

Consultation on Schedules 4 and 8 Possessions and Performance Regimes

Centro Response

Background

1. Centro welcomes the opportunity to respond to the consultation regarding the Schedule 4 and 8 regimes. Centro is currently developing proposals for the creation of a West Midlands area local rail franchise from the expiry of the current London Midland franchise in 2015, and the effective operation of the industry performance regimes is of key importance to us.
2. Centro is considering taking revenue risk as part of a devolved franchise structure and this would expose Centro directly to the money flows arising from the Schedule 4 and 8 regimes. This also gives Centro the opportunity to consider the appropriateness of the regimes in a West Midlands context and will allow us to develop the appropriate franchise incentive regimes with a new local rail operator.

Schedule 4 and 8, Performance and Industry Costs

3. Centro recognises that the Schedule 4 and 8 regimes date back to privatisation, and therefore there is a lot of industry experience in their operation. The improvement in industry performance data and monitoring arrangements necessary for their operation has underpinned the improvements in train service performance that have occurred over recent years. However, it is disappointing that the consultation document does not explicitly discuss the costs associated with operating the regimes, for example the staff required to manage the delay attribution process.
4. Centro notes that there is little evidence that Schedule 8 is a key driver of behaviour relating to train performance, and that there are other targets and incentives which are far more powerful in driving good performance. This is important as it means that the primary function of Schedule 8 is in relation to providing compensation for long-term revenue loss (or gain) arising from a certain level of performance. In the West Midlands, it is Centro which is looking to hold this long-term revenue interest in the local rail services, and Centro which will need to balance future revenues and costs of service provision on behalf of the taxpayer.
5. Delivering high performance levels is very important to passengers, however Centro recognises that delivering consistently good performance levels on a congested network with multiple passenger and freight operators is challenging. There are clear trade-offs which will have to be made relating to service

frequencies and service performance, although the exact relationship is complex depending on individual circumstances. If Network Rail were to be incentivised on the basis of Schedule 8 alone, then this is likely to lead to longer distance services generating most revenue (and thus Schedule 8 payments) being prioritised over the local services which, though carrying many passengers and generating significant wider economic benefits, generate less revenue. It is therefore important that these behavioural impacts from Schedule 8 are recognised and that other targets exist which incentivise Network Rail to focus on delivering high quality local services.

6. Centro is also concerned that the money flows arising from the Schedule 4 and 8 regimes drive a lot of industry costs – for example Capacity Charge and cost of undertaking disruptive renewals and enhancements. It is therefore important that the industry cost drivers arising from the Schedule 4 and 8 regimes are properly understood before a full analysis of payment rates can be undertaken.
7. It would also be helpful to understand the role of Schedule 4 and 8 costs in supporting the development of business cases for investment projects to improve performance.

Schedule 8 and Capacity Charge

8. Centro in particular is very concerned about the Capacity Charge, which has been the subject of previous consultation responses. The Capacity Charge is paid by train operators to Network Rail, in order to allow Network Rail to then pay it back to TOCs through the Schedule 8 regime to compensate for the element of Schedule 8 costs driven by network congestion. This process is very similar to the Access Charge Supplement (ACS) process which occurs in the Schedule 4 regime. Centro was very surprised therefore that the Consultation Document made no mention of the fact that the Capacity Charge effectively funds part of the Schedule 8 regime and did not include Capacity Charge income in the overall financial analysis of the money flows for Schedule 4 and 8.
9. The Capacity Charge represents a real, unavoidable cost to TOCs, which is similar in scale to Variable Track Access Charge, and in CP5 is expected to earn Network Rail around £175 Million per annum. For every train mile which operates, Capacity Charge can represent a reasonably significant proportion of the total cost, which is then passed back to industry funders such as Centro.
10. If Schedule 8 payment rates can be reduced, then this would lead to an immediate and real cut in industry costs through a reduction in Capacity Charge. Similarly, if there was a mechanism for recalibrating Schedule 8 to effectively neutralise or re-base the congestion impact of delays at the start of CP5, then £175 million of annual costs to the industry could be reduced.

