should be reasonably straightforward: the industry has a long history of modelling this area and whilst some models may be in need of re-calibration, the methodologies are at least well understood.

    For our railway, the social benefits are significant but equally are difficult to quantify. Consider one small and partial example. The railway runs along the Esk Valley bottom, linking the communities in the valley. Schools and healthcare are either at Whitby or Middlesbrough with healthcare in particular gravitating towards James Cook Hospital in Middlesbrough (and served by its own station which, from a standing start, is now the third most used on the line after Nunthorpe and Whitby). The main road link, the A171, runs above the valley so all buses have to take a pretty circuitous route if they are to link up these communities. The railway provides an essential link for schools and healthcare and therefore the social benefits of the railway are substantial.

14. Would you expect a better understanding of costs to be an essential precursor to value-based charges?

    We suspect that the difficulties of this model and the political considerations of what it might throw up make it less likely to be implemented.

15. To what extent do you think the benefits of this package can be realised through more information alone, without passing that into charges?

    Noting that we believe if there is to be change, it is important to concentrate on one approach, we believe that some further preliminary work, possibly with a pilot project, could prove useful, either to confirm the methodology or to show that the effort required cannot be justified.

    The refresh of WebTAG may be one way of capturing the social benefits of the railway and could provide pointers as to the value or otherwise of this approach.

Chapter 6 - Package of improvements to short-run variable charges

16. What options would you expect to see in a long list of improvements to Network Rail's short-run variable charges?

We do not believe that in the context of the Esk Valley Line these charges are significant at present. However, the VUC may become a factor if services are increased in line with the S106 agreement with Sirius Minerals.

In the context of community and rural routes, we would suggest that care needs to be taken not to incentivise reduced use of the railway. Assuming that closures are not planned, which seems to be a clear political imperative, we would suggest that every effort needs to be made to encourage use of the asset wherever possible: a railway that isn't used at all still has costs and the network engineers cry of "it would be easy if it wasn't for the trains" needs to be resisted – its why the asset exists.

17. What options do you see as a priority for this package?

    We would be concerned if this review where to encourage the industry into a state of inertia. We have evidence of Network Rail waiting for "the digital railway" and we would be concerned if this review dragged on and provided another reason for inaction.

18. What costs and benefits do you see with this package?

    We have no specific comments on this.

Chapter 7 - Supporting packages

19. We would welcome comments on:

    a) whether open access operators should face charges implemented under the infrastructure costs package;

    b) what forms of adjustments to charges might be appropriate for open access operators, relative to franchised operators; and

    c) how current incumbent open access operators should be treated.

    We would note that the North Yorkshire Moors Railway operates steam services between Whitby and Grosmont and we would be very concerned if any changes in costs made their operations more uneconomic. They bring considerable benefits to Whitby and the surrounding area and are only able to operate as they rely on volunteers' support. It would be unfortunate in the extreme if their operations were of necessity curtailed on the branch at the very time when Government is actively seeking ways of making heritage railways more a part of the overall provision of public transport.

    We do however recognise that the loads impacted on infrastructure by steam locomotives whether NYMR or charter, do cause greater damage than light weight Sprinters.

20. Would you like to see either of the complexity options developed further?
21. Are there other options you would like assessed to reduce complexity?
22. What costs and benefits would you expect with these options?

Chapter 8 - Implementation of the structure of charges

23. In chapter 8, we started to highlight issues associated with implementation of a new charging structure and potential actions to alleviate negative impacts. Do you have any views on options for implementing a new structure and what would be the impacts of these options?

    We have no specific comments on this as the impact would be felt by our TOC, Northern.

24. We understand the structure of charges has the potential to impact the options in this consultation (particularly in the draft impact assessments), for different groups? Please explain your response.

    We have no specific comments on this other than the comments we have made earlier about not allowing this implementation to induce a state of inertia for our TOC, Northern and Network Rail as we are developing substantial plans in connection with the S106 funding from Sirius Minerals.

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10 March 2017

Dear John,

Response to ORR's Consultation Improving incentives on Network Rail and train operators: A consultation on changes to charges and contractual incentives

Thank you for the opportunity to respond to this consultation. This response is made by FirstGroup on behalf of our Rail Division and its train operating companies: Great Western Railway; TransPennine Express; Hull Trains; and East Coast Trains Ltd.

Our response addresses a number of key areas which cause us some significant concerns. These are addressed in summary below and also in our more detailed responses to questions posed within the consultation document. We build on the themes established in our letter of 12th August 2016 to the Office of Rail and Road's (ORR's) initial consultation on PR18.

FirstGroup is a core member of the working groups established by the Rail Delivery Group (RDG) in relation to the PR18 process. We are fully supportive of the draft response to this consultation developed by RDG and our comments are closely aligned with the position taken by RDG. We understand from RDG that its response will be submitted after the next National Task Force (NTF) meeting which is considering the downstream impacts of the proposals to alter the structure of Schedule 8. Nonetheless we feel it is important to make additional comments on the recommendations and issues raised within ORR's consultation and this document therefore represents FirstGroup's response.

Summary of Issues

We are concerned that the ORR is proposing a wide-ranging and complex set of changes to charges and incentives for CP6, which require a significant amount of consideration and analysis before they can be clearly understood. The scale of the change, coupled with the uncertainty over exactly the level of funding that will be required by Network Rail in CP6 means that it is extremely difficult to understand the total impact of the potential changes being considered. Each of the proposed changes in approach cannot be considered in isolation as they are often interrelated and it is therefore not always possible to provide a definitive position at this stage. However, we have endeavoured to consider the intent of each recommendation and the likely outcomes and provided comment on that basis.

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CP6 will see for the first time individual regulatory settlements for each of the Network Rail routes and also for the National System Operator (NSO). This is a significant and substantial change in approach, which on its own will require extensive dialogue and detailed review within the industry. We would strongly advocate that this fundamental change in approach should be the priority for PR18 and that any other material policy changes to charges and incentives should be deferred. To attempt the scale of alteration to these aspects of the regulatory regime at the same time, particularly when the Network Rail requirements for the next five years are not yet understood other than at the highest level, is concerning and could ultimately lead to unwanted or unintended outcomes which are not in the interests of the end-users of the railway.

In our letter of August 2016, and as set out in the draft RDG response, the industry, led by RDG, undertook a significant and comprehensive Review of Charges project following PR13. This work, as provided to ORR, concluded that an evolutionary approach to charges and incentives in PR18 should be taken. It is therefore disappointing that despite this extensive piece of work that involved the entire industry the ORR is now proposing significant and almost unparalleled changes to charges and incentives for the next Control Period.

Of particular concern to us is the emphasis that is being placed on making changes to the structure of charges and incentives with the apparent intent of ensuring operators behave or take specific actions, rather than focusing on how to ensure there are effective incentives on a monopoly, not for profit, Network Rail. This approach seems to ignore the fact that all types of train operators (freight, open access and franchised) already have very real commercial incentives to deliver effective, efficient and quality services to their customers. All operators already have significant incentives in place to improve performance through the very nature of their business, as they exist to serve their customers: rail's end-users; passengers and freight customers.

As well as these commercial pressures, franchised operators also have additional incentives and requirements placed upon them through the terms of and commitments within their Franchise Agreements. These imperatives shape behaviours and are reflected into industry processes at the tactical level through the Network Code. Network Rail by its very nature as the monopoly infrastructure provider does not face similar these same consumer, commercial, reputational contractual pressures, and we would expect that the focus for the ORR should be to ensure that a regulatory regime is in place that encourages and incentivises Network Rail to a similar degree.

The area of the proposals that FirstGroup is most uncertain over is that associated with Schedule 8, specifically both the TOC element of the regime and the associated suggestion that there should be a change in approach to Network Rail benchmarks removing the relationship between regulatory outputs and incentives to deliver those outputs. The structure of Schedule 8 is fit for purpose, as concluded by the Review of Charges work, and achieves its core purpose of being a liquidated damages regime. We agree that it is time for a recalibration of a number of elements of the regime including monitoring points and payment rates so we accurately reflect revenue impacts for the next five years. However, to seek to change the structure of the regime on the back of an arbitrary decision by ORR that the purpose of Schedule 8 is different to what it was established for is extremely worrying and is not justified by evidence.

We also have concerns over the proposed ability to bear test in relation to fixed charges and how this can be calculated given it is not yet clear what the overall financial settlement for Network Rail in CP6 will be. In particular, we face the very real prospect of an increase in Variable Useage Charge (VUC) due to the increased level of spend that Network Rail is stating that is needed in CP6, which would have to be taken account of before determining whether operators can bear any additional charges.. There is also the related question of how this would fit with proposals in the Department for Transport's (DfT) consultation on PSO Levy.

We would also like to understand what is intended by the third footnote under the summary table on page 4 of the consultation. This seems to suggest that all track access charges will be variable, rather than a combination of fixed and variable, reflecting both the fixed nature of Network Rail's required costs within a Control Period and variable in relation to wear and tear caused by actual use.

Detailed Comments

Taking each of the questions posed in the consultation:

Fixed cost charges:

Q1: Do you support our proposal to levy fixed cost charges on all operators, including open access operators, to the extent that they can bear them (option 2)?

We have considered the four options for fixed term costs as set out in the consultation. We are not supportive of Options 3 and 4, which leaves a choice between Option 1 and 2, noting that ORR favours the latter. Option 1 appears to have been dismissed by ORR due to its belief that caps can no longer be applied to charges, in particular Capacity Charge. However, as Capacity Charge is not a cost directly incurred, as it is not levied on base line traffic, we would advocate that this means capping can continue to be used, which has been effective during CP5, albeit not the long term solution that the industry needs. During the RDG's Review of Charges, extensive work was undertaken to consider how to address the issues surrounding this charge, and we provide more detail on this below, in response to the specific question relating to Capacity Charge.

To consider Option 2 as the approach for CP6, which is based on the principle that fixed charges applied to all operators, albeit with an ability to bear test in place requires us to be convinced that a number of issues are addressed. These are as follows:

- Establishing an effective ability to bear test (see below) The relationship with any PSO levy
- What is the level of funding that the charges need to reflect?
- What happens when an operator cannot actually bear the proposed charge – how is that element of the fixed charge requirement recovered by Network Rail
- What happens in the case of a new entrant when the funding for the Control Period has already been spread across all of the existing operators
- The relationship with the Not Primarily Abstractive test and how operators will be able to access the Network in the future
- Ensuring that Network Rail is incentivised to accept additional traffic to the Network (i.e. the relationship with operational performance)

The linkage with the Department for Transport's ongoing PSO levy consultation is of particular importance, as this could result in further additional charges for passenger operators. This also requires an ability to bear test. When taken together these two proposals would also mean a new approach in determining how access rights are granted and operators achieve access to the market. We are therefore keen to understand from ORR whether or not these tests and approaches will be cognisant of each other.

The ability to bear test is of particular importance and we will need to ensure that it properly takes account of a number of factors including:

- increases in other charges as a result of changes in approach and the overall level of the settlement for CP6;
- is at a suitably granular market segment level to be relevant
- recognises that existing operators have gained access to the Network through a different regulatory structure (i.e. have been subject to the NPA test)
- recognition that Open Access Operators (OAO) already pay an element of fixed charges (through the Capacity Charge being levied on their services)
- the longer term business model of existing businesses (including historical position)
- implications for existing operators across Control Periods and any new applicants and entrants during CP6; and
- what data will be required and how will it be used, recognising its commercially confidential nature (particularly as regards OAOs given their competitive position).

As mentioned above before assessing this proposed approach it is imperative to understand the funding that is actually required by Network Rail for CP6. Without this first step, it is not clear what the actual level of charges that operators are being asked to bear will be. This is fundamental for both freight and OAOs as it could have a bearing on the cost of operation and erode their competitive position within the overall transport market and therefore put these services and the markets they serve at risk.

Fixed cost freight charges:

Q2: Do you support our proposal to simplify the current charging regime by having a single freight mark-up charge?

This is not a specific concern for FirstGroup, however, we agree with and support the position established by RDG.

Q3: Do you support the recommendation to apply Network Rail's cost allocation methodology (discussed in this chapter) to freight mark-up charges?

This is not a specific concern for FirstGroup, however, we agree with and support the position established by RDG.

Stations charges:

Q4: Long term charge: Do you support our recommendation that the methodology for the LTC at managed stations be recalibrated?

Whilst we do not consider that this is a priority for PR18, we would agree that greater levels of transparency in this charge would be welcome. If the proposals recognise the investment that has been made in stations, including renewal in modern equivalent form, then this is a welcome first step, notwithstanding the potential change in costs. However, we would advocate that further flexibility in the regime would incentivise investment in stations, helping to drive efficient and more customer focused outcomes. This flexibility would see the charge being adjusted as a to reflect the lower cost of operating the station as a result.

Q5: Qualifying expenditure: Do you agree with our recommendation that we support the work to make total QX charges more transparent at both managed and franchised stations?

Whilst we do not consider that this is a priority for PR18, we would agree that greater levels of transparency in this charge would be welcome.

Variable usage charge:

Q6: Do you support our recommendation not to make fundamental changes to the VUC for PR18?

We support the conclusion that there should not be any changes to the methodology and that the approach should continue to be based on the VTISM model.

Notwithstanding this, it is increasingly clear that Network Rail require an increased settlement for undertaking Operations, Maintenance and Renewal (OMR) activity on the Network during CP6. This is therefore likely to impact on the amount of funding (i.e. maintenance and renewal) that is needed to be recovered through this charge leading to an increase for operators. This demonstrates that until we are clear on the overall funding requirement and the holistic impact on charges, it is difficult to answer questions definitively on individual elements.

Q7: Do you have any suggestions for 'recalibration' style changes to the VUC you would like to see considered for PR18 implementation?

No, we are content with the current approach.

Capacity charge:

This is an area that we are disappointed that the ORR has not taken due consideration of the extensive work undertaken as part of the industry's Review of Charges. There is currently a distinct lack of incentive for Network Rail to encourage more traffic on to the network, something that is increasingly required to meet demand. The Capacity Charge is supposed to ensure that the additional costs for Network Rail of more traffic (including the potential performance and Schedule 8 disincentive) are offset. We were therefore hopeful that the ORR would consider the extensive work undertaken in this area by the Review of Charges and make changes that seek to address this problem. However, instead of incentivising Network Rail, it appears as if the proposals are more focused on the implications of the charge for operators.

Q8: Do you support our recommendation not to replace the CC with adjustments to Schedule 8 benchmarks?

Whilst we acknowledge that the ORR does not wish to take this proposal forward and we are supportive of not making unnecessary changes to Schedule 8 we are still keen to understand how the ORR will address the apparent disconnect between needing to grow volume on the Network to meet demand versus the trade-off with performance and potential additional infrastructure costs.

Q9: Do you think we should: (a) retain the existing CC (but remove the caps on open access, freight and charter operators); (b) remove the existing CC and recover lost revenue through fixed cost charges; or (c) do you have any alternative proposals?

We do not support the proposals put forward by ORR, as it is not clear whether the ORR is trying to incentivise growth or charge operators for useage. The Review of Charges work undertaken by the industry provided some extensive and useful work in this area and we are disappointed that the ORR has not taken this on board.

As referenced above, we would prefer that the ORR retains the current arrangements (Option 1) for recovery of fixed costs given the uncertainty around the implications of Option 2. This would mean the retention of the use of caps, which we believe is permitted for the reasons already outlined. However, in the scenario where the ORR takes forward Option 2 in respect of fixed costs then this would mean that (b) would have to be adopted.

We also believe that there is still time to consider alternative approaches, whilst the implications of Option 2 are considered in more detail. As such we would suggest that the ORR takes the time to reconsider all the options available, including those put forward by the industry in November. These options, along with those proposed by ORR, are considered in the RDG response to this consultation against a clear set of principles for charges established by RDG.

Traction electricity charge:

Q10: Do you support our recommendation to keep the loss incentive mechanism?

FirstGroup supports the arguments put forward by the cross-industry Traction Electricity Steering Group, which are also supported by RDG as a whole. As such, we do not believe that the mechanism as currently designed meets the core objective of promoting reductions in system losses of incentivising on-train metering. In fact, it is worth noting that new electric rolling stock, significant volumes of which have been or are in the process of being procured, is delivered with meters already fitted. We would therefore advocate the removal of the current mechanism.

Electricity asset usage charge:

Q11: Do you support our recommendation that the EAUC not be altered, beyond recalibration, in PR18?

We are supportive of the proposed approach.

Coal spillage charge:

Q12: Do you support our recommendation to abolish the CSC?

This is not a specific concern for FirstGroup, however, we agree with and support the proposal.

Schedule 8:

Q13: Passenger compensation: What are your views on the options of passenger compensation recovery and improving the transparency of compensation relating to Network Rail's actions?

Schedule 8 and passenger compensation are two distinct and separate issues, as highlighted within the consultation document and need to be treated as such. We recognise that there is value in Network Rail bearing the cost of end-user compensation when as a result of its actions passengers suffer delays and are entitled to compensation as set out within operators' passenger compensation regimes. This could enhance transparency within the industry and provide a further incentive on Network Rail to manage the Network effectively and improve its own performance. However, we also recognise that this is an area of discretion for operators and that applying the approach in all circumstances may not be appropriate. We would therefore advocate that where this option is requested by an operator a common set of principles should be identified. We have given some thought to what these would be and would suggest the following:

- Ensure passengers are properly compensated, using the "Delay Repay" principles that are in place for most operators;
- Network Rail will need to be funded to cover compensation costs (for Network Rail caused delay up to an agreed level of performance);
- Payments should be not discretionary where the delay/repay system is in place;
- The process for the attribution of delays and cancellations set out within Schedule 8 as the methodology for determining responsibility for lateness and cancellations should be used to allocate the proportion of the actual passenger compensation to be paid by Network Rail to the relevant operator, where payments to customers under the Delay Repay regimes have been made; and
- Passenger compensation arrangements, where implemented, should be included in Track Access Contracts.

Q14: Approach to setting benchmarks: Do you support our recommendation to only make changes to delink passenger operator benchmarks and Network Rail benchmarks for freight operators from past performance (but to leave the approach to the other benchmarks unchanged)?

No.

There has to be a level of past performance in order to set benchmarks to achieve the desired outcome of improved performance. This is just as true in the context of the funding in place for Network Rail to deliver for its customers and ultimately the end user as it is for passenger operators. Quite correctly there are no regulatory targets for operators, as they have their own existing commercial and contractual incentives to deliver good performance, as such the only method left to set a benchmark is the use of past performance. We are not sure why the ORR believes that operators do not have incentives to improve their performance against a benchmark based on historic delivery. As we explain in more detail below, operators are incentivised through their own revenues and reputation to improve performance. Franchised operators also face an incentive to improve TOC on Self delays and cancellations through the performance regime contained within their franchise agreements.

Network Rail benchmarks must be appropriate for each operator and be set at a level cognisant with service delivery (i.e. Service Group). This is also consistent with Network Rail devolution and the move towards regulatory settlements by Network Rail Route.

We accept that using PPM is not necessarily appropriate to set Network Rail benchmarks or even for enforcement purposes. However, Network Rail can be measured on delays and cancellations that it causes and these can provide a clear and effective regulatory target. With Network Rail funded to deliver improvements through the Control Period there is a trajectory of performance that can be used to set benchmarks within Schedule 8.

By linking the benchmarks to these regulatory targets will ensure that Network Rail is incentivised to deliver in a manner consistent with the regulatory settlement. We would advocate that with such a relationship in place that there would not be a need for additional fines to be levied against Network Rail for failures to deliver against its targets as it would already be paying out compensation to operators if it under-performs against the benchmark trajectory.

Q15: Measure of passenger operator performance: Do you support our recommendation to change the measure of passenger operator performance to one based on the delay caused to other operators?

FirstGroup rejects this proposal and cannot understand how the ORR has reached the recommendations set out in the consultation document. The proposals do not reflect the original and clear purpose of the regime and also demonstrate a lack of appreciation of the consequences of such a proposal and ignores the imperatives already in place for operators to improve performance.

Schedule 8 is a liquidated damages regime that is based upon average performance against a benchmark level of performance. It was set up on this basis at privatisation to avoid the clearly onerous and inefficient alternative of claims between parties of the impacts on operator businesses of late trains outside of their control. Network Rail pays TOCs for poor performance, against a benchmark level, to offset revenue loss the TOC suffers from Network Rail not delivering that set level of performance. Equally where Network Rail performs well against that benchmark, TOCs pay a "bonus" to Network Rail. As such, Schedule 8 provides train operators with compensation for unplanned service disruption caused by Network Rail and other train operators. This means that for franchised operators they can assume when bidding a certain level of performance in the knowledge that if Network Rail fails to deliver they will be compensated ensuring that risk premiums factored into bids are reduced.

The regime also ensures that there is an incentive on both Network Rail and operators to deliver a targeted level of performance for which, in Network Rail's case, it is funded. This performance level should be linked to a relevant regulated output (i.e. Network Rail caused delays and cancellations) relating to each train operator as there is then a clear link to the end user (the passenger).

The proposal to alter the TOC regime such that it is focused on TOC on TOC also demonstrates a lack of understanding of the behavioural consequences of the change. In the proposed scenario TOCs will want to be in control of incidents in order to minimise the scale of loss, rather than Network Rail and will not accept decisions that are taken in their name by Network Rail where they believe those decisions have not been appropriate or have led to unjustified delays to other operators. This would lead to a conflict between Schedule 8 incentives and the Network Code processes developed through the ROC which is not sustainable and puts at risk the improved working relationships that have been established through alliance and joint working arrangements across the industry. A full and detailed impact assessment of the proposed change must be carried out before any further decisions are taken on these proposals.

We also understand that Network Rail is concerned about the level of payments that are being made through the Star Model process, in that it is not financially neutral, as this part of the regime intends Network Rail to be, as a result of current performance. There are three logical reasons for this:

- The calibration of the regime for CP5 was not accurate (it equally could be the case that Network Rail over-recovers on TOC on TOC)
- Network Rail has not been managing incidents and reducing secondary impacts in CP5 as well as it did in CP4 when the Star Model was calibrated

- That the imperatives already in place for operators to improve performance has meant that the management of TOC on Self delay has out-performed the assumed level

We also note that the ORR contends that Network Rail's data systems, specifically PEARS, are also part of the problem that means the current regime is based on TOC on Self delay rather than TOC on TOC. This is a strange and confusing argument for two reasons:

- As we have already established the regime is a liquidated damages regime and is bilateral between each operator individually and Network Rail and uses the Star Model as the principle to establish Network Rail neutrality for TOC on TOC. This also means that Network Rail is incentivised to manage incidents on the Network to reduce the level of TOC on TOC delay. For this reason, operators pay Network Rail for their own poor performance using a payment rate based on the value that Network Rail requires to pay other operators (this is why some operators have higher payment rates than others).
- PEARS is the system used by Network Rail to process performance data using the algorithms set out in Schedule 8 to determine accountability for lateness (and cancellations), and measure those results against the benchmarks and calculate the payments for the Network Rail and operator parts of the regime and that these are in accordance with the terms of the contract and ultimately the purpose of the regime. We would, however, agree that the recording of train running information is not granular enough and that improvements in this area would help to improve the industry's understanding of causes of loss of time and therefore help Network Rail manage the network.

TOC on TOC delay actually reduced in 2016/17 compared to 2015/16 and is by far the smallest category of delay. Network Rail and TOC on Self delays have both increased this year compared to last[1]. There is also an increase in PPM failures from all categories which when taken together suggests that there is an increase in reactionary delay from all incidents, reflected to a certain extent in the Delay per Incident (DPI) measure. This is about management of the network rather than one category of delay over another.

Suggesting a change in the regime such that TOCs are responsible for other TOCs delay does not help resolve this issue, as TOCs are not responsible for the management of the Network or for managing incidents that take place (regardless of cause). This is the role of Network Rail and the current regime helps to incentivise this. Changing the basis of the regime will mean that TOCs will be less likely to accept Network Rail decisions on the management of incidents if there are impacts on other operators. Ultimately TOCs will be incentivised to dispute incidents where they feel that if different decisions had been taken then the amount of delays attributed to them will be reduced. This is a perverse outcome and not one that currently exists.

One of the comments that has already been made by Network Rail in relation to these proposals is that this new approach could mean that TOCs will be more likely to cancel services and therefore reduce reactionary delay. However, this argument does not consider some of the fundamental concepts of train service delivery:

- Cancelling services materially affects the passengers using that service, this is most manifest in the case of a long distance intercity service where the frequency is low and the ability of passengers to complete a journey is much reduced where a

[1] Taken from the February NTF Report

cancellation is considered. Operators also need their scarce resources to be in place for the next service, which is difficult to achieve with cancellations.

- Cancelling services has a significant impact on revenue and also results in larger compensation payments.
- Finally, the Schedule 7.1 Franchise Agreement regimes are particularly penal in regard to cancellations, with target levels typically much less than 1% of services being an acceptable level. Some incidents may be exempt from being counted under this regime through the Service Recovery mechanism, but that is already the case, and something that Network Rail already encourages, without necessarily fully appreciating the terms of the contract. Amending the Schedule 8 regime will not change these factors. The Franchise Agreement incentive is discussed further below.

Network Rail already has the ability to implement Train Regulation Policies that can include provision to cancel trains where continuing to run would cause further disruption. Since it is the case that Network Rail are incentivised to do this under the current structure of Schedule 8 (i.e. the Star Model) it is interesting to note that it is not often the chosen solution, because it does not minimise overall disruption to passengers both on that train and on related services.

In addition to the current TOC element of Schedule 8, there are a number of incentives already in place on train operators to reduce delays and improve performance. Whilst the majority of these have their basis in TOC on Self causes (because this is within the control of operators) there is always a consequential benefit to the level of TOC on TOC delay. The following are the main incentives on operators (in no particular order):

- Franchise Agreements
- Revenue
- Reputation
- NRPS

Taking each of these in turn:

Franchise Agreements

Each TOC has a Schedule 7.1 performance regime within its Franchise Agreement which has a separate TOC on Self delay minutes and TOC on Self cancellations element. Both of these are set at challenging levels reflecting the desired outcome for the franchise, reflected during the development of the franchise through the letting process.

The regimes have different target levels within them, with the most severe level being the "breach" level. These levels reduce (i.e. are tougher to achieve) throughout the franchise term, reflecting the initiatives and investment contained within the franchise. Regular failure to achieve this level results in termination of the franchise, which is the most compelling incentive for operators. However, failure to achieve any of the levels results in various actions set out in the franchise agreement, from financial to detailed action plans to improve performance, which in themselves will require additional investment or financial commitments.

The cancellation regime is particularly stringent, as referenced above, with even one missed station call being counted as a part (i.e. half) cancellation.

Revenue

There is a clear and unequivocal link between performance and revenue. Poor performance leads to reductions in revenue both on the day itself and in the longer term, for which the vast majority of train operators (open access or franchise) are on risk for. As such operators are incentivised to ensure that good performance is achieved, such that revenue is not impacted because of their service delivery.

Reputation

As with revenue, the reputation of an operator is key in attracting passengers and retaining those passengers, particularly in a competitive market within which a number of operators or alternative modes of transport exist. Increasingly operators receive instant feedback on performance of train services through social media, and this is regardless of who caused the delay. Operators recognise the role they have to play in managing customer expectations and delivering good service and good punctuality and reliability helps with this and our reputation.

NRPS

The National Rail Passenger Survey (NRPS) undertaken by Transport Focus is a key measure for operators and demonstrates the satisfaction that passengers have with the service provided. Punctuality of the service is consistently one of the top three factors in determining overall satisfaction, with poor performance resulting in less positive overall sentiment. This is a clear articulation of the reputation point mentioned above.

Most franchised train operators are also measured against NRPS through franchise agreements with financial penalties in place for non-delivery of targets and good NRPS scores are important to owning groups in pre-qualifying or being awarded new franchises

Reducing TOC on Self incidents leads to a reduction TOC on TOC delay. Network Rail is responsible for managing the network and is accountable for performance. With this proposal implemented TOCs will want to manage incidents and ensure that they are in control of decisions. Network Rail decisions will be disputed and every decision will be challenged as operators will be incentivised to reduce the TOC on TOC delays that are attributed to them. This will fundamentally change the relationship in operational management.

In conclusion, if Network Rail is concerned about the level of payments being made under the star model then a recalibration of the levels is required and probably justified. But, to suggest a fundamental change to the regime to tackle the smallest category of delay (and one that at worst has a flat trajectory) without a full and comprehensive impact assessment to understand the consequences is inappropriate and in our view the proposals will worsen performance, remove incentives and drive inefficiencies. The existing structure has worked well and driven improvement and has ensured that risk is managed.

We therefore request that ORR takes the time to pause and together with RDG and NTF undertake a full assessment of the proposed changes which takes into account all relevant factors, including the impact on behaviours. Once this is complete a further round of consultation with the industry should be undertaken ahead of a final decision.

Such an approach need not halt the proposed recalibration work for Schedule 8, as data is still required to be collected and analysed to ensure that the financial elements of the regime (historic performance, volumes of passengers and revenue) are accurate. However, we would accept that a pause in the approach to conclusions on how benchmarks are set and linked to the regulatory regime for Network Rail may be appropriate.

Q16: Sustained poor performance provisions: Do you support our recommendation to limit SPP to costs compensation only?

FirstGroup does not support this recommendation.

The proposal fails to recognise the long term revenue loss of sustained periods of poor performance that Schedule 8 does not account for and the cumulative effect on customers' perception of rail as a transport choice. Schedule 8 only compensates for revenue loss in the short to medium term and in the case of both open access and franchised operators the impacts of long run poor performance will have a significant and unforeseen impact on revenues. We recognise that these situations are rare, but they do happen and as such the regime should adequately provide for them. We also recognise that there are points at which Schedule 8 will provide adequate revenue compensation, but that there will have been significant costs incurred which are unexpected and should be compensated.

Therefore, we would propose a two-stage approach that fits in part with the approach proposed by ORR for cost recovery, but also deals with the rarer but potentially business critical events of long run poor performance. Our approach, therefore would have a level above which only costs are claimable and a second level where both revenue and cost compensation are claimable. These would be defined as "Types" of SPP and we would propose a distinction as follows:

- SPP Type 1 – using the current SPP level of c10% above benchmark, but at this level and up to the threshold for Type 2 only costs can be claimed
- SPP Type 2 – a higher level of c25% above benchmark – opens up revenue as well

Schedule 4:

Q17: Do you support our recommended prioritisation of schedule 4 issues? If you think we should reconsider any of the areas we have de-prioritised please submit supporting evidence.

FirstGroup is supportive of the priorities for Schedule 4, and would make the following comments:

- Bus cost compensation – the recalibration of this part of the mechanism is welcome, and needs to more accurately reflect the actual situations that prevail when possessions are taken by Network Rail. Currently all operators receive compensation regardless of whether buses are used or not, and also a set figure is used regardless of circumstance. By calibrating the regime on a more granular level using information available from operators a more appropriate level of compensation would be payable.
- Notification Discount Factors – a review of these is also welcome, and we support the use of evidence from operators and the industry as to the impact on customers' behaviour as a result of planned disruption to the normal timetable. This work should include a review of the additional costs incurred by operators both in terms of the volume and complexity of possessions (i.e. requiring more management input) and as a result of late notification of changes to or cancellations of possessions.
- Access Charge Supplement – linked to the proposed route regulation approach for CP6 it would be helpful if the future calculation of the ACS more accurately reflected the OMR possessions that Network Rail requires on specific routes. This would ensure that there is a meaningful relationship between the ACS that an operator pays and the possession volume incurred. This approach would also link with the

comments about in respect of costs associated with planning and amending possessions.

- Sustained Planned Disruption – the thresholds for this compensation is currently set to high and needs review.

We would also recommend that the ORR undertakes a full review of the contractual drafting of Schedule 4 to ensure that it is fit for purpose and clearly sets out how the various mechanisms work. In too many places, particularly as regards the train-bus-train mechanism, the drafting is cumbersome and confusing, leading to operators and Network Rail having to agree separately what the intent is. This is not ideal and leads to bespoke arrangements. We would be willing to assist with such an initiative.

Q18 Do you wish to submit relevant evidence regarding: (a) processes associated with planning possessions; and/or (b) planning alternative arrangements to deal with planned disruption (e.g. the notification that is needed to arrange bus replacement services)?

GWR is already assisting with the provision of evidence to ORR in relation to the points made above and in particular cost compensation and notification factors.

Aligning operator and Network Rail incentives

Q19: Do you have any views on how financial incentives could be improved to encourage collaboration between Network Rail and operators to reduce industry costs?

We do not believe that REBS is an appropriate mechanism for incentivising operators as it is too difficult to significantly affect Network Rail's spend on OMR activities, particularly on multi-operator routes. It would be more appropriate to align management teams and incentives as is currently being explored by Network Rail and train operators through alliances and joint management.

The volume of Network Rail's spend is such that in relative terms a small overrun on cost for Network Rail significantly outweighs any potential impact a TOCs could have. It is also the case that Network Rail's actual performance against target varies widely across routes (and most operators cross route boundaries). This also means that any benefit that should accrue from the current REBS mechanism is often capped as the control period progresses removing any incentive.

Any replacement for REBS ought to be focused on those specific areas that TOCs can have some influence. These would tend to relate to operational management; possession management and project delivery, all areas that a number of TOCs are already working jointly with Network Rail on, a good example being Great Western Railway. It may not therefore be appropriate to insist on an incentive mechanism to deliver

Q20: Do you have any views on the cost categories you think could be controlled by operators and whether these costs would be suitable as the basis of a potential future mechanism?

There are no specific cost categories associated with the infrastructure that operators would be able to control under the current structure of the industry. However, with closer alignment of teams in operational delivery it may be possible to control costs associated with management of specific and related activities.

Once again, thank you for the opportunity to comment on this consultation. Should the ORR wish to discuss any aspect of this response in more detail please do not hesitate to contact me.

Yours sincerely

Russell Evans

Policy & Planning Director, First Rail

Improving Incentives on Network Rail and Train Operators

A Consultation on Changes to Charges and Contractual Incentives

1. Freight on Rail, which is a partnership of the transport trade unions, the rail freight industry and Campaign for Better Transport, thanks the ORR for the opportunity to comment on this consultation.

2. The ORR consultation includes detailed questions on specific charges and incentives. We expect that some Freight on Rail members will respond to these in their own responses. This response therefore highlights areas which we consider ORR must include in their impact assessment on any increases in the total level of charges and incentives which will apply to the freight sector.

3. The PR18 review of charges is a critical process which will determine how ORR can also help to promote rail freight, in accordance with its statutory duties and current Government Guidance (see annex A)

4. We believe that the ORR must take into account what the DFT Rail Freight Strategy of September 2016 said in relation to the ORR review of Track Access Charges, (See Annex B)

5. We also believe that account must be taken of the Scottish Ministers' Guidance to the ORR. (Annex C)

6. Furthermore we ask the ORR to take into account what the DfT Freight Carbon Review of February 2017 said about the role of rail freight when assessing charges -
'*shifting freight from road to rail can result in significant CHG emission savings as well as economic and safety co-benefits*'.

7. The Prime Minister, Theresa May MP, confirmed the Government's support for rail freight at Prime Minister's Question Time on January 25th. Her commitment now needs affordable freight access charges.

8. For PR18 to deliver a successful outcome for freight, it will therefore need to provide a fair and pragmatic framework for operators and customers. This should include;

    a. Ensuring that the total cost exposure for freight operators and customers is affordable, and does not lead to price shocks;

    b. Recognising Government's ambitions for modal shift, and enabling this through recognition of competing road costs and incentives;

    c. Maintaining customer and investor confidence through a stable cost framework;

    d. Ensuring that any incentives are simple and effective, and work in both directions, so that operator and customer action is rewarded in the short and medium term, and that Network

Rail can clearly identify the benefits achieved from freight actions.

9. Need for holistic assessment of charges and costs

Freight on Rail believes that the Government needs to have a holistic approach and treat all modes equally to achieve its economic, social and environmental goals. The new role of ORR monitoring how well Highways England (HE) is delivering against the performance specification represents a key opportunity to improve integration between the different freight modes. ORR which says cost transparency is necessary to support effective decision making, already has core skills in assessing performance which it can use to analyse outcomes on HE projects, set benchmarking and monitor expenditure against budgets to allow more scrutiny. The ability to compare costs and subsidies across both modes is valuable as it will enable Government to fully compare the costs and benefits of different modes, social outcomes and opportunities for efficiency. The Government can therefore deliver its policy on a balanced playing field recognising the value equation between freight subsidy and the direct and indirect benefits to the UK economy. Decisions that influence modal shift and modal share will have an impact on actual costs of that provision. In previous Periodic Reviews, the potential for traffic to convert from rail to road has only been assessed as part of the economic analysis yet the impact on the road network of such a move has been limited only to social benefits.

It would be counter-productive to price rail freight out of the market as it would force trainloads of freight back onto the road network where the Government and society would have to pay the higher external costs as highlighted in the DfT Rail Freight Strategy of September 2016. Paragraph 135 P42 - *A significant increase in track access charges could result in some freight moving from rail to road, resulting in the associated economic and environmental benefits to the UK being lost.*

10. Lack of Internalisation of HGV costs

Lack of parity makes it difficult for rail to compete on price and that is why the DfT awards Mode Shift Benefits grants in recognition of reducing freight's external costs. Because HGVs are heavily subsidised and pay less than a third of the costs associated with their activities, it is difficult for rail to compete, especially in the consumer market, unless it is similarly compensated. We therefore believe that the Government needs to recognise road costs, such as road congestion, road collisions, road damage and pollution in any discussion about rail freight costs. The latest research commissioned by Campaign for Better Transport [i], which used DfT Mode Shift Benefit values, found a high level of distortion of the market across modes - which equates to an annual subsidy of around £6.5 billion. The latest revelations show that there is a strong case for equivalently supporting rail through lower rail freight access charges and continued upgrades to the Strategic Rail Freight Network and other key routes in order to allow rail to compete more fairly with HGVs. Otherwise, HGVs' external costs[ii] will continue to be a huge problem to society and the economy. These conclusions are in line with two separate pieces of research

a) MDS Transmodal study in 2007 which found a very similar amount of underpayment: £6billion.[iii]

b) Transport & Environment Research April 2016 which also found that HGVs across the EU were only internalising around 30 per cent of their costs[iv].

Whilst we recognise that road and rail freight must work together to deliver efficient logistics for the UK, we do believe that all HGV's external costs must be taken into account when examining options for rail freight costs and charges, and decisions around capacity. Therefore, we urge the Government to provide longer-term affordable track access charges for Control Period 6 (2019-2024 and beyond to give operators and customers certainty to invest.

11. The rail freight industry has invested over £3 billion over the past ten years. In order for it to continue investing it needs to have confidence in the viability of the industry which fair and affordable access charges would provide.

12. Latest rail freight growth figures show potential of industry as it adapts to steep losses in coal traffic. As your figures show, consumer traffic¸ which has increased all year, grew over five per cent in quarter three compared to last year, setting a new record for the highest amount of freight moved per quarter since quarterly figures were issued in 1998/99. Similar positive results for the construction sector which has also expanded all year grew by almost seven per cent in quarter three.

13. **The socio economic benefits of rail freight**

Safety
In 2015 HGVs were involved in almost six times more fatal collisions than cars on local roads with similar figures for the previous 2 years. Source*: Traffic statistics table TRA0104, Accident statistics Table RAS 30017, both DfT*

Congestion
An consumer freight train can remove 75 HGVs and an aggregates train can remove up to 160 HGVs – *Network Rail Value of Freight 2013*

Road infrastructure Damage
A six axle 44 tonne HGV are up to 138,000 times more damaging to road surfaces than a ford Focus – *4th power law*

Environment
HGVs account for around 21% of road transport NOx emissions while making up just 5% of vehicle miles – DfT Freight Carbon Review February 2017- Page 7 paragraph 3

Rail freight produces 90 per cent less PM10 particulates and up to 15 times less nitrogen dioxide emissions than HGVs for the equivalent journey. Highways England figures show that HGVs are producing around 50 per cent of the nitrogen oxide pollution from road pollution on the strategic road network even though they only make up 5 per cent of road miles driven in the UK.

Rail freight produces 76 per cent less CO2 emissions than the equivalent HGV journey- *Network Rail Value of Freight 2013*

Annex A

Extract of Current Guidance to ORR from Secretary of State for Transport.
http://www.railwaysarchive.co.uk/documents/DfT_HLOSGuidance2012.pdf

Rail Freight

32. The Government recognises the important role that rail freight plays in the nation's logistics and in the achievement of the Government's sustainable distribution objectives. The Government wishes to facilitate the continuing development of a competitive, efficient and dynamic private sector rail freight industry and is committed to ensuring that policies and regulations should work to this end and should not create unnecessary transactional costs or other obstacles to the achievement of these objectives and future growth.

33. In an industry where planning and operational decision-making are increasingly devolved, the Secretary of State wishes ORR to have regard, in exercising its statutory functions, to the importance of sustaining efficient and commercially predictable network-wide freight operations, including in decisions about access rights and charging structures.

34. The Secretary of State wishes the ORR, in developing any proposals, and in making decisions in relation to rail freight, to note particularly the Government's rail freight policy[2]. The Secretary of State wishes to be advised by the ORR of, and to discuss with the ORR, any material measure which the ORR proposes to take or policy which it proposes to pursue which would adversely affect the competitiveness of rail freight compared to other modes.

Annex B

DFT Rail Freight Strategy of September 2016 said in relation to the ORR review of Track Access Charges, the following extracts P10 Paragraphs 26/27, P42 paragraph 135 in italics-

26 At the same time, we recognise the positive benefits of rail freight for the UK- including its environmental and air quality benefits relative to road freight and its impact on reducing road congestion. These benefits are not currently recognised in the track access charging regime.

27 We will continue to support ORR's work to develop appropriate track access charges for freight from CP6, including by understanding the overall impacts on the rail freight industry of any changes. Alongside this we are considering whether further support may be needed from Government in future in recognition of the benefits to the UK economy and society of modal shift to rail which incurs far lower congestion and pollution costs and helps to improve road safety. Any new support would be subject to the identification of future funding and would need to be designed in a way that would avoid distorting the market.

P42

Paragraph 135 - *At the same time, we recognise the positive benefits of rail freight for the UK- including its environmental and air quality benefits relative to road freight and its impact on reducing road congestion. These benefits are not currently recognised in the track access charging regime.*

A significant increase in track access charges could result in some freight moving from rail to road, resulting in the associated economic and environmental benefits to the UK being lost.

paragraph 136 -As set out in the Secretary of State For Transport's guidance to ORR in July 2012, in setting track access charges we would expect ORR to note the government's rail freight policy, including the importance of sustaining efficient and commercially predictable network-wide freight operations. The *guidance to ORR also notes that the Secretary of State wishes to be advised by ORR of, and to discuss with ORR, any changes to the charges which ORR proposes to pursue which would adversely affect the competitiveness of rail freight compared to other modes.*

Actions P43 paragraph 139 -DfT will continue to support ORR's work to develop appropriate track access charges for freight from CP6, including the overall impacts on the rail freight industry of any changes. In particular, DfT is keen to support ORR's work to ensure that decisions about track access charges levied on rail freight reflects the cumulative impacts of different charges on the rail freight industry and are joined up with Government decisions on wider support and funding to freight.

Paragraph 140 – DfT will continue to co-ordinate the work of the Freight Investability and Sustainability Group (FISG) to develop thinking on the potential for wider changes to funding alongside more cost-reflective track access charges for rail freight, including whether further support may be needed from Government in future to retain the economic and environmental benefits of rail freight. Any new support would be subject to future funding being identified and would need to be designed in a way that would avoid distorting the market.

Annex C

Extract of Scottish Ministers' Guidance to ORR

http://www.transport.gov.scot/system/files/documents/guides/The_Scottish_Ministers__Guidance_to_the_ORR_July_2012.pdf

Rail Freight

21. Scotland's rail freight network is important to Scotland's economy. Accordingly, the Scottish Ministers expect the ORR to pay due consideration to any changes to policy which may impact that network.

22. In developing the track access charges arrangements for freight operators, the Scottish Ministers expect the ORR to use a mechanism which recognises the impact that freight operators have on the network but maintains the attractiveness of rail to freight customers, and which is adaptable to prevent the outputs of businesses in Scotland from becoming uncompetitive in their key markets.

Philippa Edmunds, Freight on Rail Manager, Campaign for Better Transport March 2017

http://orr.gov.uk/consultations/pr18-consultations/consultation-on-changes-to-charges-and-contractual-incentives

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[i] *Addendum to Metropolitan Transport Research Unit MTRU 2014 report February 2015. Heavy Goods Vehicles – do they pay for the damage they cause 2014*
[ii] *i.e. those that HGVs impose on others that are not included (internalised) in their normal operating costs*
[iii] *page 22 of The impact of road pricing on freight transport in Great Britain A study for Transport 2000 by MDS Transmodal, June 2007*

[iv] *https://www.transportenvironment.org/sites/te/files/publications/2016_03_briefing_Are_trucks_taking_their_toll_II_FINAL.pdf*

Response to ORR's December 2016 Charges and Incentives Consultation

This pro-forma is available to those that wish to use it to respond to our consultation. Other forms of response (e.g. letter format) are equally welcome.

Please send your response to pr18@orr.gsi.gov.uk by **9 March 2017**.

Full name	Chris MacRae
Job title	Head of Policy – Rail Freight and Scotland
Organisation	Freight Transport Association
Email*	
Telephone number*	

*This information will not be published on our website.

Please make any comments regarding the questions in the accompanying text box. We welcome comments in relation to the information outlined in both the consultation document and supporting documents, or regarding the policy areas more generally.

Chapter 2: Infrastructure Costs

Fixed cost charges:

1. Do you support our proposal to levy fixed cost charges on all operators, including open access operators, to the extent that they can bear them (option 2)?

FTA's concern is a potentially big change to the cost base as Network Rail has not achieved the 30% cost efficiencies target it was set for CP5. Therefore as Track Access Charges have to reflect the costs directly incurred then this potentially means that they have to increase in line, thereby putting up costs for FOCs that get passed to the end customer (the shipper) using rail freight. There is obviously a chronic need to get Network Rail costs down, but in the seeming absence of the ability to do so this causes the potential for an acute problem as described above.

Fixed cost freight charges:

2. Do you support our proposal to simplify the current charging regime by having a single freight mark-up charge?

While freight is run as a private sector enterprise in response to customer demand for moving goods between destinations – that can and does change – passenger operations are run to state or devolved funder specifications and the private sector firms that do so are generally in receipt of government funding to provide this thereby the franchise agreement effectively immunises these passenger operators from changes in track access charging.

The “what the market can bear test” (allowed under the EU Directive on Access Charging) which will be more important this time given ORR’s change to fixed costs mark-ups - how will this test be evaluated, will the results be available to allow evaluation of impacts of potential charges etc etc?

Fixed cost freight charges:

3. Do you support the recommendation to apply Network Rail's cost allocation methodology (discussed in this chapter) to freight mark-up charges?

We have a concern over the potential level of Network Rail’s CP6 costs and how that links arithmetically to variable charge levels - in terms of:

- the failure of Network Rail to achieve assumed CP5 efficiencies (30%)
- Network Rail’s reported aspiration for an increase in OMR (Operations, Maintenance and Renewals) budget of something like 20% above current (i.e. pre-efficient 30% cost base reduction) levels
- any change in the balance between variable and fixed costs, either in total and / or between freight and passenger

Station charges:

4. **Long term charge (LTC):** Do you support our recommendation that the methodology for the LTC at managed stations be recalibrated?

Not applicable to rail freight: no comment.

Station charges:

5. **Qualifying expenditure (QX):** Do you agree with our recommendation that we support the work to make total QX charges more transparent at both managed and franchised stations?

Not applicable to rail freight: no comment.

Chapter 3: Short-run variable charges package

Variable usage charge (VUC): 6. Do you support our recommendation not to make fundamental changes to the VUC for PR18?
The impact of the proposed ending of the CP5 “cap” on variable usage charges, especially for aggregates and steel is a fundamental concern to us.
Variable usage charge: 7. Do you have any suggestions for ‘recalibration’ style changes to the VUC you would like to see considered for PR18 implementation?
We would ask whether or not any increases in charges can be phased-in?
Capacity charge (CC): 8. Do you support our recommendation not to replace the CC with adjustments to Schedule 8 benchmarks?
The Capacity Charge (on the price that extra services should pay for taking capacity on the network) is where there we have fundamental philosophical differences with the ORR approach - and there are big risks for freight.
Capacity charge: 9. Do you think we should: (a) retain the existing CC (but remove the caps on open access, freight and charter operators); (b) remove the existing CC and recover lost revenue through fixed cost charges; or (c) do you have any alternative proposals?
As stated already while freight is run as a private sector enterprise in response to customer demand for moving goods between destinations – that can and does change – passenger operations are run to state or devolved funder specifications and the private sector firms that do so are generally in receipt of government funding to provide this thereby the franchise agreement effectively immunises these passenger operators from changes in track access charging.

Traction electricity charge: 10. Do you support our recommendation to keep the loss incentive mechanism?
As stated already FTA's concern is a potentially big change to the cost base as Network Rail has not achieved the 30% cost efficiencies target it was set for CP5. Therefore as Track Access Charges have to reflect the costs directly incurred then this potentially means that they have to increase in line, thereby putting up costs for FOCs that get passed to the end customer (the shipper) using rail freight. There is obviously a chronic need to get Network Rail costs down, but in the seeming absence of the ability to do so this causes the potential for an acute problem as described above.
Electricity asset usage charge (EAUC): 11. Do you support our recommendation that the EAUC not be altered, beyond recalibration, in PR18?
As per 10. above.
Coal spillage charge (CSC): 12. Do you support our recommendation to abolish the CSC?
Yes.

Chapter 4: Contractual Incentives Regime

Schedule 8: 13. **Passenger compensation:** What are your views on the options of passenger compensation recovery and improving the transparency of compensation relating to Network Rail's actions?
Not applicable to rail freight: no comment.

Schedule 8: 14. **Approach to setting benchmarks:** Do you support our recommendation to only make changes to delink passenger operator benchmarks and Network Rail benchmarks for freight operators from past performance (but to leave the approach to the other benchmarks unchanged)?
As per 10. above.
Schedule 8: 15. **Measure of passenger operator performance:** Do you support our recommendation to change the measure of passenger operator performance to one based on the delay caused to other operators?
As per 10. above.
Schedule 8: 16. **Sustained poor performance (SPP) provisions:** Do you support our recommendation to limit SPP to costs compensation only?
As per 10. above.
Schedule 4: 17. Do you support our recommended prioritisation of schedule 4 issues? If you think we should reconsider any of the areas we have de-prioritised please submit supporting evidence.
As per 10. above.

Schedule 4: 18. Do you wish to submit relevant evidence regarding: (a) processes associated with planning possessions; and/or (b) planning alternative arrangements to deal with planned disruption (e.g. the notification that is needed to arrange bus replacement services)?
As stated already FTA's concern is a potentially big change to the cost base as Network Rail has not achieved the 30% cost efficiencies target it was set for CP5. Therefore as Track Access Charges have to reflect the costs directly incurred then this potentially means that they have to increase in line, thereby putting up costs for FOCs that get passed to the end customer (the shipper) using rail freight. There is obviously a chronic need to get Network Rail costs down, but in the seeming absence of the ability to do so this causes the potential for an acute problem as described above. And again as stated already while freight is run as a private sector enterprise in response to customer demand for moving goods between destinations – that can and does change – passenger operations are run to state or devolved funder specifications and the private sector firms that do so are generally in receipt of government funding to provide this thereby the franchise agreement effectively immunises these passenger operators from changes in track access charging or disruptive engineering access.
Aligning operator and network rail incentives: 19. Do you have any views on how financial incentives could be improved to encourage collaboration between Network Rail and operators to reduce industry costs?
We would argue for an appropriate Freight Efficiency Benefit Sharing scheme rather than the unattractive Route – level Efficiency Benefit Sharing of the current control period. This is important to progress freight cost reduction visibly.
Aligning operator and network rail incentives: 20. Do you have any views on the cost categories you think could be controlled by operators and whether these costs would be suitable as the basis of a potential future mechanism?
As per 19. above.

Any other points that you would like to make

How will ORR approach their assessment of an efficiency target for Network Rail? We really need a long term (10 years) view to be factored in from day one as part of the fix to any proposals for higher variable charges.

How will ORR seek to co-ordinate evidence from industry (specifically rail freight shippers and 3PLs using rail) on what the % tipping point of increase in rail freight costs would be to cause reverse modal shift to road and change the accepted geographical distance over which rail has an economic advantage in their business and what that could mean in reverse modal shift volumes back to road? Obviously such commercially sensitive information elements of this would need to be requested to be redacted from any public version of responses put on the ORR website.

Thank you for taking the time to respond.

Office of Rail and Road PR18 Consultation

Consultation on changes to charges and contractual incentives

Response from Freightliner Group

March 2017

INTRODUCTION

This is the response of Freightliner Group Limited encompassing its subsidiaries Freightliner Limited and Freightliner Heavy Haul Limited to the Office of Rail and Road's (ORR) consultation on changes to charges and contractual incentives

PERIODIC REVIEW PRIORITIES

Freightliner's priorities for the Periodic Review 2018 are:

- A continued emphasis on improving safety
- A stable, national and simple charging and incentives framework, which does not increase the overall level of charges paid by freight operators
- Reducing overall industry unit costs and delivering efficiency
- A greater focus on optimisation of capacity and careful balancing of passenger and freight needs by the System Operator
- Delivery of value for money outputs through a long term programme of infrastructure
- A customer focused ethic throughout Network Rail and a supplier who wants our business to be successful

EXECUTIVE SUMMARY

Rail freight industry

- The rail freight industry is at a financial cross-roads following the sudden decline of rail's traditional bulk commodities. This is having a profound impact on the financial health of the industry, with the ORR's analysis of statutory accounts showing that freight operating companies collectively lost £105 million, with total income of £912 million in 2015.
- Decisions that are made as part of this Periodic Review process will have a direct impact on:
  - the amount of freight carried by rail in Great Britain
  - the ultimate viability of freight operators
- It is important to be cognisant that freight operating companies operate without the protection of a franchise agreement, and are therefore entirely exposed to changes in the level and structure of charges. With intense competition from road and feeder shipping increases in access charges cannot be considered to automatically pass-through to customers.
- In light of the current financial challenges and challenging business environment, it is particularly important for the sector to have a period of stability and certainty in future charges.
- We appreciate that the periodic review process takes time and that due process must be followed, however we ask ORR to consider the viability of providing an indicative range of charges at the earliest possible opportunity. This will allow a high-level impact assessment to be made, enabling the DfT to understand whether any mechanisms are necessary to support the sector. As highlighted in the consultation, such support mechanisms may require state aid clearance from the EU. This clearance could take up to two years.

Short-run variable charge

- The decision by the ORR to close down some of the options previously considered at an earlier stage of the review process is welcomed.
- We support the ORR proposal to prioritise areas of reform or changes to the current framework

that deliver improvements and offer most value. In that context, we are very supportive of the option proposing the removal of the Capacity Charge and the recovery of lost revenue through higher fixed cost charges.
- The ability to extend caps appears to be a grey area in the legislation and there may be an opportunity to maintain the caps, if the results of the periodic review see direct costs increase.
- The ORR is urged to consider robust, independent analysis of the impacts of decisions made given the modal alternatives and the relatively elastic demand for the remaining rail freight services.
- As in PR08, we suggest a 10-year efficiency target in the calculation of the Variable Usage Charge to ensure that charges are not set in excess of the long term efficient levels.

Current Network Rail cost challenge

- Although this consultation is about the frameworks and mechanics of the charging and incentives regime, the key will be the inputs into the cost model. This will have a direct impact on the level of charges.
- We are aware that Network Rail is facing significant challenges to renew, maintain and operate an increasingly busy and congested network. The ORR's recent Network Rail Monitor highlights the cost pressure that Network Rail is facing and has identified the key factors driving current underperformance against budget.
- Although it is unclear what impact Network Rail's cost pressure will have on access charges, it is clear that greater collaboration and industry effort is needed to reduce overall costs. This should take priority over devising methods to allocate costs between operators.
- The impact of Network Rail's cost challenges on the calculation of track access charges is perceived to be a serious threat in PR18 and is a very significant concern for all freight operators.

Schedule 8

- The incentives regime is a very important part of the consultation, particularly noting that the unforeseen gearing challenges in CP5 has created a swing in Schedule 8 payments from freight operators to Network Rail over the control period.
- Despite improvements made to freight operators to significantly reduce self-delay, the impact of rising delay per incident (which is not in the control of operators), since the recalibration of the benchmarks has further amplified what was already a difficult performance regime.
- This periodic review process provides an opportunity to review the appropriate level of benchmarks and payment rates, including the cancellation rates.

Schedule 4

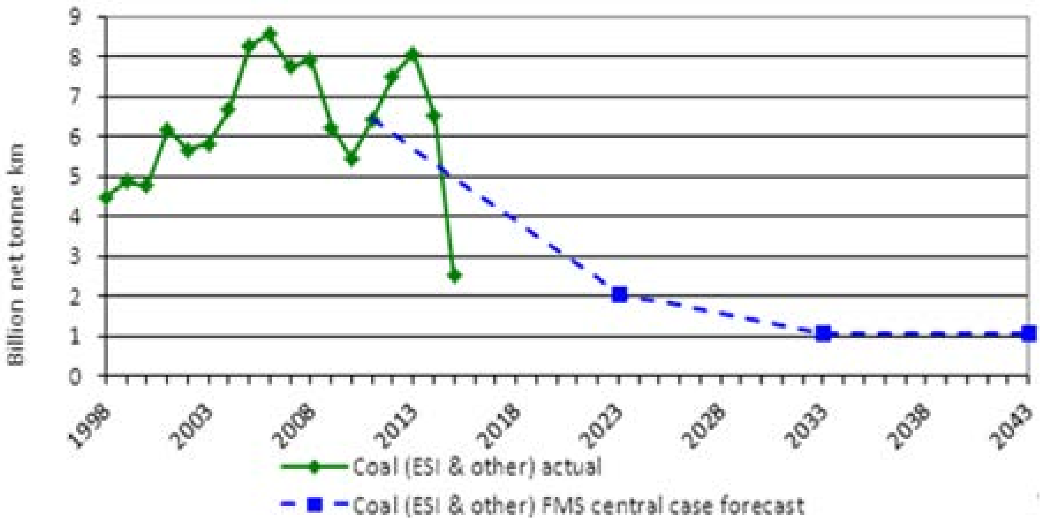
- Although not referenced in the consultation improvements to freight Schedule 4 should be considered as part of PR18.
- The current Schedule 4 payment rates are nowhere near cost reflective. Increasing the rates would not necessarily require an increase in the funding pot, as any increase would likely be more than off-set by a reduction in Network Rail's costs through greater efficiency.
- Some minor changes are suggested to the freight Schedule 4 to streamline administration and cash flow in the regime.

