First transforming travel

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Dear Ekta,

Review of arrangements for establishing access charges for CP4

Thank you for giving us the opportunity to comment on the review of charges for CP4. We were very happy with the review of the existing charges by Network Rail. It went very well and the direct contact from Network Rail to its customers was a successful process from our point of view. The consultation process worked very well and led to an "no surprises" result which was generally accepted as reasonable.

Our only concerns relate to the effects of the changes to the structure of charges on our contractual arrangements with Franchise funders. We responded on this issue to the independent review and an extract from our response is attached to this letter.

It should be noted that, while ORR is now preparing for the CP5 process, for TOCs the arrangements in Franchise Agreements for CP4 are still not resolved. Thus we approach the normal financial year end still not sure of the financial affects of a change which was implemented at the very start of the financial year. For the purposes of planning our future business, it would help if more weight was given in the CP5 review to the unpredictable financial effects that changes in the charging regime have on the operation of a Franchise Agreement.

I reiterate that from our perspective as a TOC owner group, the CP4 process itself worked very well. The few issues you raise with the Network Rail review process were, we accept, problematic for you but had little effect on us. Our principle problems with the review stem from the interaction with Franchise Agreements.

I hope this response is helpful to you. If we can be of any further assistance please do not hesitate to contact us. As a first point of call I suggest an email to Mike Price at First ScotRail (mike.price@firstgroup.com, or tel. 07880 503148). Mike will be able to determine who in FirstGroup is best placed to respond to a particular question.

Yours sincerely

Mary Grant
Managing Director, Rail

EXTRACT FROM FIRSTGROUP RESPONSE TO REVIEW OF CP4

"The Problem with the Review

In this review, and indeed past reviews, changes were made which cannot be predicted by the Financial Models nor can a simple NNLNNG calculation be made. The changes have financial effects which are dependent on unknown future events. These changes are made by ORR with a good intention, to change the economic signals, so one would expect future behaviours to be affected and to some extent the outcome should be unpredictable.

As an example, in the review changes were made to Schedule 4 and the Network Change compensation provided under the Network Code. Previously, the TOC compensation was greater for Network Change than for routine maintenance. At the ORR review the Network change compensation, which was previously based on reclaiming costs, was abolished and a unified fixed compensation regime was introduced which provides slightly more compensation than was previously gained from routine maintenance. This new compensation applies to both routine maintenance and enhancements. Thus Train Operators can lose where Network Change occurs but gain when routine maintenance takes place. The Franchise Financial Models cannot predict the effect of this change.

This Schedule 4 change has 2 intended positive effects. It makes the cost of future Network improvements more predictable for funders. The change also means that when Network Rail close the railway for maintenance work they are paying out compensation which is much closer to the industry's true costs and getting a better economic signal which discourages longer than necessary possessions of the track.

We are now struggling with the funding bodies (the DfT and Scottish Ministers) to determine how to resolve the situation. Considerable money time and effort is being devoted to find a way to model the effects of the Change on the Train Operators to comply with the provisions in Franchise Agreements and at least partially reverse the effects of the ORR change. This process from a Train Operator's perspective is risky, time consuming and an un-necessary diversion from our main business. It previously took considerable time to resolve the same issues around Schedule 8 following the ORR interim review. Until it is resolved presumably the financial plans of the funders must also be in doubt. This doubt over future funding to some extent reverses the intended effect of the change.

Proposed issues for your review.

While we understand that it is important that a Regulating body adjusts the economic signals to the industry it regulates through the charging mechanisms and we recognise the theoretical benefits of these changes, the overall value of them must be questionable when another body is spending time and taxpayers money to effectively reverse the effects of that action on one of the parties. Where the calculation is straightforward and the costs are minimal, such as simple changes in rates, there is no doubt that the current system is the best possible outcome. Where changes are easily implemented the Franchise Agreement ensures that Franchisees can plan their business and Network Rail gets the correct economic signals when planning its business. However where the change is not straightforward or easily evaluated we are less convinced of the value and believe that further thought and investigation would be of benefit. We believe that the possibility of introducing conditional changes to the access agreements which only apply on Franchise termination should always be considered as an alternative. Any adverse or positive economic effects on Network Rail could at least in part be compensated for by ORR in its review of the direct public funding Network Rail receives and by straightforward interim changes in other charges and payments. By ORR seeking to temporarily negate some of the effects of the change during a Franchise a lot of time could be saved and a significant risk of mis-calculation via the current franchise agreement systems would be eliminated from Train Operators and funders, allowing them to better plan their businesses.

We would ask you to consider in your review whether ORR is properly considering the effects that their changes have on the operation of the Franchise Agreements. The costs to the Franchisee and the funders and the effect it has on business and funding plans. Also we would ask you to consider whether they are properly considering to what extent the effect of the operation of the Franchise Agreements prevents the intended change in economic signals having the effect that was intended by ORR."