11. Centro would have welcomed a more in depth discussion of these issues within the Consultation Document as Centro believes there is a real opportunity to save industry costs through reform of Schedule 8.

Impact on Franchise Bids and Other Costs

12. Centro notes that there was some limited analysis undertaken on the potential impact on franchise bids through a reduction of payment rates, which concluded that if Schedule 8 didn't cover the full long-run revenue impacts of poor (or good!) performance then bidders would add a risk premium into bids. With Centro looking at taking revenue risk for a West Midlands franchise, and the Brown review recommending that the DfT reconsiders its approach to revenue risk on certain franchises, the impact on franchise bids is likely to be even less clear than the SDG analysis suggested. As a funder, Centro would like the ability to make an informed decision on the impact that reduced Schedule 8 payment rates have on Capacity Charge (and other costs), in order to allow an effective trade-off to be made on revenue against cost. At present the information is not available to allow such an analysis to be undertaken. It is notable that TOCs are generally protected from the impact of these changes through the provisions in their franchise agreements and they have little direct financial incentive to challenge the underlying financial structure behind Schedule 8 and Capacity Charge.

13. Centro is therefore surprised that the ORR and the Rail Delivery Group do not seem to have challenged the industry costs driven by the Schedule 4 and 8 regimes more fully as part of the PR13 process. It is notable that the Brown review recommends that a full review of the track access charging regime is undertaken in advance of CP6.

14. During CP5 Centro believes that the Schedule 8 payment rates need to be pitched at as low a level as possible in order to reduce industry costs while providing short-term revenue protection for operators from poor performance delivered by Network Rail (and other operators).

Schedule 4 Regime

15. The Schedule 4 Possessions Regime also drives costs for the industry, and in particular impacts on the cost of undertaking maintenance, renewal and enhancement work on the network. The process of paying an Access Charge Supplement (ACS) to Network Rail allows NR to then pay Schedule 4 payments back to TOCs based on the number of possessions taken. Centro would like to understand the level of ACS which might be payable in relation to a devolved West Midlands franchise, along with a view as to likely levels of disruption in CP5, in order to assess whether a standard Schedule 4 regime is appropriate for a devolved franchise. We note, for example, that there could be some significant

levels of disruption associated with major renewals projects such as the Birmingham New Street area signalling renewal scheme.

16. As part of developing a devolved franchise, Centro might take the view that there are different ways of delivering replacement travel arrangements during disruption, rather than requiring an operator to have to rigorously arrange replacement buses which directly mirror rail lines. As an *Integrated* Transport Authority, Centro might take the view that it is better placed to organise replacement services directly, or work with bus operators to allow rail passengers to travel on parallel bus routes. We would like to explore all these options and consider negotiating a bespoke Schedule 4 regime with Network Rail which could allow the ACS to be spent to the greater benefit of passengers rather than just to provide financial compensation back to Centro. Centro welcomes the fact that Network Rail has indicated its willingness to explore bespoke Schedule 4 arrangements.

Conclusions

17. Centro is seeking to become funder and specifier of local rail services in the West Midlands, and therefore the workings of the Schedule 4 and 8 regimes could in future have direct financial implications for us. We would like to understand more fully the potential impacts before being able to comment more deeply, however, as outlined above Centro believes that there are a number of issues which need to be addressed and we are concerned that the money flows are not fully transparent in the context of overall industry costs and revenues. It is also important to demonstrate that the costs of operating the regime are proportionate to the benefits it delivers.

18. The planning assumption for CP5 is that Schedule 8 is financially neutral (with a lack of clarity over how Capacity Charge impacts on this), assuming a performance target which delivers a flattening out of overall punctuality levels across the network. As Schedule 8 is primarily designed as a compensation rather than an incentive regime, Centro would like to understand further what the base level of revenue for a potential devolved West Midlands franchise is assumed to be at the proposed performance levels for CP5 and how variations in performance would change that assumed revenue base.

