EAST MIDLANDS TRAINS

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Ref: ORR

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Dear Richard,

<u>Periodic Review 2013 – First Consultation – May 2011</u>

Many thanks for the opportunity to respond to the recent consultation document on the Periodic Review – First Consultation – May 2011.

EMT recognises that developing a package of proposed improvements for inclusion within the Periodic Review 13 is going to be a challenging task as the industry enters into a period of change as a result of Network Rail devolution and the proposed outputs of the McNulty report. Understanding the dynamics of these two different workstreams and converting some of these thought processes into PR13 improvements is going to be difficult, but it does provide a great opportunity for moving the industry forward and enabling it to prosper over the coming years.

The comments below are based on the consultation document and the recent ORR workshop that EMT attended in Manchester. This response does not seek to address all the individual questions raised in the document but tries to cover a number of themes that align to the key challenges contained within the introductory section of the consultation.

Efficiency and reducing costs

Clearly, the industry should be looking at reducing its costs base and some of this is currently taking place but is mainly done in isolation i.e. by Network Rail and / or by TOC. The approach likely to yield the greatest benefit is by closely aligning some of the financial aspects of the NR/TOC operation wherever possible, whilst still protecting the interest of customers and reducing the impact on tax payers.

In order to maximise the effect and produce greater efficiencies there needs to be a clearer understanding of the costs of operating the railway from a NR / TOC point of view. In order for this to happen there needs to be an improving picture with regards to the visibility of financial data, this may happen in part as a result of Network Rail's devolution strategy but further work needs to be done to understand industry costs going forward.

Managing risks and rewards

The movement of Network Rail towards devolution and working more closely with operators at a route level should provide clearer visibility of the financial aspects in running the railway and therefore greater scope for reducing costs. It should also provide an opportunity to look at aligning incentives for Network Rail and TOCs to provide improved businesses cases to deliver improvements to the end customer.

The development of joint industry business cases (NR/TOC) would ensure a tighter control of management costs whilst trying to maximise the benefit for both parties. This would help prevent some of the perverse incentives that happen today. An example of this is the EMT staff at Market Harborough who Network Rail trained to respond to bridge incidents. We incur the costs when incidents apply but Network Rail saves significant amounts of Schedule 8 payments. Whilst the above is the right thing to do from a customer's perspective, more work needs to be done to improve the incentives.

There are some further examples of joint business cases being developed, for example the joint EMT/NR agreement on Manton route learning. This is clearly the right thing to do from a TOC/NR point of view. However, it has taken so long to develop a bespoke agreement there is little incentive to developing this on a more widespread basis especially with relatively short franchises.

The development of joint industry business cases can create an incentive to work together for the overall industry benefit but does involve some element of risk management. Sharing the benefit and managing the risk at a route level is important to the success of both businesses. EMT are supportive of this approach but are not supportive of the 'risk sharing' approach that would allow Network Rail to use operating surplus generated in one route area to support deficiencies in another route. This does not create the right incentives at a NR/TOC route level.

Compensation regimes

Both the Schedule 4 and Schedule 8 regimes have been around for some time and whilst not perfect, they do provide a consistent approach to incentivising and compensating TOCs. EMT would like to see Schedule 4 and Schedule 8 rates to be set for the full franchise period with any variation at Control Period change to be accounted for between ORR and DfT. This comes from our experience of dealing with the CP4 changes and how long it has taken to try and agree the numbers.

With regard to Schedule 8 there is clearly a need to have a regime that influences performance that reflects on-the-day and emerging issues and delivers a focus on the final end user, the customer. The regime needs to bring both Network Rail and TOCs closer together to deliver improved performance through joint incentives. So if the current Schedule 8 is fit for purpose, it probably is, but it may just need some care and attention rather than a major overhaul. There probably needs to be a sense check of the payment rates and benchmarks, a look at how Schedule 8 work on new longer-term franchises and an assessment of what to do with the payment rates for joint ventures within new and existing franchises. With the potential for closer working between NR/TOCs, is there a need to have a localised compensation mechanism on some branch lines which reflects the impact on customer volumes?

Whilst the Schedule 8 regime provides an incentive to both TOCs and Network Rail to improve operational performance by paying financial compensation where performance is better than / worse than benchmark, the payment rates on some of the rural lines are currently too low which lead to a real disbenefit to the TOC and very little financial incentive to Network Rail. We have seen a reduction in performance on our Derby - Crewe services for a variety of reasons, but because the financial incentive to Network Rail is low, it does not incentivise Network Rail to commit to the prioritisation on delivering improvements for this particular area.

