



OFFICE OF RAIL REGULATION

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To
All Rail Freight Operators,
Network Rail Infrastructure Limited,
Rail Freight Operators Association,
Department for Transport and
Transport for Scotland

Dear colleagues

REVIEW OF FREIGHT PERFORMANCE REGIMES

The purpose of this letter is to consult freight industry colleagues and other interested parties on our proposals for changing such performance regimes in freight track access contracts as part of the periodic review 2008. These have emerged from discussions we have had with the industry through the auspices of the freight performance regime review industry-working group.

Background

On 1 December 2006 we wrote to you outlining our reasons for this review and identifying certain key issues we thought might be examined as part of it. To help inform our thinking, we proposed the establishment of an industry-working group to represent freight interests and invited participants. The working group's remit and membership is at **Annex 1** for ease of reference.

At its first meeting on 31 January 2007, the working group identified and subsequently discussed a number of key issues, e.g., benchmarks, cancellation rates and thresholds, payment rates and incident caps and access charge supplement methodology. The working group were generally content with the structure of the performance regime, which



INVESTOR IN PEOPLE

it saw as working reasonably well, and agreed that in reviewing the regime the focus should be:

- (a) to keep it as simple to administer as possible, and to avoid any additional administration and set up and running costs;
- (b) to ensure that it should not in itself lead to a competitive advantage for any operator; and
- (c) to review the performance regime metrics and methodology with a view to:
 - (i) supporting the existing regime;
 - (ii) providing more standardisation, including where possible achieving a consensus on FOCs having the same or similar benchmarks and payment rates; and
 - (iii) aiding simplicity and ensuring there was no additional transaction costs.

It was also agreed that we should meet individually with FOCs holding firm access rights, to enable them to discuss openly with ORR and Network Rail the impact any change might have on their existing confidential performance regimes. We also met with those FOCs who currently have no firm access rights. At these meetings we discussed:

- (a) the operational and financial impact of delays and cancellations;
- (b) time sensitivity of individual traffic flows;
- (c) operational impact of poor performance;
- (d) the way forward to improve metrics; and
- (e) any other individual areas of concern.

Our proposal

The working group met again on 4 June 2007 to review our findings and to agree a set of proposals. These are set out in detail in the attached Annexes, but briefly our proposals are:

- (a) Benchmarks (Annex 2) – Network Rail's expected performance levels will be common to all freight operators and freight operators will have a common third party benchmark based on recent historic performance;

- (b) Cancellation Rates (Annex 3) – an expected level of cancellation would be determined with compensation for cancellations above this level being significantly higher than currently exists;
- (c) Payment rates (Annex 4) – a common Network Rail payment rate will be used for all freight operators, also, all freight operators will have the same train operator payment rate.

We believe that the proposals will:

- (a) provide a suitable incentive to both Network Rail and FOCs to improve performance;
- (b) provide an appropriate balance of risk and reward for both Network Rail and FOCs;
- (c) not lead to any perverse incentives on either Network Rail or FOCs in regard of performance (for example favouring one FOC because of its size);
- (d) not act as barrier to entry to new FOCs to the market; and
- (e) not itself aim to provide competitive advantage to any FOC.

Consultation questions

In considering the proposed principles it would be helpful if consultees could address the following questions:

- (a) do consultees agree that using normalised delay is the most appropriate measure of performance?
- (b) do consultees agree that it would be appropriate to have the same performance benchmark for all operators?
- (c) do consultees agree with the proposals for cancellations and long delays?
- (d) what do consultees believe would be the most appropriate way to measure cancellations? And
- (e) do consultees agree that it would be appropriate to have one common payment rate for both Network rail and operator third party delays?



Can we ask for your responses by no later than **Friday, 14 September 2007**. These should be e-mailed to Neil Leedham at ORR neil.leedham@orr.gsi.gov.uk.

Yours sincerely

A handwritten signature in black ink that reads 'Bill Hammill'. The signature is written in a cursive style with a long, sweeping tail on the final 'l'.

Bill Hammill



Annex 1

Review of Freight Performance Regimes Working Group

Aim

To review the effectiveness and efficiency of freight performance regimes in track access contracts.

Purpose

The purpose of the working group will be to:

- assess how current performance regimes are working and the effectiveness of them – freight v passenger and FOC v FOC? Is a change necessary or required?
- Identify what freight performance regimes should, ideally, achieve and how can this be accomplished. Is a new mechanism required and what does it do?
- agree what changes to the model clauses are required and how they should be effected; and
- agree a timetable for taking matters forward.

Issues for consideration

The following aspects of existing freight performance regimes should be reviewed and considered for change:

- (f) Payment rates;
- (g) Cancellation rates;
- (h) Cancellation thresholds;
- (i) Benchmarks that reflect time sensitivity of traffic;
- (j) The expression of benchmarks;
- (k) Common recalibration period for all benchmarks; and

- (l) Common and visible methodology for calculation of incident caps and access charge supplements.

In addition, the working group will need to consider the following issues:

- do payment and cancellation rates offer adequate incentive to Network Rail to improve freight performance? Do these rates need changing? If changes were needed, how would this be implemented?
- do the benchmarks adequately and accurately reflect the time sensitivity of the traffic?
- should the benchmark metric be common to all freight regimes? If so, what metric would you propose?
- should the benchmark calibration period be common to all agreements within a control period?
- should the cancellation threshold be the same for all freight regimes?
- should there be a visible method of calculating Incident caps and associated Access Charge supplements?

