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Dear Richard

Direct Rail Services (DRS) is pleased to respond to the ORR's first consultation on periodic review 13. DRS appreciates the importance of this periodic review, particularly in the current climate of industry change and efficiency savings. DRS do not have any issues with this content being published on the ORR website.

Please accept apologies on behalf of DRS for this late response.

### **Specific questions Response from DRS as below.**

#### **Chapter 3 (our objective for PR13)**

Q1 Do you agree with our proposed objective for the review? If not, what issues would you add or subtract?

[DRS agree in principle.](#)

#### **Chapter 5 (high-level timetable)**

Q2 Do you have any views on our proposed timetable for the review? Do you need further information to plan your involvement with PR13? [DRS consider that certainty and stability are crucial factors for the continuation and growth of the rail freight industry which depends on the private sector. The Periodic Review presents an opportunity to reinforce that stability and certainty – but it also represents a risk. Undertaking a Periodic Review with the associated uncertainties about the funding of the infrastructure provider, the High Level Output Specifications and the process for matching the two creates uncertainty. This uncertainty is multiplied when there is a possibility that ORR will review and restructure freight access charges. DRS welcomes ORR's intention to place a cap on the level of certain freight access charges well in advance of its determination \(paragraph 6.62\(f\) of the consultation document\) but suggests that ORR should, as it did in PR08, significantly shorten the timescales relating to decisions on rail freight.](#)

## Chapter 6 and annex B

### *Price control separation and Network Rail devolution*

Q3 Do you think that our approach to the disaggregation of Network Rail financial (and other) data to operating route is appropriate? Is the information we are

requiring Network Rail to produce set at the right level? Do you have views on the information train operators should produce?

Disaggregation of financial and other data to route level is clearly important for the success of Network Rail devolution. As a general principle, DRS is supportive of cost management and decision-making being devolved to the lowest level of any organisation where they can most effectively be managed. However, the individual routes of Network Rail are not separate entities per se as together they form part of a national network and in many cases share common asset and operating practices and characteristics. It is important that any process of disaggregation does not inadvertently damage national network benefits or increase costs elsewhere. National operators, such as DRS, have no “natural fit” between the services their customers require them to operate and the organisational boundaries of Network Rail’s routes. In terms of transparency of train operator financial information, DRS are a business operating in the highly competitive freight market, with strong competition from other rail operators and road hauliers. It is therefore inappropriate (as well as exceptionally complex and artificial) to disaggregate freight company costs against NR routes. It is implicit in both McNulty and the PR13 Consultation document that rail freight companies would not be expected to be subject to the same expectations as Franchises, but for the avoidance of doubt this should be set down explicitly.

Q4 Which aspects of the price control should be separated for England & Wales and Scotland, e.g. should the efficiency assumption be separate?

In principle, DRS supports the approach that was previously adopted by ORR for PR08 (i.e. with similar efficiency and cost of capital assumptions for both Scotland and England & Wales). Unless Governments are minded to demand specific regional exceptions, DRS sees no reason to change this position. In particular, DRS urges ORR to ensure that a simple, national access charging structure is retained for rail freight.

Q5 Do you think there should be further separation of the price control for Network Rail’s operating routes and, if so, which aspects of the price control should be separated?

DRS is not convinced that the costs and effort of establishing separate price controls for Network Rail’s operating routes will be justified. DRS is not sure how the routes would address the necessary balance of route and national required outputs, costs and enhancements.

## Chapter 6 and annex C

### *Outputs*

Q6 Is the current approach to defining obligations in terms of outputs the best approach? What outputs should be defined? Should there be a move to more use of outcome based obligations? Would another approach be appropriate such as specifying inputs or intermediate measures?

In principle, this is the best approach.

Q7 What are your views on how we should compile and present 'scorecards' of Network Rail's performance in CP5?

Rail Freight Operators Association ("RFOA"), has suggested a framework to Network Rail of metrics for CP5 that covers performance, network availability, capacity, journey times, network capability and seeks to address this balance for rail freight. This framework would contain a mix of regulatory enforceable metrics and bilateral plans that would be commercially confidential between the parties. RFOA is in discussion with Network Rail to develop a strategy for taking this framework forward.

Q8 Should we make more use of 'whole system' outputs over which Network Rail does not have full control, or focus on more narrowly defined outputs which the company is fully responsible for?

In principle, for rail freight, DRS believes that ORR should focus on more narrowly defined outputs for which Network Rail is fully responsible and leave wider "whole system" rail freight outputs to the market. Unlike the passenger franchises, rail freight is a private sector activity with strong competition in which end-customers have choice both of mode and of rail freight operator. End customers can 'vote with their feet' if their rail freight operator or the wider rail freight industry does not deliver the service they require

Q9 How should output obligations be defined in the context of devolved Network Rail routes with separate price controls?

The rail freight market in the UK is a nationwide market in which freight flows are driven by market needs which have no relationship to Network Rail route boundaries. It is essential for rail freight that it is able to compete with other transportation industries whose usage of the road network is free at the point of use and not subject to route or other operational boundaries. This means that rail freight needs to retain an access regime that is similar, if not identical, to the one in place. DRS is not convinced there is any case for changing the PR08 establishment of separate price controls for England & Wales and Scotland (reflecting the different funding regimes) and maintaining GB wide access charging for rail freight.

Q10 How should the balance between the number of output obligations and their individual significance be struck?

DRS supports a relatively small number of specific output obligations with respect to rail freight and believes that the structure and size of the PR08 output obligations

were broadly fit for purpose. As set out in paragraph 13, RFOA is already in discussion with Network Rail about some potential augmentation of these for CP5.