19. Centro is not clear how setting arbitrary performance targets at the start of a Control Period can translate into differences in the revenue earned by TOCs for the same absolute level of performance. In effect a 90% level of performance one day could result rewards being paid to Network Rail, while the next it earns the TOC compensation. As a TOC can offset many of these swings in money flows through the provisions in franchise agreements, Centro is concerned that they (and NR) may not be as interested in pursuing the best industry approach.

Centro, however, is very concerned that the best solution is reached in the interests of both taxpayers and passengers.

20. Our responses to the individual consultation questions are listed below.

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Centro

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Specific Consultation Questions

Transparency of possession management

1. What are your views on whether or not passengers and freight customers adequately consulted on the planning of possessions? What activity currently takes place?

Centro believes that it should be consulted fully on future possession strategy. At present Centro's engagement is only in relation to specific renewal and enhancement projects in which we have an interest where we are asked to comment on the general approach to possession strategy for a project. With Centro potentially having a more direct interest in a devolved rail franchise (for example taking revenue risk and possible arranging replacement transport), we would expect a higher level of detailed engagement with Network Rail.

2. What are your views on whether we should encourage Network Rail to consult with passengers and freight customers in the planning of its possessions?

Centro would look to jointly consult alongside Network Rail with passengers and stakeholders if required on any particular issue relating to possession strategy for a new West Midlands franchise.

3. If we were to encourage Network Rail to consult with passengers and freight customers in the planning of its possessions, do you have any suggestions on how we might go about doing this, for example, how such an obligation would be phrased and monitored?

Centro would look to develop a "Partnership Agreement" with Network Rail covering this among other issues.

Schedules 4 and 8 overall

4. Do you agree with the SDG research findings and conclusions on whether to set Schedule 4 and 8 payment rates so they do not compensate train operators in full for the impact of service disruption due to Network Rail and other train operators? If not, please tell us why?

Centro believes the SDG research is interesting, but doesn't recognise other contractual models as indicated in the Brown Review. The Brown review highlights that funders should not look to offload all aspects of risk onto bidders, and suggests that future franchise competitions could be based on different models. It should therefore be an issue for the funder and specifier of an individual franchise to consider whether the payment rates cover the full revenue loss in the context of the overall commercial framework for a franchise. As such Centro does not agree that SDG's conclusions are reliable in relation to the financial impacts on future franchise bids.

5. Do you agree that we should continue to set Schedule 4 and 8 payment rates so that they compensate train operators for the full financial impact of service disruption due to Network Rail and other operators, where we do so currently? If not, please tell us why?

Centro believes that reducing Schedule 4 and 8 rates should be a priority in order to reduce wider industry costs. Long-term revenue risk sits with industry funders rather than TOCs,

and the financial compensation rates need to be considered in the wider context of cost and revenues flowing in the industry. For a locally specified franchise where the funder takes revenue risk, having reduced costs and charges could be more important than being fully compensated (theoretically) for revenue loss.

6. Are you of the view that there are other steps we could take to encourage train operators to have a stronger influence on the behaviours of Network Rail, in addition to those we are doing already?

Centro notes the many steps being taken to encourage TOCs to influence Network Rail, however Centro is concerned whether TOCs are generally sufficiently resourced to properly challenge NR over issues of concern. In the West Midlands, Centro will be considering the relationship with NR as we develop a devolved local franchise proposition, and to what extent Centro and the TOC will work together to drive NR performance. Having local accountability for performance with a "West Midlands Rail Board" type arrangement will allow NR to be more publicly accountable to local stakeholders than is currently the case.

7. Do you agree with our proposal not to introduce the Joint Restrictions of Use concept into Schedule 4 of template track access contracts? If not, please tell us why?