1.0 OVERVIEW AND CONTEXT

1.1 Financial viability of the rail freight sector

The rail freight industry is at a financial cross-roads, following the sudden decline of rail's traditional bulk commodities. The doubling of the UK's top-up carbon tax from April 2015, alongside the reduction in the gas price and the gradual move to renewable energy, reduced the amount of coal moved across the sector by 64.2% in 2015-16 compared to 2014-15[1]. While a reduction in coal volumes was expected, the decrease was significantly faster than the forecasts projected. Chart 1 shows Network Rail's forecasts for ESI coal volumes against actual tonnages moved.

Chart 1: ESI coal forecasts against actual volumes



Source: Network Rail

This is having a profound impact on the financial health of the industry. The ORR's analysis of statutory accounts shows that the financial position of freight operating companies (FOCs) has worsened considerably since the last periodic review and the operators' collectively lost £105 million, with total income of £912 million in 2015[2]. Underlying trading for 2016 is likely to have worsened, once the full year impact of the decline of rail's traditional bulk commodities have been factored in.

As a result, the industry has entered a transitional period as rail freight operators look to restructure their businesses. More than 1,100 redundancies have been announced across the sector. In addition, there also exists a surplus of coal carrying wagons, and over-supply of locomotives, all with on-going lease commitments.

1.2 Impact of the periodic review on the sector

Freight operators have consistently highlighted the importance of certainty and stability of charges, however in light of the current financial climate and challenging business environment this is more important than ever.

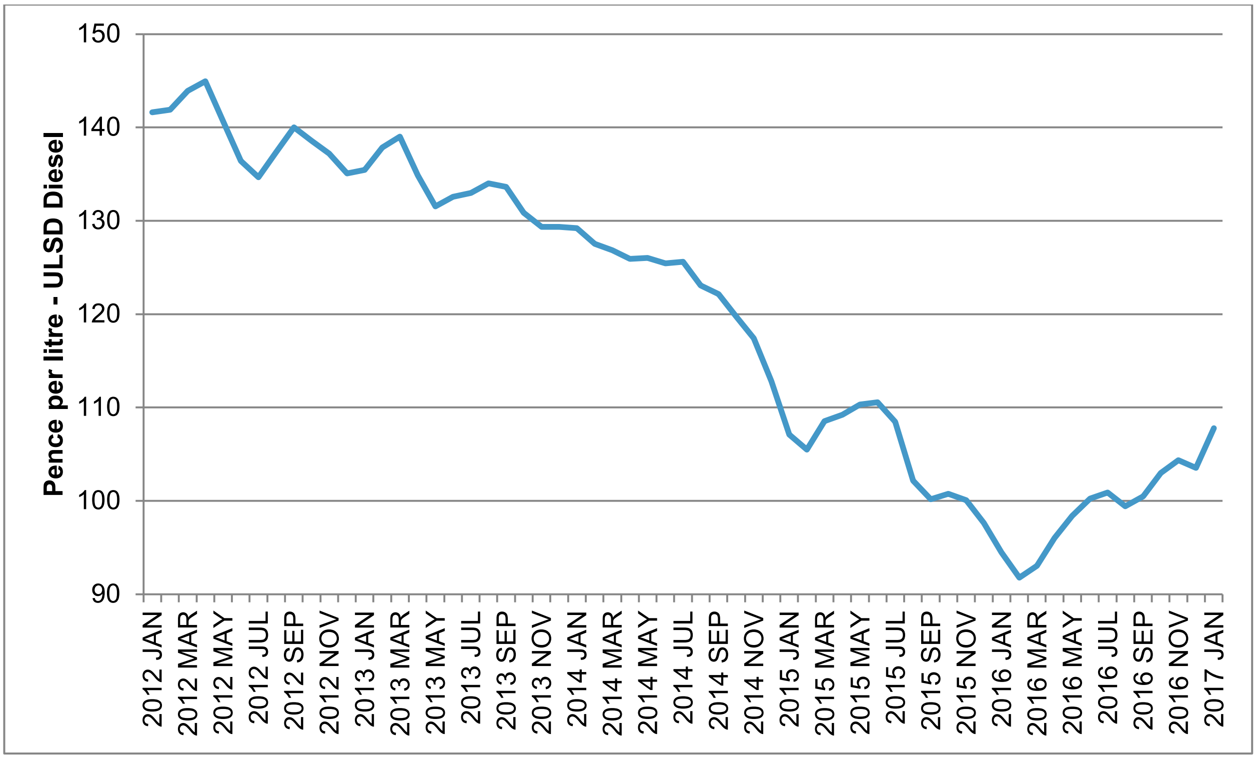
Decisions that are made as part of this Periodic Review process will have a direct impact on the amount of freight transported by rail in the UK, and ultimately the long-term viability of the sector. In particular the overall level of access charges and the balance of the incentive regimes will impact on the ability of rail freight to compete with road freight and feeder ship.

Analysis commissioned by the ORR during PR13 highlighted that most market sectors are unable to withstand an increase in charges without significant loss of traffic to road. There is no reason to believe

[1] Freight Rail Usage 2015-16 Q4 Statistical Release, ORR, 2016
[2] UK Rail Industry Financial Information 2015-16, ORR, 2017

that this position has changed, with the continued freezing of fuel duty and lower oil prices than during the PR13 process. Combined with the improved efficiency of road operators, there is likely to be less ability to bear any increase in charges now compared to the PR13 assessment. Chart 2 shows the weekly diesel price in the UK since 2012 adjusted for inflation.[3]

Chart 2: Diesel price in the UK adjusted for RPI (CHAW) since 2012



Source: Department for Business, Energy & Industrial Strategy and Office for National Statistics

Whilst rail freight operators have also benefitted from lower fuel costs, it should be noted that fuel costs make up a much higher percentage of the overall costs of road freight than of rail freight, estimated to be 40% versus 15% average.

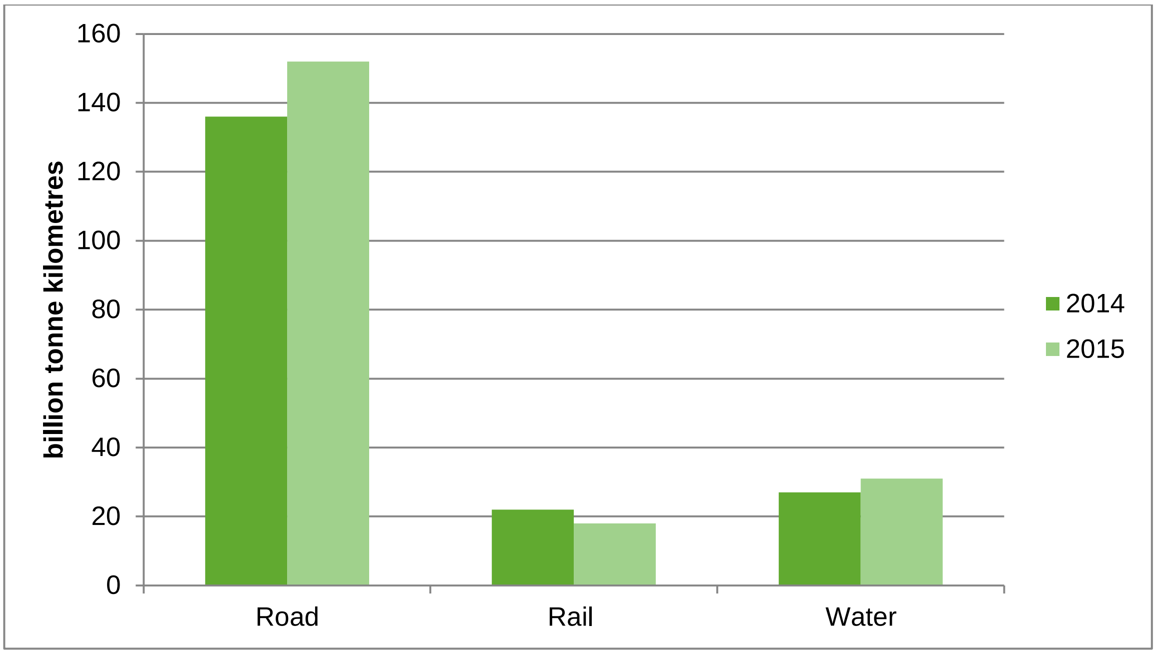
1.3 The freight market

Rail freight operators compete in the freight transport sector, which is dominated by road. Following the decline of rail's traditional bulk commodities, virtually every market segment competes with road freight, and in the deep-sea intermodal sector, with feeder shipping. The competition that the rail freight sector faces from feeder shipping is increasing. The £400m investment in the Liverpool2 container terminal by Peel Ports is evidence of the significant competition. Opened in November 2016, the port advertises feeder services to a host of European and UK ports, including the port of Southampton, which compete directly with rail freight[4].

The latest Department for Transport (DfT) freight transport statistics shows growth in road and water volumes between 2014 and 2015 and a reduction in rail volumes, driven by the decline in traditional bulk commodities[5]. Chart 3 shows the changes in volumes year-on-year.

[3] Weekly road fuel prices, Department for Business, Energy & Industrial Strategy, 2017
[4] Peel Ports, 2015 https://www.peelports.com/news/2015/secretary-of-state-for-transport-and-mayor-of-liverpool-tour-port-s-new-terminal-construction
[5] Transport Statistics Great Britain, Department for Transport, 2016

Chart 3: Tonne kilometres of domestic freight was moved within Great Britain

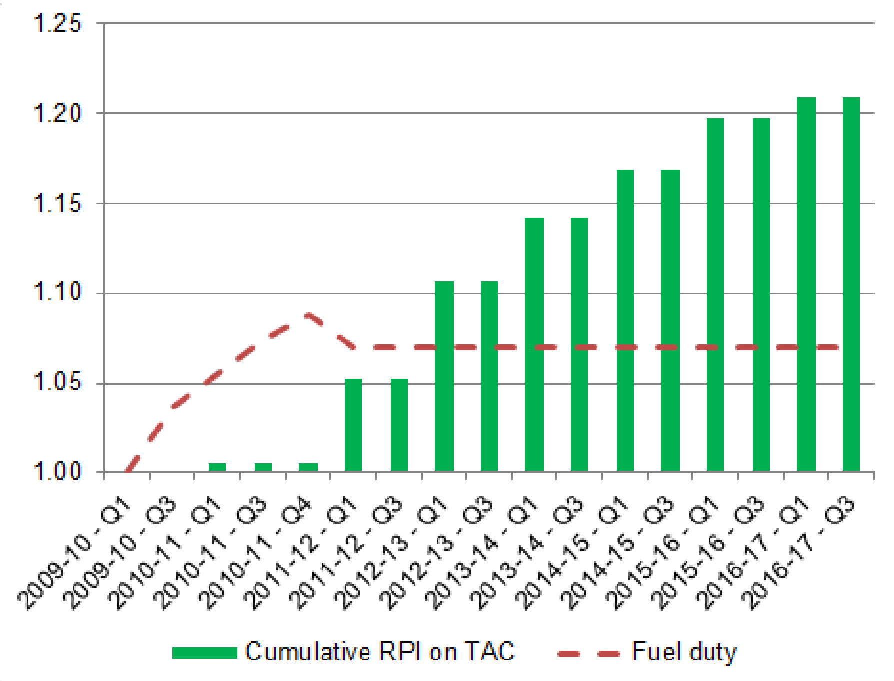


Source: Department for Transport – transport statistics

Against the backdrop of this highly competitive environment, it is important to note that neither road hauliers nor feeder shipping companies have to worry about the impacts of a periodic review every five years, and enjoy relatively straightforward access to their networks. In the road sector, unlike for rail, there is no direct link between the costs of road wear and tear caused by lorries and the fuel duty paid by the road hauliers.

In addition fuel duty has been frozen in real terms since 2011, whilst access charges paid to Network Rail have increased by over 20% RPI over the sample period. See Chart 4:

Chart 4: RPI on track access charges versus change in fuel duty



Source: Office for National Statistics and Network Rail

1.4 Impact of charges review on franchised operators

This is a very important consultation for the rail freight sector, as FOCs operate without the protection of a franchise agreement and are therefore entirely exposed to changes in the level and structure of charges. The level of access charges directly impacts on the ability of rail to compete with road and feeder, noting that any increase in access charges cannot be considered to pass-through to customers.

The market and regulatory regime for franchised passenger operators is very different. Currently over 90% of trains on the network are operated by franchised operators and these operators are largely protected from changes to access charges. Noting the challenge this creates in using access charges as a mechanism to positively influence behaviour, cognisance should be given to the actual commercial impacts that changes in the regime will have.

1.5 Benefits of rail freight to Britain

Rail freight provides Government excellent value for money and the prize for having a competitive and sustainable rail freight sector is substantial. Many benefits fall outside the railway balance sheet, however the externality and productivity benefits are substantial.

The productivity gains for UK plc, and the congestion and wider environmental benefits generated by rail freight, are worth over £1.6bn per annum to the UK economy.[6] These figures exclude the benefits to British businesses of an efficient logistics chain or the wider benefits of supporting economic growth (particularly outside of London and the South-east).

The reduction in freight volumes resulting from an increase in charges would be likely to cause the economic benefits to disappear at a faster rate than the additional costs recovered from higher charges. This highlights the importance of ensuring that the benefits that fall outside the railway balance sheet are understood when evaluating the future charges and incentives regime.

1.6 Government Rail Freight Strategies

Both Transport Scotland and the DfT recognise the importance of having charges, and a charging structure, that supports existing rail freight, and encourages growth.

In its rail freight strategy Transport Scotland offers "broad support [for] the industry's calls for some degree of long term certainty in the charging regime" and as a result is planning to "revise the Scottish Government Guidance to ORR to better reflect rail freight and the need for a stable regulatory environment to support growth".

The DfT issued a Rail Freight Strategy in September 2016. Paul Maynard MP, the Rail Minister stated *"rail is the most environmentally-friendly means of land transport, which can help to meet our ever-growing demand for consumer goods. Rail freight is a vital part of the national economy and it is difficult to imagine how industry could operate effectively and competitively without it"*.

This strategy highlighted the importance of stability: "… *Government recognises the importance of a stable policy framework to enable rail freight to grow and achieve its potential. That is why we have been working with the industry to develop a clear vision for rail freight, in order to provide the level of stability from Government that will help the industry plan ahead and provide greater certainty to customers and investors."*

Chapter 4. of the Dft Rail Freight Strategy[7] deals with track access charges. The fact that there is a whole chapter on the topic demonstrates its deemed importance. The below is extracted text from this chapter:

"… we recognise the positive benefits of rail freight for the UK – including its environmental and air quality benefits relative to road freight and its impact on reducing road congestion. These benefits are not currently recognised in the track access charging regime. A significant increase in track access charges could result in some freight moving from rail to road, resulting in the associated economic and

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[6] Freight Britain, Rail Delivery Group, 2015

[7] Rail Freight Strategy, Department for Transport, 2016 https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/552492/rail-freight-strategy.pdf

environmental benefits to the UK being lost, particularly for those commodities where rail freight is in direct competition with road and operators therefore have a limited ability to pass on any increase in costs to their customers.

As set out in the Secretary of State for Transport's guidance to ORR in July 2012, in setting track access charges we would expect ORR to note the Government's rail freight policy, including the importance of sustaining efficient and commercially predictable network-wide freight operations. The guidance to ORR also notes that the Secretary of State wishes to be advised by ORR of, and to discuss with ORR, any changes to the charges which ORR proposes to pursue which would adversely affect the competitiveness of rail freight compared to other modes.

We also recognise that, because track access charges are reviewed at each control period (set at every five years), this can make it difficult for the industry to plan ahead and take long-term investment decisions. Track access charges are linked to the costs of the network, which are reviewed every control period, and it is therefore difficult to provide visibility of the level of charges further ahead than this. We welcome ORR's early and proactive engagement with the industry as part of the current review of charges and are keen to support this as PR18 progresses."

"DfT will continue to support ORR's work to develop appropriate track access charges for freight from CP6, including by understanding the overall impacts on the rail freight industry of any changes. In particular, DfT is keen to support ORR's work to ensure that decisions about track access charges levied on rail freight reflect the cumulative impacts of different charges on the rail freight industry and are joined up with Government decisions on wider support and funding to freight."

2.0 CHAPTER 1 – INTRODUCTION AND CONTEXT

Highlights:

- We welcome the on-going engagement with the ORR throughout the periodic review process. This has meant that there have largely been no surprises in the consultation document.
- Nonetheless the direction of travel for CP6 is not without its serious threats. The impact of Network Rail's cost challenges on the calculation of track access charges, is a very significant concern for all freight operators.
- Greater clarity over Network Rail's costs will allow ORR to conduct a robust, independent analysis of the impacts of decisions made in the periodic review process, with consideration given to the modal alternatives and the high elasticity of demand for the remaining rail freight services.
- As in PR08, we suggest a 10-year efficiency target in the calculation of the Variable Usage Charge to avoid setting charges in excess of the long term efficient levels.
- Respecting the need for due process to be followed, we ask ORR to consider the viability of providing an indicative range of charges at the earliest possible opportunity. This will allow a high-level impact assessment to be made, enabling the DfT to understand whether any mechanisms are necessary to support the sector and sufficient time to seek necessary clearances.

2.1 Engagement

Freightliner welcomes the decision by the ORR to close down some of the options previously considered at an earlier stage in the review. Getting early clarity on the direction of travel is welcome, and we particularly support the decision not to pursue geographical variable charges in PR18.

There has been considerable engagement to date by the ORR with operators and Network Rail, co-ordinated by the Rail Delivery Group (RDG). It is pleasing that there has been so much interaction, with early thinking presented by way of frequent working papers. In many areas it is clear that the ORR has listened and acted on the views and evidence put forward by the rail industry. We also recognise that as a result of this engagement there have largely been no surprises in the consultation document. This is helpful in terms of planning workload and briefing colleagues, customers and partners that we work with.

However, that does not mean that the direction of travel for CP6 is not without its serious threats to the viability of rail freight. It is now emerging that this could be a very challenging periodic review for FOCs and customers. Some of this is driven by considerable uncertainty about increasing Network Rail costs and how these may translate into increased access charges.

2.2 Network Rail Costs

It is clear that Network Rail is facing significant challenges to renew, maintain and operate an increasingly busy and congested network and as a result is under considerable cost pressure. The ORR's recent Network Rail Monitor identified the key factors driving current underperformance against budget.

At a headline level ORR expects Network Rail to underperform the regulatory performance measure by £1,025m in 2016-17. This compares to a forecast shortfall of £211m (3.1%) against a budget of £6,784m, which is itself £635m worse than the ORR determination. In addition there is a £179m adjustment for missed regulatory output.

Although this is only a snapshot of the financial challenges facing Network Rail in CP5, it remains difficult to understand by how much costs have increased for the core activities of maintenance, operations and renewals (as delayed work banks and performance levels also have to be accounted for).

It is unclear what impact any cost increases will have on the calculation of track access charges, particularly given that current figures are before any efficiency target is set by ORR. Nevertheless we are very concerned that the headline figures in ORR's Monitor and Network Rail's own submission for funding in the Initial Industry Advice document for CP6, will result in a significant increase in the considered level of direct costs being added to the direct costs 'hopper' for CP6.

2.3 Holistic review of all charges and incentives

It is important that the whole package of charges and incentives are looked at holistically, and we welcome ORR's recognition of this. We urge the ORR to ensure that this holistic assessment includes independent analysis of the impacts of decisions made, taking into account the modal alternatives and the high elasticity of demand for the remaining rail freight services.

Such an assessment cannot be performed with any certainty until Network Rail's costs are known, and their efficiency target is assessed and decided upon. Without this cost data and efficiency targets the impacts cannot be assessed. This was the case during the previous periodic review, in PR13, where the structure of charging regime was generally understood and supported, however once the full costs were known it was quickly apparent that the level of charges were unaffordable. This created a significant amount of uncertainty and instability for the industry.

2.4 Network Rail efficiency targets

It is unclear to us at what stage in the periodic review process the ORR will decide on Network Rail's CP6 efficiency target and how this will be translated into access charges. We note that in Control Period 4, a 10 year efficiency target was assumed in the calculation of the variable charges and we suggest that this option is considered again in the context of increasing Network Rail costs, which are not yet at long term efficient levels, and charges set at Year 10 levels.

2.5 Timescales

We welcome the publication in the consultation of the ORR's timescales for the review. We do understand that the periodic review process takes time and that ORR must follow due process, however the timescales of the review are very challenging for the rail freight industry. Prolonged uncertainty about the level of future charges is very unhelpful in terms of business planning and making decisions about investments. It is difficult to explain to existing and potential customers why there is such a high level of uncertainty about access charges, especially as this is just not a factor for other modes.

We therefore urge the ORR to support the rail freight industry as much as possible in narrowing down options and particularly to consider the viability of providing an indicative range of charges at the earliest possible opportunity.

Given that the impact on franchised passenger operators is much less than on freight and open access, and that the settlement for freight does not have to be mirrored for passenger there is a strong case for bringing forward the decisions on freight to an earlier stage in the review. It would be very helpful if freight charges could be narrowed down to a reasonably tight range and we urge the ORR to consider the viability of providing a range of charges at the earliest possible opportunity.

This will allow a high-level impact assessment to be made, enabling the DfT to understand whether any mechanisms are necessary to support the sector. As highlighted in the consultation, such support mechanisms may require state aid clearance from the EU. This clearance could take up to two years.

3.0 CHAPTER 2 - INFRASTRUCTURE COSTS

Highlights:

- Increased transparency of allocation of costs is welcome but consideration of the appropriateness of allocating the fixed costs of the rail network to freight, rather than just the avoidable costs of freight, is needed.
- Given that the fixed costs remain whether there is freight traffic or not, we would suggest that it is more appropriate to instead allocate just the avoidable cost of freight.
- It is clear that greater collaboration and industry effort is needed to reduce overall costs.
- Simplifying freight mark-ups into one fixed charge is welcome.
- The decision to include the market can bear test on a location-by-location basis is a surprise. Not only does this juxtapose from the decision not to pursue the geographically based variable charges, but it does not take into account the portfolio of services that customers expect from freight operators, nor that road and feeder competition have no such market adjustments.

3.1 Industry collaboration to reduce costs

We understand and welcome the overall direction of travel to increase cost transparency and we note the proposed move to increase transparency through the allocation of costs. We would however prefer to see a greater focus on why costs are increasing (not decreasing), leading to greater collaboration and industry effort to reduce overall costs. This should take priority over devising methods to allocate costs between operators.

Freightliner appreciates that this may be dealt with elsewhere within the ORR, but in our view the greatest priority should be understanding cost causation better, rather than devoting industry time and greater focus to allocating fixed costs to different users.

3.2 Freight Efficiency Benefit Sharing scheme (FEBS)

There is a greater opportunity for operators to work with Network Rail to help save costs. We suggest that consideration is given to a Freight Efficiency Benefit Sharing scheme that was jointly commissioned by Network Rail and the FOCs in 2014 (see Appendix A). This is an upside only scheme that could support cost savings that would not otherwise be achieved. Experience from the Route Efficiency Benefit Sharing scheme highlighted that freight operators cannot the take the risk of being exposed to a regime with a downside, when their ability to control Network Rail's costs is limited.

With the decline of some of rail freight's traditional bulk commodities there may be an opportunity to rationalise some assets infrastructure across the network that may now be considered redundant. Such a benefit sharing scheme would help to address Network Rail concerns about the ability of such a rationalisation project to pass through Network Change.

3.3 Allocation of costs

There are many different ways of allocating costs, none of which are right or wrong. In an industry where there are such high fixed costs, and the network costs, such as renewals and structures have such long life spans, it is difficult to allocate costs to any particular traffic. These are costs that would remain even if a minimal train service operated. Any allocation of fixed costs, whatever the methodology, is just an allocation, and is not reflective of costs that could be saved. For these reasons we do not support the ORR proposal to translate fixed cost allocations into the basis for charges.

There are different purposes in allocating costs to franchise, open access and freight operations. When considering how avoidable and fixed costs are allocated the purpose of the allocation should be clear. Thought is needed when allocating fixed costs not to create potentially harmful unintended consequences. An example of this might be if, by allocating the fixed costs of the network to freight, it distorted the business case for rail freight, and resulted in policy decisions that reduced freight volumes on the rail network.

Freightliner notes from the impact assessment that as a result of the revision of the cost allocation methodology and recovery of fixed costs from all operators, it is the expected that there will be a higher allocation of costs to freight than under the previous approach, based on the LEK avoidable methodology.

Given that the fixed costs are just that, and will remain whether there is freight traffic or not, it would be illogical not to encourage more rail freight, which supports £1.6 billion[8] of external and productivity benefits outside the railway balance sheet. It would seem more appropriate not to allocate the fixed costs of the rail network for freight, but instead to allocate just the avoidable cost of freight.

3.3.1 LEK methodology

In PR13 Network Rail commissioned LEK to consider the avoidable cost of rail freight on the rail network. The approach used by LEK in this exercise was to consider the avoidable costs of freight by commodity grouping and on the basis of activity, i.e. a bottom up approach. There was considerable wider stakeholder engagement led by Network Rail and the result was a robust and detailed and logical analysis that was broadly supported by both Network Rail and wider stakeholders.

Network Rail has commissioned Brockley Consulting to undertake work in PR13 to consider a methodology to allocate all avoidable and fixed costs, to all operators. The purpose of this exercise is quite different to the purpose of the LEK work and we understand in particular that there is an appetite for more accurate allocation of fixed costs to franchised operators, than the current methodology. We met with Brockley Consulting on a couple of occasions during 2016 to understand their proposed methodology. The methodology proposed is a high level top down approach, and is far less detailed than the methodology used by LEK in PR13. At our last meeting Brockley Consulting indicated that it was appropriate to allocate just avoidable costs to the freight sector, though we have not seen anything to confirm this from Network Rail.

We agree that it would be more appropriate for the freight sector to allocate avoidable costs only, and do so on a bottom up and activity based methodology, more akin to the LEK work. The purpose of the Brockley Consulting work is quite different, and the high level top down allocation method seems much less appropriate for a nationwide and constantly evolving sector, and there is a risk that the allocation will have wide reaching impacts on the perceived value of the rail freight sector.

As this work develops, we are keen to continue to engage with Network Rail and the ORR. At this stage, we have not seen any detail of the roll-out by Network Rail of the Brockley Consulting methodology, but assume it is the intention to engage further as this work progresses. We suggest that further consideration is given to the appropriate methodology for allocating avoidable costs to the freight sector.

3.4 Incremental changes to freight mark-up charges

The proposal to simplify the Freight Specific Charge and the Freight Only Line charge to one charge, based on mark-ups, where it is deemed the market can bear the charges, is welcomed.

It is a helpful clarification that the proposed market can bear test will take into account the level of charges based on costs directly incurred. Of course these costs will only be known once Network Rail have updated the direct cost model and decisions have been made in respect of other directly incurred costs and efficiency assumptions.

We were surprised by the proposal in the consultation to include the market can bear test on a location-by-location basis, as unlike most elements of the consultation, this was not previously raised by the ORR in stakeholder meetings. Whilst we do not disagree that some individual flows of traffic are more viable than others, looking at individual movements is impractical, and will create distortions, as it does not take into account the following:

- Road and feeder competition have no such market adjustments and represent 91% of domestic freight moved in the UK.
- Customers usually buy a portfolio of services from operators – i.e. an operator offers a service on the less attractive route as part of an overall offering including more attractive routes
- In reality it is very difficult for freight operators to pass on increased charges to customers, even if in theory the market can bear increases. The practical inevitably is that freight operators end

[8] Freight Britain, Rail Delivery Group, 2015

up absorbing at least some of the increase. Given the perilous financial state of the rail freight operators, this is increasingly challenging and unsustainable.

- Having different rates for different movements will be very complicated to price and to bill:

  - Network Rail would need to build a new system to bill the different rates – this will probably be more expensive to build than the income it will generate
  - Different charges could cause competition issues between competing ports and terminals
  - It is unclear how new to rail traffic would be priced, and this could create unnecessary delay and uncertainty. Customers are telling us we must provide prices more quickly to compete with road – the FTA have set a target to freight operators to respond within 6 hours of the request[9]. Having to wait for mark-ups to be assessed would create considerable delay in being able to quote for new business, in the absence of a fully marked up price list for all possible journeys.

- To include a geographically based charge for mark-ups seems in juxtaposition to the ORR decision not to pursue geographically based variable charges in CP6

[9] The Agenda for More Freight by Rail, Freight Transport Association, 2016

4.0 Chapter 3- Short-run variable charges

Highlights:

- Overall level of charges, particularly the affordability of the short-run variable charges, is the key priority for freight operators. This is a particular concern in light of Network Rail's current cost challenges.
- While the consultation notes that the Freight Investability and Sustainability Group (FISG) could develop a mechanism to support rail freight in the event that charges increase significantly, all parties agree that an affordable settlement, though the periodic process, is preferable.
- Decline of rail's traditional bulk materials means that virtually all of the commodity markets compete directly with road of feeder services. We therefore urge the ORR to consider the cross-modal implications of any proposed increases in charges or increased complexity.
- The ability to extend caps appears to be a grey area in the legislation and there may be an opportunity to extend the caps if the results of the periodic review see direct costs increase. Releasing the caps will result in a £3.1 million a year increase in the overall access charges paid by freight operators and this will fall particularly on certain customers' business.
- We do welcome the decision by the ORR not to pursue fundamental reform of Variable Usage Charges for CP6, however we are cautious and aware that even minor changes to the calibration can result in considerable changes in charges.
- Freightliner strongly supports the option of removing the Capacity Charge and recovering the 'lost revenue' through higher fixed cost charges. It is not part of the 'minimum access package' and it cannot be considered to be collected on a 'cost directly incurred' basis.
- The option of retaining the Capacity Charge and removing the caps is untenable as it would increase the Capacity Charge by an estimated £14m – up 450%. The consultation and the accompanying impact assessments note that doing so could impact on the viability of some rail freight services and additionally there is an increased likelihood of exit from operators.
- We welcome the abolition of the Coal Spillage Charge but caution against the need for an additional clause in the Track Access Contract.

4.1 Overview

Freightliner welcomes the ORR's intention not to make significant changes to the structure of short-run charges for PR18.

For the rail freight industry the greatest priority for short-run variable charges is the overall level of charges and whether they are affordable. Any increase in overall charges will challenge the viability of the sector in its competitive position versus road and feeder. However a key focus is the level of direct costs, which translate into variable charges, and represent the legal basis for charging and mandated recovery, and consequently where there is less opportunity for policy decisions to be made to influence the outcome.

We note from the ORR's impact assessment that there is recognition that rail freight delivers a range of benefits that are not currently reflected in the marginal cost of transporting freight by road or rail, and also that the charging regime in rail affects the economics of rail versus road.

Following the sudden decline of rail freight's traditional bulk commodities, the industry has entered a transitional period as rail freight operators look to restructure their businesses, and try to develop new markets. It is clear though, that virtually all of the commodity markets that rail freight companies operate in now compete directly with road or feeder services. We therefore urge the ORR to consider the cross-modal implications of any proposed increases in charges or increased complexity.

For instance, it is important to consider that road operators pay VED and fuel duty, and in effect the road network is free at the point of use. Road hauliers do not have to worry about a performance regime or booking access onto the network, nor is there a risk around the availability capacity over of a route or the provision of diversionary routes.

4.2 Freight Investability and Sustainability Group

The impact assessment references the discussions at the Freight Investability and Sustainability Group (FISG), chaired by the DfT, and the possibility of 'increased support' that could take the form of an externality credit mechanism. This would take into account the externalities saved by transporting freight by rail, as opposed to by road. As stated, any chosen approach would be subject to EU state aid clearance as well as the compliance with the EU directives on the recovery of costs directly incurred. However, we are concerned that any EU clearance will not be straightforward to obtain as the UK negotiates Brexit.

Given the uncertainty surrounding the timescales of any EU clearance (estimated 2 years) and following the reduction of the existing Mode Shift Revenue Support scheme by £4 million a year from April 2017, it is clear to all parties at FISG that an affordable settlement, though the periodic process, would provide a more certain and deliverable solution than relying on developing and seeking approval for a new mechanism.

4.3 Caps on Charges

The variable charges for heavier axle wagons were capped in CP5, with a transition that applied through the last 3 years of CP5 and into CP6. We estimate that, if nothing else changes, the impact of the complete removal of the current cap on CP5 charges will result in an increase of £3.1 million a year in the overall access charges paid by freight operators. However, this increase will fall wholly on particular customers' business, and in itself will result in a very considerable increase in access charges, in the order of 17% for aggregates and steel traffic.

This is already a considerable additional financial burden to be absorbed in these sectors, which do compete with road, and these customers and their operators will not be able to absorb any further increase in CP6. When considering the holistic impact of the review, these increases, as a result of the cap being removed must be included

Citing 2012/34/EU and the accompanying implementing act (EU 2015/909) paragraphs 3.5 and 3.6 of this chapter suggest that the ORR is constrained in its ability to extend the current caps. Although we have not sought legal guidance this is not an interpretation we share. From our reading it would appear that there could be greater flexibility than indicated by the ORR.

The purpose of the phasing-in period is to provide railway undertakings with *"predictable charging regimes and have reasonable expectations for the development of infrastructure charges"*. The phasing-in plan for railway undertakings applies when *"railway undertakings operating the train services may see their charges significantly increase following a review of the implementation of the existing calculation modalities."* This could apply to any review – the legislation notes "a" review, not "the" review. The legislation does not specifically link such a review to a change in the methodology.

Therefore, if following a review of their existing calculation modalities, the result was an increase in the direct costs, this could enable ORR to phase-in the increased charges. As this appears to be a grey area in the legislation we urge ORR to seek guidance from the European Commission on its ability to extend the caps, if the results of the periodic review see direct costs increase.

4.4 Variable Usage Charge

Freightliner strongly welcomes the decision by the ORR not to pursue fundamental reform of Variable Usage Charges for CP6. In particular we support the decision not to implement geographical based charges in CP6, though we do note that this is rather at odds with the decision to consider mark-ups on a geographic basis.

As stated above, in our view there is flexibility for phasing in increases if the Network Rail cost model drives substantial increases.

4.4.1 Recalibration

Although the proposal is to largely retain the current structure, the ORR is considering a minor recalibration of the Variable Usage Charges for CP6. From previous experience minor changes in calibration can result in considerable changes in charges, and we suggest that great care is needed so that the recalibration does not cause unexpected distortions in the allocation of costs.

The methodology used to allocate direct costs, does not, as far as we are aware, take into account that the railway system is predominantly designed as a passenger railway. If there were only freight on the railway, the levels of maintenance etc., would be much lower, as speed and passenger ride quality would not have to be taken into account.

We suggest that the recalibration of freight and passenger charges are undertaken separately after the initial allocation of costs between all passenger services and all freight services, to ensure that changes to speeds in passenger services do not result in unexpected increases in freight charges.

4.5 Capacity Charge

The Capacity charge has been controversial since its introduction, and has been subject to challenge going back to Control Period 3.

As highlighted in detail in previous discussions with the ORR, we are not in agreement that the Capacity Charge is a short-run variable charge, with the exception of a small proportion of the charge that is collected for those trains that have run in excess of the number assumed when setting the benchmarks in Schedule 8. The benchmark gives Network Rail a level of delays that are deemed to be acceptable and they do not make payment for (indeed they receive additional bonus payments) if they out-perform their benchmarks. Therefore there is no cost to Network Rail for the assumed number of trains used to calculate the benchmark.

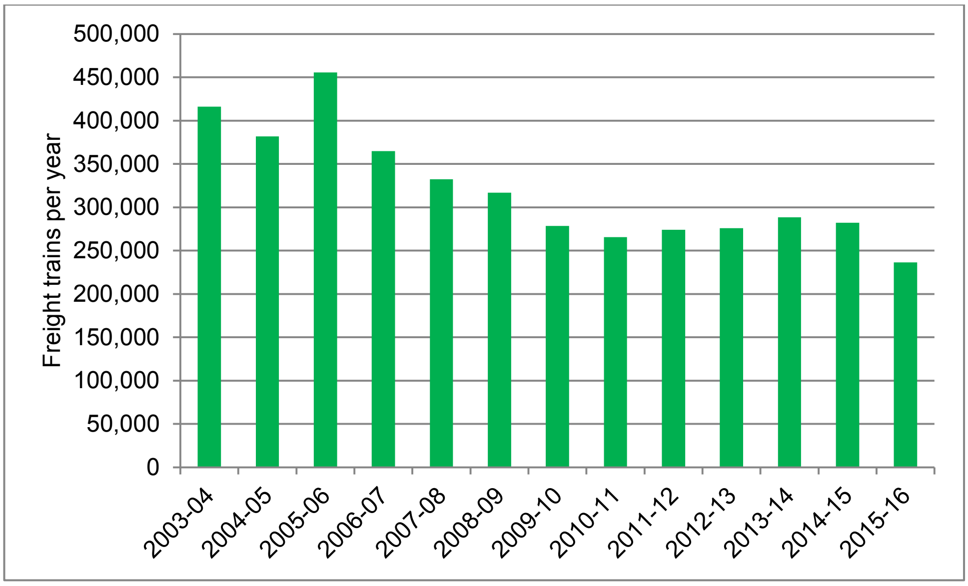
Freightliner notes that the ORR has narrowed to two the options for the Capacity Charge – 1) retain charge and remove caps for freight and open access and 2) remove the Capacity Charge and recover the lost revenue through higher fixed costs charges. Freightliner strongly supports the second of these options.

To retain the existing charge for open access and freight would not be affordable for the rail freight sector, particularly in light of the current interpretation that the caps must be released. This would increase the Capacity Charge by estimated £14m, or 450%. The consultation itself discusses the harm this could do to the rail freight industry, noting the “potential impacts on the viability of their services”. As the Capacity Charge is not part of the ‘minimum access package’ as detailed in 2012/34/EU, it is not considered to be a cost that must be charged on a ‘costs directly incurred’ basis. The ORR’s assessment about the on-going viability of some rail freight services and the impact assessment highlighting the increased likelihood of market exit for freight operators should the caps be released, raises questions over the appropriateness of collecting this charge in its current form.

As the Capacity Charge falls outside of the scope of the minimum access package, it should be treated as a mark-up meaning there is no need to apply the capping and phasing rules with the added benefit it will give added flexibility to our approach moving forward. Freightliner strongly supports the option that would see the charge removed and lost revenue recovered through higher fixed cost charges. The charge, in its current format, does not create the intended incentives on operators – particularly given that franchise agreements protect more than 90% of trains on the network from changes to this charge.

The payment also fails to consider the work that freight operators have been doing over the last 10-15 years to reduce the number of freight trains on the network. Driven by the need to reduce unit costs in order to compete with each other, and with other modes, freight operators have been increasing the length and weight of their trains operated. As a result there are 43% less freight trains operating now than in 2003-04, and over that timeframe the average weight of each train has increased by 71%. The way the Capacity Charge is currently collected does not recognise the work that freight operators have done to reduce their footprint on the network. See Chart 5 below.

Chart 5: Total number of freight train movements



Source: ORR data set

4.6 Traction electricity Charge

Freightliner supports the ORR recommendation to retain the current incentive mechanism by which Network Rail and the operators have incentives to ensure that the forecast losses are reflective of likely outturn. The sharing of transmission losses with Network Rail provides an incentive mechanism for investment. We acknowledge that this incentive maybe relatively weak, but it is preferable to not having any incentive and operators being charged for something they cannot control. There is a potential to strengthen the incentive by changing the targets or by using a regulated target to achieve an efficient level of losses from the grid operator (Network Rail).

4.7 Coal Spillage Charge

The consultation highlights that coal volumes moved have considerably reduced and the already small amounts raised by the Coal Spillage Charge are likely to decrease further.

As submitted by Freightliner during PR08, we agree with the ORR that the current Coal Spillage Charge has poor incentives as it is charged per kgtm and not per tonne. The consultation also notes the poor incentive qualities as it is not reflective of coal actually spilt.

We note that for these reasons the ORR is proposing abolishing the Coal Spillage Charge, and given the reasons stated above this seem sensible.

However, the consultation states that Network Rail has suggested a new clause being added to track access agreements that would enable costs from any spillage to be recovered from freight operators, where there is evidence to indicate who is responsible. Network Rail has not previously raised this issue with us, so we are unclear what sort of events they have in mind. There is already a clause - 10.1 (b), in the model freight contract which deals with environmental damage and this would seem to be sufficient, without adding an additional clause.

We are not convinced over the need for an additional clause in the Track Access Contract and are concerned that this would create uncertainty resulting in unnecessary disputes.

5.0 SCHEDULE 8 PERFORMANCE REGIME

Highlights:

- The Schedule 8 regime in CP5 has been very challenging for freight operators. The large swing in payments from FOCs to Network Rail, estimated in the PR13 final determination to be £10m per annum but exacerbated by increasing delay per incident. This has tilted the regime excessively against freight and a re-balancing in CP6 is required to correct for the size of the CP5 adjustments.
- The lack of a system to identify a validated pathway if a train service leaves late, often causes a largely unpredictable level of third party delay, resulting in minor indiscretions causing seemingly a disproportionate amount of disruption and increased penalties.

Impact of Delay Per Incident

- FOCs continue to work hard to improve performance and since the start of CP4 FOC on self delay has reduced by decreased 47%[10]. This improvement has not translated into a corresponding reduction in third-party minutes – down just 4% over the same timeframe[11].
- Key driver for this is the increase in third-party delays per incident (DPI) by 49% since the start of CP4. FOCs have little control over how incidents on the network are managed.
- The current regime does not incentivise Network Rail to manage incidents that are attributed to FOCs. Given the increasing impact of DPI on performance this should be reviewed during PR18.
- To create the right incentives, one suggestion is to set the FOC payment rate below the full payment rate, so in effect Network Rail pays a percentage of the FOC payment rate.

Benchmarks

- The impact of DPI is not adequately reflected in the congestion factor uplift applied to the benchmarks.
- As was demonstrated in PR13, there is a significant risk in choosing a small sample period to recalibrate benchmarks. Instead we ask that the recalibration of the CP6 benchmarks should at the minimum reflect the average for all years in CP5, but would ideally span a longer period to include CP4.

Payment rates

- Since 2003-04 the average weight of a freight train service has increased by 71%, however no adjustment to the FOC payment rate to take into account this increase has been made.
- In PR13, the freight operators submitted evidence, based on a review by LEK, for adjustments to be made to freight payment rates based on increased value of trains. This was late in the process and no action was taken. We ask ORR to consider this study and provide feedback on the robustness of the methodology and its suitability for making adjustments in PR18.
- There appears to be little correlation between train performance and passenger growth. As the long-run revenue loss caused by delays forms the basis of the passenger payment rate calculation, we ask ORR to consider whether the TOC payment rates overstate the long-run implications of performance, or at least make the rate assessment consistent between FOCs and TOCs.
- The gearing challenges and the imbalance in the ratio of payment rates to benchmarks between FOCs and NR have resulted in equivalent levels of performance between FOCs and Network Rail resulting in payments from one party to the other. Intuitively equivalent performance relative to benchmark should be broadly cost neutral.

Cancellation rates under Schedule 8

- Freightliner suggests that the periodic threshold for the payment of cancellation under Schedule 8 should be removed and all cancellations should be paid for at the higher rate. This would more closely represent the actual value of the train and would remove the incentive Network Rail has to cancel a train service that is running more than 95 minutes late.

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[10] Network Rail performance data
[11] Network Rail performance data

5.1 Context

As with all elements of the charges and incentives consultation the situation on the rail network should be compared to the situation on the road network. There is no equivalent of Schedule 8 on the road network and this means that there is much more risk borne by rail freight operators than there is by road freight operators. This is a barrier to modal switch to rail.

A key reason why no customers have taken up the option of having their own access agreement is the complexity and risk associated with the Schedule 8 regime. Since the beginning of CP5 the changes to Schedule 8 have made it even less likely that a customer would choose to bear this risk.

As the gearing and the payments by freight operators have increased from CP3 to CP5, the barrier this poses to modal shift now is much higher, and the risk of operating services is now in many cases proving challenging to the viability of even running some freight services.

5.2 Schedule 8 Overview

Schedule 8 has been very challenging for freight operators since the start of CP5.

Despite improvements made to freight operator performance inputs, the impact of rising delay per incident (which is largely not in the control of operators), since the setting of the benchmarks has exacerbated the difficulty posed by the current regime. The ORR set out in its PR13 conclusions that it expected that for exactly the same performance levels by all parties there would be a £10 million a year swing in payments to Network Rail.

This swing in payments has directly impacted on the freight operator's bottom line, and has directly contributed to the worsening financial results of freight operators. This has been very challenging for FOCs, as unlike access charges, there is no market can bear test and no possibility of passing this additional cost to customers.

The swing in payments from FOCs to Network Rail was the result of several changes, including increases to the passenger payment rates, whilst not increasing the payment rates made to FOCs, as well as increases to Network Rail's benchmark whilst using a very limited sample period to set FOC benchmarks. We believe that this has tilted the regime excessively against freight and a re-balancing in CP6 is required to correct for the size of the CP5 adjustments.

Even a very small delay is having a major impact and this is resulting in changes in behaviour that are detrimental to customer service and customer demand. Freight operators face daily dichotomies about whether to leave a terminal on time and leave customer goods in the terminal or wait for all the goods to be loaded and leave late, with the accompanying risk of causing third party delays. This does not result in satisfied customers and is not an issue experienced by customers using road.

Great care is needed that the Schedule 8 regime does not increase uncontrollable financial risk and have the opposite impact to one of the stated aims of Schedule 8. The high gearing of the current freight Schedule 8 regime and the risk of causing third party delays is directly impacting on decisions about new flows of traffic.

On top of the swing described in the PR13 final conclusions, it is clear that the freight operator Schedule 8 benchmarks in CP5 were set at a level that did not reflect the exit level of CP5 performance, but actually reflected the best two years of performance in the control period in terms of freight operator delays to third party operators.

5.3 The roulette wheel

Network Rail does not currently have a system available that will support a freight operator securing a validated pathway if a train service leaves late. As a result it is very difficult to predict the impact of a late running service – for a freight operator quantifying the delays feels akin to a spinning a roulette wheel. A very minor delay can cause a considerably sized incident, which is totally out of proportion to the original late departure. Please see below examples (more can be provided upon request):

4M92 lost **2 minutes** of time between Ipswich and Manningtree. This caused 100 **Third Party minutes**; potentially equal to **£4,771**.
4S45 18:39 Daventry – Coatbridge departed Crewe Basford Hall **3 minutes** This late start attracted **41 Third Party minutes**; potentially equal to **£1955** in Schedule 8 payments.
4C95 1400 Aberthaw – Cwmbargoed departed Aberthaw **60 minutes late due** to issues with the Silo. This late start ex Aberthaw has attracted **543 Third Party minutes**; potentially equal to **£25,901** in Schedule 8 payments.
4C42 03:20 Aberthaw – Tower Colliery departed Aberthaw **12 minutes late**. This late start attracted **61 Third Party minutes**; potentially equal to **£2,909** in Schedule 8 payments.

In these cases the freight operator has no, or very little control about the knock on delay caused by a late departure or a small loss in running time. The cost of such incidents to a freight operator is disproportionate to the minor indiscretion that caused by them. In many cases the costs of the indiscretion can equate to many months of profit on a flow of traffic.

5.4 Delay per Incident (DPI)

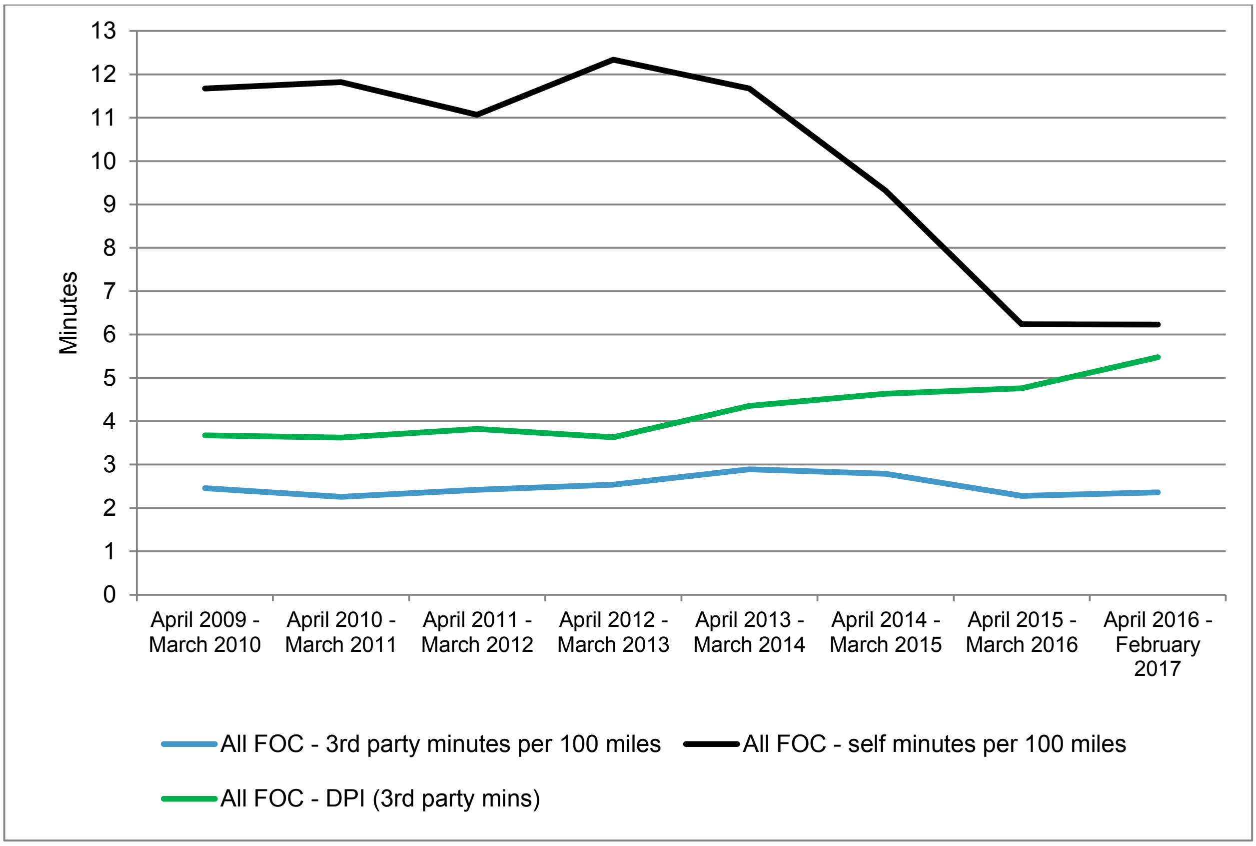
Since the beginning of CP4:

- All freight operators' self-minutes[12] **have decreased 47%**
- All freight operators' third-party delay per 100 miles **have reduced 4%** from 2.46 minutes to 2.36 minutes
- All freight operators third-party minutes per incident **have increased by 49%**

Chart 6 compares the very considerable reduction of freight operator delays caused to self (the minutes that are in direct control of the freight operators), compared to the much smaller reduction in freight operator delays to third parties. Whilst you wouldn't expect absolute correlation between the two figures this shows that there has been little reward to the freight operators for considerable achievement in reducing delay minutes which FOCs can control. A key reason for this is increasing delay per incident (DPI), which is also tracked on the below graph, and has risen by 49% since the beginning of CP4:

[12] Freight operator self-minutes represent the delays that freight operators have control of to manage and include mainly terminal delay and rolling stock failures

Chart 6: Annual change in FOC performance, self-minutes and DPI analysis since CP4[13]



Source: Network Rail data

The current Schedule 8 regime does not incentivise Network Rail to manage incidents that are attributed to operators. Freight operators have little control over how incidents are managed once they have occurred, particularly as unlike some passenger operators it is not possible to have a co-located control for a nationwide operator. Given the increasing importance of delay per incident to the overall industry performance going forward it is essential that Network Rail is incentivised to minimise delay per incident caused by operators, as well as caused by them.

One idea is to set the FOC payment rate below the full payment rate, so in effect Network Rail pay a percentage of the payment rate. This would clearly incentivise Network Rail to reduce the impact of all incidents. Something in the order of 25% would seem to be intuitively appropriate. This would likely create far a stronger incentive than relying on indicators in scorecards.

5.41 Network Rail's role in managing incidents

Network Rail's role in managing incidents on the network is critically important to their effective, efficient and prompt resolution. Two major incidents that were attributed to Freightliner over the past 12 months show the impact that this management can have. These incidents were similar – both occurred on a 2-track railway with similar passenger service levels, and both involved wagon defects, however the overall impact was very different.

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[13] Network Rail performance data

Incident: 4V36 brake failure at Manningtree	Incident: 4E01 brake defect at Cropredy
On the 13th December 2016 a seized slack adjuster on a wagon, maintained by a third-party, caused a wagon brake failure at Manningtree, on the Great Eastern Main Line. The incident started at 01:20 however normal working was not resumed until 09:25. This significantly impacted on the morning peak services into London causing a total of over 6,000 third-party minutes and a number of cancellations. The magnitude of the incident meant that Network Rail conducted a Significant Performance Incident Review (SPIR) to understand what contributed to the magnitude of the delay. The SPIR identified four 'key learning points': 1. There were missed opportunities to move the train off the main line by moving it onto Manningtree Curve. Although the driver lacked route knowledge for the curve a TOC route conductor could have been used. 2. Requirement to pool industry resources to ensure a more informed plan of action. Sending TOC fitters to site could have proved beneficial. 3. There was no need for a track inspection of the scale conducted post-incident, as all track circuits were showing clear so no indication of any damage. This significantly delayed hand-back of the line. 4. The lack of clarity on the on-call structure contributed to the over-cautious approach. Escalating to level 3 on-call maintenance would likely have clarified that the scale of on-track inspection was unnecessary. We very much supported Network Rail's decision to refer this incident to a SPIR review, so that all parties can learn lessons to help ensure that future incidents are better. It is clear from the SPIR that this incident was not particularly well managed and there were missed opportunities minimise the incident and avoid it impacting on the morning peak services. In total this incident resulted in 6,000 minutes being attributed to Freightliner, resulting in a payment of circa £300,000 (pre-incident cap), even though the incident occurred at 01:20.	In October 2016 Freightliner's intermodal service between Southampton and Leeds was declared a failure due to an air leak under the first wagon. The incident occurred just north of Banbury at 04:42 and there was a significant risk that this incident would impact on Cross Country services and Chiltern Train's morning peak services. As the estimated time of arrival of a Freightliner fitter from Southampton was 09:00, Network Rail decided to approach other TOCs and FOCs for assistance. Chiltern Trains were able to send two fitters working locally at Banbury to the site. Liaising with Freightliner maintenance staff these fitters were able to rectify the problem and enable the train to be moved into the loop at Fenny Compton. As a result the line was clear by 06:30 and disruption to other services was minimised. Network Rail's quick thinking helped ensure a prompt response to the incident, resulting in less than 1,000 third-party delay minutes being attributed to Freightliner. This is equal to approximately £50,000. *Note: It subsequently transpired that a foreign object had struck the wagon causing the air leak. As a result the incident was reattributed to Network Rail.*

The examples above show how critical Network Rail's role is in managing incidents and how this management has a significant impact on how quickly incidents are resolved and the overall delay minutes that are attributed.

5.5 Freight operator benchmark adjustment

Over the course of CP4 the FOC benchmark was adjusted by 16%, this was calculated on the basis of the increase in network mileage multiplied by the congestion factor of 1.5.

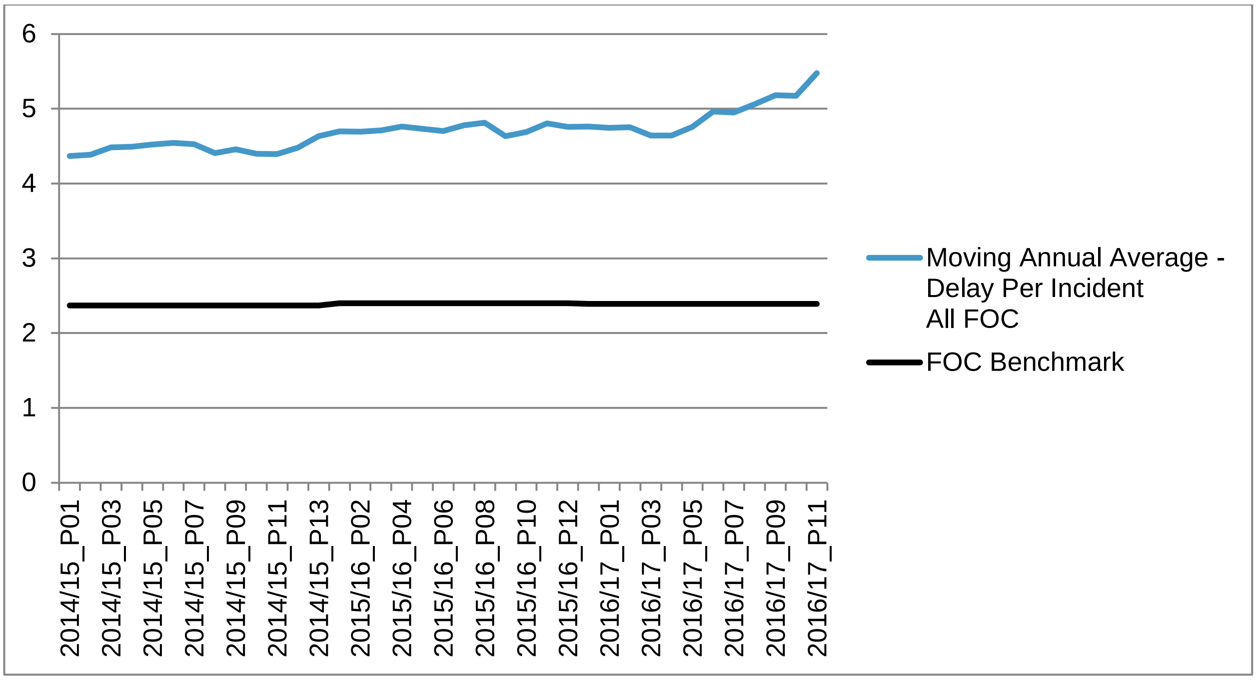
Over the same period the amount of third-party delay minutes per incident for all FOCs increased by 18%[14].

