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30 October 2020

Dear Stakeholders,

Review of train performance incentives

The railway has undergone rapid change during 2020 as it has responded to the challenges of Covid-19. The operating models of TOCs are in transition across England, Scotland and Wales, reflecting new commercial realities and progress towards wider rail reform. Throughout this change, punctuality and reliability remain key priorities for passengers and freight users, and in this letter I would like to update you on the work ORR has been doing to review the mechanisms that incentivise train performance across Great Britain. We are also inviting stakeholders to engage with us on ideas for reform, including to the contractual performance regime.

We started a review of train performance incentives in January 2020, when we asked SYSTRA to carry out research on our behalf into what influences decisions that affect train performance. We scoped this work broadly, to include all factors and mechanisms that impact performance, whether commercial, regulatory or behavioural. SYSTRA has now reported back to us, and we are publishing its report alongside this letter.

This letter summarises the messages we take from SYSTRA's research. It also notes changes to the industry's structure which may affect train performance incentives including the contractual performance regime. We also draw your attention to the 'Next steps' outlined below.

SYSTRA's research

We summarise SYSTRA's findings here, and are also providing SYSTRA's report for your review¹.

¹ SYSTRA's research was carried out between January and July 2020 (with a two-month hiatus due to Covid-19), and involved 38 interviews with a cross-section of the industry as well as an online survey. As much of SYSTRA's work was carried out before the onset of Covid-19, some of the drivers of behaviours that SYSTRA identified will have changed.



SYSTRA's report highlighted the importance of behavioural incentives. Across the industry, stakeholders stressed the importance of **personal pride and reputation**, for example in industry and regional comparisons.

ORR's **monitoring and reporting activity** could be a useful source of behavioural incentives. At present some Network Rail staff say that scorecards do influence behaviours, but they are not frequently cited by others as a key driver of performance. There is some desire that scorecards, and ORR's monitoring of Network Rail, should be strengthened – e.g. in respect of freight.

SYSTRA also draws out that **commercial incentives** play a large role in driving behaviours. Speaking mainly pre-Covid-19, TOC staff consistently saw a focus on customers as fundamental to their businesses due to a link between revenue and customer satisfaction. Some TOC staff consider that Network Rail does not match this level of passenger focus as it is a step removed from the customer relationship.

Some TOC staff felt that the **pre-Covid-19 franchising process** led to over-optimistic performance proposals, creating unrealistic performance expectations. TOCs have felt they are under commercial pressure to maximise the number of services run, in a context where Network Rail accommodates such requests where feasible – putting pressure on what has been a congested system. Some consider that prioritising an ambitious timetable and minimising operating slack can be at the cost of performance on the network. There is an appetite, including in Network Rail, to improve franchising processes.

Schedule 8 was the most contentious area in SYSTRA's discussions. The importance of financial incentives was acknowledged – for example some TOC staff feel that the regime helps make the business case for investing in performance and therefore is an effective form of incentivisation. However, Network Rail perceives that Schedule 8 sometimes disincentivises TOCs from assisting in the resolution of delays, and there is a perception that TOCs use Schedule 8 to maximise financial gain, sometimes at the expense of performance. There is a desire from different parties for accurate recording of delay incidents to feed into performance-related investment decisions, not just for Schedule 8 purposes. However, many people are frustrated by the delay attribution process, and feel that time and resources spent on delay attribution could be dedicated to resolving causes of delay. Various stakeholders stressed the need to remove barriers to collaborative working – they seek a system that incentivises high performance but with a less acrimonious culture.

SYSTRA also highlighted that access to **more and higher-quality data** would help improve whole-industry decisions on performance – such data could help with

We stress that SYSTRA's research is its own work rather than representing the views of ORR. The report reflects the views of the individuals spoken to, rather than necessarily those of their employers; these views differed considerably, even within the same stakeholder types.

service recovery and prioritisation decisions. The analytical capability in the industry may also need to be built to make best use of data that become available.

Our initial view on SYSTRA's research

SYSTRA's research shows the range of mechanisms that drive train service performance. We will now consider SYSTRA's findings, as well as changes to the industry's structure, when considering how the regime needs to evolve in future. We recognise the importance of assessing Schedule 8 within the context of the full set of incentives driving train performance.

Changes to the industry's structure

ORR last reviewed the Schedule 8 performance regime during the 2018 periodic review (PR18). However, the industry is now very different from when ORR concluded this work. In particular, as a result of the large drop in passenger numbers and revenues from March 2020 due to Covid-19, franchising authorities have replaced most franchise agreements with 'concession'-style contracts. Meanwhile, wider government rail reform is ongoing and is likely to promote greater alignment of incentives and co-ordination between 'track and train'.

These changes raise a number of issues that we need to consider when thinking about the future performance regime:

- Concession-style agreements change the nature of incentives for contracted TOCs. The system as a whole may need to adapt, while incentivising all parties to reduce disruption.
- There is ongoing uncertainty about the future shape of the rail sector, both regarding user demand and structural reform, so the industry may seek the benefits of a flexible system.
- The performance regime and its incentives cannot be considered in isolation from other issues – for example how industry incentives can be aligned to drive more collaborative working, and how the incentives on performance interact with those on capacity and passenger experience.
- A current objective of Schedule 8 is to compensate operators for revenue losses from disruption outside of their control. However, under concession-style agreements, revenue risk and exposure to Schedule 8 are likely to sit with franchising bodies rather than TOCs.
- At the same time, there will remain users of the network, for example freight and open access operators that are exposed to revenue risk. In addition, franchising bodies have differing financial models and may have a range of interests.

Next steps

The changes and issues outlined above give rise to a need to reassess the fundamental objectives of the performance regime and to consider how it will need to



evolve in future. In the coming months we will be building our initial thinking on policy options.

We will be engaging informally with stakeholders for views between now and spring 2021 when we expect to be in a position to issue a more formal consultation on the way forward. We will seek to discuss these issues with stakeholders, including at existing industry forums. We are not asking you to respond formally in writing to this letter but, if you have views or ideas on how the performance regime should develop, we would welcome a conversation. Please contact ORR's project team at Performance.Incentives@orr.gov.uk.

Yours faithfully,

A handwritten signature in blue ink, appearing to read 'Daniel Brown', is positioned below the closing text.

Daniel Brown