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Q11 Should Network Rail's output obligations include a specific safety requirement, different from its legal obligations?

DRS are aware that Network Rail already has enforceable legal obligations (including in its network licence) that incentivise it to operate its network safely and can see no requirement for anything additional.

Chapter 6 and annex D

### *Incentives*

Q12 Do you have views on how the effectiveness of the existing financial

incentives can be improved?

There is a current suite of financial incentives including Schedule 4 (Possessions Regime), Schedule 8 (Performance Regime), CP4 Efficiency Benefit Sharing Mechanism and the Volume Incentive. DRS would expect these to be reviewed as part of the PR13 process, although it was clear at the recent ORR Schedule 8 industry workshop that there was little appetite from the industry for fundamental changes to the current freight Schedule 8 regime in particular, which was only introduced at the start of CP4.

Q13 Do you have views on how the effectiveness of Network Rail's incentives to make best use of capacity could be improved?

DRS is supportive of making best use of capacity, but is not yet convinced that major changes are needed to existing mechanisms.

Q14 Do you agree that we should include a regional efficiency benefit sharing mechanism calculated at the Network Rail route level? Are there further issues about how a regional efficiency benefit sharing mechanism should be introduced which you want to highlight?

This is a complex area and DRS has serious concerns at the potential impacts on secondary users. DRS would like to see further information provided that demonstrates there is benefit to all users.

Q15 What are your views on exposing franchised passenger train operators to changes in Network Rail's costs at a periodic review?

No comment.

Q16 Do you believe that Network Rail should share in train operator revenue and/or costs? Are there further issues about introducing a revenue/cost sharing mechanism which you would highlight?

DRS does not believe that Network Rail sharing in freight operator revenue/cost would be appropriate as:

- Rail freight is a fully private sector, highly competitive activity.

- The financial position of freight operators is such that they cannot afford it (the McNulty Review confirmed the thin nature of freight operator margins).
- End customers will not pay anything additional to cover this.

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- Network Rail activity can be only a minor element of the supply chain and there is little logic in Network Rail sharing in revenue or benefit from non-Network activities.
- Any regime would have to be even-handed between freight operators to avoid any potential discrimination. Network Rail have added a new standard condition in freight property leases to the effect that if in the opinion of Network Rail the facility is not being used enough by the incumbent freight company the lease can be terminated or transferred to another freight company by 3 months notice.

Q17 We would welcome your views on possible bespoke arrangements for enhancement efficiency benefit sharing and whether there is a need for additional measures to increase the contestability of expenditure?

No comment.

Q18 Are there further new incentives which you believe should be introduced and what would the benefits be?

No comment.

Q19 Are there other interactions between incentives (and the wider regulatory framework) which we need to take into account?

No comment

## Chapter 6 and annex E

### *Financial framework*

Q20 What are your views on the duration of the control period?

There is a case for a longer duration, especially for fully-commercial activities such as rail freight and to underpin investments in rolling stock and terminals. Longer term settlements on the structure and level of access charges also help to provide long term certainty and stability for operators and customers and also align with the move to longer franchises.

Q21 Do you think that we should retain the single till approach rather than moving to a dual till approach?

Yes. There does not appear to be any benefit from adding further bureaucracy

Q22 Do you think that our overall approach to risk and uncertainty in PR08 was appropriate and are there any improvements that could be made for PR13?

DRS accepts that it is better for ORR to give Network Rail a relative amount of freedom to decide how to achieve the range of outputs, trajectories and enablers that will be set for them as part of PR13.

Q23 Network Rail faces a number of risks. At this stage, do you have any views on how general inflation risk and input price risk should be addressed?

This is the situation for all businesses and up to each business to manage.

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Q24 We plan to retain the same high-level approach to amortisation in CP5 that we introduced in CP4. What are your views?

No comment.

## **Chapter 6 and annex F**

### *Structure of charges*

Q25 Do you consider that our charging objectives remain appropriate?

Yes.

Q26 What are your views on the geographical disaggregation of variable usage charges?

DRS considers that the freight variable usage charges should remain on a national basis to avoid further complexity.

Q27 What are your views on introducing a charge levied to reflect network scarcity?

DRS opposes the introduction of a scarcity charge

Q28 What are your views on a reservation charge (assuming it would be set to be financially neutral for freight operators)?

DRS does not believe that increasing the cost of railway operation for little or no benefit is appropriate.

Q29 Should passenger open access operators pay charges that exceed variable costs. How should charges be calculated?

No comment.

Q30 What are your views on the proposals to improve incentives to reduce traction electricity consumption?

No comment.

Q31 Should we put a cap on certain freight charges in advance of our determination and should these be linked to other changes?

ORR should consider retaining freight charges at their current levels (subject to inflationary increases less the agreed efficiency factor set for Network Rail for CP5) as well as retaining the current national structure of freight charges without introducing more complexity. The proportion of Network Rail's income that is represented by freight charges is comparatively small so a doubling of freight charges will make very little difference to Network Rail's overall income but would almost certainly put rail freight operators out of business.

Given the express needs of the rail freight industry for stability and certainty, the placing of a cap on certain freight charges well in advance of ORR's determination is the right action to take and should be viewed as a standalone proposal without conditions. The leases of freight properties granted by Network Rail at commercial

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rentals no longer include termination clauses in favour of freight companies. It is essential in such circumstances that there is long term stability.

Q32 Do you have views on the interactions between these possible changes and when they should be implemented – for example whether some changes should only be introduced after other changes have 'bedded in'?

No comment.

End of Questions.

Please let me know if you require any further information.

Yours sincerely

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