Although the Schedule 8 regime encourages both TOCs and Network Rail to deliver and maintain a high level of performance, the payment rates should be reviewed to ensure that they as a minimum cover the marginal revenue loss as well as the cost of rail replacement buses so that TOCs are not at a disadvantage when providing rail replacement buses to cover for cancelled trains. When trains are cancelled, rail replacement buses have to be arranged for moving passengers so that they can continue with their journeys, in particular on the branch lines where no alternative rail services are available. The financial payment of the performance regime only covers the marginal revenue loss but never reflects the costs of rail replacement buses that TOCs incur. This needs to be reviewed and TOCs and Network Rail can work together in developing a better compensation framework for the rural network.

The current Schedule 4 / 8 regimes have taken into consideration the impact of cancellations or part cancellations on demand and revenue to train operators. However, this is not necessarily truly reflective of the disruption to customers as the number of stations to be included in the calculation is delimited and is subject to the scale of up to 1. On this basis, TOCs will only allocate major stations for each of the route sections to be under the

Monitoring Points. As a result of this, at times when Network Rail has taken disruptive possessions TOCs are not compensated for certain cancellations/missed monitoring points. This should be re-examined but would benefit from some refinement such as an increase in the number of monitoring points in Schedule 4 / 8 to reflect the impact of cancellations and the inconvenience caused to customers.

The approach of indexation by RPI to the Schedule 4 / 8 rates is intended to provide TOCs with an increase in the payment rates annually against the general inflation risk. However, it is questionable whether the annual increase in the payment rates is by the right amount reflecting the increase in revenue for each of the sectors. The current contracts provide for them to increase by RPI, whereas industry revenue is currently increasing at a rate between RPI + 4% and RPI + 6% each year, even before the introduction of RPI + 3% on regulated fares. As payment rates are based on historical data of the MRE at least a year before they are introduced, this implies that TOCs are probably undercompensated even at the start of the Control Period, and certainly are at the end of the Control Period.

As far as Schedule 4 is concerned, this was examined in detail for PR08 and again probably doesn’t need an overhaul but just a sense check to make sure it has been delivering the way it was expected to. I am not too sure that for the normal type of possessions it provides an adequate incentive on Network Rail to reduce possession hours. The incentive to reduce possession hours is mainly down to reducing the costs of the physical work, materials, manpower, equipment, better technology (like modular equipment) rather that the Schedule payment to TOCs. This is obviously not the case for major possessions and blockades when clearly Schedule 4 payments to TOCs can be an issue.

As the level of compensation through the Schedule 4 regime decreases through CP4, it is worth sense checking whether the Access Charge Supplement which is forecast for the full 5 year period is appropriate and whether it is worth having a review mechanism within the Control Period.

The Schedule 4 regime compensates TOCs for where Network Rail takes engineering possessions. The final payment is determined by a formulaic calculation based on the MRE payment rates of the service groups and a number of factors. One of the variables known as the Notification Factor provides a financial incentive for Network Rail to upload retimings of amended services by T-12 (Informed Traveller target date) in order to avoid the highest notification factor i.e. higher payments if the T-12 target is not met. However, once Network Rail failed to meet the target date, there is no incentive on them to upload retimings from the Informed Traveller due date. Hence, this particular element of Schedule 4 needs to be amended and ideally the highest notification factor should be adjusted to 1 for T-6 prior to the corresponding day to give them a higher incentive to upload altered services onto TPS by then.

Under the Schedule 4 possessions regime, TOCs are only compensated for amended services which are uploaded onto TPS. If the restriction of use has subsequently been cancelled after the amended services being uploaded, TOCs can request for the amended timetable to be reinstated back to the First Working timetable (FWT). However, there will be no compensation for TOCs despite a considerable amount of resources and management time being spent on the development and the implementation of the amended timetable.

Therefore, this has no disincentive on Network Rail to consider the impact of their decision to cancel a possession at short notice on TOCs resources but at TOCs expense. This needs to be reviewed and we welcome the ORR's view on this situation.

The other point worth considering is the costs on TOC resources if it was felt that there was a need to change the compensation regimes, this can sometimes be overlooked when looking at the bigger picture.

Track Charges

Total track charges represent 27% of Network Rail's overall income. The fixed charge accounts for 56% of the charges income within CP4 and the variable and the capacity charge account for 22% of the income.

EMT believes that there should be a review of some aspects of the track charging regime focusing on the following:

- The provision of a geographical approach to the variable charge would assist those operators who run small diesel units on branch lines, where traffic volumes are relatively low and revenue generation is limited.

- Charges that would assist in the delivery of incentives to maximise capacity through constrained parts of the network and would increase the focus on trying to accommodate additional demand.

- A review of the charges an open access passenger operator should pay and how this would affect competition between franchised operators and open access operators.

There are a number of enhancement schemes which are funded in CP4 but which Network Rail is unlikely to be able to complete in CP4 e.g. GN/GE Joint Line Scheme. Would the unspent funding for the delayed implementation of CP4 schemes be rolled forward so that Network Rail can complete these schemes in CP5?

I hope this input is useful and we look forward to engagement on this matter as the review is undertaken

Yours sincerely,

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