No comment

8. To what extent (if at all) do you think the current contractual wording of Schedules 4 and 8 is acting as a barrier to Network Rail and train operators minimising disruption to passengers and freight customers during extreme disruption, e.g. during severe weather? If you are of the view that it does act as a barrier, we welcome any specific proposals on how it can be improved.

It is important that the industry is incentivised to work collaboratively in the best interests of passengers in the event of severe disruption, and this requires TOCs and Network Rail to work together effectively. With a devolved local franchise, Centro would expect to be fully involved in any debates relating to extreme disruption and will be considering how the drafting of the franchise or train service contract would work in this respect.

Schedule 4 passenger possessions regime

9. Do you agree that the Access Charge Supplement (ACS) should be calculated using Network Rail's revised route based Schedule 4 costs estimation methodology? If not, please tell us why?

As discussed, Centro would like to look at the options for developing a bespoke Schedule 4 regime for the West Midlands. Any agreed methodology for calculating ACS will need to produce credible results for a separately defined West Midlands network which operates across two NR routes (LNW and GW).

10. Do you consider there is further value in Network Rail achieving greater disaggregation in the methodology of the ACS calculation and if so do you have any suggestions how this might be achieved?

The ACS calculation depends on having a good basis for estimating levels of disruptive possessions across a five year period. It is important that this picks up known major renewal and enhancement works (e.g. Birmingham New St area resignalling), however it is unrealistic for the full level of route closures to be known. Centro is also keen that NR takes advantage of upgrade projects (such as the New St resignalling) to implement measures which provide enhanced access to the network (such as bi-directional signalling) and which therefore allow routes to open for longer.

11. Do you agree that we should update the estimated bus mile payment rate based on actual amounts paid during CP4, rather than simply uplift the current rates by cost inflation? If not, please tell us why?

It is important that TOCs are incentivised to negotiate as good a deal as possible with bus operators for the provision of replacement bus services, and NR (and ultimately the taxpayer) should not be picking up the bill where costs are not value for money. In the West Midlands Centro will investigate whether it might be better placed to organise planned replacement bus services (while recognising the need for TOCs to cover emergencies).

12. Do you agree that we should continue with the current formula for calculating revenue loss compensation for cancelled train services when there are replacement buses? If not, do you have any suggestions for how we could improve this aspect of Schedule 4?

As mentioned above, Centro would like to investigate the option of negotiating a bespoke Schedule 4 regime for the West Midlands which recognises the fact that underlying local rail demand is already based on a certain level of planned disruption and therefore compensation is probably only relevant where there is exceptional instances of disruption.

13. Do you consider the way in which the revenue loss formula compensates franchised passenger operators when using replacement buses encourages passenger train operators to run too many buses (rather than trying to run train services using diverted route, for example)? If so, please explain why you think this is the case?

Centro believes that TOCs do not generally try and run too many replacement buses, noting that there are few diversionary route opportunities on local rail lines.

14. Do you agree that we should extend the scope of the protection provided by paragraph 2.9 of Schedule 4 to enable the recovery of direct costs related to amended or cancelled Type 1 possessions? If not, please tell us why?

Where practicable, Network Rail should pick up the costs associated with late changes to possessions to ensure that good planning is embedded in its processes.

15. If so, do you agree the threshold for triggering a claim should be £5,000 per possession? If not, please tell us why?

£5,000 seems reasonable

16. Do you agree that we should update the new working timetable notification factor to reflect changes to delay multiplier values in the Passenger Demand Forecasting Handbook (PDFH)? If not, please tell us why?

Values which most accurately reflect service groups should be used, as long as the results deliver credible payment rates.

17. Do you have any further proposals for changes to notification discount thresholds and factors? If so, please explain your reasoning?

No

18. Do you agree that we should keep the Sustained Planned Disruption (SPD) revenue loss threshold the same and uprate the cost compensation by inflation (RPI)? If not, please tell us why?

No comment

19. Are you of the view that the provisions for claiming compensation under the SPD mechanism would benefit from clarification? If yes, please highlight which areas should be clarified?