Process

The working group will:

- meet monthly commencing in January through to April 2007;
- confirm ORR as secretariat to;
 - arrange meetings at agreed venues;
 - provide agendas and meeting plans prior to meetings;
 - produce minutes of each meeting;
 - circulate correspondence to group members;

Timetable



- agreement to be reached on changes considered appropriate later in 2007;

Members

ORR	Network Rail	DfT	Operators
David Robertson (Chair) Neil Leedham (Secretary) John MacQuarrie Iain Morgan Bill Hammill	Geraint James, Richard Wall, Martin Hunt	Susie Northfield	Nigel Oatway, English Welsh & Scottish Railway Limited; Michael Leadbetter, Freightliner Group; Andy Moyle, First GB Railfreight Limited; David Stubbs, Direct Rail Services Limited; Paul Orchard, Fastline Limited. Steve Dobson – Amec Spie Rail (UK) Ltd



Annex 2

ORR's emerging proposals

Benchmarks

Currently, we propose a dedicated output measure for Network Rail in respect of freight performance in CP4. Due to the variable nature of the freight traffic, this measure should be normalised to reflect the number of train miles run by freight operators.

We propose the measure of delay per 100 train kilometres; this measure has the benefit of being recognised by the industry and has sufficient historic data available to enable a challenging target to be set for CP4.

To calculate either the Network Rail or freight operator performance against benchmark the following data would be required:

- (a) Network Rail caused delay minutes and third party delay minutes caused by the FOC in the relevant 28 day period; and
- (b) Number of train kilometres operated by the FOC.

For each 28 day period the Network Rail performance against benchmark would be calculated as follows:

Delay minutes attributable to Network Rail (NRDM)

Train Kilometres operated by the FOC (TKM)

$NRDM \times TKM/100 = \text{FOC Network Rail Delay per 100 train km}$

No compensation or bonus payments are payable if actual Network Rail performance equals the delay per 100-train km benchmark.

If Network Rail performance is worse than (i.e. more delay minutes) the delay per 100 train km benchmark then compensation will be payable to the FOC.

If Network Rail performance is better than (i.e. less delay minutes) the delay per 100 train km benchmark then a bonus payment to Network Rail will be payable by the FOC.

Capping arrangements will not change any change to the annual cap arrangements.



In respect of the Freight operator benchmark, we propose that this is based on historic performance and an improvement trajectory of between 2 and 5% annually throughout the control period.

For each 28 day period the operator performance against benchmark would be calculated as follows:

Third party delays attributed to FOC (FRDM)

Train Kilometres operated by the FOC (TKM)

$FRDM \times TKM/100 = \text{FOC Third party Rail Delay per 100 train km}$

No compensation or bonus payments are payable if actual performance by the FOC equals the delay per 100-train km benchmark.

If the FOC's performance is worse than (i.e. more delay minutes) the delay per 100-train km benchmark then it is liable to pay compensation to Network Rail.

If the FOC's performance is better than (i.e. less delay minutes) the delay per 100-train km benchmark then the FOC will receive a bonus payment from Network Rail.

ORR's emerging proposals

Cancellation Rates & Long Delays

Freight operators have argued that the current cancellation rates do not provide adequate compensation, and do not provide an appropriate incentive for Network Rail to avoid cancellations.

Freight operators also voiced strong opposition to Network Rail cancelling trains, which then subsequently run in a later path. It was perceived that this was being done to reduce delay minutes even though this led to additional costs and impact on FOC revenue.

We do not consider that the current regime offers sufficient incentive to Network Rail to avoid regular long delays to freight traffic that might encourage freight customers to either switch to another operator or to another mode of transport. Having taken these views into account and seeking to keep the metrics associated with regime simple, easy to understand and administer we propose the following:

- (c) There will be a benchmark for cancellations that a freight company can expect. This will be a percentage of trains booked to run. Cancellations within benchmarked tolerance would be paid at a rate similar to the one operating today;
- (d) Should cancellations exceed the benchmark the cancellation rate payable by Network Rail should be increased to a rate which more accurately reflects the cost of cancellation to an operator;
- (e) Network Rail should be incentivised to avoid regular excessive delays. The intention of this measure is to provide an incentive on Network Rail to avoid this type of delay. It is hoped that such a scheme would avoid freight customers switching from their current operator solely on the grounds of performance; and
- (f) The metric we propose is that no more than [x%] of services planned by 2200 hours the previous evening are delayed by over 240 minutes by Network Rail (measured in each period). Should Network Rail exceed this target the will pay the operator the sum equal to 50% of enhanced cancellation rate in respect of every train over and above the target.



We have considered evidence put to us from all of the operators and we believe that the cancellation rate should be increased to between £1,500 and £4000 per train (the exact figure will be determined). The figure is based on evidence provided to us by the operators and takes into consideration the following:

- (a) Lost revenue;
- (b) Additional resourcing costs;
- (c) Savings from fuel and access charges;
- (d) Additional operating costs; and
- (e) Allowance for loss of goodwill.



Annex 4

ORR's emerging proposals

Payment Rates

We are proposing that the Network Rail payment rate will take into account the cost of delay to an operator and provide compensation for these losses. It should also provide an appropriate incentive for Network Rail to improve freight performance and should not lead to undue discrimination between passenger and freight operators.

We have received evidence from operators regarding the costs of delays. We are proposing a single Network Rail freight payment rate of between £9 and £12 per minute and believe this to be a reasonable figure as it achieves an appropriate balance between reflecting the impacts of lateness and retaining simplicity and ensuring that the regime does not provide a competitive advantage to any particular FOC. It will offer a suitable risk and reward to both operators and Network Rail.

The following formula shows how the payment rates would be applied to each contract, whether would be payable by using the following formula:

Payment rate = PR

PR x minutes variance from benchmark x Train Kilometres run/100 = payment due

We propose that the operator payment rate is common to all freight operators. This will be the average cost of delay payable by Network Rail in the star model. This would greatly simplify the regime and would significantly reduce set up costs – leading to less of a barrier to entry – and would reduce transaction costs.