Aligning incentives to improve efficiency

Response to consultation, Porterbrook Leasing, June 2012

1. The objective of giving train operators an incentive to reduce infrastructure costs is attractive in principle; however it is doubtful that the financial reward will outweigh the long term risks to assets and the additional complexity this brings to the industry.
2. As was shown by the Railtrack experience, infrastructure costs can be quickly reduced by the deferral of maintenance work. This produces new costs in terms of train maintenance, delays due to speed restrictions and ultimately additional safety risks. The recovery from the Railtrack experience has taken many years yet this situation could arise again if an incentive to defer maintenance from the optimum time is created.
3. For example, a particular viaduct may require repair, but this can be deferred by placing speed restrictions and so appear as an efficiency saving. Meanwhile water ingress over the following years causes further deterioration resulting in much more expensive repairs at a later date, but by then some of the funds being made available have been taken as a performance benefit.
4. Other manipulation of apparent efficiency levels are possible and introduce the requirement for audit, which absorbs Network Rail time and introduces new costs for specialists to carry out the audits. The attribution of savings to efficiency or deferral compared to what was already planned would become an important demand on management time as delay attribution has become for service performance.
5. Shared infrastructure will produce problems between TOCs which will require arbitration. In the example above a speed restriction may have no impact on one service which has plenty of timetable elasticity whereas it may have a high impact on another operator which operates a more demanding schedule.
6. It could be argued that a 15-year franchise avoids the problem of maintenance deferral, however since the downside risk is capped at 10% there would be an incentive to concentrate work into a “bad year”, allowing performance benefits in all other years.
7. ORR is producing a steadily increasing number of proposals to use incentives to influence TOC behaviour, yet in many cases these only have the effect of increasing costs since they are much smaller than the revenue demands of the service. Capacity charges, infrastructure impact charges and geographical disaggregation all increase administration costs which ultimately increase total costs, yet they will not change the fact that TOC revenue is dominated by running trains to big cities at peak times. The only long term effect of these incentives is to reduce franchise value by moving the costs into the franchise base cost above which the TOC will seek the same premium.
8. The most serious problem identified in the document is the line “we choose in future periodic reviews to introduce additional charges into the charging regime”. Already the increased freight VTAC charges are acting as a disincentive to long-term rail freight investment plans as they are combined with the threat of unpredictable future increases. Investment in terminals and rolling stock is based on a 30 year return with no short term gain. Any threat to the viability of the business increases risk and with it cost.