No comment

Schedule 4 freight possessions regime

20. Do you consider the current regime appropriately compensates freight operators for losses resulting from severe disruption caused by possessions? If not, what do you consider the level of compensation should be based on?

No comment

21. Do you consider that the current regime appropriately incentivises Network Rail to reduce the amount of disruption faced by freight operators due to possessions? If not, how do you think incentive effects can be strengthened?

Centro has no evidence to suggest NR isn't incentivised to minimise disruption for freight operators

22. If Schedule 4 compensation payment rates for freight operators were increased, should this be funded by government? If so, please explain why you think this should be the case? If not, please tell us why?

Centro doesn't consider there is a compelling case for the taxpayer to fund additional compensation, although the impact on economically important freight flows would need to be understood.

Schedule 8 passenger performance regime

23. Do you agree that we should keep the current Schedule 8 contractual wording in relation to what train operators can claim for under the SPP arrangements? If you do not agree, do you have any proposals for alternative wording?

No comment – although it is noted that there has been very few claims and TOCs highlight difficulties in agreeing what constitutes SPP (e.g. Thameslink project disruption)

24. Should we continue with the SPP threshold set at 10% or increase it? If not, please tell us why?

No comment

25. If we increase the SPP threshold, what are your views on the level we should set it at?

No comment

26. Do you agree that we should leave timings of Schedule 8 payments unchanged, with payments due within 35 days following the end of each four-week accounting period? If not, please tell us why?

Centro agrees that leaving the timings of the Schedule 8 payments unchanged is appropriate.

27. Do you agree that we should keep the circumstances in which Network Rail and train operators can propose amendments to Schedule 8, appendix 1 via paragraph 17 the same? If not, please tell us why?

Centro is unable to comment on the detail, however it is important that the ability to propose changes to Schedule 8 is maintained following a material change in circumstances. Centro is unclear, for example, whether a major resignalling project which delivered improved network capability and subsequent step change in performance would qualify as a change.

28. Are there any specific areas of paragraph 17 where you are of the view the drafting needs to be made clearer? If not, please tell us why?

No comment

29. Are you content for us to remove the passenger charter element of the Schedule 8 performance regime? If not, please could you tell us why and whether you would like us to take any alternative course of action?

Centro is content that the Passenger Charter element of the Schedule 8 regime is removed. However, Centro will be considering how a passenger charter regime could work for devolved West Midlands franchise and in due course may wish to engage with Network Rail regarding a shared approach to delivering a passenger compensation regime.

30. Do you agree that we should not change the way train operator cancellations to their own trains are treated under Schedule 8? If not, please tell us why?

Centro agrees that the treatment of TOC caused cancellations under Schedule 8 is not sufficiently material to warrant changing the PEARS system. However, this is on the assumption that significant issues which cause TOC cancellations (e.g. industrial action, severe staff shortages or endemic fleet reliability issues) are likely to result in the implementation of emergency timetables rather than impacting on Schedule 8 directly.

Schedule 8 freight performance regime

31. Do you agree that we should keep the Network Rail payment rate the same, but uplifted for inflation? If not, please tell us why?

Centro is not sufficiently aware of overall levels of payments flowing to/from freight operators compared to passenger operators in order to take a view on payment rates. As a regime which is primarily designed to compensate for lost revenue (as distinct from incentivising performance), it is important that the payment rates correlate to actual losses experienced by the FOCs for a given level of performance by Network Rail. In the absence of any better information, uplifting current payment rates for inflation appears to be a pragmatic way forward for CP5. However, given the significant growth in freight traffic, it is more important than ever that further research is undertaken into the appropriate payment rates for CP6.

32. Do you think that the current Network Rail payment rate accurately reflects the financial impacts incurred by freight operators as a result of Network Rail caused delays to freight trains? If not, please tell us why?

Centro cannot comment on this, however there is an issue on whether freight operators can claim for costs incurred (e.g. needing more driver spare cover) as well as revenue loss, while passenger operators can only claim for revenue loss.

