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Copy to:  
EMT Exec  
Sam Gibbins, SSWT

Ref: ORR\PR13\Implementation

4<sup>th</sup> September 2013

Dear Alice,

### **Periodic Review 2013 – Consultation on implementing PR13**

Many thanks for the opportunity to comment on the recent consultation document on specific changes ORR proposes to make to the track access agreement to implement the 2013 periodic review (PR13).

This response is made on behalf of East Midlands Trains (EMT) and Stagecoach South Western Trains (SSWT). Our comments on the proposed amendments are based on the mark-up versions of Schedules 4, 7 and 8 of the track access agreement. EMT and SSWT have responded to ORR's draft determination for the wider consultation issues and regulatory economics separately from this consultation.

### **Indexation**

- We have concerns with the proposed amendments to the indexation methodology to annually uplift Network Rail's access charges and Schedules 4 and 8 payment rates. The current approach of indexation has been used since privatization and it aligns with other arrangements across the industry. It is simple and gives certainty in terms of budget preparation, outturn forecasting and the production of actual results. Moving to an annual average RPI and the addition of a true-up mechanism will lead to uncertainty in TOC's accounting and budgeting of costs could be materially incorrect. With the proposed mechanism, there is no added value to the implementation of PR13 or to the track access contract, but added complexity to the process of monitoring and managing access charges during CP5.

- We do not agree with ORR that its proposed amendments to the indexation methodology will have no significant financial implications on franchisees. Franchised operators would not be protected from the financial impact of this change through the financial adjustment mechanism in Schedule 9 of their franchise agreement. The proposed change would therefore transfer the risk of variances in general inflation from Network Rail to TOCs. This will lead to volatility in TOC accounts due to potential large retrospective adjustments during a financial year, which will cause problems for TOC owning groups reporting to the City. The change could also potentially lead to a risk premia being factored into bids, thus reducing the value of future franchises to the taxpayer, and will cause issues at franchise handover. Therefore, we do not support this proposal as it simply passes the risk to franchised operators and potential bidders.
- If ORR is intending to change the indexation methodology, we would prefer the RPI uplift anniversary to be changed from November to January. This would provide a better alignment between inflation factors applied to Network Rail charges and the Premia uplift contained in the Franchise Agreement.

#### **Schedule 4**

- Paragraph 4.2, the payment rate per EBM is £9.19. This was the rate for the 'rest of the network' at the start of CP4. Can ORR confirm what rates will be applied for London & South East and the rest of the network from 1<sup>st</sup> April 2014?

ORR's decision as in the draft determination to adjust bus compensation rates down by 7.9% for London & South East and 8.9% for the rest of the country does not take into account the fact that the Bus Services Operators Grant for rail replacement buses is being withdrawn from rail replacement services from October 2013, which will result in the cost of replacement bus provision rising significantly for TOCs from CP5. ORR must revisit this proposal in the light of this development

- Paragraph 4.2, the addition of the 'no bus replacement' category needs further explanation. This will lead to differing interpretations of this added category between TOCs and Network Rail which can make claiming or the validation of payments more contentious and create unnecessary disputes. Further clarification on this provision is needed.
- Whenever changes to the EBM rates are proposed, ORR must also consider the train mileage change (TMC) rate as they are not mutually exclusive in the bus cost formula under paragraph 4.2. The net payment is the sum / balance between EMB (+) compensation and TMC (+/-) compensation. Changing one element of the formula without considering the balance of both could leave TOCs disadvantaged financially. This would not incentivise TOCs to work with Network Rail to deliver cost efficiencies. The formula (EBM + TMC) is devised to broadly reflect the circumstances surrounding most standard possessions regardless of the scale of the possession and other circumstances. With the addition of the proposed 'no bus replacement' category, it may create further debates of 'simplicity' of the standardised formula of cost compensation against the 'complexity' of possessions and major events.

#### **Schedule 8**

- SSWT withdrew from the Schedule 8 passenger's charter regime during CP4. This was on the understanding that ORR was willing to publish an Access Charge Supplement (ACS) value for SWT in its CP5 determination as if SSWT had remained in the regime. ORR has since

determined that it will remove this element of Schedule 8 and no longer calculate ACS values. Failure of ORR to do this will have a significant adverse financial impact on SSWT (£ millions) as the regulatory change mechanism in Schedule 9 of the SSWT franchise requires a value for CP5 to be published to calculate the franchise premia adjustment. ORR must therefore publish a Schedule 8 ACS value for SSWT in its final CP5 determination. As an alternative to calculating a new value for CP5 we propose ORR publishing the same value as for CP4.

If you would like to discuss this in further detail, please feel free to contact me.

Yours sincerely,

Lanita Masi  
Track Access & Network Change Manager  
East Midlands Trains