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25 August 2010

Dear Ekta

Consultation: High Level Review of Access Charges

This letter is a response on behalf of Southern, Southeastern and London Midland to your consultation dated 1 July 2010. I confirm that no part of this response is confidential.

Before commenting on the possible changes to access charges I would like to comment on two elements of context; one of which appears to have been misinterpreted by CEPA and the second of which has received less attention than it properly should.

On the first point CEPA's analysis of the incentive value of charges appears to have been significantly influenced by how it believes clause 18 of the franchise agreement affects the incentives on train operators. It is true that clause 18 historically neutralised many of the incentive effects on franchised passenger operators of charges; however clause 18 now only applies to a couple of operators, the vast majority of franchises operate under the provisions of schedule 9 of the National Rail Franchise Terms which are very different in effect. Clause 18 sought to return the franchisee to the position it was in when the franchise was let; schedule 9 effectively seeks to have the franchise "re-bid" in the light of the changes arising from a periodic review. Over the course of a control period the franchise will therefore respond to the revised structure of charges created by the review, however the very large financial risks arising from changes to the level of charges are reduced.

The second element that receives inadequate attention is the fact that franchised passenger operators' responses tend to be driven in large part by the specification in their franchise agreements. The incentive messages sent by the structure can only affect passenger TOC behaviour at the margins; the overwhelming majority of their services are operated in response to the specification set by the franchising authority. The CEPA report does not address this point, or question whether incentive signals should be addressed, in general, to the franchising authority rather than the train operator.

Of the four options that CEPA identified as offering potential improvements LRIC and a scarcity charge share the same disadvantage from a franchised train operator's perspective in that they will increase the marginal costs of train service provision. This will reduce the incentive to provide additional services beyond the franchise specification this potentially would limit competition and service development; it is questionable whether this would be in the end customers' interest. A further consideration with LRIC is that it is difficult to calculate and forecast accurately and in practical terms it is questionable whether it offers a better cost recovery or incentive mechanism than the current hybrid of SRIC, average costs and RAB funding.

Regional SRIC, as the report suggests, will have varying affects across the country. As with the proposal made in CP4 it will increase the level of complexity in the charging system for operators who cross more than one region; this proposal may provide specifiers and funders of services with some signals but it is not clear whether they are meaningful, or would affect behaviours.

We believe that benefit share has the potential to encourage both efficiency in Network Rail and effective collaborative working between train operators and Network Rail. However, the detail of how efficiencies are identified to individual operators and the calculation of payments will require careful consideration. It is also important that train operators are allowed to benefit full from their contribution to delivering efficiency, otherwise the incentive value of the payment is blunted or lost.

If you wish to discuss any of this further, please do not hesitate to contact me.

Yours sincerely,

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