This suggests that the congestion factor of 1.5 assumed performed to uplift the benchmark based on the more congested rail network was broadly an effective proxy for DPI.

		FOC Benchmark	DPI 3rd-party mins All FOCs
CP4 Yr1	April 2009 - March 2010	2.63	3.68
CP4 Yr5	April 2013 - March 2014	3.05	4.35
	Change	16%	18%

However, the reduction in the congestion factor in CP5, 1.5 to 1.044, has been a contributory factor in the recent increases in DPI significantly exceeding changes in FOC benchmarks. Chart 7 shows adjustments to benchmark in CP5 against the changes in DPI. So far in CP5 FOC benchmarks have increased by just 1% (they will be recalibrated again in April for Year 3 of CP5), whereas third-party delay minutes per incident have increased by 25% since the beginning of the control period.

Chart 7: Changes in FOC benchmark versus change in FOC third-party DPI since start of CP5[15]



Source: Network Rail data

In order to address the imbalance that has occurred we suggest the following solutions:

- Freight operator benchmarks should be adjusted to take into account the retrospective gap between the actual adjustment and the increase in DPI. In CP5 adjustments to benchmark are lagging well behind increases in DPI.
- From the start of CP6 the freight operator benchmarks should be adjusted annually by changes in DPI. The current congestion factor (at 1.044), as calculated by Arup in PR08, has proved to be wholly insufficient.

[14] Network Rail performance data
[15] Network Rail performance data

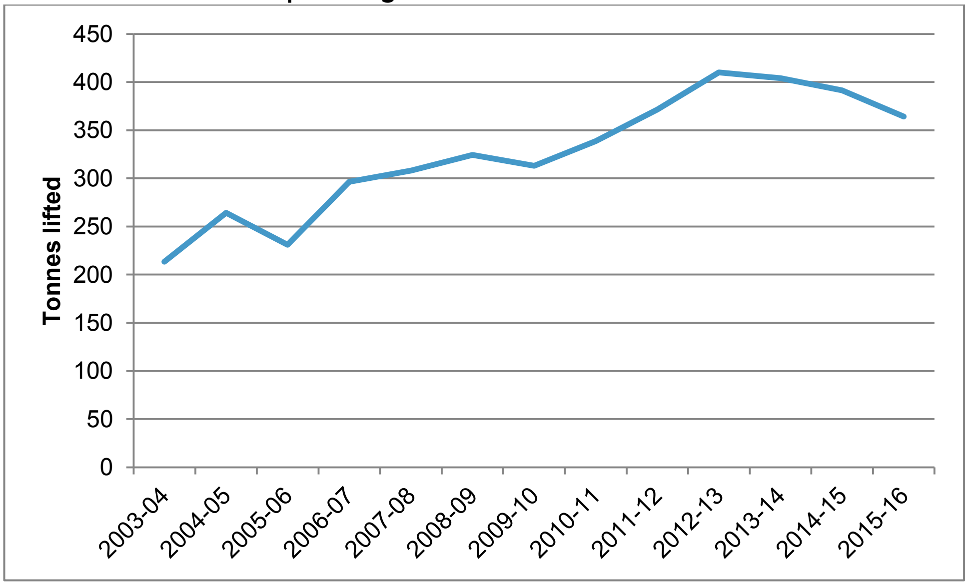
- Network Rail to have an incentive to reduce all DPI, not just DPI for their own incidents, by paying a percentage of the freight operator payment rate.

The annual lag in the calculation of the impact of traffic growth means that the benchmarks trail behind traffic increases. This means that freight operators have to absorb the impact of traffic growth across the network before their benchmarks are recalculated. This has become more marked because of the rapidly increasing delay per incident. We therefore suggest that forecasted traffic growth is used to recalculate benchmarks ahead of each year of the control period, rather than the current arrangement of ex-poste and non-retrospective adjustments.

5.6 Freight operator payment rates

Since 2003-04 the average weight of a freight train service has increased by 71%. This is despite the reduction over the last 24 months following the decline of coal. See Chart 8 below.

Chart 8: Tonnes lifted per freight train movement



Source: ORR data, freight train movements and tonnes lifted

There has been no adjustment in the freight operator payment rate to take into account this increase in the value of every freight train. Freightliner considers that this is inconsistent with the increase in the passenger payment rates from the beginning of CP5 to take into account the increased number of passengers moved by train. The rationale for this appears to be that although there is a model for calculating the impact of future lost revenue to passenger operators, there is no equivalent model for freight. However, the lack of a model should not prevent fair and reasonable adjustments being made to the freight operator payments rates.

The freight operators submitted evidence to the ORR as part of their PR13 responses, which included a report that had been prepared by the consultant LEK. This report, which is attached in Appendix B, calculated the adjustments to the payment rates necessary to reflect the increase in the tonnes of freight per train. As this evidence was submitted quite late in the periodic review process the ORR were not able to respond in detail to the report and no action was taken in PR13.

Before determining whether the industry needs to commission further work for PR18, we ask ORR to consider this study and provide feedback on the robustness of the methodology. With ORR's support of the principles, it would be a relatively straightforward task to update this report for PR18, and would avoid the unnecessary expense of commissioning a new study.

5.6.1 Passenger payment rates v freight payment rates

The payment rates for freight and passenger operators are calculated on a completely different basis. There are historic reasons for this, but this does mean that there is a considerable distortion and a lack of economic purity in the overall regime for freight operators, that cannot be overlooked.

Freight operator rates do not currently include the long-run impact on future business as a result of unreliability. However, performance is undoubtedly a key factor in both existing and potential customers' modal choice. With the decline of rail's traditional bulk commodities virtually every market segment competes with road freight and feeder shipping. The modal choice that customers have means that poor levels of performance are likely to impact on the volume of freight moved by rail and overall modal share. Conversely, if rail freight operators could increase their reliability further there is no doubt that this would support the attraction of new customers to rail.

Freightliner suggests that consideration is given to including an additional element in the freight operator payment rate that takes into account the impact of future lost business, even if it is not possible to perfectly model this impact.

5.7 Passenger payment rates

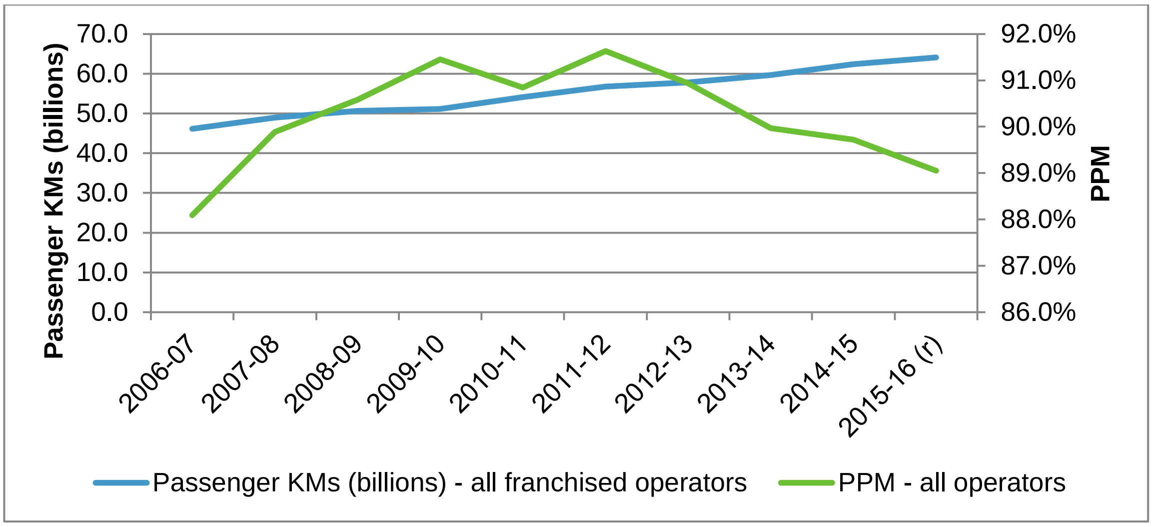
Feeding any increase to the passenger payment rates into the freight operators' payment rates would exacerbate the already high gearing of the Schedule 8 regime. This will make moving freight trains on the network even more prohibitive.

The current level of Schedule 8 payments made by freight operators are unaffordable and this is having an impact on the viability of certain rail freight flows. We are concerned that decisions will be made to remove flows from rail on the basis of Schedule 8 payment rates that do not reflect the reality of impact to future lost revenues.

We are aware that the passenger payment rates are based on the modeled expected long-run revenue loss caused by delay. Freightliner is not an expert in this area but we do observe that during a period where performance has declined, passenger volumes have continued to steadily increase.

Charts 9.1 to 9.4[16] below suggest that there is little correlation between train performance and passenger growth – we have not been able to identify a statistically significant link between these variables. In that context we would like the ORR to consider the data below and investigate further, to determine whether the payment rates are overstating the long-run implications of performance. This is particularly important in the context of competing modes, which themselves suffer significant reliability and performance issues, so cannot necessarily be considered as being better performing alternatives

Chart 9.1: All franchised passenger operators

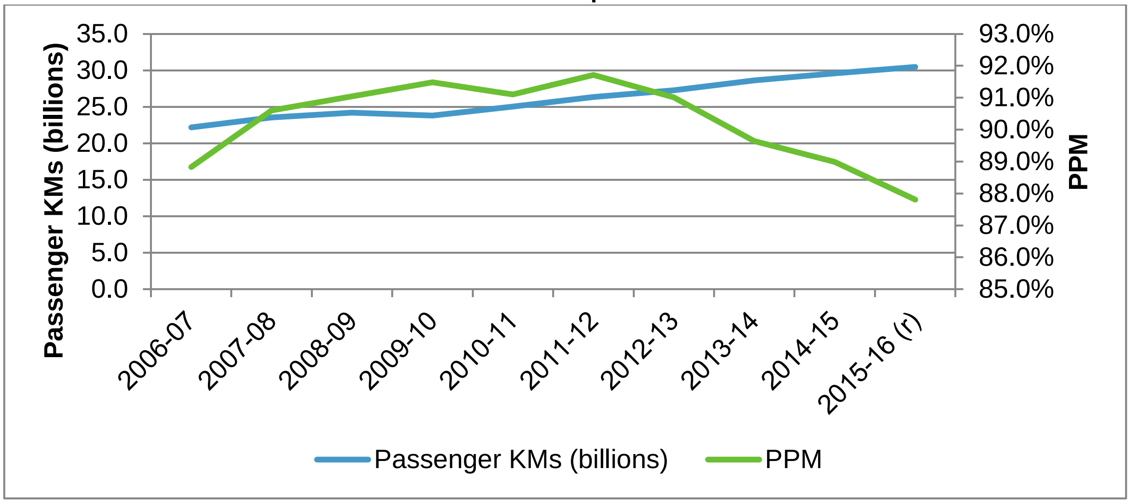


Over the last 5 years:

- PPM has declined by 3%
- Passenger KMs have increased by 13%

[16] ORR dataset, 2017

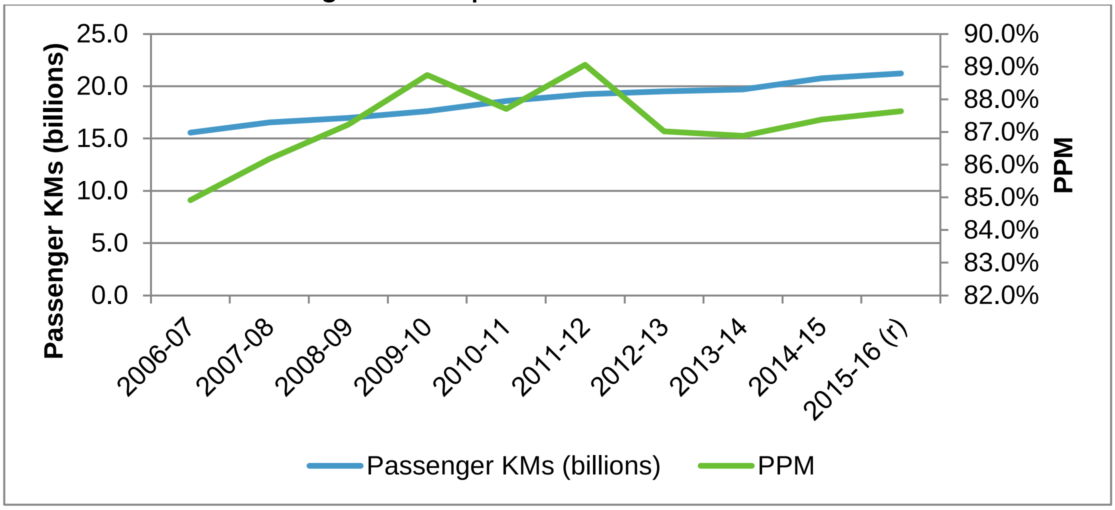
Chart 9.2: Franchised London and South East operators



Over the last 5 years:

- PPM has declined by 4%
- Passenger KMs have increased by 16%

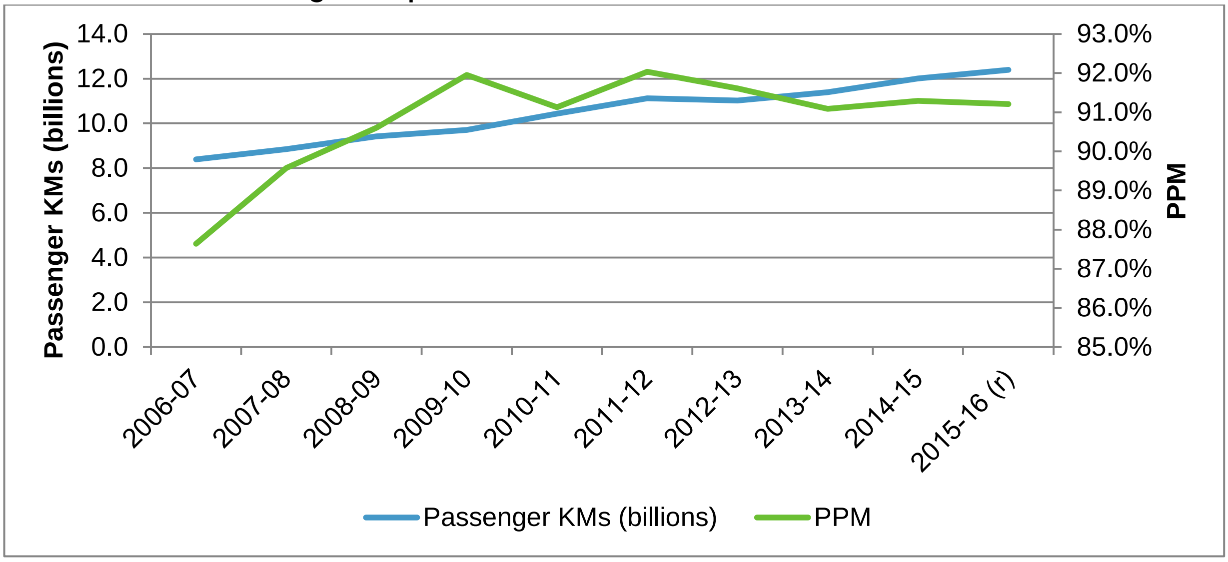
Chart 9.3: Franchised long distance operators



Over the last 5 years:

- PPM has declined by 2%
- Passenger KMs have increased by 10%

Chart 9.4: Franchised regional operators



Over the last 5 years:

- PPM has declined by 1%
- Passenger KMs have increased by 11%

5.7.1 *Taking into account delay on other modes*

As far as we understand the current Passenger Demand Forecasting Handbook does not account for delays in other competing modes. Data around delays in competing modes, predominantly road and air appears to be somewhat lagging behind the data that is available on railway delays, which is considerable. However, it is clear that other modal choices, such as car or air, also suffer from congestion and considerable delays, which impacts on decisions of travellers.

For example travel time statistics from the Strategic Road Network, England: 2016[17], published by the Department for Transport show an average delay of 9.0 seconds per vehicle per mile, compared to free flow, and on average an additional 69% of additional time is required on individual road sections to ensure on time arrival.

The Civil Aviation Authority publishes UK flight delay data[18]. The data is not in a user-friendly format but suggests an average delay of 12-15 minutes across all airports is typical.

5.7.2 *Delay-Repay*

Freightliner strongly supports ORR's recommendation not to include delay repay in passenger Schedule 8 payment rates. To do so would lose transparency for Government, particularly given that in many cases the expected level of delay repay payments are included in the franchise contracts between franchised operators and the DfT.

We also note and support, that the ORR's impact assessment anticipated that any delay-repay costs would not be expected to flow through to freight payment rates in the event that delay-repay was to be reflected in payment rates.

5.8 Imbalance and gearing of regime

Following the PR13 recalibration there is a significant imbalance in the ratio of payment rates to benchmarks between FOCs and NR. This has created an unforeseen gearing challenge in CP5, leading to a swing in Schedule 8 payments over the current control period.

[17] Travel time measures for the Strategic Road Network, England: 2016, Department for Transport, 2017
[18] UK flight punctuality data, http://www.caa.co.uk/Data-and-analysis/UK-aviation-market/Flight-reliability/Datasets/UK-flight-punctuality-data/, 2017

Table 1 below, shows the net payment under various performance scenarios. As an example if both freight operators and Network Rail outperform their respective benchmarks by 10% the freight operators pay Network Rail over £800k per annum. If freight operators and Network Rail were to under-perform their respective benchmarks by 5%, Network Rail pays freight operators approximately £433k per annum.

Table 1: Net Schedule 8 payments under various performance scenarios

	Schedule 8 payments (£) under various scenarios											
		NR under or over benchmark? *(negative = under benchmark)*										
		-25%	**-20%**	**-15%**	**-10%**	**-5%**	**0%**	**5%**	**10%**	**15%**	**20%**	**25%**
FOCs under or over benchmark? *(negative = under benchmark)*	**-25%**	**-2,052,441**	-387,657	1,277,128	2,941,912	4,606,696	6,271,480	7,936,264	9,601,048	11,265,832	12,930,616	14,595,400
	-20%	-3,306,736	**-1,641,952**	22,832	1,687,616	3,352,400	5,017,184	6,681,968	8,346,752	10,011,536	11,676,320	13,341,104
	-15%	-4,561,032	-2,896,248	**-1,231,464**	433,320	2,098,104	3,762,888	5,427,672	7,092,456	8,757,240	10,422,024	12,086,808
	-10%	-5,815,328	-4,150,544	-2,485,760	**-820,976**	843,808	2,508,592	4,173,376	5,838,160	7,502,944	9,167,728	10,832,512
	-5%	-7,069,624	-5,404,840	-3,740,056	-2,075,272	**-410,488**	1,254,296	2,919,080	4,583,864	6,248,648	7,913,432	9,578,216
	0%	-8,323,920	-6,659,136	-4,994,352	-3,329,568	-1,664,784	**0**	1,664,784	3,329,568	4,994,352	6,659,136	8,323,920
	5%	-9,578,216	-7,913,432	-6,248,648	-4,583,864	-2,919,080	-1,254,296	**410,488**	2,075,272	3,740,056	5,404,840	7,069,624
	10%	-10,832,512	-9,167,728	-7,502,944	-5,838,160	-4,173,376	-2,508,592	-843,808	**820,976**	2,485,760	4,150,544	5,815,328
	15%	-12,086,808	-10,422,024	-8,757,240	-7,092,456	-5,427,672	-3,762,888	-2,098,104	-433,320	**1,231,464**	2,896,248	4,561,032
	20%	-13,341,104	-11,676,320	-10,011,536	-8,346,752	-6,681,968	-5,017,184	-3,352,400	-1,687,616	-22,832	**1,641,952**	3,306,736
	25%	-14,595,400	-12,930,616	-11,265,832	-9,601,048	-7,936,264	-6,271,480	-4,606,696	-2,941,912	-1,277,128	387,656	**2,052,441**

Negative figure = payment to NR

Assumptions:

22,000,000 commercial freight miles per year

Year 3 CP5 payment rates, as below:

Penalties (£ p.min)	
NR to FOCs	21.02
FOCs to NR	47.71
Bonus Rates (£ p.min)	
NR to FOCs	47.71
FOCs to NR	21.02

In a balanced regime exactly the same level of performance relative to benchmark, should result in a broadly cost-neutral position. The gearing challenges in the CP5 performance regime means that this is not the case.

The solution to this is to adjust the ratio of benchmarks to payment rates to create a fair balance – so that equivalent levels of out or under performance are broadly cost-neutral.

Raising the FOC benchmark to 3.2 would be a means of providing a more balanced gearing of the regime. Table 2 show shows that doing this would result in equivalent levels of performance being largely cost-neutral.

Table 2: Net Schedule 8 payments under various performance scenarios with FOC benchmark of 3.2 minutes per 100 miles

Schedule 8 payments (£) under various scenarios											
FOCs under or over benchmark? / NR under or over benchmark?	-25%	-20%	-15%	-10%	-5%	0%	5%	10%	15%	20%	25%
-25%	73,040	1,737,824	3,402,608	5,067,392	6,732,176	8,396,960	10,061,744	11,726,528	13,391,312	15,056,096	16,720,880
-20%	-1,606,352	58,432	1,723,216	3,388,000	5,052,784	6,717,568	8,382,352	10,047,136	11,711,920	13,376,704	15,041,488
-15%	-3,285,744	-1,620,960	43,824	1,708,608	3,373,392	5,038,176	6,702,960	8,367,744	10,032,528	11,697,312	13,362,096
-10%	-4,965,136	-3,300,352	-1,635,568	29,216	1,694,000	3,358,784	5,023,568	6,688,352	8,353,136	10,017,920	11,682,704
-5%	-6,644,528	-4,979,744	-3,314,960	-1,650,176	14,608	1,679,392	3,344,176	5,008,960	6,673,744	8,338,528	10,003,312
0%	-8,323,920	-6,659,136	-4,994,352	-3,329,568	-1,664,784	0	1,664,784	3,329,568	4,994,352	6,659,136	8,323,920
5%	-10,003,312	-8,338,528	-6,673,744	-5,008,960	-3,344,176	-1,679,392	-14,608	1,650,176	3,314,960	4,979,744	6,644,528
10%	-11,682,704	-10,017,920	-8,353,136	-6,688,352	-5,023,568	-3,358,784	-1,694,000	-29,216	1,635,568	3,300,352	4,965,136
15%	-13,362,096	-11,697,312	-10,032,528	-8,367,744	-6,702,960	-5,038,176	-3,373,392	-1,708,608	-43,824	1,620,960	3,285,744
20%	-15,041,488	-13,376,704	-11,711,920	-10,047,136	-8,382,352	-6,717,568	-5,052,784	-3,388,000	-1,723,216	-58,432	1,606,352
25%	-16,720,880	-15,056,096	-13,391,312	-11,726,528	-10,061,744	-8,396,960	-6,732,176	-5,067,392	-3,402,608	-1,737,824	-73,040

Negative figure = payment to NR

Assumptions:

22,000,000 commercial freight miles per year

Year 3 CP5 payment rates, as below:

Penalties (£ p.min)	
NR to FOCs	21.02
FOCs to NR	47.71
Bonus Rates (£ p.min)	
NR to FOCs	47.71
FOCs to NR	21.02

5.9 Sample period for recalibration

In PR13 the sample years chosen to recalibrate the freight operator benchmarks were the two best performing years for the freight operators. That meant that the benchmark was set at a level that was far lower than the CP4 exit position – see Table 3 below. The CP5 benchmark was set at 2.37 minutes of delay per 100 freight operator miles, against a CP4 exit position of 2.89.

Table 3: performance in CP4 and sample years

Year of CP4	Dates	CP4 - ALL FOC performance Mins per 100 miles	
1	April 2009 - March 2010	2.46	
2	April 2010 - March 2011	2.26	ORR sample year
3	April 2011 - March 2012	2.42	ORR sample year
4	April 2012 - March 2013	2.54	
5	April 2013 - March 2014	2.89	

This demonstrates the risk of choosing a small window to recalibrate the benchmark, and is a key reason why the performance regime has been particularly challenging for the industry in CP5.

Freight performance so far in this control period has been quite volatile and therefore there is a risk that selecting a small sample period could again result in a benchmark that is not reflective of current, or long-run, performance.

Freightliner would urge the ORR to select a much broader sample period to be used in the recalibration of the CP6 benchmarks, this should as a minimum reflect the average for all years in CP5 and would ideally span CP4 – noting that investments to improve performance are generally made over a long-term time horizon and to reset the benchmarks frequently would undermine confidence of making such investments.

We have previously submitted that benchmarks should not be set just on the basis of historic performance, as this rewards poor performance and punishes good performance. Additionally this does not take into account the impacts of delay per incident nor the long-term time horizon of investments.

It is therefore suggested that many factors are considered when setting future benchmarks, and this should include in particular the impact of delays per incident as described above.

5.10 Cancellation threshold in Service Variation and Cancellation under Schedule 8

The current freight Schedule 8 cancellation rate paid to freight operators by Network Rail for services below the periodic threshold for cancellations is too low and does not even broadly reflect the losses incurred.

Cancellations that fall below the threshold – currently set at 0.41% of services operated per period are paid at just £1,991 (16/17 price levels) per service. This payment is significantly lower than the lost revenue from a cancelled train, which range from between £6,000-£14,000. The discrepancy between the lost revenue and rate paid seems at odds with one of the purposes of the Schedule 8 regime – to compensate operators.

As the £1,991 payment equates to just 95 minutes of delay, this creates an incentive to cancel a late-running freight train rather than allowing it to run 96 or more minutes late. This is of course not what either the customer or the freight operator wants – they would rather the service continued to run late rather than be cancelled.

We therefore propose that the periodic threshold should be removed and all cancellations should be paid for at the higher rate, which more closely represents the actual value of the train. It should be noted that cancellations only occur when there is a larger type event, which are always highly disruptive, so we do not see the logic of why a threshold for cancellations is required. As every effort should be made by all parties to deliver the service to the customer having such a threshold sends out the wrong message about the reliability of rail freight.

6.0 SCHEDULE 4 POSSESSIONS REGIME

Highlights:

- Although not referenced in the consultation, improvements to freight Schedule 4 should be considered as part of PR18.
- The current rates are nowhere near cost reflective, meaning that freight operators lose money every time they agree a disruptive possession.
- More cost reflective rates would facilitate greater flexibility from FOCs and the increase in any Schedule 4 payments would be more than off-set by a reduction in Network Rail's costs through greater efficiency.
- Freightliner suggests a move to the cost reflective possession impact figures that are used by Network Rail's Industry Access Programme.
- We highlight the need for clarification to ensure that the SV&C regime under Schedule 8, as envisaged in the Track Access Contract, is used to compensate for catastrophic incidents on the network, as opposed to declaring Restrictions of Use under Schedule 4.
- We suggest a couple of improvements to the Schedule 4 regime to enable more optimal and transparent industry decisions.

6.1 Overview

The freight Schedule 4 is not discussed in the ORR consultation, which is surprising given the importance of this mechanism working well to enable the best overall industry decisions to be made. Freightliner suggests that there are a number of improvements to the freight Schedule 4 regime that could be considered as part of PR18 to ensure more transparent and optimal industry decisions.

6.2 Freight Schedule 4 rates

The current freight Schedule 4 rates are nowhere near cost reflective for the freight operators. The CP5 rates are, at best, a small contribution to costs and are a long way from reflecting anything like the magnitude of the impact that possessions have on freight operators.

This means that every time freight operators accept a disruptive possession proposed by Network Rail, they are losing money. It is not sustainable for freight operators to accept any more disruptive possessions than we do today, and even the current levels are very challenging as they result in running train services at a loss.

This means that when possession options are being discussed with Network Rail, the solution that maximises efficiency for Network Rail, is not always the one chosen. Freight operators are reluctant to accept increased possessions that result in increased costs and/or loss of revenue, which is not adequately compensated.

Although on the face of it further government funding would be required to support an increase to the Schedule 4 funding pot should payments to freight operators be increased, in reality such an increase would likely be more than off-set by a reduction in Network Rail's costs as a result of efficiency improvements. Having a more cost-reflective scheme would enable more optimal and transparent industry decisions.

We suggest that consideration is given to uplifting the payment rates to make them more reflective of the impact of possessions, and to support more holistic and optimal access decisions. Network Rail's Industry Access Programme (IAP) workstream developed proxy figures which are used to model the impact of proposed possessions on freight operators. These figures are presented in Table 4 below and are much more reflective of the actual financial impact that possessions have on freight operators. We suggest a move towards these figures in the recalibration.

Table 4: Revenue impact for FOCs of possessions - IAP

Category	Cancellation of service	Amendment to service
Bulk	£6k	£3k
Multi-Customer	£13.5k	£6k

Source: Network Rail Industry Access Programme

6.3 Access Charge supplements

We do acknowledge the current situation whereby freight operators do not pay an Access Charge Supplement (ACS), unlike the franchised passenger operators. However, it is important to note that the ACS paid by passenger operators is in effect an element of the franchise payment, which passes between the operator, Network Rail and the DfT.

Freight operators are not prepared to pay an ACS as there is so much uncertainty about Network Rail's future programme (CP5 delayed renewals and enhancements are a demonstration of this). As freight operators are national, unlike franchised operators, this risk is further exacerbated. Any ACS paid by freight operators would directly impact on their bottom line.

6.4 Refining the categories in Schedule 4

As the industry now has considerable experience of the freight Schedule 4 regime, there are a few areas that we suggest could be improved. In particular we highlight some inconsistencies in the current regime.

Freight operators are often compelled to agree possessions that reduce terminal times of their services. In turn this results in being unable to fully load trains, so a portion of the onward train is sometimes not loaded. This results in a frustrated customer and a reduced payment to the freight operator. A reduced terminal time is payable under Category 1 (where the retiming is greater than 60 mins), which is a liquidated payment of just £330 (at 2016/17 prices). The lost revenue in this scenario is considerably more than this, by some multiple. We therefore propose that where there is a reduction in terminal time that also results in a loss of goods moved for the customer; that this qualifies as a Category 2 claim under Schedule 4.

Currently when a train is diverted more than once on its journey or has two restrictive events occur to it, the freight operator can only make one claim for the train, either under Category 1 or Category 2 (as relevant). However, multiple possessions represent multiple costs for freight operators and therefore where two separate restrictive events occur it should be possible to claim twice under category 1 or 2 (as appropriate). This would at least acknowledge that double costs have been incurred, or that both costs (say for example a diversion) and losses (for instance a loss of gauge) have occurred.

In a scenario where a restriction on the network necessitates that the train completes an additional reverse move, often requiring the involvement of a shunter, this cannot be claimed under Schedule 4, despite additional cost being incurred by the freight operator. Freightliner suggests that in this scenario should qualify as a Category 1 claim under Schedule 4.

6.5 Schedule 4 imperfections

Catastrophic incidents on the network are becoming more frequent, and are now almost annual events – e.g. Harbury in 2015 and Lamington in 2016 and most recently the closure of Liverpool Lime Street. Claiming compensation for these events is very complex and time-consuming. For example Freightliner has not yet received payment from the Lamington viaduct slip that happened on New Year's Eve in 2015. This creates real cash-flow issues for freight operators, particularly as Category 3 events are typically quite large.

A key driver for this complexity is Network Rail changing the categorisation of these incidents to a 'Restriction of Use' very quickly post-incident. This prevents claims under Schedule 8 (which should cover unplanned disruption) and forces a Category 3 claim under Schedule 4 (which should cover planned disruption) at a later date. Section 7 of Schedule 8 of the freight model access agreement, headed Prolonged Disruption, suggests that this is the mechanism for dealing with these types of incidents. In reality though, Network Rail is quick to declare a 'Restriction of Use'.

Given that the Network Code/Planning Rules stipulates that 'Restrictions of Use' are consulted by Network Rail, we do not think that they should be used for performance incidents which are clearly not subject to consultation, and are in effect forced onto operators with no choice. We note the recent ADA31 case between Grand Central and Network Rail, which is very relevant here[19].

Payments under Schedule 8 are more cost reflective than under Category 1 or 2 of Schedule 4 – and so this liquidated regime would be the preferred method for compensating for these larger incidents, rather than resorting to complex claims, apart from in very exceptional circumstances.

We therefore suggest that changes should be made to the current Schedule 4 and 8, which clarify that Schedule 4 should not be used for unplanned disruption. This would support claims for major incidents to be handled via Clause 7 of Schedule 8, as intended.

[19] ADA31, Access Disputes Committee, http://www.accessdisputesrail.org/New%20ADC%20Web/Access%20Dispute%20Adjudications/ADA31%20Documents/Statement%20of%20Claim.pdf , 2017

7.0 Appendices

Please see appendices, which are attached separately.

Appendix A – Freight Efficiency Benefit Sharing scheme, LEK, 2014

Appendix B – Train load impacts on the Network Rail Payment Rate, LEK, 2013

OFFICE OF RAIL AND ROAD

Response to ORR's December 2016 Charges and Incentives Consultation

This pro-forma is available to those that wish to use it to respond to our consultation. Other forms of response (e.g. letter format) are equally welcome.

Please send your response to pr18@orr.gsi.gov.uk by **9 March 2017**.

Full name	Ian Kapur
Job title	National Access Manager
Organisation	GB Railfreight Ltd. (GBRf)
Email*	
Telephone number*	

*This information will not be published on our website.

Please make any comments regarding the questions in the accompanying text box. We welcome comments in relation to the information outlined in both the consultation document and supporting documents, or regarding the policy areas more generally.

Chapter 2: Infrastructure Costs

Fixed cost charges:

1. Do you support our proposal to levy fixed cost charges on all operators, including open access operators, to the extent that they can bear them (option 2)?

First and foremost, before any decision is made to levy non-discriminatory fixed costs, there needs to be absolute transparency in Network Rail‟s efficient costs and these also need to be credible. Currently this cannot be said to be true in either case.

Regulation 12 (1) (a) of *The Railways (Access, Management and Licencing of Railway Undertakings) Regulations 2016* states that the Infrastructure Manager must draw up a business plan which is designed for the purpose of ensuring optimal and efficient use, provision and development of the railway infrastructure. Optimal and efficient are key words, here, and these must be at the heart of any decisions made on charges.

With Network Rail currently overspending on CP5 renewals, the real injustice is that operators are likely to be asked to pay for Network Rail‟s poor project planning, inefficient delivery and massive overspends as the starting point for CP6. This is unacceptable to GB Railfreight.

The fixed cost figure drives so much that it needs to be thoroughly investigated, challenged and approved as the first step in this whole process. This is likely to take up far more time than is available for the PR18 review and GBRf suggests that this proposal might sit better in the PR23 review once some real and transparent work has been carried out and evaluated.

Taking into account the above, as well as other points raised in paragraph 3, GB Railfreight cannot support ORR‟s proposal to levy fixed cost charges on all operators as part of the PR18 review.

When the Brockley Consulting work was authorised, the industry was informed that the results from it would not directly lead to changes to charges as its scope was not sufficiently advanced to lead to that eventuality.

The scope and investigation from this report is nowhere near complete enough for any outputs to be used to directly influence changes to fixed charges. As stated, it is a pilot study and a much more detailed piece of work is needed to ensure that the transparency and credibility of which fixed charges, allocated to freight operators, might be essential.

Secondly, with respect to the "what the market can bear" test, there are very different forces at play depending on the commodity and customer involved. ORR needs to bear in mind that, at present, not all of the previous fixed cost elements have even been passed on to the customer. We also need to be clear that any mark-up to a segment, brought in by the "what the market can bear" test, must not price that market segments off the network.

Historically, and even for Periodic Review 13, there has been much work carried out on which segments of the market are able to bear such cost increases and the answers have been much the same. GB Railfreight does not believe that any additional market segments would be able to bear more fixed costs and those that currently do attract additional costs, even less so than in this Control Period.

The recently published *Freight Rail Usage 2016-17 Q3 Statistical Release* tells a story about how specific markets will not be able to bear any additional access charges.

GB Railfreight is on the opinion that track access charges for freight operators should continue to be based purely on the Freight Avoidable Costs and Freight-Only Line charges, as one combined charge, but ensuring that these costs are at an efficient level as possible.

Fixed cost freight charges:

2. Do you support our proposal to simplify the current charging regime by having a single freight mark-up charge?

GB Railfreight welcomes any simplification to the access charging regime. There are currently too many individual charges associated with freight services and they"re difficult for FOCs and our customers to fully understand. A simplified pricing structure also leads to easier price modelling for new-to-rail business and existing contracts throughout the life of a Control Period.

There is, however, some concern that individual routes will look to establish their cost bases in different ways and at varying levels of efficiency. This would lead to a more complicated set of Network Rail"s baseline charges with, poor understanding of the relative charging structures between each route. It is not unreasonable to look to base the efficiency element of any cost proposals on the methodology of the Network Rail Route that has shown the optimal and most efficient way of carrying out work. However, this would need to be backed up with real evidence that said work had, in fact, been completed within that allocated budget and to required standards and efficiencies.

Most importantly, this review should not concentrate on micro-analysing each separate charge to the final degree but more on the full effects of the combination of charges and how it might destabilise the rail freight market. The previous PR13 Review process spooked our customers and caused some serious concerns about whether or not investments they were going to make would become stranded due to potentially very high increases in costs. GB Railfreight is at pains to try to ensure this does not happen, again, during this review.

Fixed cost freight charges:

3. Do you support the recommendation to apply Network Rail's cost allocation methodology (discussed in this chapter) to freight mark-up charges?

GB Railfreight does not agree with the recommendation to apply this proposed methodology.

In discussing changes to charges and incentives, the Department for Transport has expressed a strong view that Office of Rail and Road should only push for change to the charging structure if it leads to a significant and better outcome for users. GBRf agrees with this view and is clear that this new cost allocation methodology, as proposed right now, will lead to a far poorer outcome for railfreight end-customers.

Indeed, in a recent Freight & National Passenger Operators‟ Route CP6 Workshop, several of GBRf‟s end-customers made it very clear that any marked increase in access charges would drive them on to road for the moving of their particular products.

The Office of Rail and Road‟s Section 4 duties must be at the heart of the access charges review. In particular, the following duties need to be paramount in people‟s minds:

- To protect the interests of users of railway services.
- To promote the use of the railway network in Great Britain for the carriage of passengers and goods.
- To promote efficiency and economy on the part of persons providing railway services.
- To enable persons providing railway services to plan the future of their businesses with a reasonable degree of assurance.
- To protect the interests of persons providing services for the carriage of passengers or goods by railway in their use of any railway facilities, which are for the time being vested in a private sector operator, in respect of the prices charged for such use and the quality of the service provided.

The key point underpinning aspects of the fixed charge elements of this consultation is that they must be based on optimal and efficient use, also provision and development of the railway infrastructure. As previously stated in paragraph 1, “optimal” and “efficient” are key and these must be at the heart of all the work that feeds into this area.

It is GBRf‟s view that ORR does not have this data and Network Rail, itself, is uncertain about its costs. During CP5, to date, there is no clear figure for Network Rail‟s maintenance, renewals and operational costs, given they‟ve been increasing throughout the Control Period.

GB Railfreight has been studying a recent ORR Financial Monitor of Network Rail and the currently emerging CP5 scenario is that ORR expects Network Rail to underperform by approx. 17% worse than the regulatory settlement. This also includes £179M of adjustments for missed regulatory outputs.

The Network Rail Initial Industry Advice document, published at the end of January 2017, states that it expects to need 14.2% more money in CP6 than in PC5 for core activities however, more shockingly, this translates to Network Rail core activity costs for CP6 being 34.4% more than the previously ORR-set determination for the end of CP5 By the end of Control Period 5, it is estimated that Network Rail will also have deferred £3.5 billion of work.

In no way can this type of cost performance, inefficiency and behaviour be used as a starting point for newly proposed CP6 charges through to 2024.

It is vitally important that the holistic final assessment of access charges is only considered once Network Rail‟s optimal and efficient costs are really known and understood. Not doing this leads to the grossly unfair scenario whereby the CP6 baseline would be set on Network Rail‟s very inefficient works activities and poor performance as outlined above.

Network Rail‟s efficiency target, as it is forecast for the end of CP5, must be a starting point in all aspects of this consultation before new CP6 efficiency targets are superimposed.

In addition, in a similar manner to what was used in Control Period 4, ORR needs to consider bringing forward some of Network Rail‟s efficiencies and take a 10 year view on efficiency targets, from 1st April 2019, given that Network Rail‟s costs are still increasing and not at its long-term efficiency levels.

In comparing CP6 fixed cost figures with CP5, GB Railfreight believes that there are now some redundant freight costs that need to be removed from the baseline figure for this charges review.

GB Railfreight reiterates that fixed charges for freight operators should continue to be based purely on the Freight Avoidable Costs and Freight-Only Line charges (combined as one charge) but ensuring that these costs are proven to be as efficient as possible for the reasons stated elsewhere in this document.

GB Railfreight believes that there are many freight lines, loops, sidings and other tracks that have been removed from the Network but the removals have not been accounted for in the current charges process. Any fixed cost allocation methodology needs to only based on the current Sectional Appendix and established Network Changes.

The list of “Freight-Only Lines” also needs reviewing, for accuracy and efficiencies, as Network Rail has removed and also downgraded certain lines. There is also the issue that FOCs believe that some purported freight-only lines contain sections used for passenger diversionary traffic or ecs movements.

In reviewing Network Rail‟s efficiencies and actual fixed costs, as part of this charges review, the following key areas need particular scrutiny and improvement targets set:

- Continuous lowering of track access charges derived from Network Rail‟s continuing efficiencies, as you‟d expect.
- Clarity and lockdown of work required in possessions, with the benefit of cost reduction this would bring.
- Numbers of Network Rail staff (including HQ numbers) required throughout CP6 as efficiencies improve.
- As elsewhere in Europe, a fit-for-purpose railway regularly available for freight traffic seven days a week, giving new and existing customers confidence to expand.

On the matter of charges caps, GB Railfreight is not of the view that the recent European Directive (2012/34/EU) and Implementing Act (EU 2015/909) necessarily precludes the use of a capping facility for new charges, as described in the consultation document.

Condition 18 of this act states: *Given that railway undertakings need predictable charging systems and have reasonable expectations for the development of infrastructure charges, the infrastructure manager should provide a phasing-in plan for railway undertakings operating the train services that may see their charges significantly increase following a review of the implementation of the existing calculation modalities, if such a phase-in plan is required by the regulatory body.*

The second part of this condition, clearly states that “following a review of the implementation of the existing calculation modalities….”. Nowhere does it state that a review needs to have created a new methodology for a cap to be applicable. It, actually, states that the Infrastructure Manager should provide a phasing-in plan following a review (any review) that may see railway undertakings‟ charges significantly increase.

The *meaning* of this condition is clear to GB Railfreight. If the implementation of any review of charges methodology, whether fundamentally changed or not, may lead to a significant increase of charges, the Infrastructure Manager should provide a phasing-in plan. The word “may” is also important here, as a review of the methodology does not necessarily have had to definitely given rise to a significant increase of charges, but just a likelihood.

Nowhere does the Directive or accompanying Act signify that what I have described above cannot be implemented. Exactly the opposite, in fact.

GB Railfreight urges ORR to seek legal clarity on this point and, for the reasons stated above, fundamentally disagrees to the current proposal of not providing caps, or phasing-in plans, for any of the freight charges.

Station charges:

4. **Long term charge (LTC):** Do you support our recommendation that the methodology for the LTC at managed stations be recalibrated?

GB Railfreight has no view on this charge.

Station charges:

5. **Qualifying expenditure (QX):** Do you agree with our recommendation that we support the work to make total QX charges more transparent at both managed and franchised stations?

GB Railfreight has no view on this charge.

Chapter 3: Short-run variable charges package

Variable usage charge (VUC):

6. Do you support our recommendation not to make fundamental changes to the VUC for PR18?

Freight operating companies, and their customers, need simple and predictable charging systems, ideally fixed for 10-15 years, to be able to plan the future of their businesses with a reasonable degree of assurance and not risk being left with stranded investments. To this end, GB Railfreight supports ORR"s recommendation not to make fundamental changes to the Variable Usage Charge.

ORR needs to be aware that the rail freight markets are very competitive, especially with road haulage, and that a change in the structure, or even a modest change in the VUC rates for certain vehicle types, will price some flows off rail to road.

A fundamental point GBRf would like ORR to review is the principle of greater incentives and better rewards for operators introducing track-friendly wagons onto the network. A range of VUCs is created due to wear and tear from a particular loaded and unloaded wagon type that, in turn, is down to bogie, suspension type and axle weights.

There needs to be far more differentiation between "bad" and "good" wagons, with preferential VUCs for track-friendly bogies than in the present charges lists. Currently, with charges differentiated as they are, there is no real incentive for operators to invest in new wagons as there"s little financial reward. This needs to change as it sends out completely the wrong signals. This is discussed in more detail in Paragraph 7, below.

As an example, GB Railfreight believes that Network Rail (also an operator) has some of the oldest vehicles on the network, that are used regularly for moving materials in and out of possessions. These have very poor suspension characteristics and can cause more damage to tracks than some other wagons however they do not currently feature in the PR18 charges review. They should do, not least because wear and tear costs make up about 85% of the VUC but, critically, to incentivise their removal from the network and encourage replacement with wagons that have track-friendly bogies.

Variable usage charge:

7. Do you have any suggestions for „recalibration" style changes to the VUC you would like to see considered for PR18 implementation?

As discussed, greater track damage is caused by old bogies types, such as Gloucester bogies, and therefore a far greater proportion of the track damage costs should be applied to these.

GB Railfreight is committed to ensuring that its entire fleet is running on track friendly/low noise bogies by April 2019 and we would want our investment in this action to be rewarded with fairer, more advantageous rates.

An important item of detail relating to the above point is that the VUC calculator, currently in use for establishing rates, is unfit for purpose. There is no ability to input the pertinent and advantageous data relating to bogie characteristics that now exists, and which has done since the CP5 determination of charges.

This is clearly the main driver of the VUC rate and it is inadequate and unfair only to have the choice of 3-Piece, Y25 and TF25 bogies. There needs to be more options to apply additional suspension bands that are very specific to the wagon type in question.

If the VUC laden rate of a particular wagon is to be applied based on an average carrying weight, then ORR needs to ensure that all wagons on the pricelist do not indicate the Gross Laden Weight as the average, as occurs now. By doing so, FOCs are currently paying far more track access cost, for actual product carried, than should be the case.

GBRf believes that Network Rail should be able to run off an entire list of all the different average weights for each wagon/commodity mix and ensure that these are applied fairly across the VUC pricelist.

Additionally, it isn‟t clear why there are different VUC tare rates when applied across multiple commodities. For example, why is an “Industrial Mineral” empty service charged differently to a “Construction Material” empty service that uses the same wagon? This appears to be a needless discrepancy and needs addressing for CP6. Obviously, GBRf would like to ensure that that the higher rate is not automatically applied.

The default VUC rate has proven to be a real issue for GB Railfreight, where the use of existing wagons, conveying a commodity with which it has previously been un-associated, has resulted in the new flow being charged at the very inflated default rate.

What needs to be in place is a rate for all existing wagons, combined with all potential commodities that can be conveyed, before we enter a new Control Period. For new wagon types, it is impossible to supply Network Rail with an average operating weight as the flow will not have actually yet run at the time of application. Therefore, the new relevant rate cannot be established until the vehicles have actually operated for a short period of time, thus giving a fair average of the operating weight. Merely assuming the Gross Laden Weight of a wagon, as the only possible input to an access charge, is creating a large distortion on what should be beneficial VUC rates to FOCs.

By only setting up the Gross Laden Weight, this actually puts new track-friendly bogie wagons at a similar rate to existing wagons on poor track-damaging bogie types. There needs to be an agreed process for this, with pro-active support from the Network Rail Freight Team and track access billing section. The easiest solution is to remove the default charge entirely and apply the highest established rate (if available) until a new rate is established.

Freight haulage of new passenger multiple units is being dealt with in a very poor manner by Network Rail. As an example, it has taken almost two years to reach a point where specific VUC rates are established for:

a) locomotive haulage of new multiple units.

b) the running of new multiple units under their own power by a FOC. As usual, the FOC picks up the bill by paying default charges until correct rates can be agreed, often with the involvement of several parties.

There needs to be a far greater commitment to establishing accurate rates for these movements, far more quickly, combined with a clear customer-friendly process for creating a rate for new bespoke operations as outlined above.

There are going to be many more of these types of movements as brand new multiple units are built and delivered, with older units moved around the country for use with new TOCs or for scrapping.

There certainly needs to be a more complete understanding of the effects of high-speed running (>75mph) and greatly increased frequencies of these fast services on both plain line and S&C infrastructure. In previous periodic reviews, the combined effects of high-speed running and increased frequencies did not appear to have been taken as seriously as now.

It is also clear that running freight wagons at lower speeds will cause less wear and tear to plain line track, S&C and structures such as embankments. We know this as Network Rail routinely imposes lower speed restrictions for wagons that have a certain axle weight in order to minimise damage over specific sections of infrastructure. That much is clear.

GB Railfreight believes there is, therefore, some merit in having discounted VUC rates for wagons running at different speeds given each would cause different levels of wear and tear.

Capacity charge (CC):

8. Do you support our recommendation not to replace the CC with adjustments to Schedule 8 benchmarks?

As stated in Periodic Review 13, the current Capacity Charge over-recovers money from freight operating companies and should not be used as a mechanism for charging for performance benefits. Its objective is to neutralise the Schedule 8 risk of additional services entered into the timetable, over and above the baseline CP6 level of service taken for the charges review.

GB Railfreight certainly does not support any recommendation that leads to the Capacity Charge being "washed up", with Schedule 8 benchmarks, without having prior visibility and full understanding of the mechanics and actual numbers that are to be used in the recalibration. It is clear that the accurate and transparent methodology, and final benchmark figures, for TOCs has a massive effect on the FOC benchmark, and its costs, therefore GBRf wishes to see every step of how recalibration is carried out.

Capacity charge:

9. Do you think we should: (a) retain the existing CC (but remove the caps on open access, freight and charter operators); (b) remove the existing CC and recover lost revenue through fixed cost charges; or (c) do you have any alternative proposals?

GB Railfreight does not agree with a proposal that would lead to the removal of caps for freight operating companies‟ access charges nor does it believe there is a necessity to do so.

As previously mentioned towards the end of paragraph 3, on the matter of charges caps, GB Railfreight is not of the view that the recent European Directive (2012/34/EU) and Implementing Act (EU 2015/909) necessarily precludes the use of a capping facility for new charges, as described in the consultation document. Nowhere does the Directive or accompanying Act signify that what I have described above cannot be implemented. Exactly the opposite, in fact.

GB Railfreight urges ORR to seek legal clarity on this point and, for the reasons stated above, fundamentally disagrees to the current proposal of not providing caps, or phasing-in plans, for any of the freight charges.

Currently, capacity charging for freight is split into a single rate for weekdays and one weekend rate for Saturdays or Sundays. Purely to stimulate freight growth to run on days where there is more capacity, GBRf believes there should be a capacity charge rate, reduced even further, for freight trains operating on Sundays.

Traction electricity charge:

10. Do you support our recommendation to keep the loss incentive mechanism?

GB Railfreight supports keeping this mechanism.
Electricity asset usage charge (EAUC): 11. Do you support our recommendation that the EAUC not be altered, beyond recalibration, in PR18?
GB Railfreight supports not altering this charge beyond recalibration.
Coal spillage charge (CSC): 12. Do you support our recommendation to abolish the CSC?
GB Railfreight supports the removal of the Coal Spillage Charge.

Chapter 4: Contractual Incentives Regime

Schedule 8: 13. **Passenger compensation:** What are your views on the options of passenger compensation recovery and improving the transparency of compensation relating to Network Rail‟s actions?
GB Railfreight does not believe these costs should be combined in the Schedule 8 regime as it will lead to FOC payments increasing. Schedule 8 should only concentrate on compensation for expected long run revenue losses. This part of the process needs to be more transparent with checks and balances to be put in place to see if the expected losses actually materialise when taking into account actual performance levels. We believe that the threshold for cancellation of trains under the Schedule 8 regime should be removed and that short notice cancellations should all be paid at the higher rate as it is far more representative of the typical value of a freight service. Currently, there‟s a perverse incentive for Network Rail to cancel services, at short notice, which is not what we or our customer want in times of disruption.

Schedule 8:

14. **Approach to setting benchmarks:** Do you support our recommendation to only make changes to delink passenger operator benchmarks and Network Rail benchmarks for freight operators from past performance (but to leave the approach to the other benchmarks unchanged)?

GB Railfreight does not agree that Network Rail‟s freight benchmarks should be set on past performance. There was, and still is, serious concern in the freight industry that Network Rail freight benchmarks were set at too high a level at the start of Control Period 5. This has been acknowledged by ORR, on 27th February 2017, in the Freight Schedule 8 Recalibration Meeting (Presentation - Slide 11). Network Rail freight benchmarks should be set based on past performance with a % uplift to incentivise Network Rail to improve year on year.

The skewing of the payment rate : freight benchmark needs to be altered to be far more balanced and fair, with equivalent good levels of performance being cost-neutral.

Currently, TOC payment rates are set at a level that includes an element of compensation for lost future business caused by delayed or cancelled trains. The FOC payment rates do not contain any element for reputational loss or lost business but should do as the result of poor performance and cancellation is similar. This same element ought to be included in the level of payment rates.

In recalibrating the Schedule 8 benchmarks, there also needs to be a far broader sample of performance data (e.g. 5 years) so as to more truly reflect Network Rail‟s and FOCs‟ actual performance. The PR13 data sample was random in nature and wasn‟t broad enough for setting realistic benchmarks. This meant that Network Rail was, in effect, being rewarded for previous poor performance and FOCs penalised for their good performance. GB Railfreight does not want this to occur again in this periodic review.

Just one specific example of where Schedule 8 can be a bit obscure – GBRf, for example, is penalised if it delays a passenger ecs movement but Network Rail does not then pay this out to the affected TOC. This seems at odds with one of the purposes of Schedule 8 which is to compensate operators. That money, not paid out to the TOC shouldn‟t be accrued as a performance "slush fund".

Schedule 8:

15. **Measure of passenger operator performance:** Do you support our recommendation to change the measure of passenger operator performance to one based on the delay caused to other operators?

GB Railfreight does not support this proposal and would not wish to see any inadvertent consequences for freight operators. In addition, with little money likely to be available in CP6, the current level of resources in Network Rail would not allow for the increase in delay minute disputes to be resolved in a timely manner for all.

Schedule 8:

16. **Sustained poor performance (SPP) provisions:** Do you support our recommendation to limit SPP to costs compensation only?

GBRf does not support this proposal, although SPP is very rarely used the freight operators could find themselves in a situation where customers choose to use another operator or another transport mode as a result of poor performance, and having the mechanisms in place to be able to recover costs and revenues should be available to the operators.

Schedule 4:

17. Do you support our recommended prioritisation of schedule 4 issues? If you think we should reconsider any of the areas we have de-prioritised please submit supporting evidence.

GB Railfreight does not believe that the FOC Schedule 4 regime is fit for purpose as it does not compensate freight operators for the loses it incurs. The triggers for compensating operators for possessions <12 weeks out and > 12 weeks out are not aligned and need to be. The current rates are merely a contribution towards additional costs that FOCs incur for diverting or re-timing services away from possessions. This is particularly the case for possessions >12 weeks out where additional train crew are required for diversionary routes or services have to run at a shorter length, thus not contractually delivering to our customer. An example of this is given in paragraph 18, below.

Two to three years ago, the Industry Access Programme workstream engaged with FOCs to develop some proxy figures to use in measure financial impact to FOCs for diverting or cancelling trains. These were far more realistic that current Category 1 and 2 claims figures and it is to these that we need to aspire. This will also encourage FOCs to collaborate more with possession proposals as it would be compensated far more closely to its loss.

FOCs are often pushed to agree to reduced terminal times, for loading and unloading product, in order to clear a route before the possession start time. This leads to trains not being fully loaded or unloaded and claims by our end-customers which are then not compensated by the Schedule 4 regime.

A reduced terminal time, from the booked WTT service, should be a Schedule 4 trigger under Category 2 rather than Category 1 to begin to compensate for real losses incurred.

A further Schedule 4 alteration that needs to be considered is additional Schedule 4 compensation for freight services that are diverted or altered more than once. If a train is diverted over a route that is more than10 miles compared to its booked route, and it also has to run with different gauge or fewer wagons, there are wear & tear/fuel costs for the first diversion and some serious lost revenue from the second part of this scenario.

Schedule 4:

18. Do you wish to submit relevant evidence regarding: (a) processes associated with planning possessions; and/or (b) planning alternative arrangements to deal with planned disruption (e.g. the notification that is needed to arrange bus replacement services)?

In general terms, for freight services, the Schedule 4 regime should incentivise all parties to endeavour to keep freight services running, via suitably capable diversionary routes, and not just look to pay FOCs for not running the service.

GB Railfreight has a real and relevant example whereby the lack of relevant Schedule 4 triggers threatens to leave GBRf will a bill that cannot be compensated by the current regime.

With some late notice possession requests for the North West Electrification Project recently proposed, there‟s a requirement for GBRf to re-time its service to two aggregate terminals close to Manchester. Accommodating the desired possessions has meant that GBRf will have to cut down the terminal times in order be able to cycle the wagons around in 24 hours however the lack of a Schedule 4 trigger means that the optimal possession, or anything close to it, will be unlikely to be chosen.

This example is made worse as there are other FOCs also trying to cycle their services into the same terminals and, taken to the final degree, the end freight customer will tend to lose out. This is not what Schedule 4 is designed to do.

Aligning operator and network rail incentives:

19. Do you have any views on how financial incentives could be improved to encourage collaboration between Network Rail and operators to reduce industry costs?

The overhaul of the Schedule 4 regime, and a more realistic operator rate, will go a long way to ensure that money can be saved in agreeing optimal possessions and then, potentially, the largest industry cost reduction. This area offers the most significant cost savings.

OFFICE OF RAIL AND ROAD

Response to ORR's December 2016 Charges and Incentives Consultation

This pro-forma is available to those that wish to use it to respond to our consultation. Other forms of response (e.g. letter format) are equally welcome.

Please send your response to pr18@orr.gsi.gov.uk by **9 March 2017**.

Full name	Charlie Hodgson
Job title	Managing Director, Rail Development
Organisation	Go-Ahead Group
Email*	
Telephone number*	

*This information will not be published on our website.