33. Do you agree that we should re-examine the evidence base for the Network Rail payment rate with the freight industry and Network Rail in CP5, and if necessary adjust the rate to reflect cost and revenue impacts on freight operators due to Network Rail caused delays? If not, please tell us why?

Centro agrees that the evidence base needs re-examining.

34. Do you agree that we should keep the Network Rail cancellation payments the same but uplift them for inflation? If not, please tell us why?

Centro has no specific comments

35. Do you agree that we should update the congestion factor used in the calculation of adjustments to the freight operator benchmark, in order to take into account of evidence being collected as part of the update of the capacity charge? If not, please tell us why?

Centro believes that it is essential that the shortcomings in the congestion charge are mitigated in any recalibration process. For example the capacity charge is unable to reflect

usage of the network at night when congestion is not an issue and the knock-on impact of a delay is much less.

36. Do you agree that the Network Rail £ per delay minute payment rates used in the calculation of the freight operator payment rate should be weighted by third party freight operator delay affecting each service group? If not, please tell us why?

Centro would support the proposed change if it were to result in a better reflection of the impact of freight delays on other operators and resulted in more consistency between the impact of a freight train delay and passenger train delay on other services.

37. Do you agree with our proposal to continue to set the bonus payment rates at 50% of the level of the compensation payment rate? If not, please tell us why?

Centro believes that while a 50% bonus payment rate may be appropriate, it is important to be able justify any different treatment from that experienced by passenger operators (as it is for any difference in approach between passengers and freight).

38. Do you agree with our proposal not to require Network Rail to offer incident caps in return for an access charge supplement? If not, please tell us why?

Centro has no views on this, although it would clearly be undesirable for a single incident to have catastrophic financial implications on a freight operator for which no insurance measures are available to mitigate.

39. Do you agree that incident caps are something that could be provided by the private insurance market if Network Rail were not to offer incident caps at a reasonable price? If not, please tell us why?

No comment

40. Do you agree that we should continue to allow operator specific annual liability caps? If not, please tell us why?

Centro agrees that annual liability caps should be available to provide protection to FOCs and NR, and these clearly need to reflect the scale of the businesses concerned.

41. Should we continue to set reciprocal annual liability caps for smaller and new freight operators? If not, please tell us why?

Centro is not sure whether the proposed £500k level is appropriate, however it is important that new entrants are not discouraged from entering the market.

42. Should we continue to set reciprocal annual liability caps in instances where Network Rail and freight operators cannot agree on the level the cap should be set at? Or are caps on annual liability something the private insurance market could provide if no agreement is reached?

Centro is not certain that the insurance market would provide an affordable premium and the ORR would need to be ready to step assist NR and freight operators in reaching agreement.

Compensation for charter operators

43. Do you agree that a separate charter operator payment rate should be calculated using the same methodology used to calculate the freight operator payment rate, but based on delays caused by charter operators to other train operators? If not, please tell us why?

While Centro has no direct comments on Charter payments, Centro believes that Charter operators fulfil an important function on the network and the arrangements in place for compensation are appropriate to allow their businesses to function in an appropriate manner. Consideration of arrangements which allow good performance by Charter Operators to offset poor performance ought to be considered in order to mitigate against the financial impacts incidents which cause delay to other operators.

44. Do you agree with our proposal not to require Network Rail to provide incident caps to charter operators on the basis this currently results in a subsidy to charter operators? If not, please tell us why?

The approach on the provision of incident caps needs to be consistent with that taken for small freight and open-access operators

45. Do you agree that incident caps are something that could be provided to charter operators by the private insurance market? If not, please tell us why?

No comment

46. Are you content for us to set the Network Rail payment rate in the charter operator performance regime so it is the same as the Network Rail payment rate in the freight performance regime? If not, do you have any proposals on how we should update it including on the evidence we could use?

No comment

47. Are you of the view that there are any other areas of the charter Schedule 8 performance regime that should be amended?

No comment