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Sam Gibbins, SSWT
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Ref: ORR\PR13\Draft Determination

4th September 2013

Dear Valentina,

Periodic Review 2013: Draft Determination of Network Rail's outputs and funding for 2014-19

Many thanks for the opportunity to respond to the consultation document on ORR's Draft Determination of Network Rail's outputs and funding for CP5.

The comments below are based on the consultation document and the ORR workshop that East Midlands Trains (EMT) attended on 19th June 2013. This response covers some of the specific consultation questions and a number of key aspects of the draft determination from an EMT's perspective.

EMT supports the views expressed within Stagecoach South Western Trains' and ATOC's responses.

Comments on key aspects of the draft determination

Access Charges

- Track access charging in CP5 – access charges cannot be assessed in isolation from other financial regimes e.g. Schedules 4 and 8. It is important to show clearly how each individual proposal connects and interacts with other incentive regimes. For example, the interaction of capacity charge and the performance regime needs to be integrated in such a way that NR is encouraged to optimise the use of the network and accommodate growth.

- The existing approach of indexation is transparent and has served its purpose to account for price inflation. The methodology proposed by ORR for indexing track charges during CP5 introduces financial risks to TOCs and uncertainty into their accounting.

- We do not agree with ORR that its proposed amendments to the indexation methodology used to annually adjust Network Rail's track access charges, regulated station charges and Schedules 4 and 8 payment rates, caps and thresholds in CP5 to account for changes in general inflation 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. We therefore cannot support this proposal and urge ORR to consider again the impact of this proposal on TOCs and potential bidders.

Passenger Information

- The current proposals for industry funds do not include a specific provision for the proposed improvements to customer information systems that were set out in the Initial Industry Plan (IIP). These mirrored the requirements of the Secretary of State's HLOS. The industry has made the case for the important passenger benefits that can be achieved through improving and progressing information systems. We recommend strongly that ORR include these outputs in the Final Determination.

Performance

- The overall PPM target for CP5 is set to be 92.5%. Some TOCs' PPM is already above this target. There are concerns that performance improvement on the worst performing routes would come at the expense of better performing routes. Therefore, this should be reviewed in the draft determination on how further support will be given to encourage those TOCs whose performance has already exceed this target.

- There needs to be a greater recognition in the draft determination of the industry aspiration to move to and incentivise NR to recognise Right Time Railway, as opposed to just PPM, particularly in the light of the recent pressures to publish RTR figures and Passenger Focus's recent review of PPM v RTR.

Schedules 4 & 8 Possessions and Performance Regimes

- There is no proposal or consultation on the new EBM rates for cost compensation. Also, ORR's decision to adjust bus compensation rates down by 7.9% for London & South East 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.

NR cost of capital

- The current proposal for NR's cost of capital for CP5 reduces the pre-tax cost of capital for investment framework schemes from 6% in CP4 to 4.9% in CP5. On the face of it this is positive as this is an input to the calculation of facility charges for TOC assets purchased by NR. However, we think that the Final Determination should reflect the likely trajectory of the cost of capital through CP5, recognising that although NR's revenue requirement is based around an assumed rate of return, the cost of finance may be lower – even for third parties – and that therefore the level should reflect a realistic assessment of likely costs going forward.

Incentives – EC4T

- ORR has not stated what funding mechanisms are in place to support the industry to deliver schemes to reduce EC4T consumption in CP5. The industry has a target to reduce traction CO2 emissions by 12% by the end of CP5 but at the moment there is no specific funding available for schemes which support this target, including metering additional rolling stock. We welcome ORR's decision to formalise arrangements for partial fleet metering (PFM). This will enable TOCs to meter part of a fleet and be billed for EC4T as if the whole fleet was metered thus reducing the capex required to enter metered billing. The level of exposure to the EC4T wash up will be the key determinant of how widely PFM is adopted. We think that the most appropriate way to decide how partially metered fleets will be exposed to the wash up is for the industry to make a proposal through the Traction Electricity Rules.