Govia is one of the leading rail operators in the UK and is a joint venture between the Go-Ahead Group (65%) and Keolis (35%). Govia has experience running complex and challenging rail operations; currently running three major rail franchises: GTR, Southeastern and London Midland. Govia is the UK's busiest rail operator, currently providing around 35% of all passenger journeys. As a key provider of rail services, we welcome the opportunity to respond to the ORR's consultation regarding the 2018 periodic review.

This response represents the views of the three Govia-owned Train Operating Companies as well as Go-Ahead Group plc. Go-Ahead has contributed to the industry response prepared by RDG and this is intended to supplement that response.

Chapter 2: Infrastructure Costs

Fixed cost charges:

1. Do you support our proposal to levy fixed cost charges on all operators, including open access operators, to the extent that they can bear them (option 2)?

We support the proposal to recover fixed costs from all passenger operators, including open access operators. We agree that open access operators should contribute fairly to the fixed costs of running the rail network. We would however like to understand more regarding the market can bear test proposed in the consultation, in order to form a firm view on this proposal.

We are also pleased that the ORR intends to revisit the 'not primarily abstractive' (NPA) test that it applies when granting access to open access operators, as we have concerns as to whether this test is still fit-for-purpose. We have recently seen open access applications approved by the ORR which we had challenged as being primarily abstractive and which largely replicate existing service offerings provided by other operators. Furthermore, judging by the relatively low proportion of open access applications that seem to fail the NPA test, we would suggest that the benchmark for the test needs to be reviewed as we consider that the threshold is currently set too low.

Fixed cost freight charges: 2. Do you support our proposal to simplify the current charging regime by having a single freight mark-up charge?
Go-Ahead Group is not currently affected by freight fixed cost charges and it would therefore not be appropriate for us to comment on this particular proposal.
Fixed cost freight charges: 3. Do you support the recommendation to apply Network Rail's cost allocation methodology (discussed in this chapter) to freight mark-up charges?
Go-Ahead Group is not currently affected by freight fixed cost charges and it would therefore not be appropriate for us to comment on this particular proposal.
Station charges: 4. **Long term charge (LTC):** Do you support our recommendation that the methodology for the LTC at managed stations be recalibrated?
In principle, we support the proposal to improve the methodology used to calculate the Managed Stations Long Term Charge (LTC). Moving towards more accurate costs is welcomed as this will allow our operating companies to plan better, we would however like to understand more about how the netting-off referred to under paragraph 2.38 would work in practice before we are able to form a firm view on this proposal. With regards to the alternative models of station ownership and management, such as full repairing leases referenced under paragraph 2.44, we recognise that this is a regulatory 'black hole' and we would support this being addressed. As beneficiary of a station which is owned or managed in such a way, we currently have no certainty of ORR regulatory support.
Station charges: 5. **Qualifying expenditure (QX):** Do you agree with our recommendation that we support the work to make total QX charges more transparent at both managed and franchised stations?
We agree that there are benefits to making the station QX charge more transparent, and these costs could be grouped on either a regional or DfT-station category basis for more effective comparison. As part of the annual QX process, we have raised significant concerns about the levels of cost that Network Rail charges operators for operating major stations, and the lack of financial incentive for them to identify and pursue financial efficiency savings. This has resulted in some protracted disputes with Network Rail over the setting of QX rates. Therefore, the ability to compare Train Operating Company (TOC) managed stations QX with Network Rail Managed Stations QX (where these stations have a comparable size and facilities), would perhaps be beneficial.

We agree that publishing the data within the industry would be helpful in identifying best practice and improving efficiency across the industry, however we have significant concerns regarding the wider publication of this data in the public domain, as it would potentially compromise some commercially sensitive information. We do not therefore believe it would be in the industry's interest to share this financial information publicly, and it could create an administrative burden to explain these costs to those without industry knowledge (for example in the event of FOI requests). We believe it would unnecessarily attract public attention, which would be unhelpful.

We strongly support the proposal to align the timings for the calculation and approval of the management fee element of the QX charge at Managed Stations with the Periodic Review process.

Chapter 3: Short-run variable charges package

Variable usage charge (VUC):

6. Do you support our recommendation not to make fundamental changes to the VUC for PR18?

We would support some level of Variable Usage Charge reform; however, we agree that a fundamental reform (such as the geographical disaggregation of charges by Route) should not be considered a priority for PR18. Whilst we support the ORR's proposals to make minor changes and recalibrate, we would urge caution regarding the administrative burden on operators. There is also a risk of reworking analysis which was already conducted with the industry in CP4.

Variable usage charge:

7. Do you have any suggestions for 'recalibration' style changes to the VUC you would like to see considered for PR18 implementation?

Timing-wise, we would like the ORR to take account of other local recalibrations. Operators may already have a series of recalibrations on the horizon, for infrastructure changes, transferring services and CP6 for example. We would suggest that recalibrations are conducted together wherever possible in order to minimise the administrative burden.

Capacity charge (CC):

8. Do you support our recommendation not to replace the CC with adjustments to Schedule 8 benchmarks?

We support the ORR's recommendation not to replace the Capacity Charge with adjustments to Schedule 8 benchmarks.

Replacing the Capacity Charge with adjustments to the Schedule 8 benchmarks would create a situation where all operators on a particular route would suffer from higher Network Rail benchmarks regardless of whether they increased their capacity usage. It would be complex and there would be a time lag before benchmarks were adjusted.

There is also the question of materiality; how significant the change would need to be to trigger a recalibration and how frequently the recalibration would take place. Operators are likely to have at least two timetable changes annually, many more in some cases, making this approach seem unmanageable.

Capacity charge:

9. Do you think we should: (a) retain the existing CC (but remove the caps on open access, freight and charter operators); (b) remove the existing CC and recover lost revenue through fixed cost charges; or (c) do you have any alternative proposals?

In terms of incentivising different behaviours, it must be recognised that franchised operators often do not have the option to run on alternative routes or at alternative times, due to tightly-specified Service Level Commitments dictated by the franchising authorities. This effectively removes much of the intended incentive properties of the Capacity Charge mechanism, other than in the event of a franchised operator running commercial services at the margins. The levying of the Capacity Charge therefore just becomes another ‘sunk’ cost (like the Fixed Track Access charge) that is costed-in by franchisees as part of the bid process. The proposal to remove the Capacity Charge entirely and absorb these costs into the Fixed Track Access rates – as proposed in Option (b), therefore has some logic.

We agree with the RDG response that the focus seems to have shifted to the incentives that the Capacity Charge gives to operators with regard to the number of trains they run, rather than the original intent which was to remove Network Rail’s financial disincentive to allow additional traffic onto its network. From an overall industry point of view, we agree with the RDG statement that there does not appear to be a coherent set of incentives to encourage Network Rail to find additional capacity.

Traction electricity charge:

10. Do you support our recommendation to keep the loss incentive mechanism?

We do not support retaining the traction electricity charge in its current form. In areas with a large wash-up (i.e. DC networks) the wash-up is largely a function of inaccurate consumption rates and not necessarily related to the effect of losses. Therefore, exposing Network Rail to the wash-up cannot effectively incentivise it to manage losses; all it does is allow Network Rail to retain an over-payment due to poorly calibrated EC4T consumption rates.

That said, traction electricity is a significant line item in any operator’s business, and any efficiencies or mechanisms which help us to plan and forecast better would be welcomed.

Electricity asset usage charge (EAUC):

11. Do you support our recommendation that the EAUC not be altered, beyond recalibration, in PR18?

We support the ORR’s recommendation for the EAUC to remain the same; combining it with the VUC is likely to be an administrative burden, reduce transparency and bring few benefits.

Coal spillage charge (CSC):

12. Do you support our recommendation to abolish the CSC?

Go-Ahead Group is not currently affected by the Coal Spillage Charge and it would therefore not be appropriate for us to comment on this particular proposal.

Chapter 4: Contractual Incentives Regime

Schedule 8:

13. **Passenger compensation:** What are your views on the options of passenger compensation recovery and improving the transparency of compensation relating to Network Rail's actions?

We support the approach to allow passenger operators to recover the costs of compensating passengers from Network Rail. The Schedule 8 regime acts as a proxy for this; creating a direct linkage would perhaps have a positive PR impact however it would not necessarily change incentives.

Publishing passenger compensation levels and attribution of these costs between operators and Network Rail would not be helpful as this would highlight the difference between Schedule 8 payments and passenger compensation, when the relationship between the two is poorly understood and often (perhaps deliberately) misrepresented in the media. It may also be unhelpful to draw attention to the level of Network Rail failures in this context as passengers are not interested in who is at fault; their contract is with the operator.

In the future, it may be beneficial to create a centralised independent system to attribute and compensate for delays on behalf of the whole industry, however we recognise that this would not be achievable for the next Control Period.

Schedule 8:

14. **Approach to setting benchmarks:** Do you support our recommendation to only make changes to delink passenger operator benchmarks and Network Rail benchmarks for freight operators from past performance (but to leave the approach to the other benchmarks unchanged)?

We agree with the proposal to keep the current principle of aligning Network Rail benchmarks with Network Rail punctuality targets, however it is important that the punctuality targets are stretching but achievable. Experience in CP4 suggests that if performance targets become unachievable then Schedule 8 ceases to act as an incentive measure to Network Rail. On some Routes in CP5 this has already been the case, with Network Rail currently paying considerable sums of money to operators through Schedule 8 as its punctuality benchmarks (which increase each year through the Control Period) have already become unachievable.

In our opinion, setting such unrealistic targets has led to Network Rail becoming disengaged and lacking incentive to try to achieve its targets - being relatively immune financially from the impact of large Schedule 8 payments due to its publicly-funded structure.

On the other hand, experience with the WCML in PR13 was that a failure to meet its challenging performance targets in CP4 resulted in the overall benchmarks being lowered for CP5. Lowering benchmarks on the basis of poor past performance weakens the incentives for Network Rail and operators to improve their performance; because poor performance is just being effectively rewarded with lower targets.

Going forwards, Network Rail's benchmarks must be consistent with the level of funding received by Network Rail and must be realistically achievable. It is also important that Schedule 8 benchmarks align with the performance targets contained in Franchise Agreements; in recent franchises we have seen a fundamental misalignment of performance targets. Ideally Network Rail and operators should have the same KPIs including a customer facing measure, such as customer lost hours for example. As well as a lack of consistency in performance targets, there is also misalignment in terms of enforcement as operators are subject to breach and default levels built into their benchmarks whilst Network Rail is not penalised in this way.

Schedule 8:

15. **Measure of passenger operator performance:** Do you support our recommendation to change the measure of passenger operator performance to one based on the delay caused to other operators?

Through this proposal, there is a significant risk that Network Rail is no longer incentivised to minimise reactionary delay as it would no longer be exposed to the financial risk and operators would instead be penalised for decisions made out of their control by Network Rail. This risk is in part mitigated by the fact that Network Rail is measured on industry performance, which would worsen if reactionary delay worsened. Nevertheless, this is a significant issue which must be given due consideration.

For this reason, we are very concerned that Network Rail should retain a role as System Operator to directly intervene to recover from delays, irrespective of the primary cause of delay. We also have concerns regarding the complexity and reliability of the regime, including what evidence would be required to demonstrate that an operator has been impacted.

In order to achieve the same benefit of only compensating when a delay is actually caused, cancellations could be excluded from the determination of delay. We would be supportive of a change which reduces the relative risk of over-payment by operators; currently train cancellations are included in Schedule 8 as reactionary delays despite often not causing any delay to other operators. The GTR franchise in particular has suffered from the current regime during the industrial action on Southern, where many services were cancelled and therefore were deemed to have caused reactionary delay, which clearly they did not.

Schedule 8:

16. **Sustained poor performance (SPP) provisions:** Do you support our recommendation to limit SPP to costs compensation only?

We can see the benefit of limiting SPP to cost compensation only, as this would reduce the time it takes for Network Rail to authorise claims, however operators must be compensated fairly for the genuine impact of SPP. SPP provisions must also factor in lost revenue, unless Schedule 4 and 8 is calculated to take into account the long-term revenue impacts of SPP.

We would want to understand the further thinking on this before concluding our view on the intent and scope of the provision including the thresholds.

Schedule 4:

17. Do you support our recommended prioritisation of schedule 4 issues? If you think we should reconsider any of the areas we have de-prioritised please submit supporting evidence.

In terms of Schedule 4, we agree that the three areas listed; incentives created by Notification Discount Factors, the way in which the Access Charge Supplement is calculated and bespoke compensation arrangements are the highest priority areas for improvement in PR18.

In particular, the Access Charge Supplement should be addressed. With the current system, operators pay Network Rail a pre-set ACS amount throughout the Control Period - on the basis that if Network Rail delivers its committed volumes of maintenance and renewal work then the Schedule 4 receipts back to operators should balance the ACS payments. However, Network Rail under-delivered significantly in terms of renewal volumes in CP4, resulting in a windfall payment for Network Rail as the ACS payments received from operators greatly exceeded its Schedule 4 outgoings. To correct the risk of this imbalance we therefore believe there should be a 'wash-up' process to reimburse operators for payments made where access is not taken.

This particular issue is further compounded by REBS, where operators are penalised for Network Rail non-delivery. Operators are therefore financially penalised twice through these regimes for something which is beyond their control.

Schedule 4:

18. Do you wish to submit relevant evidence regarding: (a) processes associated with planning possessions; and/or (b) planning alternative arrangements to deal with planned disruption (e.g. the notification that is needed to arrange bus replacement services)?

Go-Ahead Group has no comments in this area.

Aligning operator and network rail incentives:

19. Do you have any views on how financial incentives could be improved to encourage collaboration between Network Rail and operators to reduce industry costs?

The consultation seems to start from an assumption that TOCs and Network Rail do not already collaborate. This is false. Through our alliances, Network Rail and operators do collaborate on a variety of subjects which will have an impact on the financial regimes, such as:

- Schedule 4 compensation through our collaboration in engineering access minimising costs.
- Working together to improve data quality in delay attribution, ultimately allowing both parties to drive action in areas for improvement, therefore mitigating delays and overall performance.

The Capacity Charge and REBS have not worked, and we believe that incentives based on regulated charges in this area are unlikely to be effective.

Aligning operator and network rail incentives: 20. Do you have any views on the cost categories you think could be controlled by operators and whether these costs would be suitable as the basis of a potential future mechanism?
There are no Network Rail costs which operators have any control over. We disagree with the current REBs regime and the costs categories which have been included. We do not believe that any new mechanism will drive collaborative behaviour as there are already sufficient incentives on both parties. It may be better to report on the work that operators and Network Rail are undertaking in terms of alliancing.

Thank you for taking the time to respond.

Greater Anglia response to ORR’s December 2016 charges and incentives consultation

Chapter 2: Infrastructure Costs

Fixed cost charges:

1. Do you support our proposal to levy fixed cost charges on all operators, including open access operators, to the extent that they can bear them (option 2)?

Yes GA supports the principles of more transparency in cost allocation and better reflectivity of actual costs.

Chapter 3: Short-run variable charges package

Variable usage charge (VUC):

2. Do you support our recommendation not to make fundamental changes to the VUC for PR18?

Yes GA supports ORR’s recommendations not to make fundamental changes to the VUC.

Variable usage charge:

3. Do you have any suggestions for ‘recalibration’ style changes to the VUC you would like to see considered for PR18 implementation?

GA does not view this as a priority for PR18.

Capacity charge (CC):

4. Do you support our recommendation not to replace the CC with adjustments to Schedule 8 benchmarks?

Yes we fully support this recommendation.

In our view, attempting to achieve cost recovery by adjusting the Schedule 8 benchmarks will only muddy the waters further by adding an extra layer of complexity to the Schedule 8 regime in trying to accommodate an incentive property it simply was not designed for.

We disagree with ORR’s view that the purpose of the Capacity Charge is poorly understood. We believe that it is quite clear that the Capacity Charge is a mechanism for which the sole intention is for Network Rail to recover its marginal costs in relation to Schedule 8 recoveries following the introduction of additional traffic on to the network. We believe it is wrong to ascribe any sort of incentive properties to this charge as this was not the fundamental purpose or intent of the charge. Therefore to say that “the purpose of this charge is poorly understood and this dampens the incentive effect” is not correct and ORR should be attempting to clarify this point and not muddy the waters further. If part of the perceived problem is that the charge is too complex to begin with, then trying to attribute further incentive properties to it is not going to solve this problem. We agree that a knock on effect of the charge by levying a fee on operators is that it may be argued price signals are sent to operators about introduction in traffic of further services on the network. However if the intention is to make this charge truly a means of incentivisation then the charge first needs to be fully reviewed. If ORR believes that the purpose of the Capacity Charge is to do anything other than allow Network Rail to recover its marginal costs then it must consider implementing a charging regime that is specifically designed to address and provide economic incentives in the other areas on both parties, as well as allowing Network Rail to recover its costs in respect of Schedule 8 recoveries.

Capacity charge:

5. Do you think we should: (a) retain the existing CC (but remove the caps on open access, freight and charter operators); (b) remove the existing CC and recover lost revenue through fixed cost charges; or (c) do you have any alternative proposals?

We can see that it might be tempting to succumb to the advantages of a simple “quick win” of removing the Capacity Charge and recovering Network Rail’s lost revenue via the fixed charges however we believe that it would be a shame to disregard this opportunity to create a new mechanism which does what the industry clearly needs it to do i.e. allow Network Rail to recover its costs appropriately, send signals to operators about the relative costs of the introduction of new service on the network and create new incentives on Network Rail to grow traffic on the network.

We also note that a return to recovery through fixed charges is potentially cumbersome, given that it will lead to another transactional cost, Network Rail seeking possibly excessive charges and potentially a return to the behaviours which introduction of the Capacity Charge was intended to remove.

Traction electricity charge:

6. Do you support our recommendation to keep the loss incentive mechanism?

We are generally supportive of this approach to retaining the loss incentive mechanism however we are cautious about the ORR’s reasons for continuation for the mechanism. It was always the case that an incentive mechanism to reduce transmission losses would never be a short term measure given the level of investment required by Network Rail to address the problem directly. Therefore expecting to see evidence of changes in Network Rail’s behaviour after 3 years of the control period would seem to be an optimistic expectation. However supporting its retention because it appears to have incentive properties other than those for which it was intended seems to be a rather flimsy justification for retaining the mechanism, especially given that it has caused additional money flows from operators to Network Rail. It would seem to us on that basis there are more compelling arguments to remove the charge if ORR is not content to sit it out for another control period to see if the intended incentive properties come to fruition in the longer term.

Electricity asset usage charge (EAUC):

7. Do you support our recommendation that the EAUC not be altered, beyond recalibration, in PR18?

GA is content with this approach.

Chapter 4: Contractual Incentives Regime

Schedule 8:

8. **Passenger compensation:** What are your views on the options of passenger compensation recovery and improving the transparency of compensation relating to Network Rail's actions?

We agree with ORR's view that a formulaic approach would be the most pragmatic way to achieve the recovery of passenger compensation costs and we understand that developing this option may not be achievable in the PR18 time frame.

However we do not necessarily agree that the alternative option is as difficult or as complex as envisaged. Historically, whilst Passenger's Charter was in operation several train operators used to claim amounts back each period from Railtrack/Network Rail which had been paid out to season ticket holders in respect of void days in accordance with an agreed methodology which, once up and running, was relatively simple to administer.

Schedule 8:

9. **Approach to setting benchmarks:** Do you support our recommendation to only make changes to delink passenger operator benchmarks and Network Rail benchmarks for freight operators from past performance (but to leave the approach to the other benchmarks unchanged)?

We entirely disagree with ORR's view that the current method of setting operator's benchmarks against historical service group performance creates an incentive not to improve performance. This stems from a misconception that the main driver of train operator performance is Schedule 8. In reality a train operator is more sharply incentivised by obligations under its franchise agreement, its PPM targets, its reputation and relationship with its customers and of course its fare box revenue. Therefore in reality there are a host of other far more pertinent incentives in place by which a train operator is more strongly incentivised to improve its performance and which more than offset any perceived perverse incentive created by Schedule 8 that causes an operator not to improve performance.

Nonetheless we are very receptive to exploring improvements to the setting of Schedule 8 benchmarks or indeed new ways of setting the benchmarks if a better methodology can be agreed. However we are unable give unqualified support to any recommendations for de-linking benchmarks from past performance until we are able to make informed conclusions on proposals for alternative methodologies, of which we note there are no details contained in this consultation document.

Schedule 8:

10. **Measure of passenger operator performance:** Do you support our recommendation to change the measure of passenger operator performance to one based on the delay caused to other operators?

We do not support ORR's recommendation to change the measure of operator performance to be based on delay caused to other operators.

There would appear to be a fundamental general misunderstanding which has appeared in PR18 regarding the basic principles of Schedule 8. It is, and always has been, for the purpose of incentivising Network Rail in its position as a monopoly supplier in the absence of real market forces by providing compensation to operators thereby ultimately reducing funders' financial risk. The regime was created this way because train operators have real market forces (principally revenue risk and reputational risk) driving the way their company behaves. Schedule 8 does not currently "provide operators with financial incentives to limit the delay they cause to other operators" as stated in the PR18 consultation. The only money under Schedule 8 flows between operators and Network Rail so it cannot therefore be argued that it provides for operators to limit the delay they cause to other operators as no contractual interaction between operators takes place at all. The only interaction is between an operator and Network Rail. This is so that operators are not exposed to external risks which they are not able to control and influence, which ultimately benefits the taxpayer by controlling risk premiums factored into franchise agreements.

The fundamental principles of Schedule 8 are in fact simple yet, it seems in losing sight of this, the aim appears to be to alter the mechanism however we believe this will only serve to create further opportunities for confusion, complexity and misconceptions surrounding the regime.

If the aim of doing this is to plug a gap in Network Rail's recovery of Schedule 8 costs under the "Star Model" then perhaps a closer look is required by ORR as to the reason for this gap: Schedule 8 is designed to be cost-neutral only when performance is at expected levels. If Network Rail is not meeting its performance targets then it would be expected to be experiencing a net loss in Schedule 8. This is the purpose of the regime and a sign that the regime is sending the correct financial incentives to Network Rail. As ORR's consultation says
"This option has the disadvantage of reducing the incentive on Network Rail to recover from delay it does not cause, as these would be allocated to the TOC causing the original delay." The effect of amending the measure of passenger operator performance to account for behaviours which it is unable to influence because only Network Rail is in a position to do so will ultimately have the effect of neutralising the effectiveness of the regime on Network Rail which makes it difficult for us to understand why this option is being considered.

Schedule 8:

11. **Sustained poor performance (SPP) provisions:** Do you support our recommendation to limit SPP to costs compensation only?

We support the simplification of SPP provisions in principle, particularly ORR's recommendation (b) clarity of the contractual wording around the intent of the regime and the scope for claims and the process and procedures for making claims.

Schedule 4:

12. Do you support our recommended prioritisation of schedule 4 issues? If you think we should reconsider any of the areas we have de-prioritised please submit supporting evidence.

We support ORR's recommended prioritisation of schedule 4 issues. In particular we are supportive of plans to review the operation of and provisions relating to SPD.

Schedule 4:

13. Do you wish to submit relevant evidence regarding: (a) processes associated with planning possessions; and/or (b) planning alternative arrangements to deal with planned disruption (e.g. the notification that is needed to arrange bus replacement services)?

We are very willing to share all of the information that ORR may require in respect of the above processes at any time in order to improve the regime. Please contact us to facilitate this or discuss directly with our representative at the Schedule 4 & 8 recalibration working group.

Heathrow
Making every journey better

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By email to: PR18@orr.gsi.gov.uk

09 March 2017

Heathrow Airport Limited response to: Improving incentives on Network Rail and train operators: a consultation on changes to charges and contractual incentives.

Dear Mr Cornick

Firstly, I would like to thank you for the opportunity to respond to the ORR consultation on the changes to charges and contractual incentives (the "Consultation").

Whilst the Consultation documents do not refer to Heathrow Airport Limited ("Heathrow") directly, we do not agree with the ORR view that Heathrow is covered by the relevant provisions in the Railway (Access, Management and Licensing of Railway Undertakings) Regulations 2016 and therefore that Heathrow would be impacted by the outcome of this consultation.

The point above notwithstanding, Heathrow would like to remind the ORR that Network Rail are not the only infrastructure manager (IM) in the UK and therefore any changes to the charging structure should consider the impact that this might have on the charging structures of other IMs.

Yours sincerely

Chris Joyce
Head of Surface Access, Future Heathrow

Response to ORR’s December 2016 Charges and Incentives Consultation

This pro-forma is available to those that wish to use it to respond to our consultation. Other forms of response (e.g. letter format) are equally welcome.

Please send your response to pr18@orr.gsi.gov.uk by **9 March 2017**.

Full name	Ian Leigh
Job title	Finance Director
Organisation	Heritage Railway Association
Email*	
Telephone number*	

*This information will not be published on our website.

Please make any comments regarding the questions in the accompanying text box. We welcome comments in relation to the information outlined in both the consultation document and supporting documents, or regarding the policy areas more generally.

Chapter 2: Infrastructure Costs

Fixed cost charges:

1. Do you support our proposal to levy fixed cost charges on all operators, including open access operators, to the extent that they can bear them (option 2)?

We do not support the proposals for levying a fixed access charge on open access operators.

The ORR proposal of the fixed charge being set at what OAO can bear seems that an OAO would be about as profitable as franchised operators. At this rate of return we doubt our members would continue with their operations with regular services or charter operations. As the margins would be too low for, at best a reasonable cash profit, or at worse a loss.

We doubt that new OAOs would emerge either as general operators or specifically in the heritage sector for the same reasons low margins at best and the potential for loss at worst. But with the added risk of a new charge imposed from start of operations, that the operator may not have the cash to pay. This would seem to be directly in conflict with the policy aim of encouraging on rail competition.

We would suggest that the ORR consult with the DfT and confirm that they are content that this charge would assist with the refranchising programme. Which as we understand is make more use of the heritage operators on the national network.

The charge is to cover Network Rail‟s fixed costs, apart from a few lines that are freight only the franchise operators provide the required service so surely, they should pay the fixed costs as the network is in effect provided for them? OAOs simply use the network at marginal cost as the current system recognises.

Neither is there any detail on how market segmentation would be determined, then the effects calculated and applied. Also, there is no mention of how an OAO might appeal the charge applied. As the ORR, is usually the final appeal body in the industry we have significant doubts the ORR could handle appeals about its self.

We see this is simply a raid on profits‟, unless variable charges are cut (perhaps to negative levels) in compensation. That will generate trivial sums in Network Rail terms, but be a real drain on our members‟ resources.

These concerns all stem from the fact that an OAO does not have the safety net of an access charge review that a franchise operator does with its franchise agreement.

The mix of how Network Rail is funded between the fixed charge for franchised operators, variable charges and direct government grant is currently largely set by the DfT. We doubt for franchised operators whatever the mix between charge is that it would make much difference to the services they provide. We would prefer to see that levelling the playing field (if it needs to be levelled at all) should be done by abolishing the fixed charge for franchised operators and that element of Network Rail‟s income being transferred to the direct grant. This would achieve what the ORR intends the same charges for all operators without placing the operations by our members and other OAO and freight at risk of financial disaster.

We are concerned at what effect the DfT proposed PSO levy will have on our members. We would like to see their justification for such a charge and how they think this fits in with their policy of encouraging tourism by rail and the greater use of the national network by heritage trains.

Finally, how can a fixed charge be applied to that ultimately variable use of the Network, the charter train. There is not fixed constant use of the network to ever justify a fixed charge.

In conclusion, we don‟t support the proposal that our members will be charged a fixed charge, however it is calculated. Or that future heritage operators will face the same regime.

Fixed cost freight charges:

2. Do you support our proposal to simplify the current charging regime by having a single freight mark-up charge?

No comments.

Fixed cost freight charges:

3. Do you support the recommendation to apply Network Rail's cost allocation methodology (discussed in this chapter) to freight mark-up charges?

No comments.

Station charges: 4. **Long term charge (LTC):** Do you support our recommendation that the methodology for the LTC at managed stations be recalibrated?
Our concern is that stations are maintained to be welcoming to all passengers using the station. We would suggest that long term the split of responsibilities at stations between the station facility owner and Network Rail be reviewed. If our members are going to be running more trains on the national network, we require one body to deal with who can make quick decisions, and provide cost effective upgrades, if our members wish to support works at station.
Station charges: 5. **Qualifying expenditure (QX):** Do you agree with our recommendation that we support the work to make total QX charges more transparent at both managed and franchised stations?
We agree that these charges should be more transparent and the information should be available to all operators at the stations.

Chapter 3: Short-run variable charges package

Variable usage charge (VUC): 6. Do you support our recommendation not to make fundamental changes to the VUC for PR18?
We only support this if the fixed charge is not implemented on our members. If the fixed charge is implemented on our members we will expect the variable charges to be cut (perhaps to negative values) to maintain viability of their services.
Variable usage charge: 7. Do you have any suggestions for „recalibration" style changes to the VUC you would like to see considered for PR18 implementation?
Our members tend to run at slow speeds on the network so we would support the VUC being calibrated for the actual speed attainable for the rolling stock on the Network. However, we do recognise this could make the VUC very complex to price. Our suggestion would be that operators are allowed a "slow speed discount" as they seldom run at the full speed. However, we are reasonably content with the current system and prefer this to having to pay a fixed

charge.

Capacity charge (CC):

8. Do you support our recommendation not to replace the CC with adjustments to Schedule 8 benchmarks?

The current system does provide operators some certainty in that they can reasonably assess the cost of the capacity charge as against the increased uncertainty of including the charge in the schedule 8 regime. For these reasons, we would prefer to retain the current arrangements.

Capacity charge:

9. Do you think we should: (a) retain the existing CC (but remove the caps on open access, freight and charter operators); (b) remove the existing CC and recover lost revenue through fixed cost charges; or (c) do you have any alternative proposals?

We remain committed to supporting our members in expanding their operations throughout the network for regular scheduled services and charter operations. The caps provide a back stop that allows our members to plan their operations with some financial certainty and perhaps take more risks than they would otherwise do. All for the loss of a relatively small amount of money to Network Rail. As with all the proposals we are concerned about proportionality, what is a small change for the Network Rail and the industry could be a huge one for our members. We would urge the ORR to work through some examples of their proposals to see what financial effects they might have before making further proposals.

We are against a fixed charge in principle as outlined in the answer to question 1 so we don‟t support the removal of the CC in to the fixed charge although if simplification of charges is the aim we would support the combination of the VUC and CC so long as our members did not pay more overall.

There might be a case to remove some of our members from Schedule 8 completely. In return they would provide staff to fix on the day problems with Network Rail equipment subject to them being suitably trained to do so. They might also be able to undertake track renewals to improve the quality of the infrastructure and charge this back to Network Rail at suitable rates at a much lower cost than Network Rail can do.

Traction electricity charge:

10. Do you support our recommendation to keep the loss incentive mechanism?

No comments

Electricity asset usage charge (EAUC):

11. Do you support our recommendation that the EAUC not be altered, beyond recalibration, in PR18?

No comments

Coal spillage charge (CSC):

12. Do you support our recommendation to abolish the CSC?

We support this being abolished.

Chapter 4: Contractual Incentives Regime

Schedule 8:

13. **Passenger compensation:** What are your views on the options of passenger compensation recovery and improving the transparency of compensation relating to Network Rail"s actions?

The logic for not changing the current system to include compensation paid to passengers directly from Network is well set out. We too have concerns at the level administration required to accurately record the level of compensation and the reasons why it was paid and to do this in enough detail to satisfy Network Rail, would prove burdensome for our members. So, we are content that the current system remains in place.

Schedule 8:

14. **Approach to setting benchmarks:** Do you support our recommendation to only make changes to delink passenger operator benchmarks and Network Rail benchmarks for freight operators from past performance (but to leave the approach to the other benchmarks unchanged)?

We are broadly supportive of this change.
Schedule 8: 15. **Measure of passenger operator performance:** Do you support our recommendation to change the measure of passenger operator performance to one based on the delay caused to other operators?
What we want is a regime that encourages passenger operators to run a reasonable service to the travelling public. We have concerns that this change might still cause operators to cancel trains rather than run them. For example, a late running Northern train might cause an expensive delay to a Virgin East Coast or West Coast service, it might be less expensive for Northern to cancel their train than risk a delay to another operator. We don‟t see how this change removes this perverse incentive. Given that our members railways are often in rural areas with only a few trains a day the loss of one train might be the difference between visitors arriving in time for our members‟ train or not. Our greater concern is how subsequent delay would be allocated. For example, if North Yorkshire Moors cause a delay to a Northern Train that then delays a Cross Country, which in turn delays Virgin East Coast that then delays a Southern train in the consultation is unclear if NYMR would be paying just for delaying the Northern Train or for all the consequential delays. If the total delays are charged to North Yorkshire Moors they are likely to cease operating as the risk is too great. Our view is that our members including charter operators should pay for the delay they cause directly to other operators to an affordable and low cap. For our members, this would potentially prevent them from running in any heavily trafficked area simply because the risk is too great of a serious financial loss. We would like to see some worked examples to show how the change would work, compared to the existing schedule 8.
Schedule 8: 16. **Sustained poor performance (SPP) provisions:** Do you support our recommendation to limit SPP to costs compensation only?
We don‟t have a specific view on the working of these provisions as they do not affect our members. We would like to put forward a different solution for the ORRs consideration. Instead of Network Rail paying compensation, they should be required to complete a performance improvement plan, spending the money on improving the asset performance, with the help and support of the operators to provide extra access if this is required. This then improves the performance of the infrastructure for all operators rather than simply giving one operator a cash bonus.

Schedule 4:

17. Do you support our recommended prioritisation of schedule 4 issues? If you think we should reconsider any of the areas we have de-prioritised please submit supporting evidence.

No comment

Schedule 4:

18. Do you wish to submit relevant evidence regarding: (a) processes associated with planning possessions; and/or (b) planning alternative arrangements to deal with planned disruption (e.g. the notification that is needed to arrange bus replacement services)?

As our members are outside the schedule 4 provisions we do not have any strong views on the incentives as they don‟t affect them.

We do have views on how possessions are planned. We would like a more flexible approach that prevents a significant amount of re-planning possessions. We would urge the ORR to consider with the operators and Network Rail to see if for example a complete plan including all freights and charter trains can be finalised at T-6 and then fixed it might be of benefit to both the operators and Network Rail. This would require earlier timing of charter trains by Network Rail, with earlier submission of specifications from the operators. We do want charters to be taken into account when planning possessions and not charters being planned around possessions. We would also like some mechanism to allow Network Rail to take into account spot charters and cut back possessions if this was possible.

Aligning operator and network rail incentives:

19. Do you have any views on how financial incentives could be improved to encourage collaboration between Network Rail and operators to reduce industry costs?

We don‟t see any easy and obvious solution of a financial incentive to reduce industry costs. Particularly if this is transactional between Network Rail and the operators.

The concern we have with trying to reduce Network Rail costs by cutting their funding settlement is they will simply do less. Leading to a less reliable infrastructure and more speed restrictions. We wonder if frankly the cuts have gone too far and they should be allowed an increase and an era of stability to really take stock of what they do and look at the efficiency they are achieving.

Our view is that Network Rail should be encouraged to do more of the basics such as track renewals and how they do this work. That maintenance and renewals should be looked at for “whole package costs” the costs of plant, machinery and staff should be off set against how much revenue operators would have to forgo and how much they will spend on buses. This will require some powerful modelling tools and require sharing of data between Network Rail and the operators and perhaps some clearer guidance as who takes priority when there is a conflict of interest between operators.

Our members may be interested in undertaking works on the parts of the network they use if they can agree a reasonable contract with Network Rail for doing so.

For electrification, we are keen to see the national network develop the slow progress and increasing costs of the works is somewhat disappointing. Trains powered by preserved electric locomotives, and EMUs running under their own power in locations they never ran in normal service would be something that will be popular. We view a joint venture between Network Rail, the Train Operators, the DfT and the ROSCOs should be considered. This is so that the cost transfers from the train operators and ROSCOs from having lighter less complex trains to Network Rail for the electrification works can be considered by one organisation in the long payback period of electrification.

ETCS has a similar transfer of costs effects but this time from Network Rail to the operators. This will create an overall cost saving to the industry over time. We would like to understand the effects it will have on our members. Again, some sort of a joint venture between Network Rail, the Train Operators, the DfT and the ROSCOs should be considered, to control costs in one body.

Aligning operator and network rail incentives:

20. Do you have any views on the cost categories you think could be controlled by operators and whether these costs would be suitable as the basis of a potential future mechanism?

We have concerns for example if any operator was given any control of network rail costs that the amount of work would depend on where in the franchise cycle the operator was, more at the start of the franchise with none during the middle and end for quiet enjoyment of the infrastructure. We are concerned that any control of Network Rail costs by operators would lead them to focus on the parts of the infrastructure they run over (and generate the most revenue for them) rather than the whole network. Alliancing is fine in theory but there are no Network Rail routes solely used by one operator. We are very concerned that alliancing would lead to focus on that operators‟ trains to the determent of all other operators.

So, we don‟t view that operators should directly control Network Rail‟s costs.

Any other points that you would like to make

We would make a plea for simplicity. Whilst it is very tempting to tweak charges to try and make them reflect the reality, the more complex and less easy to understand they are the more effort goes into making them work. Our members usually have few people to control the train service some of whom might be volunteers and some who work part time. Our view is keep it simple, a road coach pays £500 once a year to use all roads. Let our members‟ controllers concentrate on running the service, and not be distracted with arguing with Network Rail delay attribution on who delayed who.

So, no new charges and keep the ones we have formulaic.

Thank you for taking the time to respond.

Institute for Transport Studies
University of Leeds

ORR consultation on track access charges and contractual incentives

1. As a transport research institute, ITS has worked extensively on track access charges, and thus will respond to this consultation specifically on issues raised by that research.

2. We believe that the basis for variable track access charges should be marginal social cost. Subject to the important proviso that other modes of transport are charged on a comparable basis, such charges will encourage operators to take efficient decisions on levels of service to provide given the capacity of the system. Where the proviso does not hold, there is provision for government grants towards track access charges for freight, and for including services as part of franchises for passenger traffic.

3. We have previously cited evidence that the existing variable charge understates wear and tear and that the capacity charge understates congestion and scarcity costs (Network Charges Consultation. Response from Institute for Transport Studies, University of Leeds and also discussed with RDG, ORR and DfT) so we would support further investigations of these in due course in line with the discussions that we had with RDG concerning the appropriate timing of that work. Such a review could, potentially, lead to charges which bring in more revenue whilst improving existing incentives to train operators regarding what services they operate and what rolling stock they use.

4. Mark ups which raise variable charges beyond this will usually lead to removal of services which add more to revenue than to systems costs. Of course, how serious a problem this is depends on how the mark ups are applied, their size and how the 'ability to pay' test is implemented. Currently, for freight, mark ups are only imposed on commodities where anticipated loss of traffic is less than 1%, and if applied in this way then the loss of benefit may be small. But if fixed charges are abolished, then whatever part of infrastructure costs is not recovered by variable charges or met by Network Grant will have to be recovered as mark ups.

5. We consider that mark ups on passenger services are more problematic than for freight for two reasons. Firstly, the fact that frequency of service is a more important quality attribute for passenger services than for freight; even where a market segment is profitable, passenger operators may find it more profitable to reduce frequency in response to mark ups. Secondly, there is wide diversity of profitability of individual services within what might reasonably be defined as a market segment (for instance if ECML was regarded as a market segment, a mark up which could easily be borne by day time trains between London and Leeds might lead to withdrawal of trains to Sunderland or Hull, or on evenings or Sunday mornings). Overcoming this problem would seem to require specification of different levels of mark up for a very large number of finely differentiated market segments.

6. For these reasons, we see considerable advantages in the continued use of two part tariffs in the passenger sector, since the fixed charge will not, at the margin, influence decisions on which services to run. We believe that ideally the fixed charge in a two

part tariff should be determined as part of the long run access agreement signed by operators and based on the medium term avoidable or incremental costs of the capacity and capability they require. Such a charge will have positive incentive properties in terms of influencing these decisions, and leading them to work with Network Rail to optimise system costs.

7. Where a further mark up is needed, we consider that this should continue to be levied as a fixed charge on franchisees only. To the extent that it is desired that OAOs contribute to fixed costs, this could be done through the PSO levy, which would need to be set to cover the net impact on the franchisee's finances of OAO operation, allowing for any diversion of paths from franchised to OAO operators should that option be implemented. We recognise that this will be a complex task, particularly if OAOs play a much greater role in services in the future, whilst a mark up on variable charges might be a much simpler alternative. It is important, as also noted in the separate consultation, that the PSO levy and the proposals to change the structure of track access charges are developed together and also have in mind the different scenarios that may emerge (e.g. whether open access operation becomes more significant than presently in providing services).

8. We also wish to comment on the methods used in the pilot study of cost allocation undertaken for Network Rail. This approach does not appear to be a true avoidable cost approach because:

- It does not consider which route sections could be dispensed with if the services of a particular operator were withdrawn
- It allocates costs that are avoidable if traffic is reduced to say one train per day equally between all trains running over that section
- It adds back common costs, which are the majority of costs for Wales, according to largely arbitrary criteria.
-

9. We consider that a more informative approach would be to calculate the avoidable cost of the services of each operator. Any allocation of common costs should be shown separately; where there is a clear prime user of the assets concerned we consider that all common costs should be allocated to that operator.

We believe that the principles set out in this note are appropriate but recognise that their implementation may be much more complex than the methods currently being considered by ORR. Moreover, as noted above, the actual impact of the proposed changes will vary very much with exactly how the new approach is applied. We believe therefore that it is impossible to reach any firm conclusions on the desirability of the changes without specifying how they would be applied in much more detail and carrying out full quantitative impact assessment of all of the ORR options (options 1-4), together with the suggested options outlined in this note. We consider that full evaluation of the different possibilities is preferable to proceeding with an option (option 2) that may be inferior (though we do support in any case the proposals to further develop the cost allocation methodology).

Prof Chris Nash, Prof A Smith and Dr P Wheat

Response to ORR's December 2016 Charges and Incentives Consultation

This pro-forma is available to those that wish to use it to respond to our consultation. Other forms of response (e.g. letter format) are equally welcome.

Please send your response to pr18@orr.gsi.gov.uk by **9 March 2017**.

Full name	Tim Bellenger
Job title	Director, Policy and Investigation
Organisation	London TravelWatch
Email*	
Telephone number*	

*This information will not be published on our website.

Please make any comments regarding the questions in the accompanying text box. We welcome comments in relation to the information outlined in both the consultation document and supporting documents, or regarding the policy areas more generally.

Chapter 2: Infrastructure Costs

Fixed cost charges:

1. Do you support our proposal to levy fixed cost charges on all operators, including open access operators, to the extent that they can bear them (option 2)?

Yes we support the recommendation of option 2

Fixed cost freight charges:

2. Do you support our proposal to simplify the current charging regime by having a single freight mark-up charge?

No comment

Fixed cost freight charges:

3. Do you support the recommendation to apply Network Rail's cost allocation methodology (discussed in this chapter) to freight mark-up charges?

No comment

Station charges:

4. **Long term charge (LTC):** Do you support our recommendation that the methodology for the LTC at managed stations be recalibrated?

No comment at the present time as we would await the results of any recalibration of this charge.

Station charges:

5. **Qualifying expenditure (QX):** Do you agree with our recommendation that we support the work to make total QX charges more transparent at both managed and franchised stations?

Yes, we would support greater transparency in this charge.

Chapter 3: Short-run variable charges package

Variable usage charge (VUC):

6. Do you support our recommendation not to make fundamental changes to the VUC for PR18?

Yes we agree.
Variable usage charge: 7. Do you have any suggestions for ‘recalibration’ style changes to the VUC you would like to see considered for PR18 implementation?
No
Capacity charge (CC): 8. Do you support our recommendation not to replace the CC with adjustments to Schedule 8 benchmarks?
Yes
Capacity charge: 9. Do you think we should: (a) retain the existing CC (but remove the caps on open access, freight and charter operators); (b) remove the existing CC and recover lost revenue through fixed cost charges; or (c) do you have any alternative proposals?
Yes we would agree to retain the Capacity Charge. We would also agree that removing the caps on the charge for freight and open access operators should be removed so that these operators should pay a fairer proportion of the costs of operating the railway. A mechanism should be put in place to ensure that scarce capacity is charged at a greater rate than the marginal cost of an operation or train path. As an example for London passengers this might include an incentive to operate freight trains outside of peak hours and via routes not involving London e.g. Felixstowe to Nuneaton via Ely.
Traction electricity charge: 10. Do you support our recommendation to keep the loss incentive mechanism?

Yes

Electricity asset usage charge (EAUC):

11. Do you support our recommendation that the EAUC not be altered, beyond recalibration, in PR18?

No comment

Coal spillage charge (CSC):

12. Do you support our recommendation to abolish the CSC?

Yes

Chapter 4: Contractual Incentives Regime

Schedule 8:

13. **Passenger compensation:** What are your views on the options of passenger compensation recovery and improving the transparency of compensation relating to Network Rail's actions?

Passenger compensation must be an essential and transparent part of any compensation scheme. The current arrangements whilst well understood in the industry, are not easily understood by passengers and are a reputational risk to the industry as a whole, as they do not prioritise the interests of passengers, but instead are orientated to the contractual regimes of the industry. Therefore reforming this regime, should be seen as a priority.

Schedule 8:

14. **Approach to setting benchmarks:** Do you support our recommendation to only make changes to delink passenger operator benchmarks and Network Rail benchmarks for freight operators from past performance (but to leave the approach to the other

benchmarks unchanged)?
Yes, we would support the delinking of benchmarks to past performance, as this does not incentivise improvement by current operators and Network Rail.
Schedule 8: 15. **Measure of passenger operator performance:** Do you support our recommendation to change the measure of passenger operator performance to one based on the delay caused to other operators?
No, we do not support this. This would be a significant to passengers especially on routes into London without multiple operators providing services. This measure should be based on the delay caused to passengers, whichever operator they are using, and be quantified by the number of passengers delayed by any disruption.
Schedule 8: 16. **Sustained poor performance (SPP) provisions:** Do you support our recommendation to limit SPP to costs compensation only?
Yes, over and above other methods and means of compensation offered to passengers e.g. recent additional compensation regimes implemented by GTR.
Schedule 4: 17. Do you support our recommended prioritisation of schedule 4 issues? If you think we should reconsider any of the areas we have de-prioritised please submit supporting evidence.
No comment
Schedule 4: 18. Do you wish to submit relevant evidence regarding: (a) processes associated with planning possessions; and/or (b) planning alternative arrangements to deal with planned disruption (e.g. the notification that is needed to arrange bus replacement services)?

No comment

Aligning operator and network rail incentives:

19. Do you have any views on how financial incentives could be improved to encourage collaboration between Network Rail and operators to reduce industry costs?

This proposals seems to be about reducing industry costs rather than incentivising better performance for passengers from either train operators or Network Rail.

Some operators have commented to us that schedule 4 payments are regarded by most Network Rail managers as an occupational hazard to their budgets, rather than a means of incentivising them to do better in the future, as there appears to be no consequence to failing in this area. The ORR should consider what other measures might be put in place to change this behaviour.

Aligning operator and network rail incentives:

20. Do you have any views on the cost categories you think could be controlled by operators and whether these costs would be suitable as the basis of a potential future mechanism?

This is a worthy aspiration if this can be put into practice.

Any other points that you would like to make

No

Thank you for taking the time to respond.

Paul Cornick
Office of Rail and Road
One Kemble Street
London
WC2B 4AN

6 March 2017

Dear Paul

PR18 Consultation on Changes to Charges and Contractual Incentives

MTR Crossrail welcome the opportunity to comment on the ORR consultation to inform policy development for Network Rail Control Period 6 (PR18). We have provided our comments related to the consultation related to charges and contractual incentives below:-

1) Fixed Track Access Charges

1.1) Fixed Cost Charges

We support ORR proposals to levy fixed cost charges on all operators, including open access operators, to the extent that they can bear them.

Without this there is a risk that franchised operators (who pay their full track access costs) could end up subsidising freight and open access operators.

We also propose that freight and open access charges could be linked to the duration of the access rights held to reflect the value of the rights that are held.

1.2) Fixed Cost Freight Charges

We support the ORR proposal to simplify the current charging regime by having a single freight mark-up charge.

2) Station Charges

2.1) Long Term Charge (LTC)

This methodology would increase the charge for users of Network Rail managed stations and so could have a significant impact on TfL Rail / Elizabeth line charges, even though the overall effect on industry charges would be neutral. MTR Crossrail would like to understand the impact of these costs.

2.2) Qualifying expenditure (QX)

We support the ORR work to make total QX charges more transparent at both managed and franchised stations.

However we believe that there needs to be a recognition that QX charges are also closely linked to customer experience and customer service. The cheapest QX charge may not result in the best customer experience.

TFL Concessions (such as Arriva Rail London and MTR Crossrail) have targets that require specified levels of customer service, station staffing and station cleaning. These targets may increase the QX charge but in turn provide a high level of customer experience.

The age and condition of station assets and the facilities provided may also influence the QX charge.

We suggest that stations should be classified based on their age, condition and facilities to enable a fair comparison to take place.

3) Variable Track Access Charges

3.1) Variable Usage Charge (VUC)

We support the ORR recommendation not to make fundamental changes to the VUC in PR18.

3.2) Capacity Charge

We support the ORR recommendation not to replace the Capacity Charge with adjustments to Schedule 8 benchmarks.

We support the ORR proposal to retain the Capacity Charge, but remove the caps on open access, freight and charter operators, who should be incentivised to take account of network congestion in service planning.

We also propose that a Pathway Reservation Charge should be applied to deter operators from holding on to access rights that are not used on a regular basis (to enable a more efficient use of capacity, in particular on busy parts of the network).

We also suggest that consideration is given to varying the Capacity Charge by type of route, time of day and type of traffic to reflect available capacity.

We also question whether the Capacity Charge should be applied to Access Rights that are drawn down from a Track Access Option. In the case of Crossrail, the project is already funding the infrastructure that will deliver the access rights and required level of performance.

4) Traction Electricity Charges

4.1) Traction Electricity Charge

We support the ORR recommendation to keep the loss incentive mechanism, although we agree that the current loss incentive mechanism may not incentivise Network Rail to reduce transmission loss.

4.2) Electricity Asset Usage Charge (EAUC)

We support the ORR recommendation that the EAUC is not be altered, beyond recalibration, in PR18.

5) Changes to Schedule 8

5.1) Passenger Compensation

Our preference would be for the current arrangements to be retained, as Schedule 8 is intended to incentivise operators and Network Rail to manage disruption effectively. Passenger compensation recovery from Network Rail should only be considered if incentive effects are expected to offset the cost in terms of additional resources. We do not see how either of the options proposed is more beneficial than what is in place now, and will not justify the potential costs involved in change.

5.2) Approach to Setting Benchmarks

We support the ORR recommendation to only make changes to delink passenger operator benchmarks and Network Rail benchmarks for freight operators from past performance (and leave the approach to the other benchmarks unchanged).

5.3) Measure of Passenger Operator Performance

We strongly oppose the ORR recommendation to change the measure of passenger operator performance to one based on the delay caused to other operators. We believe that this could create perverse incentives and undermine the role that Network Rail plays in managing the recovery of the train service during disruption and ensuring that correct regulation takes place.

We are concerned that TOCs may try to influence the decisions made by Network Rail to reduce their financial liabilities, to the detriment of passengers and other passenger and freight operators.

5.4) Sustained poor performance (SPP) provisions

We support the ORR recommendation to limit SPP to costs compensation only.

6) Changes to Schedule 4

We support the ORR recommendation concerning prioritisation of schedule 4 issues, including the proposal to make a high level adjustment to the ACS to reduce the likelihood of over-recovery as Network Rail tends to overestimate the amount of works to be carried out in a control period.

7) Aligning operator and Network Rail Incentives

We have no specific views on this issue, although TfL Rail does not currently opt-in to REBS and we would object to any proposal to remove the option to opt-out.

We look forward to working with ORR, Network Rail and other industry colleagues to inform the development of the strategy for PR18.

Yours faithfully

Mark Eaton
Concession Director
MTR Crossrail
63 St Mary Axe, London, EC3A 8NH

mtrcrossrail

Network Rail's response to ORR's consultation on changes to charges and contractual incentives

9th March 2017

Table of Contents

Executive Summary

Introduction

1. Network Rail is pleased to respond to ORR's December 2016 consultation on the charges and contractual incentives regime for CP6. We welcome ORR's open approach to discussing its emerging proposals with the industry, particularly in the lead-up to the publication of this consultation.
2. We support many of ORR's proposed refinements to the charging and incentives framework for CP6. We also welcome the fact that ORR plans to conclude on some aspects of the framework in June 2017, rather than waiting until its June 2018 Draft Determination.
3. Early certainty in relation of ORR's charging policy will help us to engage in more constructive discussions with train operators in relation to the track access charges that they are likely to face in CP6. Consistent with this, we are planning to consult with industry on the more detailed aspects of the charging and incentives framework for CP6 in summer 2017. However, ORR should be aware that until it reaches firm conclusions regarding its charging policy for CP6, we will not be able to start the detailed recalibration process or initiate the required work to update our billing systems, if that is necessary.
4. Whilst we support the vast majority of ORR's proposed refinements to the charging and incentives framework for CP6, we are concerned about what appears to be limited progress in relation to the development of policy options for the Capacity Charge and some aspects of Schedule 8. These areas were identified as a priority for reform as part of the RDG Review of Charges project. Schedule 8, in particular, can have a significant impact on Network Rail's and operators' business models.
5. Indeed, we are concerned that time is already tight to conclude the recalibration process for some aspects of the regime in time for the start of CP6, in particular for Schedule 8. It is important, therefore, that ORR provides additional clarity in this area as soon as reasonably possible.

Wider PR18 context

6. The PR18 work programme is ambitious, notably the work required to implement route-level and system operator regulation. We welcome the fact that ORR is prioritising work in these areas, and seeking to limit changes to the charging and incentives framework in CP6.
7. We consider it important that the charges and incentives framework in CP6 supports industry priorities and objectives, including Network Rail's commitments in its Transformation Plan. For example, a key priority will be the ability to attract third-party investment to the railway network, which will require a flexible charges and incentives framework that is capable of accommodating different ownership models.
8. We also note the plans outlined in the Secretary of State's December 2016 written statement to Parliament on rail reform: the future of the rail network, which discusses the need for incentive alignment between Network Rail and operators. It will be important that any changes to incentives are seen in this wider context and support this 'direction of travel'.
9. Safety continues to be of paramount importance for us. Therefore, consideration of the impact on safety of any proposed changes is critical. We welcome that ORR has

included improvements in safety in its general criteria for carrying out the impact assessments on its policy proposals (which we discuss later in this response).

Areas of support

10. We are mindful that some train operators' business models are vulnerable to changes in the Variable Usage Charge (VUC). Therefore, we strongly support ORR's proposals not to make fundamental changes to the structure of the VUC for CP6.
11. We also support ORR's proposals to narrow the scope for claims in respect of sustained poor performance (SPP) in Schedule 8. We welcome ORR's proposal to review the clarity of the contractual wording for SPP. We look forward to contributing to this review and suggest that there should be a time limit for claiming for SPP in CP6.
12. We agree that there should be improved transparency around who is 'responsible' for our fixed costs, and that the cost allocation work which Network Rail has commissioned should be used to inform this improved transparency.
13. We also welcome many of ORR's proposals for incremental improvements to Schedule 4, in particular the proposed review of the Notification Discount Factors (NDFs).
14. ORR is consulting on the inclusion of passenger compensation in the performance regime. We recognise the need for passengers to be appropriately compensated when they experience disruption on the railway. However, if passenger compensation is to be included in the Network Rail performance regime in CP6, we will need funding to recover this potentially significant additional cost. We would also be concerned if this changed the nature of the relationship between Network Rail, passenger operators and passengers. It might therefore be better for train operators to pay for all passenger compensation rather than introducing potential conflict through the allocation between Network Rail and operators.
15. We also support ORR's proposal to simplify the freight charging regime by removing and/or consolidating freight charges, where appropriate.

Areas of concern

16. As set out above, there are many aspects of ORR's proposals that we support. However, we also have significant concerns about the Capacity Charge and some aspects of proposed Schedule 8 reform. In particular, we are concerned that the consultation proposals for these aspects of the regime are not yet fully developed. This is creating uncertainty across the industry and could also impact our ability to undertake the detailed calculation activities that are required to recalibrate these regimes for the beginning of CP6.
17. We will continue to participate in industry discussions to further develop proposals for these areas of the regime. We will need further clarity from ORR on its proposals in these areas if we are to commence Schedule 8 recalibration activities in summer 2017.

<u>The Capacity Charge</u>

18. We consider that the two options for the Capacity Charge on which ORR is consulting may not be practical for CP6. In particular, we are concerned that the current consultation proposals do not address the purpose of the Capacity Charge (i.e. the need to compensate Network Rail for higher Schedule 8 costs when more trains are added to the network). If our higher Schedule 8 costs are not recovered in CP6, we will be

financially worse off when more trains are run on the network. This would be an unacceptable outcome as it would be a disincentive to support growth and inconsistent with ORR's confirmed aim for PR18, which includes a better used railway in CP6 and beyond.

19. It is critical that Capacity Charge policy development is prioritised over the coming weeks. We will continue to work closely with the industry and ORR on the development of a workable solution for CP6. For a more detailed discussion on our concerns, please refer to our response to Questions 8 and 9 of ORR's consultation.

Schedule 8

20. We are also concerned that ORR's proposals with regards to setting Schedule 8 benchmarks are not well developed for this stage in the periodic review. In order for the Schedule 8 recalibration work to be completed in time for CP6, work will need to start in summer 2017. The lack of policy proposals, specifically in relation to Schedule 8 benchmarks, could place considerable strain on the required recalibration activities and the ability, therefore, to implement the recalibrated regime for the start of CP6. We welcome ORR treating this as a priority at the recently established ORR industry Schedule 8 recalibration working groups.
21. It is also important that ORR is committed to making sure that all available evidence is used to inform the recalibration of Schedule 8 payment rates for CP6, where the evidence is robust.
22. The Passenger Demand Forecasting Council (PDFC) is extending a recently commissioned Network Rail study that suggested the Network Rail Schedule 8 payment rates for London commuter services appear to be significantly too high. This is of particular concern given the substantial money flows resulting from Schedule 8 to London commuter TOCs in CP5. If payment rates do not accurately reflect revenue elasticities, the regime will not have the desired aim of 'de-risking' franchises from the effect of performance levels being different from what they were assumed to be. We urge ORR to take this new information into account in setting Schedule 8 payment rates for CP6. In addition, Schedule 8 payment rates also inform Schedule 4 revenue compensation rates. We are concerned that if Schedule 8 rates are 'wrong', this could distort the costs of taking possessions on the network. Our response to ORR's questions on Schedule 8 provides a more detailed discussion on the level of Schedule 8 payment rates.
23. More generally, it is crucial that the Schedule 8 benchmarks for train performance are set at an attainable level. We will continue to work with the industry to set appropriate performance targets, through our route stakeholder engagement process. If the Schedule 8 benchmarks are not set at a realistic level Network Rail could be faced with very significant outflows of money through Schedule 8 payments, potentially reducing our ability to invest in the rail network in CP6.

Incentives to grow traffic

24. ORR's consultation notes a concern that we have previously raised about not facing appropriate incentives to grow traffic on the network. We continue to consider that the incentives that we face to grow traffic could be improved. We are pleased that ORR recognises this issue in its consultation.

25. Whilst we strive to accommodate our customers' requests to run more services, we do not consider that the income that we currently receive provides us with a strong financial incentive to do this.
26. We believe that some of the potential changes that ORR notes in its consultation could strengthen the financial incentives that we face to grow traffic. For example, ORR suggests levying fixed track access charges on franchised passenger operators on a per mile basis and refining the volume incentive. Both of these are interesting ideas which we would like to explore further with ORR and industry stakeholders. However, because these potential changes are discussed only at a high-level in the consultation document and supporting impact assessments, it is hard for us to form a firm view on the impact that these proposals would actually have.
27. We would welcome ORR setting out the potential changes that it is considering in this area in more detail. This would help us to form a view on whether, in reality, these changes would strengthen our incentives to grow traffic, and could be implemented in time for CP6.
28. We also consider it important that potential changes in this area are considered in the round. In particular, we suggest that ORR is mindful of the overall impact of any changes to the Capacity Charge, Volume Incentive, and Fixed Cost charges together. If changes are made to these parts of the framework in isolation, it could actually weaken our incentives to grow traffic, rather than strengthen them.
29. We are specifically concerned about suggestions that ORR may use the Volume Incentive to make up for any funding shortfall on Network Rail as a result of changes to the Capacity Charge. In its draft impact assessment on options for fixed costs, ORR also suggests that changes to the Volume Incentive may be required to adjust for any shortfall in revenue created by the application of the market can bear test for freight and open access operators. If the volume incentive operates in the same way as in CP5, any payment would not be received by Network Rail until CP7, so would not help in paying for cash costs incurred by Network Rail in CP6 - for example, higher Schedule 8 costs from running additional trains. Any cash shortfall would, potentially, need to be made up by cutting expenditure in other areas such as renewals.

Impact Assessments

30. We welcome ORR's development of draft impact assessments on how changes to the charges and incentives regime will impact stakeholders, as well as its commitment to considering the cumulative financial impact of changes on operators. (We note that it is planning to publish a working paper in early 2017 to outline its methodology for this work). As above, we also welcome that improvements in safety is considered in the general objectives and criteria which are used to inform the impact assessments.
31. We recognise the challenges associated with carrying out these sorts of impact assessments. We are concerned, however, that ORR's approach to the current draft impact assessments is, in some cases, inconsistent. For example, not all of the charging proposals have been assessed against ORR's general criteria. A consistent approach is helpful, particularly in order to be able to take a holistic view of all the proposals, as well as to understand the full impact.
32. We also note that in the case of the VUC, ORR did not publish an impact assessment. Even where ORR is proposing to broadly retain the existing charging structure, we

consider that it would be prudent to understand the impact of the proposal on the relevant stakeholders by conducting an impact assessment.

33. There are also instances, for example the fixed cost charges impact assessment, where ORR has considered policy changes that are not discussed in its consultation document (e.g. whether franchised passenger FTACs should be levied on a per mile basis). Given the detailed nature of some of the impact assessments, we are concerned that such proposals could be missed and would stress, therefore, the need for alignment between the impact assessments and ORR's future consultations.

Next steps

34. We note that ORR plans to conclude on this consultation in June 2017, and that there may be a follow-up consultation in mid/late 2017 on areas where ORR has not yet set out firm proposals (including the Capacity Charge).
35. We also note that ORR plans to consult industry on which market segments could be subject to mark-ups in CP6 in autumn / late 2017. We would encourage ORR to engage with industry on this work at an early stage and be clear on its process and approach.
36. Where there is sufficient clarity in ORR's June 2017 conclusions, we expect to consult with industry on the more detailed aspects of the charging and incentives framework for CP6 in summer 2017. This should allow industry and ORR to contribute to the detailed recalibration activities and considerations for each of the charges well in advance of ORR's draft decisions on charges and incentives in its June 2018 Draft Determination. If there is a delay in ORR issuing its conclusions on charges and incentives in June 2017, this is likely impact our ability to consult, as planned, in summer 2017.
37. We will also start considering if changes in access charges for CP6 are likely to require modifications to our billing systems and track and station access contracts (on which we would expect to work closely with industry and ORR).
38. The next year will be a critical time for detailed policy development for charges and incentives. We look forward to working with our customers, funders, ORR and other stakeholders during this period and in the lead-up to implementation of any changes at the beginning of CP6.

Structure of this response

39. The remainder of this response is split into two sections. The first section responds to ORR's detailed consultation questions. The second section provides comments on ORR's supporting documents, including the impact assessments published for some of the charging proposals in its consultation.
40. If you would like to discuss any part of our response in more detail, please contact Alexis Streeter in the first instance.

1. Responses to ORR's consultation questions

Fixed cost charges

Question 1: Do you support our proposal to levy fixed cost charges on all operators, including open access operators, to the extent that they can bear them (option 2)?

Yes, Network Rail supports ORR's proposal (option 2) to levy fixed cost charges on all operators, to the extent that operators are able to bear these charges. We consider that this proposal has the potential to better align the costs that operators impose on the network with the charges that they pay. Where operators cannot bear these charges we believe that there should be a transparent subsidy to reflect this.

However, a robust assessment by ORR of the extent to which markets can bear fixed cost charges will be crucial to the success of this proposal. Therefore, we suggest that ORR starts engaging with industry in relation to this issue as soon as reasonably possible. We also note that ORR is planning to apply a consistent framework to the freight and open access operators' market can bear tests. At this early stage, we suggest not making any framework too prescriptive because the freight and open access markets are very different and this will need to be reflected in the assessments.

We are also mindful of the fact that this is a complex area. We, therefore, consider it important that when developing policy in this area that ORR and funders continue to be joined-up. For example, being clear how cost allocations, the market can bear test, the level of fixed cost charges, access rights, the NPA test, and the PSO levy all relate to one another.

We welcome the fact that ORR proposes basing the maximum level of fixed cost charges on the cost allocation work that we have commissioned. We believe that this work represents a step-change improvement in our understanding of the allocation/drivers of fixed costs and, therefore, should be used to inform the level of fixed cost charges. We also consider that there are potential benefits to be realised from increased transparency regarding who is 'responsible' for fixed costs, even if this information is not fully reflected in operators' charges. For example, it could provide additional information to funders in relation to the long-run cost impact of the services that they are specifying.

As noted, above, where a market segment (e.g. open access or freight services) cannot afford to pay all of the fixed costs allocated to it, we consider that this should be explicitly recognised in the form of a transparent grant from funders to Network Rail. At present, the costs attributable to freight and open access services are not transparent and are included in franchised passenger operators FTACs (or the grant income received by Network Rail in lieu of FTACs). This approach conceals the actual distribution of fixed costs within the industry and results in a 'hidden subsidy' to these market segments. If we want to maximise the benefits from this new more accurate allocation of fixed costs, we consider that it should be used consistently across the industry, including in relation to the allocation of network grant.

Approach to levying fixed cost charges

We welcome ORR's fresh thinking with regards to how our fixed costs could be recovered in CP6.

We note that ORR states that FTACs levied on franchised passenger operators "may become a per unit of traffic rate (e.g. a rate per train mile / vehicle mile, or another metric)"[1]. This would represent a significant departure from the current approach to levying FTACs (as a fixed lump sum each period) and any change in this respect would need to be considered very carefully.

We continue to consider that the incentives that we face to grow traffic could be improved and we are pleased that ORR recognises this issue in its consultation. We believe that this potential change to the FTAC could strengthen the financial incentives that we face to grow traffic. However, because this idea is only discussed at a high-level, it is hard for us to form a firm view on the impact that these proposals would actually have.

Whilst levying FTACs on a per mile basis would reduce the cost reflectivity of charges, it could also help improve our financial incentives to run more trains on the network. To the extent that traffic forecasts turn out to be incorrect (which they will because they are forecasts) we would receive (and operators would pay) more/less money than expected. Because most of our cost base is fixed, if traffic was lower than originally forecast the reduction in our income would be greater than the reduction in our costs. This would create, therefore, a shortfall in the money that we require to manage the network efficiently. It would also need to be taken into account in the assessment of allowances for risk.

The rationale for levying fixed cost charges on a per mile basis for freight and open access operators is that it would be impractical to charge them a fixed sum. The current freight fixed cost charges are levied on a pound per gross tonne mile because freight operators may win/lose contracts with their customers during the control period. If these charges were fixed, for each operator at the beginning of the control period, it would hinder operators' business models by making them highly operationally geared to traffic levels.

We are also mindful of the fact that open access operators do not currently pay fixed cost charges and, because of the uncertainty in relation to the effects that this will have, ORR may wish to levy any new charge on a per mile basis. This could help to mitigate potential affordability issues for open access operators because they would only pay charges when they run a train and receive revenue from passengers. We do not consider, however, that the rationale set out above in relation to freight and open access services is relevant to franchised passenger operators (i.e. passenger operators could continue to be charged a fixed charge).

We would also like to flag at this early stage that, if passenger FTACs were to be levied on a per mile basis, this would require development of our billing system to accommodate this change. The length of time required and cost impact of making changes to our billing system should not be underestimated.

[1] Footnote 3 on page 4.

We look forward to working with ORR to better understand its proposals in this area. We are keen, however, to stress that we are very open-minded about ORR's proposals.

Fixed cost freight charges

Question 2: Do you support our proposal to simplify the current charging regime by having a single freight mark-up charge?

Yes, Network Rail supports ORR's proposal to simplify the current freight charging regime by having a single-mark-up charge. Indeed, we suggested this in our response to ORR's first charges and incentives consultation.

We consider that a single mark-up charge would serve to simplify freight charges, making them easier to understand and administer. The Freight Specific Charge (FSC) and Freight Only Line Charge (FOLC) both make a contribution towards Network Rail's fixed costs. Therefore, if these charges were to be combined into a new fixed charge, the contribution from the freight industry towards our fixed costs would continue to be transparent.

We note, however, that in its consultation ORR indicates that the freight 'market can bear' test could involve considering how ability to pay varies by location. If applying the test in this way would lead to the geographic disaggregation of freight mark-ups, we would not support this change to the charging structure. We consider that any change in this respect would be inconsistent with ORR's proposal to simplify the current freight charging regime, and would make the charge disproportionately complex relative to the amount of money that it is likely to recover.

In addition, we would like to flag at this early stage that any geographic disaggregation of freight mark-up charges would require development of our billing system in order to levy the charge. As noted, above, the time required and cost impact of making changes to our billing system should not be underestimated, especially for more material changes (e.g. the geographic disaggregation of charges).

Question 3: Do you support the recommendation to apply Network Rail's cost allocation methodology (discussed in the chapter) to freight mark-up charges?

Yes, we support using the cost attribution work that we have commissioned to inform freight mark-up charges. As noted, above, we believe that this work represents a step-change improvement in our understanding of the allocation/drivers of fixed costs and, therefore, should be used to inform the level of fixed cost charges.

However, we recognise that there are good reasons for not always charging operators the full fixed costs that can be allocated to them. For example, if charging these costs would result in a significant switch in freight traffic from rail to road, with the loss of the environmental benefits that freight traffic generates.

Consistent with this, we consider that a robust assessment by ORR of the extent to which markets can bear fixed cost charges will be crucial to the success of this proposal. Therefore, we suggest that ORR starts engaging with industry on this issue as soon as possible. In addition, it will be particularly important that ORR considers the financial impact on freight operators in the round.

As discussed in our response to Question 1, above, we note that ORR is planning to apply a consistent framework to the freight and open access operators market can bear tests. At this early stage, we suggest not making this framework too prescriptive because the freight and open access markets are very different and this will need to be reflected in the assessments.

As noted above, where a market segment cannot bear the fixed infrastructure costs allocated to it, we consider that this should be recognised explicitly in the form of a transparent grant from funders to Network Rail. This grant would reflect the fixed costs attributable to a market segment, which are not recovered from train operators through charges.

Station Charges

Question 4: Long term charge: Do you support our recommendation that the methodology for the LTC at managed stations be recalibrated?

Managed Stations

Currently, the managed station long term charge (LTC) is set equal to the annual average of efficient forecast maintenance, renewal and repair (MRR) costs, based on a forecast of 100 years for operational property and 35 years for Station Information and Security Systems (SISS).

We consider that the LTC at a managed station should be set so as to recover, in the long run, all expected efficient MRR costs at that station. This long run approach is appropriate because it evens out the lumpy nature of MRR spending at these stations. In the absence of this long run approach, charges would be much more volatile.

A long run approach is also appropriate because the benefits of MRR work are seen over long periods of time. Without adopting a long run approach the costs of these works would only fall on current users, with future users not paying for any of the benefits that they enjoy.

Our approach to calculating the operational property element of LTCs for CP5 was based more heavily on local knowledge and reflected advances in our asset modelling capacity (compared with previous control periods). However, it did have limitations. In particular, the model did not take into account work carried out in previous control periods. The model also forecast costs to be zero over 100 years for a cost category where there were no expected costs in CP5.

On that basis, we support ORR's recommendation that the model used to forecast MRR costs for the LTC at managed stations should be recalibrated, in particular addressing the model limitations as described, above. Consistent with the comments made in ORR's draft impact assessment, we will ensure that stakeholders are kept informed of the likely implications of our proposed modelling improvements as the work progresses. We expect to provide further details in our summer 2017 consultation.

We would also like to highlight that the LTC is only intended to recover expected efficient MRR costs and that there are limitations to what can be achieved through the charging regime alone. We are currently undertaking a wider piece of work which is looking at raising standards at managed stations through better management models.

Franchised Stations

Although the consultation question relates to the managed station LTC, we would like to clarify that, we will not be proposing, and would not support, changes to the structure of the LTC at franchised stations. This is consistent with ORR's intention to focus on areas where there is a strong case for reform.

Our intention is to calculate franchised station LTCs consistent with the methodology used to calculate those charges for CP5 and we will discuss this further in our summer 2017 consultation.

Question 5: Qualifying expenditure: Do you agree with our recommendation that we support the work to make total QX charges more transparent at both managed and franchised stations?

We agree with ORR's proposal to support work aimed at making total QX charges more transparent at both managed and franchised stations. We think that this work can take place outside of the periodic review process and that greater transparency can be achieved before the start of CP6.

Consistent with ORR's draft impact assessment on QX transparency, we think that greater transparency of QX charges could have beneficial results. For example, the increase in available information could make it easier for operators to know whether any QX charges levied on them were likely to be cost reflective. This could lead to more informed negotiations between Station Facility Owners and operators and, over time, more efficient station operating costs.

However, like ORR, we recognise that QX figures could be misleading if published without supporting information which puts the figures into context. There are disparities between different stations which contribute to differences in QX between stations. Differences between stations include, but are not limited to:

- Differences in their area (m2) which contributes toward differences in QX because, all else being equal, one would expect the costs associated with providing services (e.g. cleaning) over a larger area to be greater;

- Differences in their usage (the number of entries, exits, and interchanges at a station) which contributes toward differences in QX because, all else being equal, one would expect the costs associated with operating a busier station to be greater; and

- Differences in the services offered by the station facility owner (SFO) at stations which contributes toward differences in QX because it means that there are costs recovered through QX at some stations that do not need to be recovered at other stations.

For this reason, it can be very difficult to make meaningful like-for-like comparisons between QX at different stations.

As noted in the draft impact assessment, we are planning on publishing on our website total QX charges for each managed station. Information about these charges will be accompanied by a document which will provide context for the figures and help to explain why QX differs between managed stations. This will possibly include a number of case studies looking at a range of managed stations and explaining QX charges at those stations. We will publish this information in due course.

We think that it is important to stress that managed stations are only a small proportion of the total number of stations across the network. Consequently we support greater transparency of QX charges at franchised stations too, which is necessary if the full benefits of QX transparency are to be realised.

QX Management Fee

We would also like to take this opportunity to confirm our intention to consult, in summer 2017, on the methodology used to calculate the management fee element of QX at managed stations for CP6.

The QX management fee for managed stations is the only part of the QX charge that is regulated and determined by ORR. The Independent Station Access Conditions require ORR approval of the management fee for managed stations before the start of each control period. The management fee is levied as a percentage of the fixed element of QX.

There are two parts to the QX management fee. The first part recovers central overheads in respect of operating, or procuring the operation of, the managed station.

The second part is a profit element, charged to reflect the risk we take on in providing the services covered under QX. For CP5 we undertook a benchmarking exercise to ascertain what would be an appropriate profit element. This benchmarking exercise considered QX charges at franchised stations, the management fee charged to retail tenants at managed stations and external advice from property experts.

For CP5, ORR approved a management fee of 6.54%. This consists of 1.54% to recover central overhead costs and a 5% profit element.[2]

In summer 2017, we expect to consult on: the costs we expect to include in the central overheads element of the QX management fee; and the results of initial benchmarking exercises to calculate an appropriate profit element.

Variable Usage charge

Question 6: Do you support our recommendation not to make fundamental changes to the VUC for PR18?

Yes, Network Rail strongly supports ORR's proposal not to make fundamental changes to the structure of the Variable Usage Charge (VUC) for CP6. Indeed, we stressed the

[2] 'Network Rail managed stations – decision on the approval of the qualifying expenditure (QX) management fee for control period 5 (CP5)' available at: http://orr.gov.uk/__data/assets/pdf_file/0008/17792/2015-04-30-management-fee-decision-letter-cp5.pdf.

importance of retaining the current structure of the VUC in response to ORR's first charges and incentives consultation, particularly given other significant industry reforms (e.g. the introduction of route-based and System Operator regulation).

We understand that ORR was considering geographically disaggregating the VUC and using top-down econometric benchmarking to inform the level of the charge. Working closely with RDG, we explained to ORR why the industry did not support introducing these changes. We welcome the fact that ORR has taken on board feedback from the industry in relation to these two potential changes, and will not pursue them further in PR18.

Question 7: Do you have any suggestions for 'recalibration' style changes to the VUC you would like to see considered for PR18 implementation?

Network Rail supports the two recalibration style changes highlighted by ORR in its consultation document. Namely, we support reviewing:

1. Whether it continues to be appropriate to apply a single speed assumption in respect of each vehicle class when they operate over different routes with different maximum line-speeds.

2. Whether the vehicles characteristics which underpin CP5 VUC rates continue to be appropriate.

In relation to point one, above, we would like to work with the industry to make incremental improvements to the current charging arrangements. However, we would want to ensure that any changes do not create an undue burden on the industry (e.g. in terms of approving new rates) and that we are able to accommodate these changes in our billing system. We will discuss potential options for reflecting different speeds in VUC rates as part of our summer 2017 consultation.

As part of our summer 2017 consultation we will invite stakeholders' views on other potential recalibration style changes to the VUC for CP6. We also hope that this ORR consultation will help to identify potential changes that stakeholders would like to see implemented in CP6. We would be happy to discuss these other potential changes with stakeholders, prior to issuing our summer consultation. Generally, we consider that any recalibration style changes for CP6 should be proportionate in the wider context of not making fundamental changes to the VUC as part of PR18. Moreover, there will need to be sufficient time left in the periodic review process to evidence and implement any potential changes.

In addition to the recalibration style changes discussed, above, which will impact on the distribution of variable usage costs between different vehicle types, Network Rail also plans to review the 'level' of the VUC for CP6 (i.e. whether on average charges are currently too high or too low). Updating the level of the charge is part of the standard recalibration process at a periodic review. However, ORR has indicated that for CP6 it would not be possible to phase in any increases in the level of the charge unless these result from substantive methodological changes. This represents a significant change in approach from PR13 and could potentially have a significant impact on operators' charges.

An initial indication of the revised level of the VUC charge will emerge over the next few months, when we translate ORR's policy decisions and our PR18 cost forecasts into proposed access charges. It is possible that our revised PR18 cost forecasts could imply a significant increase in the level of the VUC for CP6 (e.g. as a result of increased unit rates). Any increase in this respect would be exacerbated by ORR's view that it would not be possible to phase in any increase to charges, and the unwinding of ORR's caps on the CP5 variable usage charges. We are very mindful of the fact that freight and open access operators' business models are vulnerable to increases in access charges. We are, therefore, planning to develop an initial estimate of the likely change in the level of the VUC prior to issuing our summer consultation and to share this with industry. If this analysis indicates an increase in the level of the VUC, it will be important for all industry colleagues to work together and consider how this could best be managed. It will also be important that ORR considers the impact of changes to the level of access charges in the round, rather than at an individual charge level.

Capacity Charge

Question 8: Do you support our recommendation not to replace the Capacity Charge with adjustments to Schedule 8 benchmarks?

Before addressing ORR's consultation question, we have set out some general comments and observations on the Capacity Charge. In particular, we think it is important to reflect on the findings from RDG's Review of Charges in relation to the Capacity Charge, as well as to consider the purpose of the Capacity Charge, prior to responding to specific options for the charge in CP6.

Prioritisation

During RDG's Review of Charges, it was agreed that the Capacity Charge was one of the areas that should be prioritised for review for CP6. We are concerned that this has not happened, and that the current options for the Capacity Charge are not particularly well-developed for this stage of the periodic review. This may impact on Network Rail's ability to undertake a recalibration of the charge for the beginning of CP6, if necessary.

It is important that ORR prioritises its work in this area. We are currently working closely with industry colleagues, through RDG, to develop a Capacity Charge, or similar mechanism, for CP6 that is workable and acceptable to all parties. We would welcome ORR's input into these discussions.

Purpose of the Capacity Charge

ORR has presented a number of high-level options for changing the Capacity Charge for CP6. It is vital that each of these options is assessed against the purpose of the Capacity Charge which is to recover Network Rail's additional Schedule 8 costs resulting from increased traffic on the network.

We are very concerned that ORR does not appear to assess the Capacity Charge options against this purpose. For example, in the consultation document ORR notes that the current Capacity Charge "is not well correlated with congestion on the network". It should not be expected that the Capacity Charge would achieve this. Whilst in general Schedule 8 costs are higher when congestion is higher (and therefore the Capacity Charge rates are higher), this is not always the case. The Capacity Charge is dependent on both congestion-related reactionary delay and the Schedule 8 payment rates which are very wide ranging since they reflect train revenues and not congestion. For example, we observe Network Rail payment rates for one operator that are five times higher than those for another operator on the exact same part of the network. It can therefore be the case that Capacity Charge rates are relatively low in congested areas, if the Schedule 8 payment rates in that area are low.

This lack of correlation with congestion should not be considered a failing of the current Capacity Charge, which achieves its stated purpose. Any charge that is purely based on congestion would be more of a 'scarcity charge'. Whilst the Capacity Charge may share some features with a scarcity charge, this is not its purpose. If ORR considers that there could be merit in introducing a scarcity charge, this should be openly discussed.

In addition to this, ORR's impact assessments of the Capacity Charge options note that the charges and incentives regime as a whole should ensure that Network Rail has the correct incentives to grow traffic. We agree with this statement, and believe that this should be a key consideration throughout the periodic review process. However, ORR then appears to assess the Capacity Charge on its own against this. The Capacity Charge should not be expected to achieve this on its own, and we do not consider it a failing of the Capacity Charge that it does not provide Network Rail with the correct incentives to grow traffic. We consider that the charges and incentives framework, as a whole, should be assessed against this objective. The Capacity Charge, like the other short-run variable charges, plays a very important function in holding Network Rail financially neutral to changes in traffic levels. If the Capacity Charge did not achieve this purpose, Network Rail would be financially penalised from accommodating additional traffic. The Volume Incentive aims to provide a financial incentive to increase traffic levels. There would be considerable merit in reviewing the effectiveness of the current Volume Incentive and whether it needs to be further strengthened to drive intended behaviours.

Phasing in / capping the Capacity Charge

In its consultation, ORR suggests that EU legislation relating to the calculation and implementation of costs directly incurred[3] applies to the Capacity Charge, which means that it cannot be capped or phased in for CP6. We understand that this legislation applies when calculating direct costs for the purpose of setting the charges for the **minimum access package** only. The consultation document sets out that costs recovered by the Capacity Charge do not fall within the scope of the minimum access package, so we do not consider that this legislation would apply to those costs. Therefore, if ORR's interpretation of the minimum access package is correct, the Capacity Charge should be treated as a mark-up, where the rules do not contain the same restrictions on caps or phasing in. This approach would mean that the industry has more flexibility when developing Capacity Charge options during the periodic review. It is important that ORR clarifies this matter as soon as possible.

[3] Commission Implementing Regulation (2015/909)

ORR's recommendation not to replace the Capacity Charge with adjustments to Schedule 8 benchmarks

We agree with ORR's recommendation to not replace the Capacity Charge with adjustments to the Schedule 8 benchmarks.

This option was put forward as part of [RDG's Review of Charges](), and we worked with industry (through RDG) to develop this idea further. However, during the course of these discussions, we identified a number of issues with the Schedule 8 benchmark adjustment approach which we do not consider can be overcome for CP6. We have set out the most problematic of these issues, below, and would be happy to discuss these with ORR if useful:

1. This approach would create a significant administrative burden for the industry, as Network Rail's benchmarks would need to be recalibrated more frequently during the control period than currently. These recalibrations would need to ensure, for example, that the star model (whereby all Schedule 8 compensation is passed through Network Rail) was balanced. It would also be difficult to determine which traffic should be accounted for in the adjustment to Network Rail's benchmarks. For example, it may not be appropriate to adjust Network Rail's benchmarks if there have been, or were expected to be, a large number of possessions.

2. Freight and charter operators would face a cross-subsidy as they current have a single, national Schedule 8 regime for all operators. When one operator increases their traffic, Network Rail's Schedule 8 benchmark would have to change for all freight/charter operators across the entire network, in order to maintain the national regime.

3. Adjusting the benchmarks of the operator increasing its traffic may mean that Network Rail does not fully recover its additional Schedule 8 costs. While it should be possible to neutralise the additional Schedule 8 costs for the operator increasing its traffic, it would only be possible to neutralise the effect on other operators by changing their Network Rail benchmarks. This is inconsistent with the purpose of the Capacity Charge.

4. With annual adjustments, there could be a time lag of up to one year before Network Rail's Schedule 8 benchmarks change to account for additional traffic.

We understand that some freight operators may still be attracted to this approach. However, and as noted above, in order for Network Rail's Schedule 8 costs associated with additional traffic to be neutralised, this would have to involve a change to all affected operators' benchmarks, including passenger operators. Without the adjustment to the Network Rail benchmarks for affected passenger operators, Network Rail would not be held financially neutral to changes in freight traffic levels. There could be merit in exploring this option further with freight operators, provided that Network Rail is held financially neutral to the increased Schedule 8 costs.

Question 9: Do you think we should: a) retain the existing CC (but remove the caps on open access, freight and charter operators); b) removed the existing CC and recover lost revenue through fixed cost charges; or c) do you have any alternative proposals?

The RDG Schedule 4/8 and Capacity Charge group is formed of a representation of RDG members across the industry. This group agreed that, in assessing the Capacity Charge or any alternative mechanism for CP6, the following principles should apply:

1. There should be, as far as possible, a predictable and stable charging regime for all operators.

2. Trains of a similar nature operating on the same parts of the network should have their various access charges set on a consistent basis.

3. Network Rail's incremental Schedule 8 costs of traffic growth above the control period baseline should be neutralised.

4. Any Schedule 8 cost consequences of running additional traffic should be reflected in that part of the network.

5. There needs to be an effective and transparent transmission mechanism to incentivise Network Rail to balance appropriately the costs and performance consequences of additional rail traffic.

6. Any alternative to the Capacity Charge should be workable and internally consistent – there should be no 'special arrangements' for CP6.

We strongly recommend that ORR assesses its options, and any future options that are developed for the Capacity Charge, against these RDG-agreed criteria.

In its consultation, in addition to the 'do nothing' option, ORR explores three high-level options for the Capacity Charge for CP6:

Option 1: Retain the existing charge, but remove caps for open access and freight (addressed under part (a) of this question)

Option 2: Replace the charge with adjustments to Schedule 8 benchmarks (addressed under our response to question 8)

Option 3: Remove the charge and recover lost revenue through higher fixed cost charges (addressed under part (b) of this question)

'Do nothing'

ORR assesses the 'do nothing' option against two objectives: "provide accurate incentives for Network Rail to add traffic to the network" and "ensure operators take costs of service into account when using the network". In the impact assessment, ORR scores this option as only partially meeting each of these objectives. We disagree with this assessment. The Capacity Charge holds Network Rail financially neutral (in respect of Schedule 8) to accommodating additional traffic, and so achieves the first objective well in the context of the charges and incentives regime as a whole (of course, the Capacity Charge alone could not incentivise Network Rail to add traffic to the network). Also, the Capacity Charge exposes operators to the increased Schedule 8 costs that they create when additional traffic is added to the network. It therefore also meets the second objective.

Option 1: retain the existing Capacity Charge but remove the CP5 caps

This option would recover Network Rail's Schedule 8 costs associated with additional traffic on the network, and so would achieve the purpose of the Capacity Charge. It would ensure that Network Rail did not face a disincentive to accommodate additional traffic on the network. This option would also remove the current wash-up process, so would make the Capacity Charge less complex, reduce uncertainty of payments and make the charge easier to administer. On this basis, we support Option 1. However, we understand that this option may not be affordable for freight, charter and open access operators. It is important that the affordability of the whole charging regime is assessed for each type of operator, and not in isolation for each charge.

Option 3: remove the existing Capacity Charge

We are concerned that this option would not achieve the stated purpose of the Capacity Charge. It would result in Network Rail being financially penalised through additional Schedule 8 costs when traffic is above expected levels. As a result Network Rail could be financially very reluctant to accommodate additional traffic on the network. Without an adjustment to Network Rail's funding for the additional Schedule 8 costs it faces from accommodating above expected traffic levels, we cannot support this option. One way to overcome this, suggested by ORR, is to recover the 'missing' Capacity Charge income through the Volume Incentive. However, under this approach Network Rail would face a cash shortfall within CP6 since additional funding through the Volume Incentive would not be provided until the next control period. Furthermore, this would create a dual purpose for the Volume Incentive of both cost recovery and an incentive to growth traffic. We are unsure how effective this would be in practice. Below, we discuss our other concerns with this option.

We are concerned that this option is the preferred option for the Capacity Charge, according to ORR's impact assessment. In assessing this option, ORR has scored it neutrally, as "no change relative to the do nothing" against all of the specific and general objectives, on the basis that there is a large amount of uncertainty regarding mark-ups and therefore no other score could be provided. Given this high degree of uncertainty, we do not believe it is appropriate that this option is considered the "best option under each state of the world" in ORR's impact assessments.

In these impact assessments, ORR notes that the reduction in revenue from removing the Capacity Charge would be offset by an increase in the revenue recovered through revised fixed cost charges. This is not necessarily true. Fixed cost charges recover the fixed costs of running the network, and so it would be highly unlikely that these would bear any resemblance to Network Rail's additional Schedule 8 costs resulting from above forecast traffic. Furthermore, fixed cost charges would only be able to recover any costs relating to above forecast mileage if they were charged on a variable basis (e.g. per train mile). The additional Schedule 8 costs that Network Rail incurs relate to the traffic above forecast levels, and so this option would not work if ORR's proposal to charge fixed costs on a variable basis does not materialise. In addition to this, fixed cost charges will be subject to a market-can-bear test. This means that there is a possibility that certain markets will not be able to afford their full allocation of fixed costs. In this situation, Network Rail would need additional funding to ensure that its fixed costs, and additional Schedule 8 costs, are fully recovered.

Furthermore, ORR notes that this option could potentially replicate and possibly improve upon the incentives under the current Capacity Charge. We consider that this option would achieve neither of these. Fixed cost charges recover different costs from the Capacity Charge. With the removal of the Capacity Charge, operators would not consider the financial impact of Schedule 8 when planning new services. This proposal would therefore not improve upon the current Capacity Charge incentives. Fixed cost charges could also potentially set some very different incentives from those that ORR hopes to achieve from the Capacity Charge. For example, the initial work on fixed cost allocation found that the allocation of fixed costs to operators on heavily congested sections of infrastructure are often lower than in less congested areas (because of economies of scale).

Finally, this option for the Capacity Charge is largely reliant on ORR's early ideas on fixed cost charging being adopted for CP6. We are not clear whether or not these proposals will be taken forward. In fact, ORR notes that the option for fixed costs depends on the detailed design and implementation of the review of fixed cost charges which will not be known for some time. In light of this uncertainty, we would welcome ORR working with the industry to develop alternative approaches to the Capacity Charge for CP6 which do not rely on the approach to fixed cost charging. This should be a priority in the coming weeks.

Alternative proposals

Network Rail is working with the industry, through RDG; to develop alternative proposals for ORR's consideration (e.g. "£0 on baseline traffic", "Capacity Charge rebates" and "market-based wash ups", all of which are explained in detail in RDG's response) which we think are an improvement to the options that ORR has presented in its consultation. Please refer to the RDG response for further discussion of these alternative options. We would welcome ORR engagement in this process.

Traction Electricity Charge

Question 10: Do you support our recommendation to keep the loss incentive mechanism?

We consider that there would be merit in ORR discussing its proposals further with the industry before it concludes. We set out some observations below.

Management of transmission losses

In PR13, ORR stated that the intention of the loss incentive mechanism was to expose Network Rail to an additional share of the volume reconciliation (over and above the exposure we would get from our own use of traction electricity) in order to incentivise more efficient management of transmission losses.

ORR states “it is unclear whether the mechanism has had useful incentive effects” in reducing transmission losses. Interventions aimed at reducing transmission losses are expensive and the benefits are, in many cases, not sufficient to generate a positive business case for undertaking this investment, even taking a whole industry perspective. Therefore, we do not consider that the loss incentive mechanism has a strong effect with regards to this aim.

In addition, as ORR notes, the mechanism has had the unintended consequence of moving a small amount of money from modelled operators to Network Rail.

We do not agree with ORR’s view that this is because there has “consistently been a big difference between actual and forecast losses in PR13”. Instead, we think that the size and direction of the year-end volume reconciliation is mainly the result of modelled traction electricity consumption rates being inaccurate and, probably, too high. One way for train operators to respond to this would be for them to move from modelled to metered billing for their EC4T usage.

<u>Increased on-train metering</u>

It was also noted that the loss incentive mechanism could increase the incentive on modelled operators to adopt on-train metering in ‘money-back’ ESTAs[4].

We fully support on-train metering, having been involved in its initial stages and contributed to its subsequent developments.

We agree that the loss incentive mechanism could have provided an additional financial incentive for modelled operators to become metered. We are also aware of additional factors that influence whether train operators meter trains, for example franchise agreements.

<u>Incentives to accurately forecast transmission losses</u>

We do not agree with ORR’s statement that the loss incentive mechanism incentivises Network Rail and relevant train operators to ensure that forecast losses are reflective of likely outturn losses.

The Distribution System Loss Factors (DSLFs) are charged as a mark-up on metered consumption and metered train operators are, therefore, in theory incentivised to argue that our transmission forecasts are too high. An estimate of transmission losses is included in modelled consumption rates and these are taken into account in the year-end volume reconciliation. As a result, train operators who are charged for traction electricity based on modelled consumption rates would benefit from higher DSLFs (all else being equal) as these higher rates would only be payable by metered operators. They are, therefore, in theory incentivised to argue that our transmission loss forecasts are too low.

Consequently, neither metered nor modelled train operators have a financial incentive to ensure that forecast transmission losses are reflective of actual outturn as metered

[4] ‘Money-back’ ESTAs are ESTAs where the modelled kWh that operators are billed in the financial year exceeds their actual consumption, leading to a decrease in the kWh consumption allocated to these operators in the year-end volume reconciliation and, consequently, a refund from Network Rail.

operators will prefer 'low' transmission loss mark-ups, whereas modelled operators will prefer 'high' transmission loss mark-ups.

We are currently undertaking work to forecast transmission losses for CP6 and to calculate the DSLFs to be applied to metered traction electricity consumption. We are carrying out this work in a transparent and collaborative manner. For example, we have given several presentations to the cross-industry Traction Electricity Steering Group and will continue to ensure stakeholders are kept updated as the work progresses.

Risk-sharing

ORR argues that the loss incentive mechanism "shares the risk of forecasting errors between Network Rail and those train operators with modelled (i.e. non-metered) consumption". We interpret this statement as ORR meaning that it is forecasting errors in the transmission loss mark-up which is shared between NR and modelled operators. As noted previously, the transmission loss mark-up is only applied to metered operators – so, *prima facie*, it is metered operators who are most exposed to the risk of errors in forecasting the transmission loss mark-up.

The loss incentive mechanism has the effect of exposing NR to a greater proportion of the consumption that needs to be 'washed-up' in each ESTA at the year end, than would be the case if the wash-up was done purely based on modelled operators' and NR's estimated consumption. For each ESTA, NR's share of the wash-up is increased by assuming all of the estimated transmission losses (for all consumption) in the ESTA are consumed by NR. This has the effect of reducing modelled operators' exposure to the risk of the transmission loss mark-up being wrong. Therefore, we consider that this leaves modelled train operators less incentivised to ensure that transmission loss mark-ups are accurate than would be the case in the absence of the loss incentive mechanism.

Therefore, we think that there would be merit in ORR engaging further with the industry to clarify the efficacy of the loss incentive mechanism before it concludes.

Traction Electricity Charge: Further considerations

Default modelled consumption rate

We would like to take this opportunity to confirm that it is our intention to consult on introducing a default modelled consumption rate for electric train services for CP6. The purpose of a default rate would be to: provide us with a contractual basis, where a generic consumption rate does not exist, for billing modelled services whilst waiting for a modelled consumption rate to be consented to / determined by ORR; provide an incentive for operators to apply for a modelled consumption rate at the earliest available opportunity; and provide us with a contractual basis for billing metered services whilst waiting for the relevant track access contract to be supplemented to allow for billing on the basis of meter readings.

There have been occasions where the process of obtaining a modelled consumption rate for a particular fleet has taken a prolonged period of time. We are concerned that were a modelled consumption rate not to be consented to / determined by ORR before the end of the relevant financial year and a generic consumption rate for the vehicle type concerned not to exist, we could have a situation where we would be unable to bill the fleet involved for its traction electricity.

There is a deadline of the end of the relevant financial year for modelled consumption rates to be consented to / determined by ORR because of the need to conduct the year-end volume reconciliation, which reconciles modelled consumption with actual consumption. Modelled consumption rates need to be agreed before we can start the volume reconciliation. Once the volume reconciliation has started we can no longer recharge journeys that took place in the financial year to which the volume reconciliation relates. If we were unable to bill a fleet for its traction electricity consumption, this could have an adverse impact on other modelled operators who are also in the volume reconciliation. In this situation, a default modelled consumption rate would mean that we would be able to bill these services for their use of traction electricity.

Furthermore, a sufficiently high default consumption rate would incentivise operators to apply for a modelled consumption rate at the earliest available opportunity. At present, modelled consumption rates frequently have to take effect retrospectively. Because there is often a lengthy delay between services first operating on the network and modelled consumption rates for these services being consented to or determined, we have to recharge a significant number of journeys. This is time-consuming, costly and could largely be avoided if modelled consumption rates were consented to or determined sooner.

In addition, a default modelled consumption rate would provide us with a contractual basis for billing metered trains for traction electricity whilst waiting for their track access contracts to be supplemented to allow for them to be billed on the basis of meter readings.

In this situation, we need to be able to bill operators for their traction electricity usage in the intervening period between the train beginning operations on the network and the necessary supplemental agreement being consented to / determined by ORR. A default modelled consumption rate would provide us with a contractual basis for billing services in this situation, without the need to undertake overly burdensome work to model consumption rates.

Regenerative braking discounts applied to modelled consumption rates

Modelled services which utilise regenerative braking are eligible to have a percentage discount applied to their modelled consumption rates. The discount that is applied varies depending on the type of infrastructure which the service operates on (AC or DC) and, on the AC network, according to the distance between station stops.

The discounts that are currently applied were set some time ago and on the basis of estimates. We now have a significant amount of data available from meters on-board trains that are capable of regenerative braking and, as discussed at meetings of the Traction Electricity Steering Group, we think that there is merit in using this data to recalibrate the regenerative braking discounts. We are currently undertaking this work and will share the results with ORR and industry in due course.

Electricity asset usage charge

Question 11: Do you support our recommendation that the EAUC not be altered, beyond recalibration, in PR18?

We support ORR's recommendation that the Electricity Asset Usage Charge (EAUC) is not altered, beyond recalibration, in PR18.

In its Review of Charges, RDG assessed the current charges and incentives regime. It found that industry was broadly supportive of the EAUC in its current form and that it was not considered a priority area for review.

We fully support RDG's Review of Charges work and, consequently, agree with ORR's recommendation.

Coal Spillage Charge

Question 12: Do you support our recommendation to abolish the CSC?

Yes, Network Rail supports ORR's proposal to abolish the Coal Spillage Charge (CSC).

We recognise that the coal traffic has declined materially in recent years, significantly reducing the impact of coal spillage and, therefore, the revenue that we receive through the charge. This reduction, from c. £3m in 2014/15 to forecast income of c. £0.2m in 2018/19, increases the likelihood of the work required by the industry to recalibrate the CSC becoming disproportionate. We also recognise that the incentive properties of the charge are relatively weak. For example, if an operator takes steps during the control period to reduce the amount of coal spillage from its wagons, this would not be reflected in the charge that the operator pays during the control period.

As noted in ORR's consultation document, although we support ORR's proposal to abolish the CSC, we would like to explore with freight colleagues a contractual approach to recovering spillage costs. This would allow us to claim under the track access contract for the actual costs that we have incurred cleaning up spillage from freight wagons. The proposed approach would apply to all commodities, rather than just being limited to coal spillage.

We envisage only being able to claim for spillage costs where we have appropriate supporting evidence in relation to the operator that was responsible for it. We want to ensure that operators continue to take steps to minimise spillage from their wagons on the network. Unlike the current charging approach, we consider that an improved contractual approach to recovering spillage costs would be more targeted and, therefore, have a stronger incentive effect. We are mindful, however, that any contractual processes for recovering spillage costs must be proportionate and avoid undue transaction costs, if they are to be successful.

Schedule 8

Question 13: Passenger compensation: What are your views on the options of passenger compensation recovery and improving the transparency of compensation relating to Network Rail's actions?

Network Rail is supportive of passengers getting better compensation when their train services have been disrupted. If passengers receive an appropriate level of compensation for disruption, we consider that this could reduce their reluctance to use rail in the future and therefore reduce train operators' future revenue losses.

We welcome ORR considering ways to improve how passengers do get appropriate compensation when their journeys are disrupted. However, we consider that the current arrangement by which train operators are responsible for all passenger compensation has considerable merit, as it means that train operators have a financial incentive to minimise disruption in all instances. It is also consistent with the basis on which they won their franchises.

General comments

If, however, ORR does conclude that Network Rail should make financial contributions towards passenger compensation, we consider that train operator's reduced future revenue losses should be reflected in Network Rail's Schedule 8 payment rates to reflect the fact that the compensated passengers would be less likely to put off from travelling by train in the future. However, calculating this effect will be very difficult to do accurately, and the existing Schedule 8 payment rates are already very hard to calibrate. In fact, we believe that some of the current Schedule 8 payment rates may already be too high, and could be considered to provide operators with too much compensation for their future revenue losses due to delays. Therefore, some of the existing Schedule 8 payments could be put towards paying for passenger compensation.

If, however, there were to be an increase in the compensation that Network Rail pays to train operators for delays, this additional expenditure will need to be reflected in Network Rail's CP6 regulatory settlement. Network Rail will not, otherwise, be able to afford this. Alternatively, a benchmark level of delays triggering passenger compensation could be set. For performance worse than the benchmark level, Network Rail would make payments to operators to cover their passenger compensation costs. However, this approach will increase the already significant financial risk to Network Rail of below benchmark performance.

We would also be concerned that paying for passenger compensation caused by Network Rail disruption could reduce train operators' financial incentive to take actions to help Network Rail reduce the impact of delays. Train operators are currently responsible for paying all passenger compensation, and therefore have a financial incentive to help Network Rail mitigate reactionary delays.

We understand that train operators have bid for their franchises on the basis of having to pay all passenger compensation. Therefore, we assume funders would need to adjust for any compensation payments to operators from Network Rail through adjustments to the franchise financial models.

Finally, we would be concerned if the inclusion of passenger compensation in the Network Rail performance regime in CP6 would change the nature of the relationships between Network Rail, passenger operators and passengers, particularly in the approach to how disruption is managed ‘on the ground’. It might therefore be better for train operators to pay for all passenger compensation rather than introducing potential conflict through allocation between Network Rail and operators. We would welcome further discussion with ORR and industry about this.

Recovering passenger compensation costs

We agree with ORR’s recommendation not to pursue a liquidated damages regime for passenger compensation. It would be highly complex to attempt to build this into the Schedule 8 regime, and creating a new liquidated damages regime would be difficult, inaccurate, costly and time consuming. Furthermore, ORR’s proposal to not update the freight or charter operator payment rates in light of the additional compensation payment would leave Network Rail with a funding shortfall, which would need to be addressed.

We consider that a claims-based approach would have advantages over a liquidated damages approach. However, we are concerned that this could create a significant administrative burden on both Network Rail and operators. Network Rail would have a duty to ensure that operators’ claims are appropriate before paying them, and so each claim would need to be carefully assessed. To do this, it would be necessary to verify the cause of the delay which has resulted in passenger compensation payments. This would be particularly difficult when a service experiences delays caused by multiple parties, and each of the delay incidents may not trigger a passenger compensation payment in isolation. There would also be additional complexities with this approach. For example, as there is not a standard passenger compensation regime which applies to all operators, Network Rail would have to verify passenger compensation claims based on differing regimes. This would complicate the process of verifying claims. Furthermore, there appears to be an imbalance in ORR’s proposal, as operators would not be able to claim for passenger compensation payments as a result of delays caused by other operators.

In addition to this, we do not agree that Network Rail paying for passenger compensation would necessarily strengthen the financial incentives on Network Rail for dealing with disruption. Network Rail already faces strong incentives to improve performance through Schedule 8 and regulatory performance targets. Introducing an additional cost to Network Rail is unlikely to make a significant difference to our incentives. The significant money flows in the Schedule 8 regime already result in caution when accommodating additional traffic on the network or reworking timetables. An increase in the payments for disruption could serve to enhance this caution, and could create a perverse incentive whereby Network Rail may be reluctant financially to accommodate additional traffic.

Finally, we do not consider that discretionary payments to passengers, over and above standard compensation, should be included in claims for passenger compensation. This could result in vast differences in the payments that passengers receive for disruption, depending on which industry party has caused the delay. Network Rail would also face potentially high and volatile payments.

Improved transparency

We welcome any attempts to improve transparency about disruption on the railway. However, we would recommend that this transparency should also be extended to publishing passenger compensation payments as a result of the operator's own delay, and the delay caused by other operators, rather than only publishing the passenger compensation payments relating to Network Rail delays.

Question 14: Approach to setting benchmarks: Do you support our recommendation to only make changes to de-link passenger operators' benchmarks and Network Rail benchmarks for freight operators from past performance (but to leave the approach to the other benchmarks unchanged)?

Passenger regime

Aligning Network Rail passenger benchmarks with Network Rail's performance target

Network Rail supports ORR's proposal to leave the approach to setting Network Rail's benchmarks unchanged. Reflecting Network Rail's performance forecast that is reflected in ORR's Final Determination in the Schedule 8 benchmarks provides consistency on the level of performance Network Rail is expected to deliver. We consider that these forecasts would be set out in the relevant CP6 scorecard and accompanied by an appropriate degree of flexibility in the overall outputs framework to manage uncertainty and any potential changes that occur during CP6 (which Network Rail is exploring with ORR and industry as part of the outputs work for PR18).

However, we understand that the way in which our train performance forecasts are set for CP6 may be on a different basis from previous control periods, and this may affect how Network Rail's Schedule 8 benchmarks are set. Whichever performance forecasting approach is adopted, we recommend that Network Rail's Schedule 8 benchmarks are based on **a point estimate of performance which is forecast for the whole of the control period.** Most importantly, we need to ensure that the performance forecast which Network Rail is set for CP6 is reasonable and achievable. There are real difficulties in accurately forecasting performance several years ahead, and it is important that ORR recognises that Schedule 8 is therefore unlikely to be financially neutral, especially towards the end of the control period. Network Rail needs to be able to manage this significant financial risk, so it is important that the CP6 settlement provides Network Rail with an adequate mechanism to do so. For example, this could be increased debt headroom to cover the Schedule 8 financial risk. The quantum of this risk buffer should be informed by risk modelling. Without this, there is a significant chance that Network Rail could have to cut spending in other areas in order to meet its Schedule 8 obligations.

There are likely to be new performance metrics in CP6. The impact of this will need to be factored into the CP6 recalibration of Network Rail's Schedule 8 benchmarks.

Setting Network Rail and train operator benchmarks based on average network performance

We consider that introducing average Network Rail and train operator benchmarks would not result in an overall benefit to the industry compared to the current approach, and in fact may result in much worse outcomes. We have set out our reasons for this below. If ORR considers that the current approach to setting Schedule 8 benchmarks is inappropriate, we would welcome a discussion with ORR to understand the reasons for this and to explore alternative options.

Introducing average benchmarks for Network Rail and train operators would have the following issues:

a) **Cross Subsidy** between train operators and funders

Setting train operator and Network Rail benchmarks based on average performance across the network could lead to potentially large cross subsidies between train operators and, in some cases, funders. This is because the change in approach to setting the benchmarks would mean that, inevitably, some operators would face additional Schedule 8 payments, despite performing at reasonable or expected levels. These additional Schedule 8 payments would be offset by other train operators benefitting from a benchmark which is lower than their expected performance levels, resulting in a cross-subsidy between the two operators or their funders.

Similarly, the average benchmark approach would be inconsistent with route devolution as funds would need to be 'moved' between routes to balance Schedule 8. Additionally, the financial performance associated with Schedule 8 would be recorded against targets set out in Network Rail route scorecards, which will be agreed with our customers, and could show large over or under Schedule 8 payments even if performance was at expected levels.

This approach would therefore create a lack of transparency about how operators and Network Rail are performing compared to industry expectations. It is also unrealistic to expect the same level of performance to be achievable in each service group across the network, because of differences in service patterns, geography and infrastructure.

b) **Misalignment of incentives**

As part of our Transformation Plan, a key focus in CP5 and going forward is to align our targets with our customers' targets. As stated in the plan, it makes profound sense for all parts of the railway to be working to consistent targets. Currently there are many different performance targets across the industry, for example franchise performance targets, Network Rail's regulatory performance targets and Schedule 8 benchmarks. There is a limited degree of alignment between these measures currently. Network Rail benchmarks are linked to Network Rail's regulatory performance targets, however franchise performance targets are not aligned to either Network Rail's regulatory performance targets or the Schedule 8 benchmarks for Network Rail or operators. The lack of consistency in performance targets can act as a barrier to improving performance, as each party is targeted on, and aiming to achieve, different levels of performance. Setting the Network Rail and train operator benchmarks at the same level for all service groups would exacerbate this issue, since the average benchmarks would not align well to other performance measures for each train operator, or in each geographical area. This approach would, therefore, not be consistent, nor would it support the desire to align industry incentives going forward.

This approach would also send the wrong signals to industry parties about expected performance levels and would substantially weaken incentives to outperform benchmarks, since they would not reflect an achievable or representative level of performance for the majority of service groups.

c) Impact on the **recalibration of Schedule 8**

We believe that the Schedule 8 regime should be financially neutral to all parties if expected performance levels are achieved. We are concerned that ORR's proposal of an average benchmark for all service groups would not achieve this. It would not be possible for train operators to be held financially neutral for expected performance levels, as it will depend solely on how they perform compared to the network average. Similarly, average train operator benchmarks would make it difficult to ensure that Network Rail remains financially neutral through the star model to train operator-caused delays. Finally, it would be very difficult to ensure that Network Rail is held financially neutral provided it achieves its regulatory performance targets, and recalibrating to achieve this would be no simpler than the PR13 recalibration. If financial neutrality could not be achieved, this would need to be reflected in Network Rail's CP6 funding settlement.

This approach would also affect mid-control period Schedule 8 recalibrations. During the control period, we recalibrate Schedule 8 to ensure that train operators and Network Rail are held financially neutral to changes that would affect performance, for example for a significant timetable change (e.g. due to changes in franchises) or a berthing offset change. Network Rail is concerned that implementing average benchmarks in Schedule 8 could make it difficult to continue to ensure train operators and Network Rail are financially neutral to these changes. It would be important to establish, upfront, how we deal with this situation in CP6. One option would be to not recalibrate the benchmarks to account for these changes mid-control period; however train operators and Network Rail would be exposed to the Schedule 8 payments for these changes. The second option would be to recalibrate the affected service group's benchmarks, as we do currently. This would ensure that both parties are held harmless to the changes, and so would better uphold the purpose of Schedule 8. However the benchmarks would no longer be the same and the intention of the average benchmarks would be lost.

Aligning train operator benchmarks to franchise targets

We consider that there could be benefit in aligning train operators' benchmarks to train operators' franchise performance targets. Network Rail is not funded to deliver the level of performance set out in franchise targets, and so it would be inappropriate to align Network Rail's benchmarks to the franchise targets.

a) **Consistency in approach** to setting benchmarks

Currently operator benchmarks are set based on past performance, and therefore their benchmark is set at a level of performance they have proven to deliver for a sustained period of time. Conversely, Network Rail's benchmarks are currently aligned to CP5 performance targets, which are an aspirational level of performance which has not yet been achieved. Aligning train operator benchmarks to franchise targets would provide greater consistency in the approach to setting benchmarks. In turn, this may also provide a stronger incentive for train operators to improve performance.

b) **Aligning incentives**

With regards to performance levels, operators are currently targeted on franchise performance targets and their Schedule 8 benchmarks. These are not currently aligned. Aligning train operator benchmarks to their franchise targets would help resolve this issue by providing train operators with a consistent level of performance that they are expected to deliver. It is also possible that this would better align with Network Rail's regulatory performance forecasts, since a key focus of our Transformation Plan is to better align our, and our customers', targets. Specifically, in our Transformation Plan we committed to "work with DfT to create franchise targets that are aligned with Network Rail targets". However, we note that our performance forecasts will not always align with franchise performance targets, as these may not always represent the latest view of an achievable level of performance for Network Rail. As noted above, it is important that Network Rail's benchmarks are set at a reasonable and achievable level.

This option would greatly help with the current misalignment of incentives, as mentioned in the section, above. Network Rail would, therefore, support further consideration of this option by ORR and industry colleagues.

<u>Other areas</u>

Network Rail believes that there could be merit in reducing the number of decimal places currently used in the Schedule 8 benchmarks in the passenger regime. Schedule 8 benchmarks are frequently recalibrated during the control period, for reasons noted previously, which can result in minor changes to benchmarks. Reducing the number of decimal places from four to three, for example, would remove the need for recalibrating so frequently, therefore saving industry time and resources. The financial impact of implementing this approach would be minimal; if national performance on a day changes by 0.0001 minutes of average lateness, the daily cost per service group is less than £1. It is also important to note that using four decimal places implies a level of forecasting accuracy which may not be realistic.

<u>Freight and charter regime</u>

<u>Aligning Network Rail freight benchmarks with the Network Rail's performance target</u>

As noted in our response to ORR's letter inviting input to the review of Schedules 4 and 8 track access contracts, Network Rail supports ORR's proposal to align Network Rail's Schedule 8 benchmarks with Network Rail's performance target in CP6 as this would create consistency between Network Rail's targets for freight performance. As mentioned above, we consider that these targets would be set out in the relevant CP6 scorecard and accompanied by an appropriate degree of flexibility in the overall outputs framework.

We have undertaken some analysis to examine the relationship between the Freight Delivery Metric (FDM) and Schedule 8 delay minutes per 100 miles, and found that there is a robust relationship between the two measures. In light of the changes to the regime proposed, it is important to consider the expected financial impact of these changes on freight operators.

This approach cannot be replicated for charter services, as Network Rail does not have a performance target for charter operators. We therefore believe that Network Rail's charter benchmarks should continue to be based on past performance.

Continuing to base freight operator benchmarks on past performance

Network Rail is supportive of ORR's proposal to continue to set freight benchmarks based on average freight industry performance during the recalibration period.

Question 15: Measure of passenger operator performance: Do you support our recommendation to change the measure of passenger operator performance to one based on the delay caused to other operators?

We support ORR's recommendation to change the measure of passenger operator performance to one based on the actual delay caused to other operators (i.e. TOC-on-TOC), subject to it being possible to implement through PEARS. Network Rail is currently investigating whether this change is feasible and can be implemented ready for the start of CP6.

We understand that some operators may be concerned that this proposal may dampen Network Rail's incentives to manage reactionary delay on the network. However, we do not consider that this would be the case. Network Rail faces strong incentives on performance improvement, other than the Schedule 8 regime, for example target performance measures used in route scorecards (i.e. including disruption caused by parties other than Network Rail).

Furthermore, it is important to recognise that train operators already pay for the modelled impact of their own disruption on others in the current Schedule 8 regime. Therefore, ORR's proposal would not change what train operators pay for through Schedule 8, it would instead make this payment more reflective of the actual impacts, and therefore more accurate.