Comments on specific consultation questions in ORR's Draft Determination

(b) its proposal for certain aspects of the route-level efficiency benefit sharing (REBS) mechanism (as set out in paragraphs 19.10 – 19.22), comprising;
(i) its proposed approach to setting REBS baselines;
(ii) the method for calculating and reporting REBS in CP5; and
(iii) which parts of Network Rail's income and costs should be included in REBS.

- We acknowledge the principle of REBS mechanism, which is to encourage train operators to work together with Network Rail to identify and help implement opportunities to increase Network Rail's efficiency and to drive down costs. Greater alliance between train operators and Network Rail would ensure both parties to work closer together bringing a tighter control on costs whilst trying to maximise the benefit for both parties. However, this ultimate goal could be achieved only if Network Rail's costs are transparent to train operators, so that the baseline of efficiency could be identified and determined at the right level for both parties to accomplish.

- Some routes are in use by a number of train operators who would engage with Network Rail for implementing the mechanism and these train operators are aiming to achieve the same objective, i.e. increasing cost efficiency and reducing infrastructure costs. However, the major operator on the route will have more influences on Network Rail's expenditures, and it is important that any major decisions made between Network Rail and the major operator are fully visible to other minor operators on the route.

- The proposed approach of measuring financial performance of Network Rail in CP5 is challenging. The calculation of financial performance could over-complicate REBS which is supposed to be simplistic, and it will make it very difficult for train operators to understand and evaluate the benefits/risks associated with the proposed mechanism.

- ORR considered that those costs included in REBS could be influenced by train operators and the assessment of Network Rail's efficiency would only take into account the increase in cost, not the reason for the increase in cost. However, there are major events which could affect Network Rail's OM&R expenditures, but falling outside Network Rail's and train operators' control and influence. For example, the Hatfield Colliery incident in Lincolnshire in April 2013 had a huge impact on Network Rail's operating and renewal costs due to the emergency repair of the infrastructure. It also had a knock-on effect on the development of another major enhancement scheme i.e. the GN/GE upgrade resulting in many planned possessions being cancelled in order to allow the diversion of TOCs/FOCs train services via the Joint Line. Thus, it is necessary to consider how these costs are to be reflected in annual adjustments to the level of REBS performance and how they should be assessed in the measurement of Network Rail's total financial performance.

- It's proposed that REBS expenditure baselines should include Schedules 4 & 8 costs and variable usage charge income (to reflect changes in traffic volumes). We consider that REBS baselines should also include capacity charge income to be consistent with the consideration of changes in traffic volumes. And possibly, it should also include the ETCS income for the same reason.

- The key challenge for PR13 is to deliver value for money for customers and funders and significantly to bring benefits to passengers. One of the fundamental needs of the railway is 'investment' and any efficiency saving as a result of Network Rail and train operators working closely together could be re-invested back into the railway which would bring benefits to passengers and taxpayers. This has not been mentioned in the draft determination, but worth further consideration.

(h) the approach to financial monitoring in CP5, as discussed in the monitoring, enforcement and reporting chapter (chapter 23).

- We support the proposed approach to financial monitoring in CP5. It is important that NR's financial performance is to be monitored on a regulated basis. It will provide the industry assurance that NR is meeting its obligation and most importantly delivering what it has been funded to do.

- It will be useful if the monitoring is recorded and reported in a spreadsheet format. It is important that all the information is available for TOCs and the process is made simple for TOCs to follow.

- The proposal for monitoring, enforcing and reporting on Network Rail's delivery of outputs and financial performance will certainly provide train operators with confidence. While there are major projects to be delivered during CP5, for example midland main line electrification and ERTMS, we would like to see improvements in Network Rail's commitment and engagement with train operators in relation to the development of these major schemes. It would be useful if the ORR could emphasize this key aspect in their final determination.

I hope this input is useful. If you would like to discuss this in further detail, please feel free to contact me.

Yours sincerely,

Lanita Masi
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East Midlands Trains