Benefits of proposal

We have discussed this option with ORR and the industry previously, and we believe that this will bring about many benefits in addition to those already identified by ORR. For example:

- This would address one of the 'gaps' in the performance regime, identified through RDG's Review of Charges. RDG identified that "the performance regime does not encourage joint working, since operators who help out another operator to recover their service are penalised…"

- Informational benefits, as train operators would better understand how their delays affect other operators. We would work closely with train operators to help them understand this information. This information could be used to inform discussions with Network Rail about resilience planning. We expect that these informational benefits will mean that train operators take a greater interest in understanding which of their services are likely to be high-impacting on other operators (similar to how Network Rail has identified which of its assets cause most delays if they fail). TOCs could then work especially hard to ensure that these services do not cause disruption. We have included some examples of what train operators could do to minimise disruption caused by these high-impacting services (and other services which they run), below:

- Train operators may ask Network Rail to prioritise services other than their own. The current "TOC-on-Self" arrangement is likely to incentivise train operators to minimise the disruption on themselves only, regardless of the knock-on impact of this. The proposed regime would encourage train operators to be more aware of the knock-on impacts of their own delays. For example, if a TOC A train is delaying a TOC B train, the best thing to do for overall delay may be to either cancel the TOC A service or allow the TOC B train to overtake, if this is possible.
  In fact, one of the issues with the current "TOC-on-Self" regime is that train operators have to pay through Schedule 8 for cancelling their own services, even if this does not cause any reactionary delay to others. ORR's proposed approach would not require train operators to pay for a cancellation of their own service if there was no knock-on disruption. Additionally, and as train operator colleagues have pointed out, train operators already have many incentives to minimise the disruption they cause to themselves (e.g. through franchise agreements and their own revenue).
- Train operators may become even more interested in timetable planning, to ensure a robust timetable that minimises the impact of overall delay (including other operators' trains) rather than just accommodating as many trains on the network as possible.
- Train operators may put in place better operational plans to deal with reactionary delay when it does occur. For example, having additional train crew on 'stand-by', investing in more reliable trains etc. Freight operators already do this, partly due to their FOC-on-Third Party Schedule 8 regime. This could especially be the case for the train services that have been identified as being especially likely to cause significant delay to other train operators' services.
- There may be improvements to passenger communication if delays do occur, to ensure passengers are waiting at the correct platforms on stations and so can board the train quicker thus facilitating fast despatch.

- ORR's proposal does not just improve incentives. It would also ensure a better neutrality of payments through the star model. Current estimates suggest that Network Rail incurs costs of c.£15m p.a. due to the star model not being 'balanced' (i.e. Network Rail pays out more for TOC-caused disruption than train operators pay to Network Rail). Network Rail is not funded for these costs, and so must reduce activities in other areas to fund this shortfall. Better alignment of the star model will be particularly important for CP6, as there have been, and will continue to be, significant timetable changes during CP5 due to multiple franchise re-mappings. These changes would mean that the current approach (of train operators paying Schedule 8 based on a pre-determined level of reactionary delay) will be very difficult to accurately calibrate for CP6.

We believe that ORR's proposal may help drive better conversations within train operators and with Network Rail. This could then lead to more informed 'high level' decisions to deal with the impact of delays and to provide a better service for passengers. For example, through better conventions for train regulation.

Systems changes

As ORR mentions in its impact assessment, if this proposal were to be pursued for CP6, it would be necessary to update PEARS[5] such that it can process the potential new basis of train operator payments. It is intended that PEARS will be updated for CP6 anyway, so this change could be made as part of that update.

Delay attribution

Moving to a TOC-on-TOC regime may impact on delay attribution. The suggested change to the regime could result in train operators engaging more in delay attribution for reactionary delay that they have caused. This additional engagement could result in better and more transparent delay attribution, which in turn could allow Network Rail and train operators to identify performance improvement measures. However, we should also be mindful that there may be an increased number of challenges to delay attribution due to the financial incentive, and that this may require some additional industry effort.

Understanding

We recognise that this approach may make the Schedule 8 calculations more difficult to understand, as operators' payments would depend on multiple interactions with other operators, rather than just the lateness they cause themselves. If this approach were to be taken forward, we would work closely with operators to ensure they have the information needed to be able to understand the new calculations.

Question 16: Sustained poor performance provisions: Do you support our recommendation to limit SPP to costs compensation only?

We strongly support ORR's recommendation to change sustained poor performance (SPP) provisions such that claims may be made for costs only. We consider that this change could bring several benefits to the SPP mechanism, for example it could vastly reduce the amount of industry time and resource spent on processing each claim. We also note that ORR hosted an industry workshop in summer 2016 on Schedules 4 and 8, in which it raised the idea of SPP being for cost compensation only. At that workshop, there was strong industry support for this proposal.

[5] PEARS is the Network Rail performance reporting system, which calculates the Schedule 8 payments.

Alongside this change, we believe that it would be appropriate to change the SPP thresholds. Currently, the SPP thresholds are set based on Schedule 8 compensation payments from Network Rail, which reflect train operators' revenue losses. The current thresholds, therefore, bear little resemblance to the claims that could result from this change to SPP, and it would not be appropriate to use these as a trigger for cost compensation claims. We believe that the SPP threshold for a cost-only mechanism should reflect the following:

- The level of performance, below which train operators' costs are substantially different from those typically incurred as a result of 'normal' fluctuations in performance.

- Only the most extreme periods of poor performance. Changes in performance as a result of 'normal' performance fluctuations, such as seasonality (weather), should not trigger the SPP thresholds.

The original intended purpose of the SPP mechanism was to act as a safety net to protect operators against extremely poor performance by Network Rail over a sustained period. We do not consider that the SPP mechanism has worked in the way intended. The reduction of the trigger threshold to 10% from CP4 has meant that Network Rail can be technically in breach of the SPP trigger even as a result of only small fluctuations in performance (broadly speaking, a 10% fluctuation from benchmark performance roughly translates to a PPM movement of 0.5%). For example, SPP has previously been triggered by extreme weather in January and December of the same calendar year (i.e. within the same 13-period measurement timeframe) but where performance has otherwise been near to (or better than) benchmark over the year as a whole. Since the start of the control period, more than half of all operators have triggered SPP. Having a large number of train operators in SPP introduces a risk that the liquidated sums nature of the Schedule 8 regime is undermined. In addition to this, we have provided evidence to ORR which shows that the processing of an SPP claim introduces a disproportionate burden on industry resource with a correspondingly adverse impact on industry relationships, owing to their complexity and high financial value of claims. The claims necessitate the involvement of the most senior directors in both parties, and the engagement of expensive legal resources and consultants which even then does not facilitate easy resolution.

Therefore, if ORR decides not to limit SPP claims to cost compensation only, there would still be considerable merit in reviewing the current SPP thresholds. In order to justify the time and resource involved in each SPP claim, we consider that it is vital that the SPP threshold reflects the level of performance at which train operators' costs and revenue losses are substantially above those provided for in formulaic Schedule 8 compensation. We have previously recommended to ORR a SPP threshold of 30%[6], and still consider that this would be a more appropriate threshold for SPP.

[6] This is based on a report for SDG, which is available at: https://www.networkrail.co.uk/wp-content/uploads/2017/02/Sustained-Poor-Performance-final-Report.pdf

We also note that ORR has suggested revisiting the clarity of the contractual wording for SPP. As part of this review, we would welcome ORR considering introducing a time limit on claiming SPP for CP6, and note that this suggested change was supported by the industry at ORR's summer 2016 workshop on Schedules 4 and 8. The contractual wording should also reflect the suggested change to make the SPP mechanism relate to cost compensation only. Finally, we note that ORR consulted on the scope for claims during PR13. At the time, ORR concluded that it would not be possible to identify all types of claims that could arise, and so listing these (or the exclusions) in the contract may prevent some costs (or losses) from legitimately being claimed. Unless ORR now has better evidence of costs or losses that could be claimed or a more comprehensive list, we suggest that amending the contractual wording, in this regard, is not pursued again during this periodic review. However, we would welcome ORR issuing some SPP guidance which could include a list of examples of the types of costs or losses that operators could claim for. This guidance note could be updated as more examples come to light, and would not be contractually binding for either party.

Schedule 8: Further considerations

In addition to ORR's consultation proposals, we consider that there are other areas of Schedule 8 that could be improved for CP6. We would welcome the opportunity to explore these options with the industry.

Payment rates

It is important that the Network Rail payment rates are correct so that operators receive appropriate compensation for delays they do not cause. Correct Network Rail payment rates, that accurately reflect the effect of unplanned delays on long term operator revenues, de-risk franchises. This also avoids sending perverse incentives if operators over-recover from Network Rail through too high Network Rail payment rates.

In addition, Schedule 8 Network Rail payment rates also determine Schedule 4 revenue compensation rates. We are concerned that if Network Rail payment rates in Schedule 8 are 'wrong', this could distort the costs of taking possessions on the network.

a) Review of London and South East payment rates

Network Rail believes there is merit in reviewing the Network Rail payment rates for London and South East commuter services in PR18. These payment rates were reviewed by ORR in PR13 following the PDFH version 5.1 update, and ORR then expressed concerns about the payments rates for London and South East commuter services. ORR applied a downward adjustment of 10% to these services payment rates, to reflect "some of the issues Network Rail raised in relation to crowding dampening the impact of performance on demand and the longer time period between poor performance occurring and it having its full effect on revenue". However this adjustment was at an arbitrary level. We therefore believe PR18 provides an excellent opportunity to review these payment rates to ensure they are appropriate.

Network Rail commissioned an econometric study to investigate the relationship between unplanned delays and passenger demand (and consequently, operators' revenues), to improve industry understanding. The study found that: "The tentative implications of our analysis are that – at least for … London commuters – changes in lateness do not appear to cause significant changes in demand (and by extension, operator revenue). Such effects are only seen for journeys for which commuters have a choice between the train and the London Underground – and in the [study], these journeys only account for less than 5% of fare revenue.” This could be partially due to the dampening effect of crowding on the relationship between unplanned disruption on long-term revenue loss. Services in the London and South East area are often busy and are unlikely to have additional capacity to accommodate the additional demand that is suggested by the Network Rail rates when performance improves.

The consultants also recommended that: “…significant additional work is required to develop a more robust dataset and model, before any weight should be placed on these results. We have therefore made detailed recommendations for further work.”

In light of the recommendations from the initial study, PDFC is extending the analysis to include passenger demand and revenue data from a number of train operators. We strongly believe that the findings of this study should be considered by ORR and, if robust, reflected in the Network Rail payment rates for London and South East commuter services.

Splitting reactionary delay

Reactionary delay is an important issue on the network (around 70% all of delay on the network is reactionary) and therefore can have a significant impact on the end user. Reactionary delay can be influenced by both the train operator and Network Rail and is in many ways detached from the primary source and responsible party for the original delay.

If ORR decides not to pursue its TOC-on-TOC proposal, we consider that fresh thinking to address the lack of incentives for joint working for all reactionary delay should be explored.

One option to address this lack of incentives could be to share ‘financial responsibility’ for all reactionary delay. We note that we have not discussed this idea beyond Network Rail, but think that there may be merit in exploring this idea further if ORR does not pursue its TOC-on-TOC proposal. Sharing ‘financial responsibility’ for reactionary delay could help encourage operators and Network Rail to work together to minimise this delay and therefore improve passenger experiences. We believe that the attribution of all reactionary delay could be split between operators and Network Rail to acknowledge that both Network Rail and operators can play a role in reducing reactionary delay. Changing the approach could also simplify the current process for resolving disputes for delay attribution, through reducing the number of disputes and the requirement on industry resources to attribute and resolve delay disputes. This approach would not result in any increase to the administrative burden on the industry.

We also consider that there could be merit in sharing ‘financial responsibility’ for incidents on the network where it is not clear that one party is wholly responsible for the disruption, for example suicides.

Schedule 8 recalibration

The timely conclusion of policy decisions by ORR is vital in order to be able to recalibrate the Schedule 8 regime for CP6. Under the assumption that RDG will be leading on the recalibration, the ITT for the recalibration of Schedule 8 will need to be issued in August 2017, with consultants selected in early October 2017. It is important that ORR concludes on key policy decisions that affect the recalibration of Schedule 8 prior to August 2017. In particular, the following issues need to be rapidly concluded upon:

- Approach to setting benchmarks (for both Network Rail and operators).
- Measure of passenger operator performance (proposal to move to a TOC-on-TOC regime where performance is based on the actual delay caused to other operators).
- Payment rates, specifically for London and South East commuter service groups.

Freight operator incident caps

We consider that there would be merit in reviewing the incident caps within the freight operator Schedule 8 regime. We understand that these incident caps provide important protection to freight operators' businesses. However we are concerned that, when actual delay minutes caused by freight operators exceed their cap, the incident caps may limit freight operators' financial incentives to help mitigate this delay. We would welcome further discussion on this issue, and consider that ORR's Schedule 8 recalibration working groups could provide a good opportunity for this.

Schedule 4

Question 17: Do you support our recommended prioritisation of schedule 4 issues? If you think we should reconsider any of the areas we have de-prioritised please submit supporting evidence.

We agree with ORR's recommended prioritisation of the Notification Discount Factors (NDFs) in Schedule 4, and are content with ORR's recommended de-prioritisation of passenger and freight operator cost compensation, cancelled possessions and the scope of incentives. It is important to use industry resource sparingly, and that changes are only made when robust evidence is provided to support change.

This section sets out our thoughts on NDFs, and areas where we consider that the prioritisation may not be appropriate.

Incentives created by Notification Discount Factors

We support ORR seeking to better understand how passengers respond to different levels of notice of planned disruption. In any compensation regime, it is important that the level of compensation is based on robust evidence and is up to date. We consider that ORR's work in this area will ensure that Schedule 4 compensation reflects the losses that operators experience as a result of planned disruption.

In ORR's supporting document on the incentives created by NDFs, it frequently mentions that changes to the NDFs would initiate changes in Network Rail's possessions planning processes. However, a change in the NDFs may not be substantial enough to drive significant changes in the possessions planning processes. In fact, in the majority of cases, Schedule 4 is only one factor that Network Rail takes into account when planning possessions. There are a number of reasons for this:

1. Possessions planning decisions are often made based primarily on the logistics of the possession, rather than the Schedule 4 costs. For example, if the machinery cannot get to the work site, the work cannot go ahead.

2. Network Rail works to access planning timescales, which are separate from Schedule 4, and which govern how far in advance work must be planned. These access planning timescales tend to take precedence over Schedule 4.

3. Schedule 4 costs can be low in a lot of cases in comparison to other costs of undertaking engineering work. The other cost drivers may therefore be more important when planning the possession. However, we recognise that in some situations the Schedule 4 costs are significant.

In spite of the above, we continue to be of the view that updating evidence to inform Schedule 4 compensation would be beneficial to the industry.

Approach to ACS calculation

We do not support ORR's suggested changes to the Schedule 4 Access Charge Supplement (ACS) and, therefore, consider that the current approach should be retained. The reasons for this are set out below.

In considering a change to the Schedule 4 ACS, it is important to recognise the scale of the issue. The Schedule 4 ACS is currently only paid by franchised passenger operators, and the full cost is a direct pass-through to funders. While the value of the current Schedule 4 ACS may be considered to be quite high (c. £400m for the first 2 years of CP5), over this same timeframe Network Rail has paid out in excess of £600m in Schedule 4 payments to operators[7]. Therefore, it is the difference between these two figures that is actually the most important.

[7] This figure includes Schedule 4 payments for enhancement projects, which are not included in the Schedule 4 ACS.

ORR suggested three options which it considered would improve the accuracy of the Schedule 4 ACS:

> Option 1: Estimate the ACS on the basis of the delivery plan produced immediately prior to the start of the control period
>
> Option 2: Annual recalculations to adjust the ACS for business plan variations in the volume of maintenance and renewal activity during the control period
>
> Option 3: Retain the existing methodology but subject to a high level adjustment to the total ACS needed

Each of these options would involve setting the Schedule 4 ACS on a basis which would be inconsistent with the assumed level of maintenance and renewals (M&R) volumes for CP6, as set out in ORR's Final Determination. It is important that Network Rail receives a funding settlement that allows it to deliver its M&R volumes and we are concerned that these three approaches would not achieve this.

We are firmly of the view that the Schedule 4 ACS must be aligned to the M&R volumes set out in the Final Determination and are an important part of the periodic review 'package'. These M&R volumes drive costs other than the Schedule 4 costs associated with possessions (for example, the costs of materials, labour, and planning the work itself). Network Rail's funding for each category of these costs should be set on a consistent basis, to ensure a balanced and appropriate funding settlement for CP6. If ORR is concerned that Network Rail will not achieve the M&R volumes that it sets out, it should address this holistically, rather than adjusting one element of the funding for this work. We also note that ORR already takes account of deferrals of work in its annual assessment of Network Rail's financial performance. We do not consider that ORR should also address this potential issue through adjusting the funding provided through the Schedule 4 ACS before the start of the control period. Not only would this prejudge the outcome of potential deferrals in CP6, but by adjusting our financial performance for any actual deferrals, this would account for the issue twice.

More specifically, ORR's suggestion to recalculate the Schedule 4 ACS annually (option 2) would have the effect of 'reopening' Network Rail's control period funding for one element of M&R costs. If ORR does take this action, it would appear to throw into question why ORR does not reopen other elements of the regime annually, when they go against Network Rail (for example, when Network Rail makes significant Schedule 8 payments to train operators). We also do not consider that ORR's suggestion to make a high level adjustment to the total ACS (option 3) would be appropriate. Adjusting future Schedule 4 ACS payments to reflect past delivery of M&R volumes may weaken the potential incentive effects associated with Schedule 4. If Network Rail is able to deliver a more efficient approach to looking after its assets, against its plan for the control period, then the ACS could be higher than the Schedule 4 payment to operators. Network Rail should not be penalised in future funding settlements in light of such efficiency.

In light of the above, we do not consider that ORR's suggestions for the Schedule 4 ACS represent an improvement to the current ACS, and could potentially lead to worse outcomes. However, we do consider that there could be merit in updating the underlying approach to forecasting Network Rail's expected Schedule 4 costs, and therefore the ACS. We are currently exploring options for this which we believe may improve the accuracy of the Schedule 4 ACS for CP6. We hope to discuss that with ORR and industry at one of ORR's upcoming Schedule 4 and 8 Recalibration Working Groups.

<u>Bespoke compensation for major disruptions</u>

a) Sustained Planned Disruption (SPD)

Network Rail agrees that it would be useful to review the access contracts for SPD and to have better guidance in place on the compensation process for SPD. However, we do not consider that the lack of SPD claims in itself means that the SPD mechanism is not working effectively. There are a number of reasons why operators may not claim for SPD:

- Operators may already be sufficiently compensated for the impact of possession on long term revenue loss through normal Schedule 4 payments.

- Type 2 (>60 hours) and Type 3 (>120 hours) possessions are the most disruptive possessions on the network, and are most likely to contribute to an operator triggering SPD. Operators are already able to claim for actual costs for Type 2 possessions and actual costs and revenue losses for Type 3 possessions through the standard contractual mechanism. The table below shows that there have been a number of bespoke Type 2 and 3 claims that have been settled in the past few years. Operators in SPD may therefore have already recovered actual costs and revenue losses through the standard compensation arrangements. Therefore an SPD claim is only likely to cover the actual costs and losses associated with Type 1 possessions (<60 hours). These are less likely than other possessions to result in significant additional costs and losses to train operators.

Number and value of bespoke Type 2 and 3 claims settled since 2013.[8]

	Number of bespoke Type 2/3 claims	**Value of bespoke Type 2/3 claims**
Settled in 2013/14	16	£3.0m
Settled in 2014/15	27	£17.5m
Settled in 2015/16	29	£26.9m
Settled in 2016/17 (year to date)	19	£24.2m

Network Rail does not support ORR's view that the SPD thresholds are too high and therefore do not capture the most disruptive possessions. SPD is designed to apply only in extreme cases where the standard Schedule 4 compensation is not sufficient. SPD is claims based and uses significant industry resource. Therefore it is important that only the most disruptive possessions are included in SPD. Any change to the thresholds should consider the scale of impact on limited industry resources, and should be reflective of evidence showing when TOCs costs and revenue losses increase substantially above formulaic Schedule 4 compensation.

[8] Source: Network Rail CRM Claims database – extract taken on 27 January 2017.

We consider that SPD is capturing a reasonable number of disruptive possessions, and observe that at least 5% of service groups have triggered SPD so far in CP5[9]. This is also consistent with the intent of SPD set out in the track access contract. We consider that the 5% figure is about right, considering that SPD should, in our view, only reflect the most disruptive possessions (c.1%). We note ORR's concerns over the contractual wording of SPD where the absolute revenue loss threshold over three billing periods is higher than that for seven periods.

b) Category 3 disruption

In ORR's "initial thinking on negotiated compensation arrangements for planned disruption", it notes that there are some issues with the current arrangements for Category 3 disruption for freight operators. However, ORR does not set out any options for this. We have provided a suggestion for improving this, below.

Under the current arrangements, if a freight operator believes that a Category 3 Disruption has occurred, it is entitled to claim for costs, direct losses and expenses ("Actual Costs") as a result of that Schedule 4 disruption. These claims can take between one and four months to resolve once freight operators have provided suitable evidence, and require an excessive amount of industry resource[10], given the scale of the issue.

At ORR's PR18 review of Schedules 4 and 8 workshop in August 2016, freight operators suggested that a 'proxy' Category 3 Disruption rate could be introduced, calibrated to cover Actual Costs. This rate could be used for the majority of Category 3 Disruptions, but if Actual Costs significantly exceeded this, freight operators could claim these from Network Rail (with appropriate evidence). We think that this idea could significantly reduce industry resource used in trying to agree Actual Costs compensation. However, we would like to explore the idea of introducing a threshold on freight operators initiating a claim, such that claims are only made when there is a significant difference between the costs incurred and those provided for by the proxy rate. It would also ensure that freight operators received compensation for the disruption they experience in a timely manner. We consider that this option should be explored further.

c) Incentives for amended timetables

In the event of extreme weather, it is very important that the industry provides passengers with as much certainty about the level of train service that will be available, with as much notice as possible. It will often be the case that only a reduced timetable will be possible when extreme weather occurs. In the absence of a realistic (reduced) timetable on these extreme weather days, passengers are likely to experience significant delays and suffer as a result of the industry attempting to deliver an unrealistic level of service.

We would welcome reconsideration of ORR's proposed de-prioritisation of the incentives for amending timetables for PR18, specifically in the case of extreme weather. Currently, if

[9] This figure is likely to be higher, as Network Rail has no visibility of train operators that have triggered SPD due to the "Cost Thresholds", since these are dependent on the actual costs that train operators have incurred.

[10] Each Category 3 claim typically requires 30-40 person hours from Network Rail, and presumably a similar amount from freight operators.

Network Rail enters an amended timetable for a day of extreme weather, it becomes liable for Schedule 4 compensation payments (and operators and Network Rail become liable for Schedule 8 payments for any further disruption on the day). These compensation payments are inconsistent with the evidence put forward in the Passenger Demand Forecasting Handbook (PDFH), which says that:

"*Some delays are caused by circumstances that passengers understand and hence these will probably not cause the scale of impact the values would forecast; examples include snow and flooding where other modes of transport can be even more adversely affected.*"

We recognise that there may be a few difficulties with defining an extreme weather day, but see merit in exploring this issue further so that more realistic timetables can be offered to passengers. We would, therefore, welcome the opportunity to work with industry and ORR in PR18 to explore options for taking this forward.

Question 18: Do you wish to submit relevant evidence regarding: a) processes associated with planning possessions; and/or b) planning alternative arrangements to deal with planed disruption (e.g. the notification that is needed to arrange bus replacement services)?

We have briefly discussed the processes associated with planning possessions with ORR previously, and would be happy to provide ORR with a Network Rail contact who can provide more detailed insight about our possessions planning processes.

We consider that operators are better-placed to provide evidence on planning alternative arrangements to deal with planned disruption.

Aligning Incentives

Question 19: Do you have any views on how financial incentives could be improved to encourage collaboration between Network Rail and operators to reduce industry costs?

Any financial incentive aimed at improving collaboration between Network Rail and operators to reduce industry costs needs to be **simple, understandable and easy to administer**. Based on industry discussions and our own experience in CP5, we consider that the route-level efficiency sharing (REBS) mechanism, in its current form, does not meet these criteria and is not driving the intended behaviours.

While we have concerns about the current design of REBS, we consider that its intention is sound. We agree that there is merit in a having a default mechanism in place to encourage collaborative working between operators and Network Rail.

We consider that the focus for PR18, therefore, should be on addressing the current issues with REBS (which we discuss below) and developing an improved sharing mechanism that is attractive to all parties. One of the key factors contributing to the success of an improved default sharing mechanism in CP6 should be that there is a reasonable expectation that Network Rail will outperform the relevant baselines. This could mean that customers may be more inclined to be part of the mechanism.

Industry incentive alignment

The importance of aligning incentives between Network Rail and operators was set out in the Secretary of State's December 2016 written statement to Parliament on rail reforms and the future of the railway in Great Britain. We strongly support this desire to align incentives, which is consistent with commitments made in our Transformation Plan.

Currently, there are various ways in which we can work with our customers to align behaviours through shared incentives and objectives, which include alliances. Different forms of alliance arrangement may be appropriate for different parts of the railway. For example, in May 2015 Network Rail and Abellio ScotRail entered into a bespoke 'deep alliance' arrangement. While remaining separate companies, both organisations are working to achieve common aims and objectives led by a common managing director and senior management team. Other types of alliance include 'framework alliances' which focus on more specific and mutually beneficial opportunities for Network Rail and its customers.

We recognise, however, that these arrangements may not always be practicable or possible. On this basis, we see merit in the continuation of a simple default efficiency benefit sharing mechanism in CP6, subject to a number of design improvements that we discuss, below.

REBS in CP6

PR18 provides the industry with an opportunity to consider changes to the mechanism, which can be informed by experiences to-date. We would welcome the opportunity to work with the industry and ORR to redesign the current mechanism so that it is considered as an attractive default option, when bespoke arrangements are not possible.

We note that ORR plans to consult on detailed REBS policy in mid-to late-2017. Prior to this consultation we think that there would be merit in ORR holding a workshop where operators and Network Rail can feed directly in to the policy development for an improved default sharing mechanism and assist in shaping ORR's PR18 proposals.

The remainder of our response to this question sets out our views on the various design improvements and options presented in ORR's consultation.

1. Removal of REBS

A key focus in CP5 and going forward, as set out in our Transformation Plan, is to align our targets with our customers' targets. We consider that a default sharing mechanism should form part of a suite of options for collaborative working which supports this objective. We consider that it would be more appropriate to review and improve the existing REBS mechanism, than remove it and replace with something different that does not build on the experiences to-date.

For REBS to be successful in CP6, it will be important that it is seen as a viable alternative for those parts of the railway where alliances are not possible. We consider that this will be contingent on the reform of REBS to address the issues with the current mechanism that have been experienced so far in CP5. It is important that the reforms have cross-industry support so that our customers see REBS as a real opportunity to work with Network Rail to deliver improvements to the network and share in the resulting benefits.

2. Changing REBS

Whilst REBS has only been operational since the start of CP5, there are clear areas where it could be improved in light of experience to date. We discuss these below.

a) Alignment of REBS baselines to Network Rail Business Plans

The REBS route baselines in CP5 for Scotland and the nine England and Wales routes[11] are not aligned to Network Rail's business plans.

When the REBS route baselines were set as part of Network Rail's CP5 Delivery Plan, we were constrained by the need to reconcile them with the Scotland and England and Wales totals in ORR's PR13 Final Determination for expenditure / income on a line-by-line and year-by-year basis. They were also fixed for the duration of the control period. This created a disconnect between route business plans and REBS route baselines.

We strongly consider that the lack of alignment between REBS route baselines and our route business plans (which are updated during the control period) has created unnecessary complexity and constrained the overall effectiveness of REBS.

A key improvement for CP6, therefore, would be to align the REBS route baselines with Network Rail's route business plans for CP6, and for it to work alongside the process for revising and updating route business plans during the control period. This approach would ensure that the REBS route baselines are aligned to what each route is planning to deliver, and would allow for performance against the REBS route baselines to be easily and transparently tracked.

There also needs to be sufficient flexibility in REBS to recognise that Network Rail's current eight routes are not static geographies and may be subject to change during CP6 and beyond. We will need to agree how to manage possible changes to Network Rail's route structure within REBS going forward.

While we consider that flexibility to update the REBS route baselines will be important to maintain alignment with route business plans during the control period, we are mindful of the additional risk that this could have on participating operators. Participating operators would have made their decision to opt in at the beginning of CP6 on the basis of the original set of REBS route baselines, which could then be subject to further change. Consideration would be required, therefore, on whether any further opt-out provisions would be needed during the control period, following any significant changes to the route baselines.

[11] London North Eastern (LNE) and East Midlands and Kent and Sussex now operate as two routes (LNE & East Midlands and London South East (LSE)) meaning that for operating purposes we now have eight rather than ten routes across the network.

b) Narrower scope based on route income and expenditure categories

We are concerned that the current scope of REBS may be too broad, including some elements of income and expenditure that could be beyond operators' reasonable influence. On this basis, we consider that the current REBS scope could be narrowed. At this stage, we have the following observations:

- **Route income and expenditure categories:** As part of devolution and route-based regulation, there is a greater focus on routes and delivering for our customers. This includes the development of route scorecards and route business plans that are aligned to the needs of our customers. We consider, therefore, that REBS should only include income or expenditure categories that are directly within the control of the routes. Central costs that have been allocated to routes should be excluded. Income and expenditure at a route level could be more easily influenced by operators, especially since they would have more oversight of the development of route business plans, which as above, we consider should be aligned to REBS baselines.

- **Income and expenditure categories that operators can influence:** There are areas that we consider operators could influence that should continue to be included in REBS (e.g. Schedule 4 and possession planning).There are also areas of Network Rail income and expenditure (e.g. property) currently included in REBS, over which we understand operators have limited influence. We believe that enhancements should continue to remain outside of the scope of REBS because it would otherwise expose train operators to too much risk. Additionally, we suggest that Schedule 8 could also remain outside the scope of REBS since it is an incentive regime in its own right. We consider that its removal would likely assist in the simplification of REBS.

As part of the consideration on the scope of REBS for CP6, there could be an option of a more fundamental reform to the structure of REBS. One option could be to allow operators to sign up to elements of REBS rather than in its totality. For example, operators could participate in a REBS mechanism focused on just operating, maintenance and total Schedule 4 expenditure (and associated income categories). A second REBS mechanism could be focused on renewals expenditure (and associated income categories). This could allow operators to have more choice within the overall mechanism by choosing a 'type' of REBS that includes the income and expenditure categories that they consider they are most able to influence. We consider that if this idea was progressed, there should only be two or three 'types' of REBS for operators to choose from. It would add significant cost and complexity to the regime if operators could select individual income and expenditure categories to design a bespoke REBS.

We would welcome further discussion on this suggestion with industry and ORR, in particular on whether it would be practicable and if so, what groups of income and expenditure would be appropriate.

c) Optionality

There has been limited operator participation in REBS in CP5. We consider that if improvements are made to REBS (some of which are discussed, above) and that there is a reasonable expectation of outperformance of the REBS baselines, then operators could be more inclined to opt-in to REBS in CP6. If REBS is not considered to be an attractive option for operators, we are concerned that making participation mandatory would be counter-productive and unlikely to encourage greater collaboration.

We also consider that there is a strong argument for optionality to remain for freight operators and open access operators due to the fragility of their business models.

d) Sharing percentages

Network Rail agrees that financial exposure offers the potential for train operators and freight operators to work more closely with Network Rail to reduce costs and inform route business plans. We believe that operators should be exposed to both upside and downside risk to ensure that the mechanism is fair to both parties and has a genuine incentive effect. The efficiency benefit sharing mechanism (EBSM) in CP4 provided operators with upside only financial exposure. We do not consider that it was effective in encouraging collaboration between Network Rail and its customers. It is important that we build on the experiences from CP4 and CP5 to improve REBS and we consider that an upside only mechanism would not be appropriate.

While we consider that the upside and downside sharing percentages of 25% and 10% respectively are reasonable, there could be merit in reviewing the current upside and downside payment caps. The way in which they are currently applied means that they 'bite' at relatively low levels of REBS over- and under-performance. This could go some way to addressing the industry concerns that ORR sets out in its consultation that the amount of financial exposure is not significant enough to drive a change in behaviour.

e) Basis of REBS

Network Rail does not support ORR's proposal to use the cost attribution project as a basis for the cost allocation in REBS. The purpose of the cost attribution project is to inform the allocation of Network Rail's fixed costs to operators. The cost allocation work is allocating our regulatory cost base, whereas REBS is based on outturn expenditure. Instead, we think it is important to use route income and expenditure categories which are managed and recorded at a route level as the basis for REBS.

<u>Summary</u>

The response to this question has considered a number of changes and considerations in respect of REBS for CP6. We look forward to developing these ideas further in discussions with industry and ORR over the coming months.

Question 20: Do you have any views on the cost categories you think could be controlled by operators and whether these costs would be suitable as the basis of a potential future mechanism?

We note that the question focuses on the cost categories that operators can **control**. We do not believe that operators can control Network Rail's cost categories and would therefore suggest that ORR focuses on the cost categories that operators can **influence**. In regards to the cost categories we believe that operators can influence, please refer to our response to Question 19, above, in particular part 2(b).

2. Comments on ORR’s Supporting Documents

Comments on ORR’s Impact Assessments

1. We welcome ORR’s development of draft impact assessments on how changes to the charges and incentives regime will impact on stakeholders. In addition we agree that it is important that ORR’s has committed to considering the cumulative financial impact of changes on operators in its working paper in early 2017.
2. The purpose of this section is to set out comments on ORR’s impact assessments. Below we provide general comments on ORR’s approach to its impact assessments, which we consider apply to all charges. In addition, we also provide comments on the individual assessments that ORR has carried out.
3. These comments on the impact assessments are in addition to the points we have raised in response to the consultation questions, above.
4. Where we support ORR’s proposals within the consultation, we have not commented in detail on the accompanying impact assessment.

General comments on Impact Assessments

<u>Approach</u>

5. We consider the impact assessments should be ‘living documents’ and that ORR should continue to update them as the impacts of its proposals become clearer.
6. We suggest that ORR adopts a consistent approach to carrying out its impact assessments and includes the relevant objectives in this assessment.
7. We consider that ORR should also consistently assess each proposal against its general criteria, as it stated that it would do in its assessment framework document which was published alongside the consultation. We suggest that ORR sets out this assessment clearly in its impact assessment. We note that ORR does not do this in all of its impact assessments and we would encourage it to do so consistently, particularly because this is where potential implementation and data requirements issues should be identified.
8. We welcome ORR’s use of tables to structure some of its impact assessments, which includes a summary table, with ticks and crosses describing how the proposal performs against the relevant outcomes and criteria. We think that this is an accessible way for readers to understand ORR’s view in relation to how each option performs. We suggest that ORR includes these tables in all of its impact assessments, which is not the case, at present.
9. We consider that the impact assessments appear to focus more on the impact on train operators and do not assess the potential impact of changes on Network Rail in detail. We understand that it is important to assess the impact on train operators, particularly in scenarios where the impact of the change is likely to be much more significant on operators than Network Rail. We consider, however, that a brief assessment of the impact on Network Rail should also be included.
10. We consider that even where ORR is proposing to broadly retain the existing charging structure that it should still carry out an impact assessment, for example, the Variable Usage Charge (VUC). We consider that ORR proposes sufficient changes in its consultation in relation to the VUC to warrant an impact assessment. For example, ORR’s view that new legislation means that it is not possible to phase in any increases in

relation to the VUC for CP6 (except where there are substantive methodological changes) represents a significant change in approach compared to PR13. This change could also potentially have a significant impact on the level of operators' charges in CP6. Similarly, we consider that the potential 'recalibration' style changes to the VUC that ORR notes in its consultation (e.g. reflecting maximum line-speeds in charges) should be considered as part of an impact assessment.

PR18: Fixed costs- Draft impact assessment on options for fixed costs

11. We are concerned that the impact assessment may be overpromising in relation to what this proposal, and our cost allocation work, is likely to deliver. It is not clear to us that fixed cost charges, or the cost allocation work, will result in material changes in the following areas:

- Our ability to make efficiency savings. As set out in ORR's impact assessment, we already face a strong financial incentive to outperform its efficiency assumptions.

- ORR's ability to benchmark our fixed costs across the network. Particularly, as the cost allocation work will produce an improved **allocation** of our **regulatory cost base**. It will not result in more granular information in relation to the distribution of **outturn expenditure**.

- Network Rail's capacity allocation decisions which are understandably driven by administrative mechanisms. However, the cost allocation work could potentially inform funders' future decisions in relation to the specification of services.

- Open access operators scrutinising our fixed costs. In principle we agree that exposing open access operators to fixed cost charges should encourage greater scrutiny. However, in reality, scrutiny may be limited by operators' engineering expertise in relation to infrastructure costs. In addition, operators' scrutiny may focus on the market can bear test, particularly if this test is likely to act as a cap on their fixed cost charges. Methodological changes (e.g. in relation to how costs are allocated to operators) can also dominate discussions at periodic reviews, and often have a more significant effect on operators than potential efficiency savings.

- Revisiting the REBS mechanism. Particularly, as noted above, the cost allocation work is **allocating** our **regulatory cost base**, and REBS is based on **outturn expenditure.** We discuss this in further detail in our response to Question 19 of ORR's consultation.

PR18: Freight mark-up charges – Draft impact assessment on simplification option and methodological change

12. We have no additional comments on this impact assessment. Our views on the proposals for the freight mark-up charges have been captured in our response to Questions 2 and 3 and in our general comments on the impact assessments.

PR18: Station long term charge (LTC) – Draft impact assessment on the methodology at managed stations

13. We recognise the need for an impact assessment regarding improvements to the LTC cost forecasting methodology.
14. As ORR states, it is not possible to quantify the impact of the improved cost forecasting methodology at this stage. However, as the work progresses, the impact assessment will no doubt become more informative.
15. We welcome ORR's support for this piece of work.
16. As ORR writes, we will ensure that stakeholders are kept informed as this modelling work progresses and the impact of the improved methodology becomes clearer.

PR18: Qualifying expenditure (QX) – Draft impact assessment on QX transparency

17. Overall, the impact assessment is well-balanced. We agree with the comments regarding the potential benefits of QX transparency (the potential for more efficient operating costs) but also, like ORR, recognise the need to provide additional context for any QX numbers in order to ensure that the figures are not misleading.
18. Understandably, the impact assessment cannot provide any quantitative assessment of the impact of QX transparency. ORR does not have information on current QX charges or efficient operating costs.
19. The impact assessment states: "Network Rail is in the process of publishing total QX charges at managed stations on the Network Rail website. This is scheduled to be completed before the end of 2016". This has not proved possible. We will publish this information, alongside suitable contextual information, in due course.
20. Alongside the figures on total QX at each managed station, we hope to publish:

- A guide which explains QX and why QX charges differ between stations; and
- A set of case studies which provide detailed information on QX charges at a handful of managed stations.

PR18: Capacity charge – Draft impact assessment on options for the capacity charge

21. We have responded to ORR's impact assessment for the Capacity Charge within our question responses as ORR has asked for specific comments in relation to each option under consideration. Please see our response to Questions 8 and 9.

PR18: Coal spillage charge – Draft impact assessment on abolishing the charge

22. We consider that abolishing the coal spillage charge (CSC) would reduce the administrative burden on the whole industry, including Network Rail and ORR, rather than just freight operators.

PR18: Schedule 8 – Draft impact assessment on Schedule 8 and passenger compensation

23. We have no additional comments on this impact assessment. Our views on passenger compensation have been captured in our response to Question 13.

PR18: Schedule 8 – Draft impact assessment on approach to setting benchmarks

24. Network Rail is concerned that ORR did not use this impact assessment to discuss the different options for setting operator benchmarks in the passenger regime. The lack of clarity on the potential options makes it difficult for Network Rail to respond to this point in the consultation.
25. We consider that the benchmarks should be set at realistic and achievable levels of performance for both operators and Network Rail to minimise money flows in the regime.
26. It would be useful for ORR to clarify whether basing benchmarks on past performance improves or limits the overall incentive effects to improve performance. ORR presented differing views on this approach to setting freight and train operator benchmarks within the consultation and accompanying impact assessment.
27. ORR has stated that setting passenger operator benchmarks and Network Rail's benchmark in the freight regime based on past performance reduces the incentive to outperform the benchmark, since in doing so could result in a more challenging benchmark in the subsequent control period. Whilst we note that this may be an issue, we consider that there is still an incentive to out-perform the Schedule 8 benchmarks during the control period, as the respective party would receive a payment through the star model.
28. ORR stated that improved performance at the end of the control period would act as a disincentive to operators and Network Rail (in the freight regime) as it would result in a more challenging benchmark for the following control period. We note that the recalibration period used for past performance has previously been in the middle of the previous control period, so performance at the end of the control period would not impact the benchmarks of the upcoming control period.
29. ORR has not assessed its proposal to continue to set freight operator benchmarks based on average historical performance. Whilst we support this proposal, we consider that the reasoning behind this decision could have been discussed in the impact assessment.
30. We consider that ORR could have used this impact assessment to discuss the benefits of aligning Network Rail's freight benchmarks to Network Rail's freight performance measure.
31. As discussed in our response to ORR's consultation, it is important that ORR concludes in a timely manner on policy areas that affect the recalibration of the regime, such as benchmarks, so as not to delay the process.

PR18: Schedule 8 – Draft impact assessment on the measure of passenger operator performance

32. Whilst PEARS cannot currently calculate Schedule 8 payments for a TOC-on-TOC regime, we would not consider that this is why the regime is currently based on TOC-on-Self. We understand that a move to a TOC-on-TOC regime has not been discussed since before 2006. It may have been possible to update PEARS for this, if it was required in the intervening periodic reviews.
33. We do not agree that Network Rail's incentives will be reduced by a move to a TOC-on-TOC regime. Network Rail is targeted based on industry performance measures, and could face punitive measures if these are not achieved. This acts as a very strong incentive on Network Rail to improve whole-industry performance.

34. To clarify, we would only need to update PEARS and not Network Rail's billing system (TABS).

PR18: Schedule 8 – Draft impact assessment on effectiveness of the SPP regime

35. ORR has stated that the sustained poor performance (SPP) mechanism acts as an incentive for Network Rail. We consider that SPP has limited incentive effects for two key reasons:

- Network Rail cannot forecast likely SPP costs.
- As the current threshold is so readily triggered, most train operators will be in SPP at some point in the control period even when performance is near to targeted / benchmark levels.

36. ORR notes that there have been no SPP claims in CP5, potentially because train operators have been deterred by the resource intensive process of making a claim. We consider there to be other reasons why an operator may not claim whilst in SPP, for example, the formulaic Schedule 8 compensation may be sufficient to cover their revenue losses, even when train operators are in SPP. Also, SPP may be too easily triggered at performance levels that are not that different to target / benchmark levels and do not cause significant changes in train operators' costs/revenues.
37. In ORR's assessment of the options, we consider that a few key points have been missed:

- There is a higher potential for SPP claims to be made for the cost based claims option. While each claim should be less resource intensive, the increased number will have an impact on industry resource.
- An increasing number of claims could result in an increased flow of money from Network Rail to TOCs. This may mean that Network Rail has to forego other commitments to pay for this.

Comments on ORR's initial thinking and proposals

38. The purpose of this section is to set out comments on ORR's initial thinking and proposals.

PR18: Schedule 4 – Proposal not to pursue a range of schedule 4 issues in PR18

39. We have no additional comments on this supporting document.

PR18: Schedule 4 – Initial thinking on incentives created by notification discount factors

40. ORR has stated in its supporting document that "if a particular notification discount factor (NDF) is, for example, 60%, Network Rail pays 40% of marginal revenue effect (MRE)". We consider this to be incorrect. If an NDF is 60%, Network Rail pays 60% of MRE, as set out in the table that ORR provided in the impact assessment.

PR18: Schedule 4 – Initial thinking on the approach to calculating the access charge supplement

41. We have no additional comments on this supporting document. Our views on the approach to calculating the access charge supplement have been captured in our response to Question 17.

PR18: Schedule 4 – Initial thinking on negotiated compensation arrangements for planned disruption

42. We note that few responses to ORR's November 2015 stakeholder letter stated that the trigger was too high. Therefore we are unsure as to why ORR considers this as one of the two main issues that stakeholders raised in response to the letter.
43. We support ORR's suggestion to review the contractual wording and process for sustained planned disruption (SPD) with a view to making the process less cumbersome and protracted. It is important that this update ensures that TOCs provide sufficient evidence to claim for SPD and Network Rail is given sufficient time to examine the evidence.
44. As with SPP, we consider SPD to have no incentive effect as we cannot forecast compensation to operators in advance. We therefore do not think that reviewing some or all of the thresholds for triggering bespoke compensation would improve the accuracy of the incentive on Network Rail with respect to particularly long/large possessions.
45. Network Rail would like to discuss with ORR the evidence provided by TOCs for a change in the SPD threshold.

Response to ORR's December 2016 Charges and Incentives Consultation

This pro-forma is available to those that wish to use it to respond to our consultation. Other forms of response (e.g. letter format) are equally welcome.

Please send your response to pr18@orr.gsi.gov.uk by **9 March 2017**.

Full name	Liz Parkes
Job title	Head of Operations & Safety
Organisation	North Yorkshire Moors Railway
Email*	
Telephone number*	

*This information will not be published on our website.

Please make any comments regarding the questions in the accompanying text box. We welcome comments in relation to the information outlined in both the consultation document and supporting documents, or regarding the policy areas more generally.

Chapter 2: Infrastructure Costs

Fixed cost charges:

1. Do you support our proposal to levy fixed cost charges on all operators, including open access operators, to the extent that they can bear them (option 2)?

No. We're concerned, as a charitable trust and heritage railway operating on various branch-lines within the UK, (Battersby to Whitby and Sheringham to Cromer), that this will lead to an increase in costs which we will not be able to sustain, and will make continued operation on Network Rail infrastructure unviable.

Fixed cost freight charges:

2. Do you support our proposal to simplify the current charging regime by having a single freight mark-up charge?

No view on this

Fixed cost freight charges:

3. Do you support the recommendation to apply Network Rail's cost allocation methodology (discussed in this chapter) to freight mark-up charges?

No view on this

Station charges:

4. **Long term charge (LTC):** Do you support our recommendation that the methodology for the LTC at managed stations be recalibrated?

Yes

Station charges:

5. **Qualifying expenditure (QX):** Do you agree with our recommendation that we support the work to make total QX charges more transparent at both managed and franchised stations?

Yes

Chapter 3: Short-run variable charges package

Variable usage charge (VUC):

6. Do you support our recommendation not to make fundamental changes to the VUC for PR18?

Yes
Variable usage charge: 7. Do you have any suggestions for 'recalibration' style changes to the VUC you would like to see considered for PR18 implementation?
No
Capacity charge (CC): 8. Do you support our recommendation not to replace the CC with adjustments to Schedule 8 benchmarks?
No
Capacity charge: 9. Do you think we should: (a) retain the existing CC (but remove the caps on open access, freight and charter operators); (b) remove the existing CC and recover lost revenue through fixed cost charges; or (c) do you have any alternative proposals?
No, removing the caps would lead to increased costs which we would be unable to bear.
Traction electricity charge: 10. Do you support our recommendation to keep the loss incentive mechanism?

No view on this
Electricity asset usage charge (EAUC): 11. Do you support our recommendation that the EAUC not be altered, beyond recalibration, in PR18?
No view on this
Coal spillage charge (CSC): 12. Do you support our recommendation to abolish the CSC?
Yes

Chapter 4: Contractual Incentives Regime

Schedule 8: 13. **Passenger compensation:** What are your views on the options of passenger compensation recovery and improving the transparency of compensation relating to Network Rail's actions?
No views
Schedule 8: 14. **Approach to setting benchmarks:** Do you support our recommendation to only make changes to delink passenger operator benchmarks and Network Rail benchmarks for freight operators from past performance (but to leave the approach to the other

benchmarks unchanged)?
No views
Schedule 8: 15. **Measure of passenger operator performance:** Do you support our recommendation to change the measure of passenger operator performance to one based on the delay caused to other operators?
Yes
Schedule 8: 16. **Sustained poor performance (SPP) provisions:** Do you support our recommendation to limit SPP to costs compensation only?
Yes
Schedule 4: 17. Do you support our recommended prioritisation of schedule 4 issues? If you think we should reconsider any of the areas we have de-prioritised please submit supporting evidence.
Yes
Schedule 4: 18. Do you wish to submit relevant evidence regarding: (a) processes associated with planning possessions; and/or (b) planning alternative arrangements to deal with planned disruption (e.g. the notification that is needed to arrange bus replacement services)?

No

Aligning operator and network rail incentives:

19. Do you have any views on how financial incentives could be improved to encourage collaboration between Network Rail and operators to reduce industry costs?

No

Aligning operator and network rail incentives:

20. Do you have any views on the cost categories you think could be controlled by operators and whether these costs would be suitable as the basis of a potential future mechanism?

No

Any other points that you would like to make

No

Thank you for taking the time to respond.

Response to ORR's December 2016 Charges and Incentives Consultation

This pro-forma is available to those that wish to use it to respond to our consultation. Other forms of response (e.g. letter format) are equally welcome.

Please send your response to pr18@orr.gsi.gov.uk by **9 March 2017**.

Full name	Ralph C Tiffin
Job title	Director
Organisation	McLachlan+Tiffin
Email*	
Telephone number*	

*This information will not be published on our website.

Please make any comments regarding the questions in the accompanying text box. We welcome comments in relation to the information outlined in both the consultation document and supporting documents, or regarding the policy areas more generally.

Chapter 2: Infrastructure Costs

Fixed cost charges:

1. Do you support our proposal to levy fixed cost charges on all operators, including open access operators, to the extent that they can bear them (option 2)?

Knowing the fixed costs that any service should incur is essential if there is to be sensible long term planning. Option 2 is much better than the status quo.
However ideally option 4 should be chosen. It is perfectly feasible for a cost (both fixed and variable) to calculated for appropriate sections of the network – down to a path or even passenger level.

*2.7 A better understanding of these costs could improve decisions taken by Network Rail, funders, **franchising authorities** and ORR.*

The UK must be unique in the world in have essentially monopoly longer distance franchises awarded that perpetuate a state owned railway but claim there is privatisation and competition. From observation FTAC paid by the monopoly franchisees leads to some trains being run with low fares simply to generate cash flows. This makes sense for a TOC as they have a business model with no real investment, in infrastructure or rolling stock etc. The claims that "we are investing in UK railways" is an untruth. Fare paying passenger, and tax payers are the ones who invest.

While these recommendations are for the 2018 periodic review (in rail terms a short period) knowledge of fixed (and variable costs) have to be known if sensible operational planning is to be carried out for example for HS2 services.

Fixed cost freight charges: 2. Do you support our proposal to simplify the current charging regime by having a single freight mark-up charge?
A fully costed regime would be better. Then appropriate support could be openly given for environmental and economic benefits of moving freight from road to rail.
Fixed cost freight charges: 3. Do you support the recommendation to apply Network Rail's cost allocation methodology (discussed in this chapter) to freight mark-up charges?
This is a step forward but as with 2 something more sophisticated is desirable.
Station charges: 4. **Long term charge (LTC):** Do you support our recommendation that the methodology for the LTC at managed stations be recalibrated?
Yes
Station charges: 5. **Qualifying expenditure (QX):** Do you agree with our recommendation that we support the work to make total QX charges more transparent at both managed and franchised stations?
The greater the transparency the better. Costs are only one side of the business model, so data for all station income should be available if educated decisions are to be made.

Chapter 3: Short-run variable charges package

Variable usage charge (VUC): 6. Do you support our recommendation not to make fundamental changes to the VUC for PR18?
Unless a full fixed / variable costing model with capacity levels accounted for is introduced then changing the VUC's would change little. For the virtually monopoly long distance services the fixed charges (disconnected from realistic fixed costs) and variable costs have little effect on behaviour, and may even cause rail to lose revenue. There must be services that have to be run which do not meet the desired criterion in 3.8 - *3.8 operators to only operate services where the short-run marginal benefit is greater than short-run marginal cost; and* From a recent passenger survey at least one TOC may have woken up to the fact that filling trains they are forced to run with low fares has a negative effect on revenues. They'd be better not running the train – or providing a decent service that the market would pay for.
Variable usage charge: 7. Do you have any suggestions for 'recalibration' style changes to the VUC you would like to see considered for PR18 implementation?
No
Capacity charge (CC): 8. Do you support our recommendation not to replace the CC with adjustments to Schedule 8 benchmarks?
Yes

Capacity charge:

9. Do you think we should: (a) retain the existing CC (but remove the caps on open access, freight and charter operators); (b) remove the existing CC and recover lost revenue through fixed cost charges; or (c) do you have any alternative proposals?

Is there really a capacity (constraint) cost that has to be charged? Is the issue not the fixed costs allocation – thus removing the CC makes sense. If charges were allocated and made on a 'time of day' basis this would feed into truly economic pricing of paths.

But this is thwarted by the UK franchising methods we currently have.

Traction electricity charge:

10. Do you support our recommendation to keep the loss incentive mechanism?

Yes

Electricity asset usage charge (EAUC):

11. Do you support our recommendation that the EAUC not be altered, beyond recalibration, in PR18?

Yes

Coal spillage charge (CSC):

12. Do you support our recommendation to abolish the CSC?

It does seem an immaterial issue.

Chapter 4: Contractual Incentives Regime

Schedule 8:

13. **Passenger compensation:** What are your views on the options of passenger compensation recovery and improving the transparency of compensation relating to Network Rail's actions?

More transparency would be good. Generally the UK has a very generous 'delay-repay' regime compared to other countries and modes of transport.

eg Should NR (and ultimately the tax payer) pay for trespass incidents – maybe OK if a fence is left broken.

These incidents seem to be on the increase. But is this a rail problem?

Schedule 8:

14. **Approach to setting benchmarks:** Do you support our recommendation to only make changes to delink passenger operator benchmarks and Network Rail benchmarks for freight operators from past performance (but to leave the approach to the other benchmarks unchanged)?

Yes – the past is history

Schedule 8:

15. **Measure of passenger operator performance:** Do you support our recommendation to change the measure of passenger operator performance to one based on the delay caused to other operators?

Yes

Schedule 8:

16. **Sustained poor performance (SPP) provisions:** Do you support our recommendation to limit SPP to costs compensation only?

Yes

Schedule 4:

17. Do you support our recommended prioritisation of schedule 4 issues? If you think we should reconsider any of the areas we have de-prioritised please submit supporting evidence.

Yes

Schedule 4:

18. Do you wish to submit relevant evidence regarding: (a) processes associated with planning possessions; and/or (b) planning alternative arrangements to deal with planned disruption (e.g. the notification that is needed to arrange bus replacement services)?

No

Aligning operator and network rail incentives:

19. Do you have any views on how financial incentives could be improved to encourage collaboration between Network Rail and operators to reduce industry costs?

There must be many – BUT has anyone looked at whether UK rail has been losing revenue due to the franchise regime we have?

Aligning operator and network rail incentives:

20. Do you have any views on the cost categories you think could be controlled by operators and whether these costs would be suitable as the basis of a potential future mechanism?

As long as operators are in for short term they can really only control (or have the will to control) a small percentage of their costs.

If they had control of rolling stock acquisition they could have some control over a significant cost. If they paid economic access charges then they would have reason to have influence on NR - the outcome of this consultation will be small step in the right direction.

NR has little incentive to reduced its costs – politicians will simply shuffle around services etc. For instance the Western electrification. It is simply observation but the OLE, particularly the steel work looks exceedingly ‘clunky’ Over-engineered? This is also the case with the Scottish

electrification. There may be a reason – a reaction to the ELML de-scoping years ago and the effects today? Simply visually compared to European OLE etc it is no wonder costs are higher. Allocating costs is difficult – removing the cause is the real challenge. The capital costs of today become the fixed costs in operation and getting to grips with capital costs is a must. Unless, as for example for HS2, they are simply treated as sunk costs..

Any other points that you would like to make

Thank you for taking the time to respond.

Rail Delivery Group

Response to Improving incentives on Network Rail and train operators: A consultation on changes to charges and contractual incentives

Date: 9th March 2017

Rail Delivery Group response to consultation:

Improving incentives on Network Rail and train operators: A consultation on changes to charges and contractual incentives.

Organisation: Rail Delivery Group

Address: 200 Aldersgate Street, London EC1A 4HD

Business representative organisation

Introduction: The Rail Delivery Group (RDG) was established in May 2011. It brings together Network Rail and passenger and freight train operating companies to lead and enable improvements in the railway. The purpose of the RDG is to enable Network Rail and passenger and freight train operating companies to succeed by delivering better services for their customers. Ultimately this benefits taxpayers and the economy. We aim to meet the needs of:

- Our Members, by enabling them to deliver better outcomes for customers and the country;
- Government and regulators, by developing strategy, informing policy and confronting difficult decisions on choices, and
- Rail and non-rail users, by improving customer experience and building public trust

For enquiries regarding this consultation response, please contact:

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Rail Delivery Group

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1. Overview

This paper sets out industry responses, collated by the RDG, to the questions posed in the Office of Rail and Road's (ORR) consultation on improving incentives on Network Rail and train operators.

A great deal of our response is based on the RDG Structure of Charges Review and the extensive engagement facilitated by RDG through the PR18 working groups. The Structure of Charges Review was prepared and delivered by RDG in 2015/16 with view to limiting the need for a major focus on charges and incentives in PR18. Given the issues that arose with ORR's approach in PR13 industry wanted to proactively manage the situation and invested £500,000 to ensure ORR could focus its activity.

In addition, there have been over 15 RDG 'Charges and Incentives Working Group' meetings – the majority of which were attended by the ORR. As we have previously stated, the RDG values this engagement, believing it to have been an important input into the development of the ORR's approach to the subject matter under discussion. In light of significant activity in 2015 and 2016, in November 2016 when ORR announced that the major focus of activity would be getting route based regulation and the National System Operator (NSO) to work in PR18 and to limit work on charges and incentives industry was hopeful that there wouldn't be significant change to the current framework of charges and incentives.

Given the degree of reform ORR is now proposing to charges and incentives industry is disappointed that despite the work above industry is still being required to provide significant input to ORR. The proposals being made by ORR add significant complexity to an already complex set of charges and incentives. Further it is difficult to provide detailed feedback without having a holistic assessment of the overall impact of the proposed framework. Although ORR has scheduled this work now it really should have been a component of the Impact Assessment work to this consultation.

Although this consultation is about the frameworks and mechanics of the charging and incentives regime, the key will be the inputs into the cost model. This will have a direct impact on the level of charges. RDG and its members know Network Rail is facing significant challenges to renew, maintain and operate an increasingly busy and congested network. The ORR's recent Network Rail Monitor highlights the cost pressure that Network Rail is facing and has identified the key factors driving current underperformance against budget. This should take priority over devising methods to allocate costs between operators. The impact of Network Rail's cost challenges on the calculation of track access charges is a very significant concern, particularly for all freight operators.

The current approach by ORR therefore significantly limits the incentive on industry to work collaboratively and invest in activities such as the Structure of Charges Review in the future. The willingness of industry to work in this way should not be taken for granted by the regulator. Moving forward RDG would reiterate that industry is aligned in wanting a charging regime that reflects the following principles that:

- the purpose of each element of the charges and incentives regime should be clear;
- the charges and incentives regime should reflect the reality of the GB rail industry and we should not assume that changes impact all parties in the same way;
- the charges and incentives regime should align with other industry arrangements;
- the next periodic review (PR18) should prioritise areas of the regime that are most in need of reform; and

- ORR should recognise the potential impact of changes to charges and incentives on industry stakeholders

This response therefore builds on these principles and the extensive work already provided to ORR and provides a high-level industry view on the questions raised. It also comments on broader issues explored by the working groups, and includes views both where there is industry agreement and, in places, where there is no settled view on the consultation's questions.

The format of our response follows the content and layout of the ORR consultation document. We confirm that we are content for this response to be published on the ORR website.

2. Chapter 1: Introduction and Context

Page 3, Supporting Notes: Summary of proposed changes to the charging structure

Supporting note 3 notes the ORR's proposed approach for fixed cost mark-ups is to levy these where the market can bear for franchised, open access and freight operators using the cost allocation work Network Rail has commissioned by Brockley Consulting. The Brockley Consulting study, which is a useful piece of work, focussed on the long run cost that could be saved if trains were taken off the network, the capability of the network is downgraded and expenditure is avoided.

The impact assessment suggests ORR wants to use some of this thinking to replace some of the existing lump-sum fixed charges with freight-style mark-ups. This would see the costs that each passenger train operator pays (or saves) when it varies services increase to a level that sits well above the current variable usage charges. This would only work if the net benefit of the additional (or avoided) cost that Network Rail is likely to see in the face of changes in traffic levels during CP6 is much greater than the income it will get (or lose) through changes in variable usage charges.

At this stage it is therefore difficult to provide further comment or provide a view on the variablisation of fixed cost. Moving forward industry expect further detail on:

- How ORR will guarantee Network Rail is adequately funded for its activities and will not be any variability of income to cover its fixed costs?
- How Network Rail will be able to manage a changed billing process needs to be understood including the transaction costs associated with any change?
- How ORR will deal with variation in traffic resulting from issues like possessions, cancellation and reactionary delay?
- How the market can bear test will work?
- Setting of efficiency targets for CP6.

3. Chapter 2: Infrastructure costs

Fixed Cost Charges

Q1: Do you support our proposal to levy fixed cost charges on all operators, including open access operators, to the extent that they can bear them (option 2)?

RDG supports an approach that ensures DfT is agnostic to decisions about granting franchise or open access rights on the network by creating an environment of revenue neutrality. Having said that it is important to understand the overall level of potential charges and their impact – this was the purpose of the Structure of Charges Review because industry wanted to give ORR a firm basis for presenting its proposals as well as sufficient time to provide an assessment of magnitude. The magnitude of the issues is missing from these proposals, particularly because industry anticipates significant increases in maintenance and renewal costs in CP6.

Further, it is impossible to fully understand the potential impact of the ORR proposal until there is clarity on DfT's policy on Public Service Obligations (PSO) Levy and more importantly, the method by which ORR will calculate the market can bear test.

The market can bear test will be hugely important to freight and open access operators in this review and so some early indication of how ORR intends to make the assessment, and the process of consulting and working with industry will be vital. Uncertainty about the total level of access charges that will stem from uncertainty about how and when the market can bear test will be assessed, is a significant concern because of the impact it can have on end users and hence demand for rail services.

Fixed cost freight charges

Q2: Do you support our proposal to simplify the current charging regime by having a single freight mark-up charge?

RDG supports simplification of the charges regime.

The ORR proposal however seems to simplify the process and then complicate by suggesting the addition of a geographic application of the market can bear test. This appears at odds with the ORR's approach to the VUC for example where there is agreement that a 'geo VUC' would be overly complicated and difficult to administer. RDG does not support proposals to add a geographical basis for the same reasons as the VUC. In addition, freight typically sells a portfolio of commodities to customers across the network so geographic disaggregation will not align the market segments freight sells to.

Q3: Do you support the recommendation to apply Network Rail's cost allocation methodology (discussed in this chapter) to freight mark-up charges?

RDG supports the cost allocation work to increase understanding of fixed cost drivers and improve transparency but believes more work needs to be done before this can be translated into charges. Network Rail supports using this work to inform the maximum level of freight mark-up charges, where the market is able to bear a mark-up.

Freight operators do not support ORR's proposal to translate this work into charges. Operators consider that much more work needs to be done on how the methodology would be used, how it would impact on different users, and specific ranges the ORR might apply, before it could be considered for setting charges.

Stations Charges:

Q4: Long term charge: Do you support our recommendation that the methodology for LTC at managed stations be recalibrated?

We do not consider this to be a priority for this review.

Q5: Qualifying expenditure: Do you agree with our recommendation that we support the work to make QX charges more transparent at both managed and franchised stations?

We do not consider this to be a priority for this review.

4. Chapter 3: Short run Variable Charges

Variable usage charge:

Q6: Do you support our recommendation not to make fundamental changes to the VUC for PR18?

RDG members support the ORR's approach to base charges on wear and tear costs assessed mainly by an engineering model VTISM, and not to make fundamental changes to the methodology. However, the industry is aware that OM&R costs of managing the infrastructure network in CP6 might increase significantly and is concerned about the prospect of this being reflected in increased VUC.

Q7: Do you have any suggestions for 'recalibration' style changes to the VUC you would like to see considered for PR18 implementation?

No, as noted above RDG is content with the current ORR proposals although it is important that minor recalibration changes can result in considerable changes in charges and care is needed so the process doesn't generated unintended consequences.

Capacity Charge:

RDG is disappointed ORR's thinking has not developed further by this stage of the process. The original intent behind the capacity charge was to neutralise the increase in Network Rail's Schedule 8 costs of accommodating additional traffic on the network. This removes Network Rail's apparent financial disincentive to allow additional traffic on to its network. ORR now appear more concerned with the incentives that the capacity charge gives to train operators with respect to the number of trains that they run. From an overall industry point of view there doesn't appear to be a coherent set of incentives to encourage Network Rail to find additional capacity.

Q8: Do you support our recommendations not to replace the CC with adjustments to Schedule 8 benchmarks?

RDG accepts that ORR does not wish to take this proposal forward. However, it is important that ORR does focus on how to reconcile the relationships between incentives for growth with incentives for performance on a mixed use railway.

Q9: Do you think we should (a) retain the existing CC (but remove the caps on open access, freight and charter operators); (b) remove the existing CC and recover lost revenue through fixed cost charges; or (c) do you have alternative proposals?

It is also not clear in ORR's work if the primary driver for the Capacity Charge is to recover costs or incentivise growth. This needs to be clearer. RDG therefore does not support the two proposals from ORR.

Option 1 (referred to as (a)) in the question is not supported by the industry. ORR suggests that the implementing regulation (2015/909) applies to the Capacity Charge, meaning that it cannot be capped or phased in for CP6. RDG believes the implementing regulation applies when calculating direct costs for the purpose of setting the charges for the minimum access package. ORR state that costs recovered by the Capacity Charge do not fall within the scope of the minimum access package so it does not make sense that it applies to capacity charge costs. The Capacity Charge should therefore be treated as a mark-up meaning there is no need to apply the capping and phasing rules with the added benefit it will give added flexibility to our approach moving forward.

Option 3 (referred to as (b)) in the question is not supported by the industry. This option in effect 'gives' up on any attempt to neutralise Network Rail's Schedule 8 costs of additional traffic, and therefore would put Network Rail at a financial disadvantage if it accommodated more traffic than anticipated. RDG freight members however, would support this ORR proposal.

In response to part c) of the question - an additional three proposals were discussed by industry. To help demonstrate the options we have compared ORR's proposals to the alternative proposals. We have assessed each proposal against the RDG Structure of Charges Principles. We have not assessed ORR's Option 2 (adjustments to Schedule 8 benchmarks) as ORR dismissed this option in its consultation document. RDG notes however that freight members typically don't support approaches that rely on wash-ups.

<u>(£0 on baseline traffic)</u>

Traffic below a baseline would only pay the Capacity Charge according to ORR's affordability test. Traffic above a baseline is a direct cost to Network Rail, and so operators would pay this at the full CP6 rate. This would be achieved through an annual wash-up for above baseline traffic.

<u>Capacity Charge rebates</u>

As discussed at the November RDG Schedule 4/8 and Capacity Charge group all operators would pay the full, CP6 rates on all traffic. However, operators would receive a 'rebate' each period, equal to baseline traffic CP6 rate. This is netted off each operator's Capacity Charge payments each period. Operators effectively pay the full CP6 rate on above baseline traffic only.

Market-based wash ups

All operators would be placed into a 'market', according to ORR's affordability test. For each market, a weighted average Capacity Charge rate would be calculated, based on the full CP6 rates of each operator/service code within that market. Similarly, a level of baseline mileage would be defined for each market. Annually, actual mileage would be compared to baseline mileage. No Capacity Charge is payable on baseline mileage. Traffic above baseline is charged at the full CP6 rate, split amongst all operators within that market.

RDG and its membership have provided four alternative approaches to date. Moving forward we would like to work collaboratively with ORR to consider them and consider.

	ORR Option 1	**ORR Option 2**	**£0 on baseline traffic**	**Capacity Charge rebates**	**Market-based wash ups**
There should be, as far as possible, a **predictable and stable** charging regime for all operators	✓✓	✓✓	×	×	✗
Trains of a **similar nature** operating on the same parts of the network should have their various access charges set on a **consistent basis**	✓✓	✓✓	✓✓	×	✓✓
Network Rail's **incremental Schedule 8** costs of traffic growth above the control period baseline should be **neutralised**	✓✓	××	✓✓	✓✓	✓✓
Any Schedule 8 cost consequences of running additional traffic should be **reflected in that part of the network**	✓	××	✓	✓	✓
There needs to be an **effective and transparent**	✓	××	✓	✓	✓

	ORR Option 1	ORR Option 2	£0 on baseline traffic	Capacity Charge rebates	Market-based wash ups
transmission mechanism to incentivise Network Rail to balance appropriately the costs and performance consequences of additional traffic					
Any alternative to the Capacity Charge should be workable and internally consistent – there should be **no 'special arrangements'** for CP6	×	×	✓✓	✓	✓✓
There should be no 'over-recovery' of Schedule 8 costs	××	✓	✓	✓✓	✓✓
The administrative burden should be proportionate	✓✓	✓✓	×	✓	✗
Legality of option	××	✓	?	✓	✓

Key: **×× Actively goes against principle** **× Does not achieve principle** **✓ Partially achieves principle** **✓✓ Fully achieves principle**

Traction electricity charge:

Q10: Do you support our recommendation to keep the loss incentive mechanism?

Our members have mixed views about whether to keep the loss incentive mechanism in its current form although we consider there would be merit in ORR discussing its proposals further with the industry before it concludes its position. Operators do not support the retention of the loss incentive mechanism in its current form whilst Network Rail considers that there would be merit in ORR discussing its proposals further.

Through the cross-industry Traction Electricity Steering Group (TESG), the issue of traction electricity system losses has been discussed ahead of the publication of this consultation. For reasons previously outlined at TESG, the industry agrees with ORR's assessment that the loss incentive mechanism has not been effective in its primary purpose of promoting reductions in system losses, or in incentivising increased levels of on-train metering. In addition, some in the industry think it has been ineffective in incentivising increased levels of on-train metering.

Network Rail thinks that the loss incentive mechanism could have provided an incentive for modelled operators to adopt on-train metering. However, Network Rail is also aware of additional factors that influence the decision to adopt on-train metering, for example franchise agreements.

The consultation document states that ORR's proposed retention of the loss incentive mechanism is to provide "incentives to ensure that the forecast losses are reflective of likely outturn". Whilst RDG members agree that there are benefits to improving industry's understanding of EC4T, it is also important that any incentive mechanism is able to feasibly promote its stated objectives. There is concern that at best, ORR's expected outcomes are not realistic, and at worst that the mechanism creates a perverse incentive. The issues outlined below need to be addressed in any mechanism moving forward:

- Forecasting losses to set an 'accurate' Distribution System Loss Factor (DSLF) is extremely complex. It is well accepted that at present, errors in modelled consumption rates contribute to a greater amount of the end of year EC4T wash-up than errors in the DSLF. There are also other possible contributing factors to the wash-up including errors with grid supply point and on-train metered data. Therefore, it is extremely difficult to begin to effectively analyse wash-up data as a means of understanding losses until on-train metering levels are significantly higher than at present.

- Losses are known to vary by year and by ESTA, which further inhibits the ability to 'accurately' forecast losses on a network wide basis using wash-up data or other methodologies. In any case, under present provisions under the Traction Electricity Rules, DSLFs are set for the duration of the control period, which is important in providing certainty to metered operators. This would prevent any changes to DSLFs within a Control Period even if industry was able to determine a more robust forecast for losses.

- In the prevailing situation where the end of year EC4T wash-up corrects an overcharge to operators, the loss incentive mechanism generates a net financial loss for modelled operators, and a net gain to Network Rail. Therefore, operators and Network Rail have opposing incentives to accurately forecast losses: if the DSLF is set too low there is a loss to Network Rail and a gain to modelled operators, and vice versa if the DSLF is set too high. This seems to strongly contradict ORR's intention to share risk, and the industry's general aim to better align incentives.

Electricity asset usage charge:

Q11: Do you support our recommendation that the EAUC not be altered, beyond recalibration, in PR18?

RDG members support the ORR's approach.

Coal spillage charge:

Q12: Do you support our recommendations to abolish the CSC?

RDG members support the removal of the CSC. Moving forward Network Rail believes contractual measures should be used be if a major coal spillage were to occur. Freight operators however, point out there is already a clause in the model track access freight that deals with environmental damage.

5. Chapter 4: Contractual incentives regime

Q13: Passenger compensation: What are your views on the options of passenger compensation recovery and improving the transparency of compensation relating to Network rail actions?

Reform of passenger compensation arrangements and keeping them separate from Schedule 8 are a priority for industry. As ORR helpfully points out in Box 4.1, passenger compensation and Schedule 8 perform very different functions. While Schedule 8 provides a useful a framework and data set for attributing delay that can be used to inform a passenger compensation regime that is where the relationship should end.

RDG supports greater transparency for passengers in understanding the causes for delay and the subsequent compensation they receive to mitigate any impact of that delay. A system that does that should reflect the following features.

- It should ensure passengers are properly compensated, i.e. compensation should not be a token response to the impact of delay;
- If ORR concluded Network Rail should contribute to compensation, Network Rail will need specific ring fenced funding to cover compensation costs (for NR caused delay);
- Payments should be not discretionary where the delay/repay system is in place;
- Passenger compensation arrangements need to be included in Track Access Contracts; and
- TOC-on-TOC related compensation should be left with operators to manage (assuming no change to Schedule 8 TOC-on-TOC measures in CP6).

Q14: Approach to settling benchmarks: Do you support our recommendation to only make changes to delink passenger operator benchmarks and Network Rail benchmarks for freight operators from past performance (but to leave the approach to other benchmarks unchanged)?

No. RDG believe there are a number of issues that can be taken forward by ORR and DfT to significantly improve and align the contractual incentives faced by TOCs and NR and more should be done in this area.

With regard to TOCs the first step would be to align Schedule 8 benchmarks with those targets contained in the franchise agreement. For example – if the benchmark is based on TOC-on-Self delay (as contained in the franchise agreement) it is clear because it is contracted to government. This should be converted into the train operators' Schedule 8 benchmarks.

With regard to FOCs, Network Rail believe the freight benchmarks have previously been calibrated at a level which reflects a realistic, attainable, level of performance, based on historical actual results.

This makes the regime is cost-neutral if performance remains on benchmark throughout the control period. Further work will be done in the coming months to analyse current FOC performance that will assist the industry in setting a fair benchmark in the future.

Freight members believe the freight benchmark needs to take into account the increase in Delays per Incident ("DPI") as their evidence suggests that the current adjustment mechanism (based on a congestion factor multiplier calculated by Arup for CP5) is not creating the right incentive. Since the start of CP4 evidence from freight members suggest:

- All freight operator self-minutes has decreased 47%;
- All freight operator third-party delay per 100 miles has reduced 4% from 2.46 minutes to 2.36 minutes; and
- All freight operators delay per incident (DPI), based on number of third-party minutes per incident, has increased by 49%.

Network Rail notes that DPI has partly increased because overall freight traffic patterns have shifted southwards in the past 2 years. There are significantly fewer coal trains serving northern power stations, while intermodal and construction traffic based on the southern ports and quarries has seen a slight increase. There have also been some very large incidents attributed to the FOCs such as the recent Lewisham derailment.

Freight operators consider that they have little control over how incidents are managed. However Network Rail considers that freight operators do have some control over the impact of their incidents, in terms of standby locos, mobile fitters and train crew resourcing / route knowledge.

With regard to NR benchmarks RDG believes the benchmark must be consistent with the funding level received by NR and the benchmark has to be realistically achievable.

Q15: Measure of passenger operator performance: Do you support our recommendation to change the measure of passenger operator performance to one based on the delay caused by other operators?

There are clear divisions within the industry but there are also broad agreements and shared concerns in a range of areas. To focus the debate RDG has set out the following to assist ORR with its decision-making.

Shared industry agreement

There is broad agreement across industry that Schedule 8 is structured to leave operators in a financially neutral position from marginal revenue losses to one party driven by performance incidents caused by others. Schedule 8 uses a liquidated damages process that is simple to apply at the point of action and ensures that all delay incidents are “owned” by someone. Schedule 8 flows money from “perpetrators” of delay incidents to “victims” of delay incidents. It is benchmarked so no money flows when performance is at the target level but industry parties are incentivised to improve their performance, such that they reduce their payments (or increase their income) through Schedule 8. The delay attribution process generates delay causation data that is invaluable in underpinning the development of effective performance improvement and asset management strategies.

Shared industry concern

There is also shared concern across industry in a number of areas. With regard to performance metrics it is not clear that the Network Rail AML benchmarks align properly with Performance Targets (currently set in terms of PPM) or whether TOC-on-Self AML benchmarks reflect the operator's performance trajectory. With regards to payments it is not clear that the Network Rail Payment rates accurately reflect the actual marginal revenue impact of deviation from target performance levels or that operator payment rates accurately reflect the actual "Star Model" payments that Network Rail make to "victim" operators for reactionary delay associated with operator incidents. The money flows in Schedule 8 create tensions between industry parties in the delay attribution process.

The importance of Joint Working

Despite rising levels of reactionary delay being a matter of shared concern, Schedule 8 contains no specific incentives to drive joint working between industry parties in this area. This appears counter to overall approach to devolution and the emphasis from government that has joint working as a priority.

RDG supports the collaborative work to support the PDFH review of delay/revenue elasticities, greater industry involvement in the process to recalibrate benchmarks and NTF, Route and Operator Performance Strategies that all focus strongly on joint working between industry parties aimed at reducing reactionary delay. It is within this context that ORR's proposal needs to be considered because there are clear areas of disagreement and clear gaps in ORR's proposal.

ORR's proposal

Network Rail supports ORR's Schedule 8 proposal to move to a regime where train operators pay for the actual delay/lateness that they cause to other train operators, as opposed to an estimate of that delay/lateness. Train operators already pay for the modelled impact of their own disruption on others in the current regime. Therefore, ORR's proposal would not change what train operators pay for through Schedule 8, it would instead make this payment more reflective of the actual impacts.

Instead, Network Rail believes that it may help drive better conversations within train operators and with Network Rail. This could then lead to more informed 'high level' decisions to deal with the impact of delays and to provide a better service for passengers – for example, through better conventions for train regulation.

Operators are concerned by the revisions that ORR are proposing which they consider cuts across the core principle identified by ORR in Box 4.1 that "Schedule 8 helps operators manage risks they cannot control" despite the consensus that the regime is broadly fit for purpose. Operators are particularly concerned about the downstream impacts in terms of how operators and Network Rail work together to recover the Network. Operators are also concerned the ORR proposal will weaken the incentive on Network Rail in its role as system operator to effectively deal with operator related incidents.

ORR's impact assessment provides limited analysis of the potential impacts downstream and comments from ORR at the London Charges and Incentives Workshop reinforced that while this was considered as an improvement to an economic incentive no analysis has been done to consider how the incentive may impact downstream activity.

RDG therefore strongly urges that ORR work collaboratively with industry to review the potential downstream impacts of the approach and further consider how the regulator can better incentivise joint working to manage disruption on the network before a final decision on the policy is taken. As a first step, RDG is working with the National Task Force (NTF) to consider the potential downstream impacts in further detail as well as potential options for increasing incentives on Network Rail to manage recovery of TOC-on-TOC reactionary delay.

Industry concerns not being addressed

The ORR proposal does not perfectly balance the “Star Model”, as operator payment rates would still be based on historical correlation and there is no proposal to ease tension in the delay attribution process and there is no proposal to set underlying performance targets for the benchmark calibration process. However, the ORR proposal improves the balance of the star model (if correctly calibrated), as it becomes less reliant on accurately calibrating the expected performance impacts as a result of operator-caused disruption. RDG is strongly of the view these issues should also be considered as part of the PR18 review.

RDG also needs to note for the record that during PR18 Working Group meetings, ORR commented that Stagecoach/Virgin supported its proposals for TOC-on-TOC, however that is not the case. Stagecoach/Virgin does support further investigation of the issue but does not support the current ORR proposal, without the results of this further investigation.

Q16: Sustained Poor Performance provisions: Do you support our recommendation to limit SPP to cost compensation only?

RDG members agree that the current approach to SPP is costly, time consuming and difficult to resolve. Having said that it is important that operators are fairly compensated for the impact of SPP.

Network Rail supports the ORR proposal but will also consider investigating further options for reform. Operators are strongly opposed to the current ORR proposal because there are periods of sustained poor performance where there is a long run impact on revenue This is of particular concern to operators as business plans / franchise bids (depending on whether you are an OAO or a franchisee) are based on a forecast of performance. When performance falls significantly short there will be a longer-term impact on revenue.

RDG would therefore like to propose a two-stage approach to SPP that incorporates ORR’s existing proposal. For stage one, the proposal presented by ORR would be used for SPP at, for example, 10% and above the benchmark (and be subject to cost only). For stage two at, for example 25% above the benchmark, the SPP would be opened to revenue claims as well to reflect the long term revenue impacts noted above. The SPP thresholds at each stage should be based on evidence of increased costs / revenue losses that train operators experience as a result of performance being significantly different from Schedule 8 benchmarks.

Schedule 4:

Q17: Do you support our recommended prioritisation of schedule 4 issues? If you think we should reconsider any of the areas, we have de-prioritised please submit supporting evidence.

RDG welcomes the areas ORR has prioritised for improvement as these reflect the conclusions of the RDG’s review of charges completed a year ago. Having said that Freight members will be suggesting some detailed recalibrations in their responses. RDG also noted that there are specific contractual drafting issues that need to be resolved for CP6.

Q18: Do you wish to submit relevant evidence regarding: (a) processes associated with planning possessions; and/or (b) planning alternative arrangements to deal with planned disruption (e.g. the notification that is needed to arrange bus replacement services)?

RDG has no comments in this area.

Aligning operator and Network Rail incentives

Q19: Do you have any views on how financial incentives could be improved to encourage collaboration between Network Rail and operators to reduce industry costs?

Q20: Do you have any views on the cost categories you think could be controlled by operators and whether these costs would be suitable as the basis of a potential future mechanism?

It is essential that incentive mechanisms and targets are aligned between delivery organisations. Ideally these would be aligned through the franchise design process and the ORR periodic review process that sets the commercial model for freight and NR. More needs to be done by ORR and DfT to align incentives and targets, and there needs to be an integrated programme between DfT and ORR to address this and make explicit the choices between capacity and performance. ORR needs to pause and wait for the release of the DfT Rail Strategy and then work collaboratively with industry to develop incentive mechanisms that support the delivery of that strategy.

As well as aligned incentives, ORR needs to check that the incentives are right. Do they encourage passenger and end-user needs to be put first and reflect the trade-off between capacity and performance? The purest and most powerful incentive to align is revenue/growth in the form of perhaps farebox, freight revenue/growth, and other customer/economic benefits. This alignment has the potential to be the strongest incentive for passengers and the end users of freight services to be at the heart of the railway and a significant driver of efficiency and more consideration of how ORR will incentivise this through the scorecards will be an important consideration moving forward.

Aligned reliability and punctuality performance incentives, alongside adequate resourcing of OM&R, are key to reversing declining operational performance. Metrics in this area are being reviewed by government as part of the Gibb review of Southern with a customer weighted measure likely to be recommended. Any new performance metric should be developed with industry through RDG NTF. We recognise that a one-size fit all approach may not work - routes (NR and TOC) should be able to argue for a metric that best represents the situation (and reflect in franchise and route scorecard). Performance metrics must be set at an achievable and honest level: there is a clear trade off to make between capacity and performance.

System wide alignment of incentives will take some time to achieve as they affect commercial models for private and public companies as well as having an impact on the taxpayer. In the meantime, route scorecards are an initial important step to aligning incentives between delivery organisations. Although there has been some negative feedback about how they were introduced, there is commitment to evolving them to become properly aligned and reflective of the customer and the stages and timelines in doing so.

The focus for ORR should be to develop a mechanism that supports collaboration between Network Rail routes and operators, noting that a ‘one size fits all’ approach simply won’t work. Solutions could range from joint frameworks through to deep alliances. Further at the moment there only limited ability for an operator to influence OM&R costs on a route. For these reasons RDG does not believe the current REBS regime creates the necessary incentives for improved collaboration.

RDG believes the following changes could improve REBS including:

- set the baseline for no more than 2 years and use the NR delivery plan rather than the ORR determination;
- limit the items in REBS to key OMR costs that operators and NR Routes influence can (noting there is no operator influence now); and
- getting more engagement from operators in the process early through the process to develop route Strategic Business Plans, route Delivery Plans and route Scorecards.

An approach with these features will ensure there is both sufficient flexibility for the scheme to be re-baselined to reflect achievable efficiency benefits whilst developing a sense of shared ownership and collaboration. REBS is considered as one of a potential suite of mechanisms to encourage collaboration (alongside material alliances as an example) that should be used where appropriate.

In 2014 NR and freight operators jointly developed options for a FEBS (focussed on freight avoidable costs) and suggest these options are further develop for CP6.

Improving Incentives on Network Rail and Train Operators

A Consultation on Changes to Charges and Contractual Incentives

Response from Rail Freight Group

March 2017

1. Rail Freight Group is pleased to respond to the ORR's consultation on Charges and Contractual Incentives as part of Periodic Review 2018 (PR18). No part of this response is confidential.

2. Rail Freight Group is the representative body for rail freight in the UK, with around 120 member companies from across the sector including freight operators, customers, ports, terminal operators, developers, rolling stock and supply chain companies and support services . Our aim is to increase the volume of goods moved by rail.

General Comments and Summary

3. Rail freight, which operates almost exclusively in the private sector, is a key part of UK freight and logistics. Overall, rail accounts for around 12% of surface freight transport, with significantly higher shares in some parts of the market. Compared to road freight, rail freight has significant environmental advantages including;

    a. 76% less CO2 than the equivalent journey on road
    b. 90% less PM10
    c. 15x less NOx
    d. Up to 20x safer than road
    e. Each train keeps up to 75 lorries off the road, reducing road congestion and road damage.

4. Governments support rail freight because of its environmental benefits and because of the contribution it makes to economic growth and prosperity. RDG estimate that the value of these benefits is £1.6bn pa for the UK. Both Westminster and Holyrood Governments have set out their support for rail freight in recently published rail freight strategies, which help to promote the case for growth by outlining a stable and supportive policy environment.

5. Against this backdrop the PR18 review of charges is a critical process which will determine how ORR can also help to promote rail freight, in accordance with its statutory duties and current Government Guidance (see Annex A)

6. The changes in the rail freight market since PR13 are well understood. Freight operators have lost 20% of their volume since the start of CP5 with commensurate impacts across all sectors of the business, including the realignment of resources and staff. This process is not yet complete, and we

expect to see further reductions in coal traffic across the remainder of CP5 and CP6 as the residual coal power stations close.

7. These changes have inevitably impacted on freight operators' financial performance. ORR's recent UK Railway Financial Information shows that for the most recent dataset no freight operator paid a dividend, and the combined performance showed a £100m deficit of income over expenditure. The ability of freight operators to absorb cost increases within their profits is therefore very limited.

8. Freight operators are seeking growth in other markets, and recent statistics show that construction and intermodal continue to increase. However, for both these sectors, competition with road freight is acute, with road benefitting from lower fuel costs, frozen duty and investment in the road network. Whilst we do not suggest that road costs should necessarily increase, the competitive position must be a key factor in ORR's considerations, given that for most customers, road freight is a viable and affordable choice.

9. The experience of PR13 demonstrates the absolute necessity of ensuring that the total charges for freight operators is affordable and balanced. With proposed changes across most areas of the charges and incentive regimes this is just as relevant for PR18. It is a key concern of the sector to ensure that this is done, and sufficiently early in the process to avoid price shocks and allow time for re-consideration if charges are found to be unaffordable. We recognise that ORR wish to do this, but the current timescales, and volume of work to be completed are already such that this is now a key risk for freight operators.

10. For PR18 to deliver a successful outcome for freight, it will therefore need to provide a fair and pragmatic framework for operators and customers. This should include;

    a. Ensuring that the total cost exposure for freight operators and customers is affordable, and does not lead to price shocks;

    b. Recognising Government's ambitions for modal shift, and enabling this through recognition of competing road costs and incentives;

    c. Maintaining customer and investor confidence through a stable cost framework;

    d. Ensuring that any incentives are simple and effective, and work in both directions, so that operator and customer action is rewarded in the short and medium term, and that Network Rail can clearly identify the benefits achieved from freight actions.

    e. Understanding the implication of data cost allocations with decision makers and observers, and ensuring that effective and coherent messages are provided to avoid perverse decisions.

11. ORR are working in a more open and consultative manner than previous reviews which is welcome. Nonetheless there are still some significant emerging concerns for the sector, summarised on the table below. Of most concern is the potential significant increase in variable charges as a result of Network Rail cost increases, and the lack of a clear timescale and process for a holistic assessment of cost increases and impacts. There is already sufficient information to be concerned over the affordability of the possible changes.

12. The table below provides a summary of key points by each area, and more information is provided in the detailed comments below.

Charge Area	Key comments
Variable Charge	• Welcome decision not to fundamentally review approach to variable charge calculation. • Note the 'uncapping' of CP5 charges which will increase charges regardless of any other increases. • Significant concerns over increased costs of OMR from Network Rail and the read through into potentially significantly higher variable charges • Need for ORR to set effective efficiency assumptions on Network Rail including consideration of a long term target.
Ability to pay test and mark ups	• Concerned to ensure assessment recognises overall financial position of sector and holistic approach to PR18 changes. • Concerned to recognise network effects and to avoid route by route assessment. • Lack of clarity over timescales for this assessment compared to Network Rail's calculation of variable charges.
Fixed Charges	• Lack of clarity around status of Network Rail's work and the potential range of outcomes from different options • Distinction between transparency of information for decision making and charge • Risks around perception of rail freight sector without equivalent analysis of road network. • Ability to validate costs against forecast change e.g. from coal sector
Capacity Charge	• Purpose remains unclear, particularly as an incentive regime. • Charges have not fallen despite reduction in freight services • Removal of caps risks an unaffordable increase in costs for freight. • Option to abolish and recover through fixed cost is preferred
Schedule 4	• Need to review freight regime as part of review in particular payment rates.
Schedule 8	• CP5 regime has been a significant impact on freight operators, and focus of CP6 should be to ensure it is fair, balanced and effective. • Any changes to the TOC regime should not impact unnecessarily on FOC regimes.
Coal Spillage Charge	• Agree with proposal to abolish • Any proposals for future contractual approach should be developed by NR and operators
Merger of FSC and FOL charges	• Agree with this approach
REBS	• Freight operators reluctant to commit to scheme as they have little or no control over major cost categories. • Proposals for a freight scheme targeting specific areas worthy of development if actual cost savings can be established.

Specific Comments

Introduction and Context

13. We note ORR's view that charges and incentives can provide for improved outcomes for freight customers. We support this aim, and understand the role that effective charges and incentive regimes can bring. However, for most customers, the central consideration in deciding whether to use rail is the overall cost of haulage of which charges, in totality, are an important part. The ORR must therefore remain focussed on ensuring that the overall package for freight is affordable, effective and delivers to key aims including modal shift and growth. ORR must therefore consider the cross modal impacts of its decisions as well as those confined to railway outcomes.

14. The right incentive can deliver effective change, for example, the incentive to operate more track friendly wagons has encouraged the market to use this technology in almost all new build wagons. However other incentives have been less successful, for example the coal spillage charge which did cause the expected investment by customers only for the charge to increase. ORR must be clear which specific actions it wishes freight operators customers to take, and ensure incentives are aligned, including Network Rail's response to them.

15. We are concerned to ensure that ORR are able to allow sufficient time to ensure a holistic assessment for freight can be concluded well ahead of draft determination, and any necessary adjustments made. We note for example that the market can bear test is expected to be concluded ahead of Network Rail's conclusions on variable charges, and any discussion on efficiency and are concerned to understand how these can therefore align.

Infrastructure Costs

Q1 Do you support our proposal to levy fixed cost charges on all operators, including open access operators, to the extent that they can bear them?

16. As this is permitted by the prevailing legislation, we understand that ORR will wish to assess the option, as it did in PR13.

17. With respect to the four options shown, we agree that Options 1 and 2 are the only reasonable options. It is unclear how the two options differ for freight and this should be clarified. However, and for the record, we would strongly oppose Option 4 which would remove business certainty, prevent investment, and leave rail freight unable to effectively compete with road. Such an approach should only be undertaken if and when road freight is also required to pay a fixed charge.

18. The 'market can bear' assessment is critical to this proposal. As we have not yet seen details of the remit and work plan for this, it is hard to comment in detail. However, we would note that;

a. The definition of market should acknowledge the network wide operation of freight by commodity sector, and resist any route by route assessment which does not reflect the buying decisions of customers, and the operational model of operators.

b. A route by route approach is misaligned with ORR's agreed approach to the variable charge in PR13. It is not clear how it would be billed, and it risks being seen as discriminatory for example between different ports.

c. The assessment must take account of all potential cost increases when considering the ability to pay more. This must include Network Rail's reassessment of the variable charge, the capacity charge, Schedule 4 and 8 costs and other charges. The difference between these categories is not material in customers' decision making.

d. The assessment should recognise the competitive position with road freight, and the simplicity of the charges for road. With the ongoing freezing of road fuel duty, the competitive position is likely to have deteriorated since the PR13 assessment, and this should also be updated.

19. We would suggest that the following factors should be included in the test;

i. Impact on the rail freight market and current traffic volumes;
ii. Impact on future growth;
iii. Impact on FOC profitability and hence FOC ability & willingness to invest;
iv. Impact on Network Rail;
v. Impact on third-party involvement, and crucially the willingness and ability of third parties to invest in rail freight;
vi. The impact of exogenous factors such as the oil price and the freezing of fuel duty for road freight;

20. For certain commodities, the assessment will inherently be looking at the economics of very specific individual businesses (so, for example, Drax power in the case of biomass, a small number of steel businesses and so on). The assessment will need to respect this, and engage in early dialogue with those companies. It will also be important to recognise the link between their supply chains and other aspects of Government strategy, such as generation policies and industrial strategy. We would therefore urge early engagement with relevant departments such as BEIS.

Potential Impact of Increase in Charges / Ability to Pay

21. Although we understand that ORR wishes to refresh the assessment, it is worth recapping the PR13 work and conclusions, including the 2012 MDS Transmodal study on the impact of changes in track access charges on rail freight. As part of this, MDS Transmodal assessed the impact of (inter alia) a 50% increase in VUC and a 100% increase in VUC. The conclusions, accepted by ORR, were:

Impact of % changes in VUC on Tonnes and Tonne kms by commodity

Commodity	**Tonnes**	**Tonnes**	**Tonne kms**	**Tonne kms**
% change in VUC	**+50%**	**+100%**	**+50%**	**+100%**
Other (Nuclear)	0.0%	0.0%	0.0%	0.0%
ESI Coal	-0.2%	-0.4%	-0.2%	-0.4%
Other Coal/Biomass	-0.3%	-0.7%	-0.5%	-1.0%
Iron Ore	0.0%	0.0%	0.0%	0.0%
Automotive	-6.3%	-12.1%	-5.1%	-10.1%
Metals	-2.0%	-3.9%	-2.1%	-4.2%
General Merchandise	-3.9%	-7.5%	-4.6%	-8.8%
Petro/Chem/Ind Min	-3.8%	-6.9%	-6.5%	-11.4%
Intermodal	-7.4%	-14.3%	-6.6%	-12.9%
Domestic waste	-7.4%	-14.3%	-6.3%	-12.3%
Construction	-8.7%	-16.1%	-7.7%	-14.8%
Total	**-4.0%**	**-7.6%**	**-4.6%**	**-8.9%**

(*Source: MDS Transmodal Stage 1 report for ORR 12 February 2012*)

22. In the same report, MDS Transmodal also assessed the potential for modal shift from rail to road given such higher access charges. They concluded that

    a. There was a HIGH risk of Intermodal, Automotive and Domestic waste traffic switching to road;
    b. There was a MEDIUM risk of Construction, Petro/Chems/IndMin, General Merchandise, Metals, Iron Ore and Biomass traffics switching to road;
    c. There was LOW risk ESI coal and nuclear traffic switching to road.

23. MDS Transmodal also concluded in addition to the impact on FOC profitability, there would be an additional mode shift cost of £51m in HGV environment external cost. This compared with c£53m of additional VUC revenue (of which £13.4m of this related to ESI coal traffic which has now mostly ceased due to Government energy policies). These were complex calculations, but MDS Transmodal suggested that, at a minimum, environmental external costs would exceed any increase in VUC revenue for Intermodal, Construction, Domestic waste and Petro/Chems/IndMin.

24. It is evident from the current situation with PR18 that, absent any changes in direction from those signaled in the Consultation document and the Initial Industry Advice, the effects on freight customers and FOCs may very well be similar to those assessed by MDS Transmodal in looking at both a 50% and a 100% increase in VUCs – in other words,

    a. Loss of current volume – up to 16% in key growth markets such as intermodal and construction;
    b. Stunted growth prospects;
    c. Modal shift to road and increased environmental external costs;
    d. Deterioration in both FOC and sector financial positions; and
    e. Loss of investor confidence.

25. Given the overall financial position of the sector, the impact of the 'coal shock', low road price and the greater modal choice of customers in sectors other than coal, it is unclear how such changes could be viable for the sector, and ORR should therefore place great weight on finding an outcome which does not significantly undermine rail freight.

Q2 Do you support our proposal to simplify the current charging regime by having a single freight mark-up charge?

26. To the extent that any mark-up is judged to be affordable we agree that it should be a single charge.

27. We note the proposals to levy the fixed charge as a per traffic fee, which is an easier option for freight operators. However the overall risk exposure of Network Rail should be taken into account.

Q3 Do you support the recommendation to apply Network Rail's cost allocation methodology (discussed in this chapter) to freight mark-up charges?

28. We understand the desire to have greater transparency of costs to inform decision making, including the fixed costs. However we are concerned to ensure that any allocation is fair, that it supports the right decision making and that it does not create perverse outcomes or unclear perceptions of freight.

29. The work undertaken for Network Rail takes a range of approaches which provide an equivalent range of outcomes. These are different to those used by LEK during PR13 to estimate freight avoidable costs. There appears to be no consensus on whether top down or bottom up approaches are most suitable, nor which of the assessed approaches will be used. Given the range of possible outcomes this is concerning.

30. It is of note that although there has been some exposure to the work, there appears to be no intention to formally consult on the approaches and results. Further, the initial work was not aimed at increasing or informing charges, but at improving Network Rail's cost transparency. We question whether it is appropriate therefore to use the work to set charges without further consultation, assessment or development.

31. Although we understand that some parts of the assessment consider costs which can only be measured over the long term, there has been no attempt to validate outturn costs against modelled assessment. For example, we would by now expect Network Rail to have some concept of the costs it might be forecast to save due to the decline of coal traffic on the network. This has not been forthcoming. There should be clarity about the escapabilty of costs in the event of reduced freight volumes as a key part of any allocation.

32. If the aim of the fixed cost allocation is to inform decision making, then it is likely that decision makers need to understand costs that could be reasonably saved by different policy choices on supporting freight. This would tend to suggest that

avoidable cost approaches are most likely to be useful for considering decisions about marginal traffic such as freight.

33. Effective decision making for freight must also inherently be cross modal yet there is no equivalent data for the trunk road and local road networks to inform Government choice. Providing detailed analysis of rail freight costs without equivalent road costs is therefore likely to be distortionary to decision making. Given ORR's wider role on the highways network this should be a major factor in determining how to present and assess fixed costs for the freight sector in totality.

Short Run Variable Charges

Q6 Do you support our recommendation not to make fundamental changes to the VUC for PR18?

34. We support the recommendation not to make fundamental changes to the structure and assessment of VUC for PR18.

35. We note that the caps applied to the VUC and other charges in CP5 are unlikely to be able to be continued into CP6. As a minimum this should be assessed and included in any overall assessment of changes.

36. However, the consultation is silent on the largest risk to VUC which arises from the expected increase in Network Rail's costs which will feed into the models which calculate VUC rates. We are aware that Network Rail are predicting significant cost increases on top of the failure to achieve the CP5 efficiency target which risks a significant increase in VUC rates for freight. We understand that cost increases of over 30% could be likely, albeit that the analysis is not yet underway. ORR must ensure that the results of this form a key part of any ability to pay test.

37. Further, the consultation is also silent on how ORR intends to assess Network Rail's efficiency for CP6 and how this will be included in any calculation of charges. We understand that the reclassification of Network Rail may lead to some different approaches to the efficiency assessment, but this should be defined and included as part of the VUC calculation and ability to pay test.

38. By way of comparison, it is useful to reflect on what the freight sector has already done to help drive efficiency. Actions include:

    a. By running longer, heavier trains, more goods are transported using fewer freight trains resulting in increased efficiencies both in terms of resources and network capacity. Between 2001 and 2015 (i.e. before the decline in coal volumes), rail freight volumes increased by 15% but the number of trains reduced by 25%.As a result, the payload per train increased by 40% over the same period.
    Operators and customers are continuing to press for longer trains to operate, and are challenging Network Rail to assess how this can be achieved. This is resulting in continued improvements.

b. Freight operational performance is at historically high levels with the Freight Delivery Metric averaging over 94% and “Arrivals to Fifteen” averaging over 86%.

c. In the past four years, over 5,000 unused or spare paths have been relinquished by FOCs back to Network Rail either to increase ‘white space’ or for identification as Strategic Paths.

d. Continued private sector investment in new equipment, including reliable and more environmentally friendly locomotives and wagons with “track-friendly” suspension.

e. Strategic freight sites have been reviewed, and several locations released for disposal, having been assessed as having no future rail freight use.

39. However it is difficult to see where, if at all, the freight sector and freight customers are receiving any recognition of, or benefit from, these achievements. This failure risks creating a perverse incentive – why should rail freight continue to strive for such efficiency if it is rewarded with cost increases, not decreases?

40. We consider that ORR should consider how best to assess Network Rail’s efficiency for freight as applied to any variable charge, and consider whether a long term efficiency overlay can be applied, recognising the actions which are being taken by the sector. This should be on top of any general efficiency target which is applied to Network Rail’s OMR costs.

41. DfT’s view (set out in Richard Carter’s letter to Joanna Whittington of 27th July 2016) was that “changes (in PR18) should only be made where they lead to a significant better outcome for users”. The letter goes on to make clear that “we would be concerned at changes which increased complexity, and potentially costs, without clear evidence these would lead to improvements for users and taxpayers”. It is not clear how the likely impact of some of the outcomes from the proposed and potential changes to charges and incentives will benefit, or lead to improved outcomes for freight customers and we urge the ORR to reflect on this and to set out the anticipated benefits as a matter of urgency.

Q7 Do you have any suggestions for “recalibration” style changes to the VUC you would like to see considered for PR18 implementation?

42. We do not consider this to be a priority area for PR18. If changes are to be considered, the modelling of VUC does not include higher passenger train speeds, and this should be remedied.

43. Network Rail’s NSC trains do not pay access charges, but do contribute to OMR costs. These must be explicitly excluded from any assessment of freight costs be they variable, fixed or related to performance etc. ORR may wish to assess separately whether these trains are operating efficiently – many ballast trains for example are now shorter than would be generally used in commercial bulk haul

construction services.

44. The allocation of VUC between wagon types should be briefly refreshed to ensure that all current wagons are appropriately included.

Q8 Do you support our recommendation not to replace the CC with adjustments to Schedule 8 benchmarks?
Q9 Do you think we should (a) retain the existing CC (but remove the caps on open access, freight and charter operators); (b) remove the existing CC and recover lost revenue through fixed cost charges; or (c) do you have any alternative proposals?

45. The role and purpose of the capacity charge remains unclear, as it purports both to be a cost recovery mechanism for Network Rail, and an incentive regime on Network Rail and operators. In the latter case, the desired outcome of the incentive is also unclear, but is appears to be to encourage fewer trains to be operated, thus reducing performance delays. We are unclear how that incentive aligns with Government objectives for the railways.

46. However we note that, despite freight operating fewer trains as a consequence of the reduction in coal, and freight performance improving significantly, we have not seen any proposals which would reduce the capacity charge for freight, which suggests that the incentive effect is at best misaligned. Equally there is little evidence that Network Rail is incentivised to increase capacity as a consequence of the charge. The capacity charge therefore appears to act solely as a cost recovery mechanism for Network Rail.

47. We strongly oppose the proposal to keep the capacity charge and remove the cap. This could see freight charges increase by up to 450%. As highlighted this would be a significant impact for freight operators, and could lead to modal shift, and to market exit. As outlined above, a holistic assessment of the overall affordability of freight charges is required, and any proposals to uncap the capacity charge must be a key part of that.

48. We would support the proposal to abolish the charge and recover through the fixed charge, subject to the market can bear test. As the charge is a cost recovery mechanism, this would achieve the same outcome and would appear to have merit in simplification.

Q10 Do you support our recommendation to keep the (Traction electricity) loss incentive mechanism

49. No comment.

Q11 Do you support our recommendation that the EAUC not be altered, beyond recalibration, in PR18?

50. No comment.

Q12 Do you support our recommendation to abolish the CSC?

51. We support the recommendation to abolish the CSC.

Contractual Incentives Regime

Schedule 8

52. The Schedule 8 regime in CP5 has been very challenging for freight operators. The large swing in payments from FOCs to Network Rail, estimated to be £10m per annum, has tilted the regime against freight and a re-balancing in CP6 is required. Whilst we recognise the imperative of good performance on the network, and in all parties acting responsibly, the balance must ensure that freight operators are able to deliver customer requirements effectively and are able to plan and operate their business with certainty.

53. Although the imperative of right time departures is understood, freight operators need to be able to manage with some flexibility. For example, a late running inbound service cannot always be recovered to a right time departure. The inability to secure a validated pathway if a train service leaves late, often causes a largely unpredictable level of third party delay, resulting in minor indiscretions causing seemingly a disproportionate amount of disruption and increased penalties. Even a very small delay is having a major impact and this is resulting in changes in behaviour that are detrimental to customer service and customer demand. An appropriate balance needs to be found in the context of good overall management of the network.

54. Since the start of CP4 'FOC on self' delay has reduced by decreased 47%. However, this improvement has not translated into a corresponding reduction in third-party minutes – down just 4% over the same timeframe. Key driver for this is the increase in third-party delays per incident (DPI) by 49% since the start of CP4. FOCs have little control over how incidents are managed, and it appears that the current regime does not incentivise Network Rail to manage incidents that are attributed to operators.

55. The impact of DPI is not also adequately reflected in the congestion factor uplift applied to the benchmarks. As was demonstrated in PR13, there is a significant risk in choosing a small sample period to recalibrate benchmarks. The recalibration of the CP6 benchmarks should therefore take a longer timeframe, and at the minimum reflect the average for all years in CP5.

56. Since 2003-04 the average weight of a freight train service has increased by 71%, however no adjustment to the freight operator payment rate to take into account the increase in value, has been made. In PR13, the freight operators submitted evidence, based on a review by LEK, for adjustments to be made to freight payment rates based on increased value of trains. This was late in the process and no action was taken. ORR should now consider this study and determine whether there should be adjustments in PR18.

57. The gearing challenges and the imbalance in the ratio of payment rates to benchmarks between FOCs and NR have resulted in equivalent levels of performance between FOCs and Network Rail resulting in payments from one party to the other. Equivalent performance relative to benchmark should be cost neutral.

Q13 What are your views on the options of passenger compensation recovery and improving the transparency of compensation relating to Network Rail's actions?

58. We have no comment on the principle, but any change should not drive an increase in FOC payment rates.

Q14 Do you support our recommendation to only make changes to delink (Sch. 8) passenger operator benchmarks and NR benchmarks for freight operators from past performance (but to leave the approach to other benchmarks unchanged)?

59. No comment.

Q15 Do you support our recommendation to change the measure of passenger operator performance to one based on delay to other operators?

60. This approach is used in the current FOC regime and we share concerns that operators are not in control of how incidents are managed and that this regime does not incentivise Network Rail to manage incidents that are attributed to operators.

Q16 Do you support our recommendation to limit Sustained Poor Performance to cost compensation only?

61. No comment.

Q17 Do you support our recommended prioritization of Schedule 4 issues? If you think we should reconsider any of the areas we have de-prioritised please submit supporting evidence.

62. Any changes to Schedule 4 should act to incentivise Network Rail to effectively manage diversionary routes to enable freight to keep running. This should also be a particular role for the NSO.

63. Although not referenced in the consultation, improvements to freight Schedule 4 should be considered as part of PR18. This should include ensuring that the payment rates are cost reflective. Currently freight operators lose money every time they agree a disruptive possession. More cost reflective rates would therefore facilitate greater flexibility from FOCs and the increase in any Schedule 4 payments would be off-set by ensuring greater efficiency in possessions, whilst recognising customer impacts. For example, the rates could be aligned with those used by Network Rail's Industry Access Programme (i.e. between £6k-

£13.5k per cancellation depending on commodity).

Q18 Do you wish to submit evidence regarding: (a) processes associated with planning possessions; and/or planning alternative arrangements to deal with planned disruption?

64. No comment

Q19 Do you have any view on how financial incentives could be improved to encourage collaboration between Network Rail and operators to reduce industry costs?

Q20 Do you have any views on the cost categories you think could be controlled by operators and whether these costs would be suitable as the basis of a potential future mechanism?

65. Greater collaboration is critical to deliver better outcomes for freight customers, drive growth and to recognise and deliver cost savings for Network Rail, freight operators and customers. Where appropriate, formal mechanisms can help to support this.

66. However, experience over the last control period has shown that whilst there is good collaboration, and some good outcomes, the link to cost savings by Network Rail is often weak or none existent. Freight operators are reluctant to enter into mechanisms where the ability to actually leverage savings, despite actions, is unclear.

67. Any formal mechanism must therefore be targeted at specific areas where clear action by both parties can result in discernible cost savings, rather than at generalised regimes.

Annex A

Extract of Current Guidance to ORR from Secretary of State for Transport.
http://www.railwaysarchive.co.uk/documents/DfT_HLOSGuidance2012.pdf

Rail Freight

32.The Government recognises the important role that rail freight plays in the nation's logistics and in the achievement of the Government's sustainable distribution objectives. The Government wishes to facilitate the continuing development of a competitive, efficient and dynamic private sector rail freight industry and is committed to ensuring that policies and regulations should work to this end and should not create unnecessary transactional costs or other obstacles to the achievement of these objectives and future growth.

33.In an industry where planning and operational decision-making are increasingly devolved, the Secretary of State wishes ORR to have regard, in exercising its statutory functions, to the importance of sustaining efficient and commercially predictable network-wide freight operations, including in decisions about access rights and charging structures.

34.The Secretary of State wishes the ORR, in developing any proposals, and in making decisions in relation to rail freight, to note particularly the Government's rail freight policy[2]. The Secretary of State wishes to be advised by the ORR of, and to discuss with the ORR, any material measure which the ORR proposes to take or policy which it proposes to pursue which would adversely affect the competitiveness of rail freight compared to other modes.

Extract of Scottish Ministers' Guidance to ORR
http://www.transport.gov.scot/system/files/documents/guides/The_Scottish_Ministers__Guidance_to_the_ORR_July_2012.pdf

Rail Freight
21. Scotland's rail freight network is important to Scotland's economy. Accordingly, the Scottish Ministers expect the ORR to pay due consideration to any changes to policy which may impact that network.

22. In developing the track access charges arrangements for freight operators, the Scottish Ministers expect the ORR to use a mechanism which recognises the impact that freight operators have on the network but maintains the attractiveness of rail to freight customers, and which is adaptable to prevent the outputs of businesses in Scotland from becoming uncompetitive in their key markets.

Response to ORR Consultation on changes to charges and contractual incentives – Mr. S Arkins

Brief Introduction: Until recently I was employed in the rail industry as a Senior Signalling Design Manger responsible for the delivery of safety critical signalling system design with Atkins until retirement. I joined the rail industry (BR) in 1976 and was employed in the field continuously until retirement.

I have no particular comment in relation to the various charging and incentive proposals contained within this consultation, that being more relevant to those stakeholders directly affected. However, my reason for responding to the consultation is to observe the worrying lack of mention and therefore acknowledgement of the potential impact certain proposals in this consultation may have on safety behaviours / system safety of those tasked with maintenance, operation and renewal of the network who will inevitably be placed under even greater pressure to complete or be expected to devise coping strategies. In particular I refer to the proposals to transfer greater proportion of financial compensation for network delays which are attributed to Network Rail to train operators to aid them in passenger compensation and the inevitable ‘incentives’ that will be devised to limit any financial exposure over and above those already in place.

I wish to observe that any changes to the compensation regime should take ensure greater financial penalties must not lead to any incentive which could lead to a reduction in network system safety by;

- reduction in time to attend to failures;
- reduction in staff safety to attend to failures trackside;
- increased pressure placed on maintenance staff to complete works
- increased use of ‘work rounds’ or deferment of repairs to minimise delay attribution times.

In particular any proposal to increase financial penalties against Network Rail should understand how human factor measures will be identified to ensure ‘no less safety’ outcomes than at present results. These measures should be documented, measured and recorded for future trends.

It is far too simplistic to make a general assumption that these proposals will lead to no discernible reduction in safety. Any proposals to alter the financial incentives on Network Rail to reduce delays, either through efficiency in dealing with repair of faults or possession management should be accompanied with PROOF of concept in so far as safety is concerned.

Yours

Mr S Arkins

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Mr Paul Cornick
Office of Rail and Road
One Kemble Street
London WC2B 4AN

09 March 2017

Dear Paul,

Thank you for the opportunity to respond to the recent PR18 consultation on the changes to charges and contractual incentives.

This response represents views on behalf of Stagecoach Group and its subsidiary companies. Stagecoach Group is broadly supportive of the comments expressed in the Rail Delivery Group (RDG) response to this Consultation. Our responses to the specific questions on which we have views are set out below:

Fixed cost charges

Q1 – Do you support our proposal to levy fixed cost charges on all operators, including open access operators, to the extent that they can bear them (option 2)?

Stagecoach Group understands the need for transparency in fixed cost charges.

Open Access Operators (OAO) enjoy the longest access rights in the UK and should make a contribution to the fixed costs of the network. Stagecoach Group supports competition, but where it is based on a level playing field and applied on a consistent basis, regardless of the type of operator. It is clear that the passenger market on the ECML can bear the fixed costs and this is supported by the evidence of profit margins and revenue growth reported by the existing OAOs.

It is important that operators understand the proposed Market Assessment approaches and therefore the ORR must involve operators in the development of the approach at an earlier stage so that they can have an input into the analysis.

Once the analysis is completed on the market can bear test and this is shared with the industry, it will be useful to understand how it will affect the overall charging framework.

Fixed cost freight charges

Q2 – Do you support our proposal to simplify the current charging regime by having a single freight mark-up charge?

Q3 – Do you support the recommendation to apply Network Rail's cost allocation methodology (discussed in this chapter) to freight mark-up charges?

Whilst Stagecoach Group operators are not directly impacted by freight, we believe that as the network becomes capacity constrained, our operators will be competing for capacity. We understand the need for additional freight capacity on the network, but there needs to be a balanced trade-off between reserving capacity for potential freight growth and occasional use of the freight paths against running additional passenger trains every hour. For example, if freight paths are "blocking" passenger paths, it could be argued that freight operators should pay for that reservation of capacity.

Station charges

Q4 – Long term charge: Do you support our recommendation that the methodology for the LTC at managed stations be recalibrated?

Stagecoach Group supports in principle any methodology improvement which makes managed station Long Term Charge's more visible, cost reflective or provides greater transparency on the major fluctuations on LTC from one control period to the next.

However, we do not support any methodology improvement that results in inflating the LTC and charges to Beneficiaries. Para 2.38 states that ORR does not expect to see "a significant increase to charges overall", as any increases "should be matched by a reduction in the total amount recovered by other charges." Stagecoach Group requests further clarity on what other charges ORR is referring to and why/how these would be expected to reduce accordingly.

Q5 – Qualifying expenditure: Do you agree with our recommendation that we support the work to make total QX charges more transparent at both managed and franchised stations?

Stagecoach Group supports, in principle, any work to make QX charges more transparent but does not consider that publishing QX charges would necessarily encourage improved cost efficiency. It could potentially lead to more protracted negotiations / disputes on QX charges between parties and potentially expose an operator's commercial confidentiality.

Short-run variable charges package

Variable usage charge

Q6 – Do you support our recommendation not to make fundamental changes to the VUC for PR18?

With the proposed changes being made to other charges and incentives in this consultation, Stagecoach Group supports ORR's recommendation not to make fundamental changes to the VUC as part of this Periodic Review.

Q7 – Do you have any suggestions for 'recalibration' style changes to the VUC you would like to see considered for PR18 implementation?

Capacity charge

Q8 – Do you support our recommendation not to replace the CC with adjustments to Schedule 8 benchmarks?

Stagecoach Group supports ORR's recommendation not to replace the Capacity Charge with adjustment to Schedule 8 Benchmarks.

Q9 – Do you think we should: (a) retain the existing CC (but remove the caps on open access, freight and charter operators); (b) remove the existing CC and recover lost revenue through fixed cost charges; or (c) do you have any alternative proposals?

Option 1 of the Capacity Charge in the consultation retains the existing charge and removes the caps, this option will give all operators a predictable and stable charging regime. The charge needs to be transparent and clearly show what the charge is for. Stagecoach Group would not expect the Capacity Charge to rise as a result of the impact of any 'market can bear' test. We believe Option 3 will add further complication to the fixed cost calculation.

The Capacity Charge must be consistently applied to operators competing in the same market for the same passengers. As a minimum, the cap should be removed. The current arrangement artificially distorts competition allowing OAOs to undercut the franchised operator on an unfair basis. OAOs are mature businesses with long term access rights that have delivered high levels of growth and profit margins in the industry and can bear the costs.

Traction electricity charge

Q10 – Do you support our recommendation to keep the loss incentive mechanism?

The aim of the loss incentive mechanism is to provide financial incentive to Network Rail to minimise transmission losses, but by sharing the risk with the operators as the mechanism currently lessens the incentive on Network Rail to reduce the loss. We believe that Network Rail must be incentivised by ORR in CP6 to reduce losses to an efficient level.

Electricity asset usage charge

Q11 – Do you support our recommendation that the EAUC not be altered, beyond recalibration, in PR18?

Stagecoach Group agrees with the ORR recommendation that the EAUC not be altered in PR18.

Chapter 4: Contractual Incentives Regime

Schedule 8

Q13 – Passenger compensation: What are your views on the options of passenger compensation recovery and improving the transparency of compensation relating to Network Rail's actions?

It is reasonable for Network Rail to compensate train operators costs of passenger compensation where the poor performance is caused by Network Rail itself. Stagecoach Group believes that this also incentivises Network Rail to work with operators to reduce delays to passengers and customers.

We welcome this proposal in principle, but the industry needs to agree a simple and realistic approach to claim for the costs. We do not want to see any increased burden on administration or unnecessary disputes over any claim.

Further, as the Delay Repay regime (compensation to passengers) is a feature of Franchise Agreements (and is being extended to Delay Repay 15 (minutes)), it should be funded through that Agreement and should not be confused with repayments made under the Schedule 8 regime. The Agreement however, assumes a level of performance and when operators dip below that level of performance due to Network Rail's poor performance, there is a compelling case for Network Rail to pay their share of Delay Repay.

This is already the case for Sustained Poor Performance where Network Rail is liable for all relevant losses.

Q14 – Approach to setting benchmarks: Do you support our recommendation to only make changes to delink passenger operator benchmarks and Network Rail benchmarks for freight operators from past performance (but to leave the approach to the other benchmarks unchanged)?

Stagecoach Group does not support delinking the passenger operator benchmarks from past performance. Of the suggestions in the consultation, using the average across all operators that is used in the freight regime, would not give the level of detail as there is in the current benchmarksThe passenger operator's benchmarks should have cognisance to those contained in the franchise.

Stagecoach Group does not agree with the proposal to change the measure of train operator performance from TOC-on-Self to TOC-on-TOC and we need to fully understand how any changes to benchmarks would be affected by this proposal.

If Network Rail want softer targets, they will need to compensate TOCs through Schedule 8. ORR needs to look at this in the round, not just from Network Rail's perspective. The benchmark needs to reflect the point at which customers will reward that level of performance, not just what will keep Network Rail financially neutral.

Q15 – Measure of passenger operator performance: Do you support our recommendation to change the measure of passenger operator performance to one based on the delay caused to other operators?

Stagecoach Group acknowledges that joint industry working is important to continued improvement in performance. However, we are concerned that Network Rail will be insouciant to minimise the impact of delays and reactionary delays on the network if Schedule 8 is used to manage the increase in reactionary delay.

Moving from TOC-on-Self to TOC-on-TOC as a base for TOC performance measure will not necessarily reduce reactionary delay because the main increase in reactionary delay is not due to the prime cause of TOC-on-TOC incidents. It is Network Rail's responsibility to manage the infrastructure and regulate train services running on the network; it would be difficult for operators to influence/reduce reactionary delay outside the routes they operate on. It is more sensible for train operators to focus on reducing their TOC-on Self delay which in turn helps reduce reactionary delay.

A change to the regime would create an additional administrative burden on the industry with an increase in delay attribution disputes and an increase in delay attribution staff to review incidents and challenge Network Rail on train service regulation.

We are also concerned with the impact of this proposal further downstream such as changes to industry systems including PEARS, Bugle, Compass and modification to the Network Operations Code-Train Regulation and the National System operators. Such impacts need to be fully understood and we do not believe that the proposal has considered them carefully.

This proposal to change the regime needs detailed testing before we can make a judgement on this. Stagecoach Group TOCs are working with Network Rail to understand what the change to TOC on TOC will be and this work is ongoing.

Q16 – Sustained poor performance (SPP) provisions: Do you support our recommendation to limit SPP to costs compensation only?

Stagecoach Group does not support this recommendation. The Sustained Poor Performance provision needs to compensate for the lateness and cancellations that the Schedule 8 compensation regime under compensates, without this Network Rail has no incentive to deliver improvements.

The application of the provision should be made much simpler to avoid being time consuming and hard to resolve by being made formulaic based on a multiplier of the payment rate and from the moment SPP is triggered, there should be an automatic right for operators to claim Delay Repay costs due to Network Rail's poor performance, based on actual costs and these should be paid immediately.

Schedule 4

Q17 – Do you support our recommended prioritisation of schedule 4 issues? If you think we should reconsider any of the areas we have de-prioritised please submit supporting evidence.

Some of the contractual wording and definitions in the contract are ambiguous, which has caused Network Rail to dispute with train operators on cost claims, for example, the definition of 'Direct Costs'. Network Rail tends to interpret some of the terms inconsistently when rejecting train operators' claims for costs. We would welcome discussions with the ORR to review and revise some of the wording and terms for reference in the contract.

Q18 – Do you wish to submit relevant evidence regarding: (a) processes associated with planning possessions; and/or (b) planning alternative arrangements to deal with planned disruption (e.g. the notification that is needed to arrange bus replacement services)?

For long distance operators, the key to planning possessions is to ensure reservations open at T-12 – the regime must support this as a minimum. VTEC also open reservations at T-26 (weekdays), enabling them to compete more effectively with airlines and extending the booking horizon is becoming more of a commercial imperative. Late notice (within T-12) should result in minimal discount, and in the final week, there should be no discount as passengers will have inevitably made their plans. For late notice cancellations, the regime needs strengthening so that operators are adequately compensated for revenue losses and additional costs. For example, proposed strike days are good examples where matters entirely within Network Rail's control have resulted in significant losses for operators and this needs to be addressed, as TOCs' customer behaviour has changed significantly and continues to do so.

Further, there should be a high level re-opener where Network Rail has failed to deliver its renewal or maintenance volumes and there should be a trigger level to avoid minor variances to plan.

Aligning operator and network rail incentives:

Q19 – Do you have any views on how financial incentives could be improved to encourage collaboration between Network Rail and operators to reduce industry costs?

Stagecoach Group believes the administrative burden on managing the regime and transaction costs are likely to have outweighed any incentive value of the regime and this needs to be addressed.

Q20 – Do you have any views on the cost categories you think could be controlled by operators and whether these costs would be suitable as the basis of a potential future mechanism?

No.

Yours sincerely,

Graeme Hampshire
Business Development Director

Response to ORR's December 2016 Charges and Incentives Consultation

This pro-forma is available to those that wish to use it to respond to our consultation. Other forms of response (e.g. letter format) are equally welcome.

Please send your response to pr18@orr.gsi.gov.uk by **9 March 2017**.

Full name	Carol Smales
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*This information will not be published on our website.

Please make any comments regarding the questions in the accompanying text box. We welcome comments in relation to the information outlined in both the consultation document and supporting documents, or regarding the policy areas more generally.

Chapter 2: Infrastructure Costs

Fixed cost charges:

1. Do you support our proposal to levy fixed cost charges on all operators, including open access operators, to the extent that they can bear them (option 2)?

Yes we support this recommendation. All operators on the rail network should bear a share of fixed cost charges.

Fixed cost freight charges:

2. Do you support our proposal to simplify the current charging regime by having a single freight mark-up charge?

Yes.

Fixed cost freight charges:

3. Do you support the recommendation to apply Network Rail's cost allocation methodology (discussed in this chapter) to freight mark-up charges?

Yes.
Station charges: 4. **Long term charge (LTC):** Do you support our recommendation that the methodology for the LTC at managed stations be recalibrated?
This methodology would increase the charge for users of Network Rail managed stations and so could have a significant impact on London Overground and TfL Rail charges even though the overall effect on industry charges would be neutral. TfL needs to understand the impact in more detail rather than just conceptually.
Station charges: 5. **Qualifying expenditure (QX):** Do you agree with our recommendation that we support the work to make total QX charges more transparent at both managed and franchised stations?
TfL supports the case for increased transparency of QX. Train operators have limited influence over the QX they pay to Network Rail and other operators and a benchmarking process is required to achieve greater transparency. It should be recognised that the level of QX is related to the provision of customer services and to the age and condition of station assets.

Chapter 3: Short-run variable charges package

Variable usage charge (VUC): 6. Do you support our recommendation not to make fundamental changes to the VUC for PR18?
Yes.
Variable usage charge: 7. Do you have any suggestions for ‘recalibration’ style changes to the VUC you would like to see considered for PR18 implementation?
No.

Capacity charge (CC):

8. Do you support our recommendation not to replace the CC with adjustments to Schedule 8 benchmarks?

Yes

Capacity charge:

9. Do you think we should: (a) retain the existing CC (but remove the caps on open access, freight and charter operators); (b) remove the existing CC and recover lost revenue through fixed cost charges; or (c) do you have any alternative proposals?

TfL thinks the CC should be retained and made far more effective than the current blunt instrument which has had little impact on behaviours.

Open access, freight and charter operators should be incentivised to take account of network congestion in service planning and so the capacity charge should be retained with the caps removed as these were a transitional arrangement (option a).

ORR should introduce markedly greater differentiation of the CC by time period (peak, offpeak, night-time, etc.) and day of the week, as well as by location and type of traffic into the capacity charge to make it more effective. This should apply to both passenger and freight operators to incentivise more efficient use of the network. Higher peak charges particularly at individually heavily congested locations on the network should be offset by lower charges at less busy times such that the revenue impact is neutral across relevant locations where there and obviously alternative routes for some types of traffic. Hence the CC tariff for Camden Road on North London Line and Oakham on the F2N could be linked such that the overall impact is revenue neutral, varying as it should by time of day / week. The charge should be zero on relatively lightly used routes where operators have a genuine choice of heavy used avoiding urban railways. This would incentivise freight traffic to shift away from peak use of routes through London and toward off peak paths and routes such as Felixstowe Nuneaton which continue to have spare capacity despite best efforts of earlier investment decisions.

Even in the morning peak, freight path utilisation ranges from 35% on South and West London Lines to 50% on North London Line. The capacity charge should be set at a premium for unused paths so that operators are deterred from holding onto access rights that are not used on a regular basis.

Traction electricity charge:

10. Do you support our recommendation to keep the loss incentive mechanism?

Yes.

Electricity asset usage charge (EAUC):

11. Do you support our recommendation that the EAUC not be altered, beyond recalibration, in PR18?

Yes.
Coal spillage charge (CSC): 12. Do you support our recommendation to abolish the CSC?
TfL has no comments

Chapter 4: Contractual Incentives Regime

Schedule 8: 13. **Passenger compensation:** What are your views on the options of passenger compensation recovery and improving the transparency of compensation relating to Network Rail's actions?
Schedule 8 is intended to incentivise operators and NR to manage disruption effectively. Passenger compensation recovery from NR should only be considered if incentive effects are expected to offset the cost in terms of additional resources.
Schedule 8: 14. **Approach to setting benchmarks:** Do you support our recommendation to only make changes to delink passenger operator benchmarks and Network Rail benchmarks for freight operators from past performance (but to leave the approach to the other benchmarks unchanged)?
TfL supports the case for setting more challenging benchmarks for passenger and freight operators. Delinking passenger operator benchmarks from past performance and focusing instead on the performance that the railway has been funded to deliver will better incentivise the industry to improve performance.
Schedule 8: 15. **Measure of passenger operator performance:** Do you support our recommendation to change the measure of passenger operator performance to one based on the delay caused to other operators?
The existing PPM measure does not provide an adequate incentive to operators on high volume metro style routes. We believe that the interests of passengers in urban areas would be better served by a performance measure based on headways rather than arrival time at specific points, and on volumes of passengers affected similar to the Journey Time Metric and Lost Customer Hours measures used to measure and report London Underground service performance. We have introduced our own incentive regimes into TfL's rail concession contracts to ensure that our operators are incentivised to deliver a high frequency, even interval

service and this is reflected in the fact that TfL Rail and London Overground are consistently within the top five performing operators in Great Britain. We believe that this model should be applied more widely to services of a similar type.

Schedule 8:

16. **Sustained poor performance (SPP) provisions:** Do you support our recommendation to limit SPP to costs compensation only?

Yes, on the basis that revenue losses continue to be recovered through Schedule 8 claims.

Schedule 4:

17. Do you support our recommended prioritisation of schedule 4 issues? If you think we should reconsider any of the areas we have de-prioritised please submit supporting evidence.

We support the proposal to make a high level adjustment to the ACS to reduce the likelihood of over-recovery as NR tends to overestimate the amount of works to be carried out in a control period.

Operators should be compensated for revenue loss and other costs during long blockades. Experience of Gospel Oak Barking electrification works has shown that lost revenue and other costs associated with replacement bus provision, staffing and marketing can be significant and should be the subject of compensation.

Schedule 4:

18. Do you wish to submit relevant evidence regarding: (a) processes associated with planning possessions; and/or (b) planning alternative arrangements to deal with planned disruption (e.g. the notification that is needed to arrange bus replacement services)?

No.

Aligning operator and network rail incentives:

19. Do you have any views on how financial incentives could be improved to encourage collaboration between Network Rail and operators to reduce industry costs?

TfL is not convinced that the REBS regime provides incentives to operators to influence Network Rail's costs particularly where routes and operators are not aligned.

We would object to any proposal to remove optionality.

Aligning operator and network rail incentives:

20. Do you have any views on the cost categories you think could be controlled by operators and whether these costs would be suitable as the basis of a potential future mechanism?

We do not believe that operators can control Network Rail’s costs to the extent that an incentive mechanism would affect behaviour.

Any other points that you would like to make

Thank you for taking the time to respond.

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Full name	Peter Sargant
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Yes.

Fixed cost freight charges:

3. Do you support the recommendation to apply Network Rail's cost allocation methodology (discussed in this chapter) to freight mark-up charges?

Yes.

Station charges:

4. **Long term charge (LTC):** Do you support our recommendation that the methodology for the LTC at managed stations be recalibrated?

Yes – in principle, although noting that there will be further consideration of this when the scale of the impacts of the new methodology has been developed, and noting that this is proposed to apply to NR managed stations.

Station charges:

5. **Qualifying expenditure (QX):** Do you agree with our recommendation that we support the work to make total QX charges more transparent at both managed and franchised stations?

Yes.

TfWM supports the UTG view that the current system of unregulated QX charges seems difficult to justify. It gives Station Facility Operators (SFOs) and Network Rail (in the case of managed stations) a clear monopoly with respect to other franchised train operators (who are effectively required to make a certain number of calls at each station and whose demand elasticity to QX charges is therefore probably very low). It also adds an extra layer of uncertainty to the franchising process (SFOs will be unsure how much exactly they will be able to extract in QX charges and non-SFOs will be unsure how the level of charges they may be liable to pay).

We support the ORR in its proposal to require the publication of QX charges, and we would encourage it to go further and request the publication, on a consistent and disaggregate basis, of information relating to station management costs and outputs (e.g.: quality of services provided). This additional information would be essential in order for the ORR and other interested parties to carry out a meaningful benchmarking exercise to determine the efficient level of station maintenance and operation costs.

Chapter 3: Short-run variable charges package

Variable usage charge (VUC):

6. Do you support our recommendation not to make fundamental changes to the VUC for PR18?

Yes.

Variable usage charge:

7. Do you have any suggestions for 'recalibration' style changes to the VUC you would like to see considered for PR18 implementation?

No.

Capacity charge (CC):

8. Do you support our recommendation not to replace the CC with adjustments to Schedule 8 benchmarks?

No.

TfWM (and previously Centro) has long had concerns about Capacity Charge which we have expressed in previous consultation responses.

The consultation document notes in 3.20 that capacity charge is designed to do two things:

- It provides NR with additional revenue to cover the increase in Schedule 8 payments that typically results from adding traffic
- It provides operators with some incentives to take account of the financial impact on other operators of the change in performance that typically arises from increased use of the network, thereby sending price signals to train operators and funders to promote better use of network capacity.

It currently does neither of these things effectively.

Given that the charge applies to all services (and not just additional ones), the charge creates huge money flows in the industry of which the vast bulk does not relate to the financial impact of adding traffic. If we want a regime that compensates NR for adding traffic then we need to have a regime that targets that particular issue rather than one that attaches significant and arbitrary costs to all services.

The highly complex processes that underpin the creation of the Capacity Charge tariffs are still not capable of reflecting the true impact of running additional trains on the network meaning that price signals are often not appropriate. The costs are also highly dependent on the way that service codes are structured, and with single service codes often operating through both congested and uncongested parts of the network and covering peak and off-peak services it is challenging for the impact of an individual service to be properly identified. The flat rate charge for freight exemplifies the problem.

It is also worth noting that in practice the price signals sent by the charge will have little impact on the service plans being developed by local and regional bodies (e.g. TfWM, West Midlands Rail and Midlands Connect in the West Midlands). Where local funding authorities develop either short term plans for more services, or more strategic long term plans for investing in the network, the main drivers will be identifying and securing network capacity for local passenger trains on a congested mixed-use network and funding the costs associated with rolling stock and traincrew for the services.

Local and regional bodies are also looking to invest in enhancing the capacity and capability of the network to support their service development plans and the formulaic and arbitrary Capacity Charge regime does little to support these plans.

TfWM therefore believes that the industry should be looking adjust Schedule 8 benchmarks as the preferred solution in order to mitigate the need for Capacity Charge and the big money-go-round it creates. By effectively neutralising the Schedule 8 benchmarks at the start of each Control Period, the issues about capacity charge can then focus on what effect incremental (or decremental) services have above or below a baseline.

TfWM notes that the ORR does not favour this solution, however we believe that conceptually this is the right approach. We recognise the major challenges this approach would have, some of which go to the heart of the overall Schedule 8 regime.

Capacity charge:

9. Do you think we should: (a) retain the existing CC (but remove the caps on open access, freight and charter operators); (b) remove the existing CC and recover lost revenue through fixed cost charges; or (c) do you have any alternative proposals?

If Schedule 8 benchmarks can be neutralised then Capacity Charge should only apply to services above or below a baseline, and ideally be sufficiently sophisticated to recognise the true impacts on Schedule 8. There is clearly a balance to be struck between ensuring that Network Rail is incentivised to accept additional traffic onto the network but not be over compensated for the performance impact.

In the event that changing Schedule 8 benchmarks is not feasible then TfWM believes that continuing with Capacity Charge but removing the caps on open access and freight should only be considered if some of the shortcomings with the current charges can be addressed and the removal of the caps allows a level playing field across all operators.

TfWM has doubts, however, that removing the caps from freight and open access is likely to possible without major impacts on these businesses, in which case moving towards a solution which recovers lost revenue through fixed charges is likely to be preferable.

Traction electricity charge:

10. Do you support our recommendation to keep the loss incentive mechanism?

Yes.

Electricity asset usage charge (EAUC):

11. Do you support our recommendation that the EAUC not be altered, beyond recalibration, in PR18?

Yes.

Coal spillage charge (CSC):

12. Do you support our recommendation to abolish the CSC?

Yes.

Chapter 4: Contractual Incentives Regime

Schedule 8:

13. **Passenger compensation:** What are your views on the options of passenger compensation recovery and improving the transparency of compensation relating to Network Rail's actions?

The consultation document provides a comprehensive and robust assessment of the advantages and disadvantages of different options. We agree with the ORR's assessment that neither of the options being considered is clearly superior to the alternatives.

We would agree that there could be some reputational and incentive benefits from directly exposing Network Rail to the rail passengers through a link to the TOC compensation arrangements. However we agree that there are many practical difficulties with this.

As a matter of principle, passenger compensation recovery by train operating companies directly from Network Rail should only be considered if incentive effects, and resulting benefits, are expected to offset the additional administrative cost, complexity and uncertainty. Our current view is that this is unlikely to be the case though we would support further work in this area.

Schedule 8:

14. **Approach to setting benchmarks:** Do you support our recommendation to only make changes to delink passenger operator benchmarks and Network Rail benchmarks for freight operators from past performance (but to leave the approach to the other benchmarks unchanged)?

TfWM would support the general recommendation, however we note that the approach to Schedule 8 benchmarks will need to be aligned with the final conclusions relating to the capacity charge.

Schedule 8:

15. **Measure of passenger operator performance:** Do you support our recommendation to change the measure of passenger operator performance to one based on the delay

caused to other operators?

Yes.

Schedule 8:

16. **Sustained poor performance (SPP) provisions:** Do you support our recommendation to limit SPP to costs compensation only?

Yes, conditional on revenue losses continuing to be recovered through Schedule 8 claims.

Schedule 4:

17. Do you support our recommended prioritisation of schedule 4 issues? If you think we should reconsider any of the areas we have de-prioritised please submit supporting evidence.

Yes.

Schedule 4:

18. Do you wish to submit relevant evidence regarding: (a) processes associated with planning possessions; and/or (b) planning alternative arrangements to deal with planned disruption (e.g. the notification that is needed to arrange bus replacement services)?

No.

Aligning operator and network rail incentives:

19. Do you have any views on how financial incentives could be improved to encourage collaboration between Network Rail and operators to reduce industry costs?

TfWM supports the UTG view that we don't think the REBS mechanism is likely to be effective. This is largely because (a) there are significant asymmetries of information between Network Rail and TOCs, (b) the impact of specific interventions by any one agency are difficult to isolate from background trends and from the actions of other stakeholders and (c) because the effect of actions by one stakeholders on others are small in scale.

We believe that any measures that increase transparency and our collective understanding of cost information and cost drivers would have a positive effect on the ability of any one stakeholder to influence the behaviour of others, and on their willingness to work collaboratively with other agencies.

More generally, we believe there are fundamental challenges in the way Network Rail is regulated, which render it virtually un-accountable to its direct customers and to stakeholders

other than the DfT and the ORR. We have previously argued that the devolution of franchising powers and infrastructure funding to local stakeholders such as transport authorities and sub-national transport bodies would enable these organisations to challenge and incentivise the behaviour of both TOCs and Network Rail more effectively than DfT or the ORR are able to, by virtue of their greater knowledge of the local context in which the rail network operates.
Aligning operator and network rail incentives: 20. Do you have any views on the cost categories you think could be controlled by operators and whether these costs would be suitable as the basis of a potential future mechanism?
No views.

Any other points that you would like to make

Thank you for taking the time to respond.

Rail Strategy and Funding
Rail

Buchanan House, Glasgow G4 0HF

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Date:
22 March 2017

By e-mail: PR18@orr.gsi.gov.uk

Response to the ORR`s consultation on charges and contractual incentives

Thank you for the opportunity to comment on the ORR`s PR18 consultation on charges and contractual incentives. We have set out below some general points that we would wish the ORR to reflect on and consider, as well as some more detailed comments on some of the issues raised in the consultation.

In particular we would note the good work done by the industry over recent years on the transparency of rail industry costs and appreciate the level of detail and depth which is now available on costs and finance information at route level.

The Scotland route is in some respect ahead of the game, with the separation of the price control in place in CP4 and CP5. Therefore, we would expect to see the ORR to build on this experience to arrive at unit costs, and to model the effects of the charges and incentives, in a way which is truly reflective of the Scottish route. We also expect to see a high degree of flexibility in the ORR's approach to charges and incentives, particularly given the maturity of the route structure and the collaborative relationship between NR and ScotRail through the Alliance.

There are a number of areas within this consultation where the ORR is still developing its thinking, or where there is insufficient data for us to reach a formal position. We would therefore appreciate a meeting with the ORR to discuss our response and the specific implications to and for Scotland, and the Scottish Government as funder and franchising authority, from potential changes to charges and contractual incentives.

Delivering an efficient railway for Scotland

We have previously outlined our wider strategy for rail in Scotland and how this supports the Scottish Government's objectives on inclusive growth. The railway performs best when it is available and reliable. We are clear that an effective charges and incentives regime is vital in delivering the appropriate behaviours which place customers and end-users at the core of the railway. To this end the charging regime should be transparent, coherent and logical, with a clear purpose to encourage joined-up working across the whole system, focussed on minimising disruption and extracting the optimum utility from the network.

Given the wider context of changing industry structures and the move towards closer collaborative working between passenger operators and NR as infrastructure manager, it is also vitally important that the regimes are able to evolve and develop accordingly. The ScotRail Alliance has brought infrastructure management and service delivery together to support a whole-industry approach and help support transformative change in the quality and provision of services by placing the needs of customers at the centre of decision making. This approach has benefitted not only domestic passenger services, but all services operating across the Scottish route through greater resilience and more effective use of network capacity. We firmly believe that more can be achieved and it is vital that the regulatory charges and incentives do not act as a barrier, particularly to strong localised incentives, but rather act as a catalyst for greater collaboration.

Journey Times

It is worth highlighting the strategic importance that the Scottish Government attaches to rail journey times and journey time improvements. The National Transport Strategy, as refreshed last year, has consistently included the following three key strategic objectives across all modes in Scotland: improved journey times and connections, reduced emissions, and improved quality, accessibility and affordability. The current HLOS for CP5 and the associated ORR determination continue to show the priority accorded to rail journey time improvements by Scottish Ministers. An effective charging and incentives regime for CP6 must act in support of achieving journey time improvements.

Asset Data

Linked to the principle of transparency of cost and finance information we would expect to see the ORR work to improve the provision of accurate and updated NR asset data to all operators, for example on gauging capability. This is important as inaccurate or out of date information leads to risk, delay, unnecessary expenditure and ultimately inefficiencies and can deter for example new freight traffic from using the network.

Infrastructure costs

Transparency of fixed infrastructure network costs, FTAC

I have made the point earlier in this letter that we would expect that cost modelling will be truly reflective of the actual costs on the Scottish route, and not a proxy based on GB data. This is essential to ensure cost reflectivity and transparency and to provide meaningful comparative regulation across the GB network.

Throughout PR13 and in earlier PR18 consultations, Transport Scotland has highlighted its concerns that the existing fixed track access charges (FTAC) model lacks cost reflectivity, particularly in the context of cross-Border services in Scotland. These are typically heavier and faster trains that generally cause greater wear and tear on the track and whose FTAC in Scotland is borne by ScotRail and funded by Transport Scotland through our franchise payments. This was a particular concern for us during PR13 and remains unresolved during CP5.

We therefore welcome the pilot work undertaken by NR in Wales to better understand the impact that variable levels of traffic, weight and speed have on NR`s fixed costs in maintaining the infrastructure and to consequently devise a cost allocation methodology on this basis. Our expectation is that this depth of detail will be available and useful for the Scottish route.

In keeping with the emerging principle that those operators who generate the greatest wear and tear on the network bear a proportionate cost, where they can afford to do so, and in line with our previous representations, the ORR must consider as a priority how to ensure that any (increased) charges arising from the adoption of this methodology in relation to cross-Border traffic on the Scotland route does not continue to be funded by the Scottish Government. We expect that any move towards the adoption of this cost allocation methodology is also carefully screened to ensure that no unintended consequences that are contrary to government policy objectives will prevail - taking cognisance that the policy objectives of the Scottish Government can be different from those of the UK Government.

Before finalising our policy position with respect to the preferred option of the ORR we therefore require additional information from the ORR and NR on the application of the emerging cost allocation methodology, its impact on the full network in Scotland – including the more remote sections of the rail network - and on the Scottish Government as a specifier and funder of the rail network in Scotland and as franchising authority.

The rail freight sector in Scotland is facing significant challenges to replace its traditional markets such as coal and clarity, certainty and predictability on the level of freight charges is essential. The ORR must as a matter of priority work with stakeholders and funders to understand how the update to the market can bear test will impact on the freight sector in Scotland and take the broader economic considerations articulated in the Scottish Government's rail freight strategy into account. In developing and applying the market can bear test the ORR has to reflect market conditions and explore options to allow the test to be reviewed within a control period when material market changes occur, as was the case with freight (coal and steel) in Scotland. The rail freight sector has already driven efficiencies in the costs within their own control and they should not now dis-benefit from a failure to appropriately control, apportion and test the ability to bear additional costs.

In providing additional clarity regarding passenger and freight 'markets' the ORR must demonstrate clarity, simplicity and certainty into the charging regime yet reflect the distinct geographical needs of passenger and freight services and the priorities of funders. More generally on freight, we support the simplification of the charging regime by having a single freight mark-up charge. We also believe that the abolition of the Coal Spillage Charge is logical given the decline of coal traffic on the network.

Station charges

We note that the ORR propose to make only minor changes to station charges in PR18 that are focussed on improving the methodology used to calculate the managed station LTC and increasing the transparency of the station QX charge. The ORR will be aware of the clearly stated policy position that there can be no sale or disposal of Scottish railways assets including stations without the express consent of Scottish Ministers.

Variable usage charge (VUC)

We note the ORR`s view that changes elsewhere in the regulatory framework and the move towards route-level regulation should contribute to improvements in efficiency and use of the network and that therefore the case for fundamental reform of the VUC is less urgent in PR18. We would welcome a discussion with the ORR on the consequences of the implementation of recalibration changes to the VUC in PR18 and we need to understand any potential issues regarding the potential disaggregation of charges and the implications, particularly for freight of the removal of the cap.

Capacity Charge

I note the industry view, as expressed by the Rail Delivery Group, that a coherent set of incentives to encourage NR to deliver and release additional capacity on the network is lacking and that the capacity charge does not deliver on its original intent of overcoming NR`s reticence to release additional capacity given NR's additional exposure to Schedule 8 compensation payments as a consequence of potential disruption arising from a more intensively used network.

In our recent consultation on our future rail infrastructure investment strategy we highlighted the need to maximise the use of additional capacity on our existing network in support of our strategic objectives for rail. Given this context, we are clear that any capacity charge regime must properly and fully incentivise NR to identify and release additional capacity where the physical capacity exists. The onus therefore is on the ORR to make a convincing, evidence-based case on the best approach to ensuring that NR is fully incentivised to release capacity in a way which is efficient and where it can be put to optimum use.

Electrification Asset Usage Charge (EAUC)

The incentive properties of the EAUC are questionable. As part of your considerations we would expect to see greater emphasis on the potential for environmental incentives – as well as economic signals - on transmissions loss, which would support our objective to maximise rail's contribution to overarching climate change and emissions targets. We would welcome further discussions with the ORR on this.

Regulatory incentives regime

The ScotRail Alliance has helped ensure that Scotland`s railway is more joined-up and that decisions taken are focussed on end-users. In this context, we believe that incentives are most effective where the key decisions are taken closest to the needs of the rail user and funder, for example, within the ScotRail Alliance. We also recognise that there is a need to ensure that regulatory protections are in place for those services which operate across a number of NR routes. We would welcome a discussion with the ORR on how we strike the optimum balance on this.

Schedule 8

We note the general consensus from the industry that the regime is broadly aligned to its intended purpose – to incentivise operators and NR to work together to minimise the impacts of unplanned disruption. It therefore makes sense to explore change at incremental level, rather than transformative change. We expect that the impacts of the ORR's proposals to change Schedule 8 benchmarks are fully analysed to ensure that neither perverse incentives nor sub-optimal outcomes are introduced, and that benchmarks are fully aligned to regulatory outputs.

The ORR`s proposal to base the passenger operator performance measure on direct TOC-on-TOC delay, rather than a proxy, appears sensible and would support greater reflectivity and transparency. The fundamental principal of TOCs and NR working collaboratively together to recover from incidents must continue to be incentivised through any changes, with rail users at the heart of considerations. Further detail of the actual impact of this proposal on the Scottish route is required to enable our fuller consideration of these issues.

Alignment of Schedule 8 and passenger compensation

There are options presented in terms of the possible inclusion of passenger compensation payments in the Schedule 8 regime based on the perception of unfair gain to TOCs following disruption. We believe that this issue is something which could be better addressed through other measures outside of the Schedule 8 process; for example through operators increasing passengers' awareness of and access to the passenger compensation regime which the industry is already committed to. Based on the information available, we would not support the alignment of Schedule 8 and passenger compensation.

Schedule 4

We are aware that an undesirable side effect of the current regime`s Notification Discount Factor (NDF) is to encourage NR to plan speculative possessions as lower compensation payments are payable the earlier operators are notified of planned works. Speculative possessions can cause avoidable impacts on passengers and train operators, and impact adversely on the railway's reputation. We welcome the ORR`s ongoing work to update the NDF and to conduct research on how advance notice of planned disruption mitigates impacts on passengers. As part of this it is essential that passengers' and freight customer's views are fully considered, as ultimately it is they who suffer the most through the closure of the railway.

Alignment of NR and operator incentives, REBS

As part of the PR13 discussions we noted our reservations about REBS as a mechanism and that our preference was localised arrangements within the route where possible, with REBS as the default position. Our opinion on this has not changed, and we would welcome a further discussion on REBS with the ORR.

Conclusion

We reiterate the importance of an effective charging and contractual framework in driving the right behaviours and decision-making that will deliver a railway that is available and reliable and one that will align with the strategic priorities of the Scottish Government. We expect a flexible approach from the ORR which works for the Scotland Route, which consolidates on progress in the current control period, and we would reaffirm our position that the strongest and most effective incentives are in local decision-making and accountability.

We look forward to continued work with the ORR to achieve this.

Yours sincerely,

John Provan
Head of Rail Strategy and Funding

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Full name	Pedro Abrantes
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Fixed cost freight charges:

3. Do you support the recommendation to apply Network Rail's cost allocation methodology (discussed in this chapter) to freight mark-up charges?

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Yes.
Station charges: 5. **Qualifying expenditure (QX):** Do you agree with our recommendation that we support the work to make total QX charges more transparent at both managed and franchised stations?
Yes. The current system of unregulated QX charges seems difficult to justify. It gives Station Facility Operators (SFOs) and Network Rail (in the case of managed stations) a clear monopoly with respect to other franchised train operators (who are effectively required to make a certain number of calls at each station and whose demand elasticity to QX charges is therefore probably very low). It also adds an extra layer of uncertainty to the franchising process (SFOs will be unsure how much exactly they will be able to extract in QX charges and non-SFOs will be unsure how the level of charges they may be liable to pay). We support the ORR in its proposal to require the publication of QX charges, and we would encourage it to go further and request the publication, on a consistent and disaggregate basis, of information relating to station management costs and outputs (e.g.: quality of services provided). This additional information would be essential in order for the ORR and other interested parties to carry out a meaningful benchmarking exercise to determine the efficient level of station maintenance and operation costs.

Chapter 3: Short-run variable charges package

Variable usage charge (VUC): 6. Do you support our recommendation not to make fundamental changes to the VUC for PR18?
Yes.
Variable usage charge: 7. Do you have any suggestions for ‘recalibration’ style changes to the VUC you would like

to see considered for PR18 implementation?

No.

Capacity charge (CC):

8. Do you support our recommendation not to replace the CC with adjustments to Schedule 8 benchmarks?

Yes

Capacity charge:

9. Do you think we should: (a) retain the existing CC (but remove the caps on open access, freight and charter operators); (b) remove the existing CC and recover lost revenue through fixed cost charges; or (c) do you have any alternative proposals?

We are minded to support option (a). Following the changes made in PR13, the capacity charge does play an incentive role, albeit imperfect, and this would be strengthened if the caps were removed on open access, freight and charter operators.

However, we would like to remind the ORR of the position we have held throughout PR13 and into PR18, which is that the very limited variation in the capacity charge levied between time periods and between days of the week (in particular, Sunday v other days) significantly undermines the objectives of the charge. We would point to the example of subsidised off-peak services (e.g.: late evening or Sunday services), which impose little or no capacity costs on the network, but are typically levied the same capacity charge as peak services operating on the same route. The consequence of this anomaly is that certain off-peak services, which would operate under a more differentiated charging structure, may not do so, with a resulting loss of efficiency.

We would therefore encourage the ORR to consider introducing greater differentiation by time period and day of the week into the capacity charge.

Traction electricity charge:

10. Do you support our recommendation to keep the loss incentive mechanism?

Yes.

Electricity asset usage charge (EAUC):

11. Do you support our recommendation that the EAUC not be altered, beyond recalibration, in PR18?

Yes.

Coal spillage charge (CSC): 12. Do you support our recommendation to abolish the CSC?
Yes.

Chapter 4: Contractual Incentives Regime

Schedule 8: 13. **Passenger compensation:** What are your views on the options of passenger compensation recovery and improving the transparency of compensation relating to Network Rail's actions?
The consultation document provides a comprehensive and robust assessment of the advantages and disadvantages of different options. We agree with the ORR's assessment that neither of the options being considered is clearly superior to the alternatives. As a matter of principle, passenger compensation recovery by train operating companies directly from Network Rail should only be considered if incentive effects, and resulting benefits, are expected to offset the additional administrative cost, complexity and uncertainty. Our current view is that this is unlikely to be the case though we would support further work in this area.
Schedule 8: 14. **Approach to setting benchmarks:** Do you support our recommendation to only make changes to delink passenger operator benchmarks and Network Rail benchmarks for freight operators from past performance (but to leave the approach to the other benchmarks unchanged)?
Yes.
Schedule 8: 15. **Measure of passenger operator performance:** Do you support our recommendation to change the measure of passenger operator performance to one based on the delay caused to other operators?
Yes.
Schedule 8: 16. **Sustained poor performance (SPP) provisions:** Do you support our recommendation

to limit SPP to costs compensation only?

Yes, conditional on revenue losses continuing to be recovered through Schedule 8 claims.

Schedule 4:

17. Do you support our recommended prioritisation of schedule 4 issues? If you think we should reconsider any of the areas we have de-prioritised please submit supporting evidence.

Yes.

Schedule 4:

18. Do you wish to submit relevant evidence regarding: (a) processes associated with planning possessions; and/or (b) planning alternative arrangements to deal with planned disruption (e.g. the notification that is needed to arrange bus replacement services)?

No.

Aligning operator and network rail incentives:

19. Do you have any views on how financial incentives could be improved to encourage collaboration between Network Rail and operators to reduce industry costs?

As we have argued in our relevant response to PR13 we don't think the REBS mechanism is likely to be effective. This is largely because (a) there are significant asymmetries of information between Network Rail and TOCs, (b) the impact of specific interventions by any one agency are difficult to isolate from background trends and from the actions of other stakeholders and (c) because the effect of actions by one stakeholders on others are small in scale.

We believe that any measures that increase transparency and our collective understanding of cost information and cost drivers would have a positive effect on the ability of any one stakeholder to influence the behaviour of others, and on their willingness to work collaboratively with other agencies.

More generally, we believe there are fundamental challenges in the way Network Rail is regulated, which render it virtually un-accountable to its direct customers and to stakeholders other than the DfT and the ORR. We have previously argued that the devolution of franchising powers and infrastructure funding to local stakeholders such as transport authorities and sub-national transport bodies would enable these organisations to challenge and incentivise the behaviour of both TOCs and Network Rail more effectively than DfT or the ORR are able to, by virtue of their greater knowledge of the local context in which the rail network operates.

Aligning operator and network rail incentives: 20. Do you have any views on the cost categories you think could be controlled by operators and whether these costs would be suitable as the basis of a potential future mechanism?
No views.

Any other points that you would like to make

Thank you for taking the time to respond.

Paul Cornick
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B2 4DN

9th March 2017

Dear Paul,

West Coast Trains Limited's Response to the ORR's Consultation on Changes to Charges and Contractual Incentives

Thank you for the opportunity to respond to the PR18 consultation on the Changes to Charges and Contractual Incentives. This response, attached to this letter as Annex A, represents the views of West Coast Trains Limited "Virgin Trains" and Stagecoach Group.

Yours Sincerely

Darren Horley
Commercial Operations Manager
West Coast Trains Limited

Annex A – West Coast Trains Limited's Response to ORR's Consultation on Changes to Charges and Contractual Incentives

1) Fixed cost charges

Q1 – Do you support our proposal to levy fixed cost charges on all operators, including open access operators, to the extent that they can bear them (option 2)?

It is common knowledge that Open Access Operators (OAO) enjoy longer access rights in the UK. Hence, the principle should be raised as to whether OAOs should contribute towards the fixed costs of the network. Whilst Virgin Trains supports competition, it believes it should be on a "level playing field" and applied consistently across all routes regardless of the type of operator. It should not be forgotten that OAO profit margins and revenue growth consistently outperform the franchised operator – this supports Virgin Trains view that OAO could bear additional charges. The growing passenger market on core interCity trunk routes suggests that OAOs could bear the fixed costs, this is evidenced by the continual ambitions of OAOs to introduce new services on these corridors.

Equally, Virgin Trains and Stagecoach Group believe it is important that operators understand the proposed Market Assessment approaches and request ORR involves operators in the development of the approach early on enabling them to input into the analysis.

2) Fixed cost freight charges

Q2 – Do you support our proposal to simplify the current charging regime by having a single freight mark-up charge?

Q3 – Do you support the recommendation to apply Network Rail's cost allocation methodology (discussed in this chapter) to freight mark-up charges?

Virgin Trains understand the importance the role of freight has for growing in the economy thus, a need for additional freight capacity on the network. Having said that, there should be a balanced trade-off between: reserving capacity for potential freight growth (including occasional use of the freight paths) against operating additional passenger services. Over 85 per cent of the network that Virgin Trains operate over is at, or close to operating capacity; consequently, Virgin Trains and Stagecoach Group operators will be competing for scarce capacity. Therefore, if reserved freight paths are "blocking" passenger paths, it should be argued that freight operators should pay for that reservation of capacity.

3) Station charges

Q4 – Long term charge: Do you support our recommendation that the methodology for the LTC at managed stations be recalibrated?

Virgin Trains supports in principle any methodology improvement which makes Managed Station(s) LTC's more visible, cost reflective and provides greater transparency on the major fluctuations on LTC from one control period to the next.

Having said that, Virgin Trains does not support any change in methodology which have an ability to inflate the LTC and charges to Beneficiaries. Para 2.38 states that ORR does not expect to see "a significant increase to charges overall", as any increases "should be matched by a reduction in the total amount recovered by other charges". Virgin Trains seeks further clarification on what "other charges" ORR is referring to and why/how these would be expected to reduce accordingly.

Furthermore, Virgin Trains are interested to understand if this change will impact on the Station Change thresholds which do not necessarily fall within Control Period timelines.

Q5 – Qualifying expenditure: Do you agree with our recommendation that we support the work to make total QX charges more transparent at both managed and franchised stations?

Virgin Trains supports in principle any work to make QX charges more transparent but doubts that publishing QX charges will necessarily encourage improved cost efficiency.

It should be argued that where an SFO is off costing 100 per cent of the QX charges; for example, Managed stations – that greater visibility of costs on the procurement changes should be provided e.g. should a TOC representative be present to ensure it is for the good of the station and not just for Network Rail.

Q6 – Do you support our recommendation not to make fundamental changes to the VUC for PR18?

With the proposed changes being made to other charges and incentives in this consultation, Virgin Trains supports ORR's recommendation not to make fundamental changes to the VUC as part of this Periodic Review. Although, any decision made to refine the calibration of rates should reflect true "wear and tear" impact and drive better cost apportionment. Further, the VUC in its current form aid clear business case justification and incentives for investment in fleet improvements; for example, Hall bush fitment to the class 221 fleet.

4) Capacity charge

Q8 – Do you support our recommendation not to replace the CC with adjustments to Schedule 8 benchmarks?

Virgin Trains support the ORR's recommendation as trying to replace this with adjusted Schedule 8 benchmarks would be complex and create room for errors.

Q9 – Do you think we should: (a) retain the existing CC (but remove the caps on open access, freight and charter operators); (b) remove the existing CC and recover lost revenue through fixed cost charges; or (c) do you have any alternative proposals?

Option 1 of the Capacity Charge in the consultation retains the existing charge and removes the caps, this option will give all operators a predictable and stable charging regime. The charge should be transparent and clearly show what the charge is for. Virgin Trains and Stagecoach Group would not expect the Capacity Charge to rise as a result of the impact of any 'market can bear' test. Both Owning Groups believe the proposal under Option 2 to replacement the CC with adjustments to the Schedule 8 Benchmarks will be overly complex and as stated in the consultation, would in any case push a large proportion of required recovery on the fixed track access charge. The Option 3 of removing the CC and recovering fully via the Fixed charge would remove the ability of TOCs to save cost in the event of reduced mileage due to disruptive events and therefore be a disincentive to NR. On the other hand, it would reduce the marginal cost to operators of running additional services within the control period.

Moreover, Virgin Trains strongly believes the Capacity Charge must be consistently applied to operators competing in the same market for the same passengers. In relation to the West Coast Mainline the market can bear the Capacity Charge; therefore, as a minimum the cap should be removed. The current arrangement artificially distorts competition allowing OAO to undercut the Franchised Operator on an unfair basis.

5) Traction electricity charge

Q10 – Do you support our recommendation to keep the loss incentive mechanism?

The aim of the loss incentive mechanism is to provide financial incentive to Network Rail to minimise transmission losses, but by sharing the risk with the operators as the mechanism currently lessens the incentive on Network Rail to reduce the loss. Virgin Trains believe that Network Rail must be incentivised by ORR in CP6 to reduce losses to an efficient level.

6) Electricity asset usage charge

Q11 – Do you support our recommendation that the EAUC not be altered, beyond recalibration, in PR18?

Virgin Trains agree with the ORR recommendation that the EAUC not be altered in PR18.

7) Contractual Incentives

Q13 – Passenger compensation: What are your views on the options of passenger compensation recovery and improving the transparency of compensation relating to Network Rail's actions?

Virgin Trains believes Network Rail should reimburse train operators for passenger compensation payable because of Network Rail's poor performance or instances of network failure. This would also incentivise Network Rail to work with operators to reduce delays to passengers. Having said that, the industry must agree on a simple and realistic process to claiming/recovering such costs. Virgin Trains does not envisage any increased burden on administration or unnecessary disputes over such claims.

Further, as the Delay Repay regime (compensation to the passenger) is a feature of Franchise Agreements (and is being extended to Delay Repay 15 (minutes)), it should be funded through that Agreement and should not be confused with repayments made under the Schedule 8 regime. The Agreement however, assumes a level of performance and when operators dip below that level of performance due to Network Rail's poor performance, there is a compelling case for Network Rail to pay their share of Delay Repay. This is already the case for Sustained Poor Performance where Network Rail is liable for all relevant losses.

Q14 – Approach to setting benchmarks: Do you support our recommendation to only make changes to delink passenger operator benchmarks and Network Rail benchmarks for freight operators from past performance (but to leave the approach to the other benchmarks unchanged)?

Virgin Trains do not support delinking the passenger operator benchmarks from past performance. Of the suggestions in the consultation, using the average across all operators that is used in the freight regime, would not give the level of detail as there is in the current benchmarks.

Of the suggestions in the consultation, using the average across all operators that is used in the freight regime, would not give the level of detail as there is in the current benchmarks. The passenger operator's benchmarks should have cognisance to those contained in the franchise.

Virgin Trains does not yet agree with the proposal to change the measure of train operator performance from TOC-on-Self to TOC-on-TOC. A better understand how any changes to benchmarks would be affected by this proposal would be needed.

It could be argued that if Network Rail wants softer targets, they will need to compensate operators through the Schedule 8 regime. ORR should look at this in the round, not just from Network Rail's perspective. The benchmarks should reflect the point at which customers will reward that level of performance, not just what will keep Network Rail financially neutral.

Q15 – Measure of passenger operator performance: Do you support our recommendation to change the measure of passenger operator performance to one based on the delay caused to other operators?

Virgin Trains and Stagecoach Group are working with Network Rail to assess the impacts of what a change to the TOC on TOC regime would look like, this work is ongoing. However, despite the outputs of this work, Virgin Trains believe it is the responsibility of Network Rail to manage the infrastructure and regulate train services operating on the network. Moreover, it would be difficult for operators to reduce reactionary delay outside the routes they operate over. It will always be better time invested if train operators concentrated their efforts on reducing their TOC-on Self delay which in turn helps reduce reactionary delay. Virgin Trains immediate areas of concern with any change is that Network Rail may be insouciant to minimise the impact of delays and reactionary delays on the network if Schedule 8 alone is used to manage reactionary delay.

Q16 – Sustained poor performance (SPP) provisions: Do you support our recommendation to limit SPP to costs compensation only?

Virgin Trains does not support this recommendation. The Sustained Poor Performance provision should compensate for the lateness and cancellations that the Schedule 8 compensation regime which currently under compensates, without this Network Rail has no incentive to deliver improvements.

The application of the provision should be made much simpler to avoid being time consuming and hard to resolve by being made formulaic based on a multiplier of the payment rate and from the moment SPP is triggered, there should be an automatic right for operators to claim Delay Repay costs due to Network Rail's poor performance, based on actual costs and these should be paid immediately.

8) Schedule 4

Q17 – Do you support our recommended prioritisation of schedule 4 issues? If you think we should reconsider any of the areas we have de-prioritised please submit supporting evidence.

Some of the contractual wording and definitions in the contract are ambiguous, which has caused Network Rail to dispute with train operators on cost claims, for example, the definition of 'Direct Costs'. Network Rail tends to interpret some of the terms inconsistently when rejecting train operators' claims for costs. It is long overdue in that discussions with the ORR to review and revise some of the wording and terms for reference in the contract are needed.

Q18 – Do you wish to submit relevant evidence regarding: (a) processes associated with planning possessions; and/or (b) planning alternative arrangements to deal with planned disruption (e.g. the notification that is needed to arrange bus replacement services)?

Virgin Trains is a long distance operator with a commercial model that expects passengers to be able to purchase tickets and seats up to 12 weeks (T-12) in advance; in some cases, reservations open 26 (T-26) weeks (weekdays) in advance to effectively compete with the airlines.

Virgin Trains strongly believe that late notice (within T-12) possessions should result in minimal discount factors being applied; moreover, in the final week there should be no discount as passengers will have inevitably made their travel plans. In regards to late notice possession cancellations, the regime needs strengthening so that passenger train operators are adequately compensated for revenue losses and additional costs incurred. The non-strike days in 2014 are good examples where matters that sit entirely within Network Rail's control (managing pay talks) resulted in significant losses for passenger operators.

Finally, the Access Charges Supplement, there should be a high level re-opener when Network Rail fails to deliver its renewal or maintenance volumes as measured against it Regulatory Targets – there should be a trigger level to avoid minor variances to plan and Virgin Trains this should be clearly measured by use on the 'Scorecard' approach.

End
March 2017
Virgin Trains

Ken Skates AC/AM
Ysgrifennydd y Cabinet dros yr Economi a'r Seilwaith
Cabinet Secretary for Economy and Infrastructure

Llywodraeth Cymru
Welsh Government

Stephen Glaister
Chair, Office of Rail and Road
One Kemble Street
London
WC2B 4AN

9 March 2017

Dear Stephen,

I welcome the opportunity to respond to the consultation on rail charges and contractual incentives as part of Periodic Review 2018 (PR18)). During the next control period, the Welsh Government will be continuing to subsidise the Wales and Borders franchise which we are currently procuring. We will also be delivering an ambitious programme of infrastructure works including the south Wales Metro.

Devolution, both in terms of more responsibility to the Network Rail routes and more generally in terms of establishing devolved authorities' roles, should be at the centre of thinking in respect of future charges and incentives. As the current manager, and from 2018 a franchising authority, the issue of track access charges is particularly important to the Welsh Government. We will be responsible for funding the cost of the franchise, but without responsibility or funding for rail infrastructure. The Welsh Government will potentially be exposed to the effects of changes to costs associated with operating the franchise and we expect the ORR to have due regard to our unique position when developing proposals for charges and incentives in PR18.

Based on the existing information, of the four options for fixed track access charges (FTAC), the proposal in Option 2 to change the allocation of FTAC between operators is of particular concern. It appears likely, based on the work already carried out in respect of the Wales Route, that operators of rural lightly trafficked services would pay more FTAC and that operators using routes characterised by less challenging topography would pay less. This is likely to result in the costs of operating trains that already have good levels of service becoming cheaper, while areas with fewer existing services would become more expensive as fixed costs are distributed across fewer services. ORR should consider, therefore, the social value of infrastructure when setting fixed charges to ensure that there is a greater understanding of the benefits that the rail network delivers.

It is difficult to assess the full extent of the likely actual changes in charges to different operators without a better understanding of how the proposed 'market can bear test' would be applied. This may protect franchised services from cost increases, but may not provide the same protection to non-franchised services (services that could be delivered by the franchisee that are not part of the core franchise).

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As a result, operating additional services desired, which might generate only modest marginal costs for Network Rail, may prove prohibitive due to the additional fixed access charges of doing so. While I recognise the need for operators to pay their fair share, ORR needs to ensure that any change does not prohibit operators and funders from improving service quality, capacity and connectivity for passengers.

The effect of applying FTAC to freight operators also needs to be carefully considered, as reflected in the UK Government's Strategic Rail Freight Strategy published in 2016. The strategy recognises the key role rail has in the future in supporting the sustainable movement of freight and I share the aim of promoting its use. The environmental and air quality benefits of rail freight relative to road freight and its impact on reducing road congestion are not currently recognised in the assessment resulting in Option 2 being favoured and a thorough understanding is needed of how any changes will impact on the rail freight industry overall is needed. Any approach that increases the costs of transporting freight by rail would reduce the likelihood of encouraging modal shift from road to rail and detract from the policy aim. More focus should be given, therefore, to the incremental costs that freight services impose on the network, rather than allocating a proportion of fixed network costs to freight operators.

If Option 2 is to be applied, then a greater proportion of Network Rail's total revenue requirement should be raised through short-run variable charges - particularly through a more effective capacity charge. Moreover, allocating FTAC based on network capacity utilisation under Option 3 would offer a fairer approach to allocating fixed costs - particularly with better alignment to the capacity charge. Taking this approach, generally, operators of more frequent services where network capacity is at a premium - and the marginal costs of running additional services are outweighed by the benefits (including revenue) - are likely to see an increase in fixed track access charges whereas operators of lower frequency services would potentially see a reduction.

In terms of variable track access charges, I would welcome the proposal to differentiate these charges based on speed. I believe the disaggregation of usage charges by line performance could, if appropriately implemented, make a contribution towards incentivising Network Rail to increase line speeds and reliability - consequently improving its service for travellers.

Due to existing funding arrangements and agreements with the Department for Transport, the Welsh Government will need to be compensated for any increases in track access charges for the Wales and Borders franchise. It will be important for the ORR to make this clear in the implementation of any changes. The number and type of services will be important in setting charges for the next control period. As Transport for Wales is currently procuring the next Wales and Borders franchise to commence in 2018, there is some uncertainty around the services that will operate. I would expect, therefore, my officials to have sight of the methodology for forecasting future services and input into the process when appropriate.

Yours ever,

Ken

Ken Skates AC/AM
Ysgrifennydd y Cabinet dros yr Economi a'r Seilwaith
Cabinet Secretary for Economy and Infrastructure

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9th March 2017

Consultation on changes to charges and contractual incentives

This response is compiled from the perspectives of the Swindon and Wiltshire Local Enterprise Partnership (SWLEP) as a potential third-party infrastructure funder, together with its associated local transport authorities (Swindon Borough Council and Wiltshire Council) that may provide revenue support in the early years of enhanced rail passenger services. Its main concern is to ask ORR to ensure that the charging regime sufficiently incentivises delivery of new services to the extent that provides a long-term economic benefit.

I cannot claim to be an expert upon the railway financial structure. A response is made more difficult by the consultation options specifying a general direction of progress; not a worked-up solution. However, I will try to convey some of the concerns being experienced, which may or may not be valid in the final charging scheme.

Cost neutrality

To some extent, you may be considering changes to the charging regime as cost-neutral to the DfT, as costs would be recovered either via franchise agreements or via direct Network Grant. However, the allocation of charges may have a significant effect upon the apparent business case for schemes promoted by third parties such as the SWLEP.

Apportioning track access charges

Most of the railway routes through the SWLEP area are used by a diverse mixture of high speed and local passenger services, intermingled with heavy freight, including Network Rail's internal traffic of engineering trains. Therefore I am interested in how route costs would be shared between each service type, and whether this would impact upon the business case for service enhancements.

Market-can-bear test

It is not clear how the calculation of fixed track access charge might impact upon new passenger services funded by third parties for the first three years of operation. If a new service or service enhancement has to bear FTAC in addition to variable costs, it should be noted that it is almost inevitable that the new service would be operating financially below the market average during its early years. In this case, the FTAC cost cap implied by the market test would be ineffective. Is there a case for specific provision in the market segmentation process to cover new service patronage ramp-up?

While the above paragraph was written with franchised operations in mind, it is relevant also to open access operations.

Transparency and cost base for FTAC

I would like some reassurance that the new cost allocation process would not result in third parties being charged twice; once for direct funding of infrastructure enhancements; and secondly via train operators and track access charges calculated upon the notional cost of infrastructure required to run the service.

Capacity charge

I am aware that the scale of the existing capacity charge has the potential to make a significant difference to the business case for certain service enhancements being considered and that uncertainty over the future scale of charges adds risk.

I understand that the capacity charge is primarily concerned with performance risk and is part of an internal flow of funds between rail industry bodies. The SWLEP will not have an active part in this, but I would like to suggest that any modification or replacement of capacity charge has the following features:

a) It fairly reflects the performance risk of capacity limitations
b) It is intelligible to bodies such as the SWLEP and local transport authorities and reasonably predictable
c) It would go beyond internal compensation arrangements and provide a mechanism by which third party investors could recoup a part of their expenditure through the value of rail congestion relief.

David Phillips
Senior Transport Planner