

Iain Morgan
Senior Economist
Telephone 020 7282 2060
Fax 020 7282 2044
E-mail iain.morgan@orr.gsi.gov.uk



OFFICE OF RAIL REGULATION

20 April 2007

See Attached List

Dear Sir/Madam

PR08: Changes to the passenger performance regime (Schedule 8)

Introduction

1. The periodic review 2008 (PR08) will determine Network Rail's regulated outputs, revenue requirement and access charges for control period 4 (CP4) which we expect to be between 1 April 2009 and 31 March 2014.

2. The purpose of this letter is to set out the proposed scope of changes to the passenger performance regime to be considered as part of PR08 and to identify the key points in the plan for delivering this work. This incorporates in particular the discussion of the industry group meeting on 30 January 2007. In your response to this letter, you have an opportunity to comment on the scope of work and on the plan for carrying it out before the work starts later in the PR08 process.

3. As part of PR08, we have decided to consider possible changes to the performance regime (Schedule 8 of train operators' (TOCs) track access contracts) to maintain or improve the achievement of the regime's objectives:

- to compensate TOCs for the revenue effects of lateness and cancellations caused to their train services by Network Rail or other TOCs; and
- to encourage Network Rail and TOCs to minimise lateness and cancellation levels both through operational and investment decisions.

4. We would normally expect to consider changes to Schedule 8 as part of a periodic review. This is because we can make the changes to all track access contracts (or all of a particular type of track access contract e.g. passenger) simultaneously and at the same time as Network Rail's new financial framework is determined.





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5. We met with groups of industry representatives at the end of January 2007, one attended by passenger stakeholders¹ and the other by freight stakeholders. These meetings discussed the scope of the changes that might be considered as part of PR08 and the approach to deliver these changes. This letter focuses on the passenger performance regime work².

6. You should feel free to respond on any part of this letter and we would particularly welcome your views on:

- any proposed change to the scope and reasons why you support the particular change; and
- any comments on the process and timescales for carrying out the PR08 work on the passenger performance regimes.

7. Consultation responses should be sent in electronic format (or if not possible in hard copy format) by 1 June 2007 to:

Iain Morgan

Senior Economist

Office of Rail Regulation

(020) 7282 2060

iain.morgan@orr.gsi.gov.uk.

8. Responses will be published on our website. Respondents should indicate clearly if they wish all or part of their responses to remain confidential to the Office of Rail

¹ Attending the passenger industry group meeting on 30 January 2007 were representatives of ATOC, several TOCs, Network Rail, DfT and ORR. Transport Scotland were unable to attend but would be part of a group managing the later work.

² Freight stakeholders have agreed a remit for work on the freight performance regime. Because of the differences between the freight and passenger regimes, and the recent performance regime review which only considered changes to passenger performance regimes, different work is involved in considering changes to the two regimes. However, part of the overall work will need to consider the interaction between them through the star model. The timescales of the freight performance regime work are consistent with the passenger work. For further information on this workstream please contact Bill Hammill on (020) 7282 2088 (bill.hammill@orr.gsi.gov.uk).



Regulation (ORR). Where a response is made in confidence, a statement summarising the submission should accompany it, excluding the confidential information, which can be treated as described above. We may also publish the names of respondents in future documents or on our website unless a respondent indicated that they wish their name to be withheld.

9. We are publishing a copy of this letter on our website at <http://www.rail-reg.gov.uk/upload/pdf/pr08-perfreg-let-200407.pdf>.

10. Our meeting with industry representatives reached the following main conclusions:

- the current structure of Schedule 8 should be retained (this is consistent with the conclusions of the 2005 performance regime review which, while identifying complexities with the current regime, found that its structure was generally the best available to achieve the regime's objectives³);
- the scope of the work should focus on those aspects of the regime not reviewed at the 2005 performance regime review, in particular a re-calibration of the Network Rail and train operator benchmarks (performance points) and the modelled TOC-on-TOC impact reflected in the TOC payment rate in the regime;
- one aim of the changes should be to cause the rates in the Star Model⁴ to be in balance at the start of CP4 (1 April 2009). At that point, each payment to Network Rail for the effects of one TOC's lateness on other TOCs should equal the corresponding payment(s) to TOCs from Network Rail relating to the impact of that lateness;
- further consideration should be given to how Schedule 8 might support the work being carried out as part of PR08 to look at the overall incentive framework. This

³ We would continue to consider approving bespoke regimes where this meets the specific needs of Network Rail, the particular train operators, their customers and funders. See paragraph 2.3, Review of the Schedule 8 performance regime, final conclusions, Office of Rail Regulation, London, December 2005. This is available on our website at <http://www.rail-reg.gov.uk/upload/pdf/266.pdf>.

⁴ The Star Model is the process of payments between train operators via Network Rail for the effects of one train operators' caused lateness on other train operators (Toc-on-Toc impact).

should include the possible revision of payment rates in support of any revenue sharing mechanism between Network Rail and TOCs⁵; and

- a representative industry group, similar to that formed during the 2005 performance regime review, should manage the work. ORR would chair this group, as this will make it easier to co-ordinate progress with other PR08 workstreams and timescales.

Scope of work on passenger performance regime within PR08

11. The areas of work the group identified were:

- Network Rail and TOC benchmarks (performance points);
- TOC payment rates;
- Sustained poor performance (SPP) threshold; and
- Other issues (see below).

Network Rail and TOC benchmarks (performance points)

12. The benchmark or expected performance level is generally set out in column B (Network Rail) and F (TOC) of Appendix 1 of Schedule 8. We reviewed both benchmarks most recently at the access charges review 2003 (ACR2003) based on data from October 2001 to October 2002. It is important that the benchmarks are set at a challenging but realistic level. This is both to provide sufficient incentives to the parties to improve performance and to determine an appropriate target level of performance where no amount is payable under Schedule 8.

13. In PR08, we propose to review both the Network Rail and TOC benchmarks. The determination of the appropriate Network Rail benchmark will be informed by the Governments' high level output specifications (HLOSs)⁶ due to be published in July 2007

⁵ See Chapter 8 of Periodic review 2008 Advice to Ministers and framework for setting access charges, Office of Rail Regulation, London, February 2007 (<http://www.rail-reg.gov.uk/upload/pdf/316.pdf>) and Periodic review 2008 Enhancing Incentives for Continuous Improvements in Performance: a consultation document, Office of Rail Regulation, London, July 2006 (<http://www.rail-reg.gov.uk/upload/pdf/298.pdf>).

⁶ Both the Secretary of State for Transport (in respect of England and Wales) and Scottish Ministers (in respect of Scotland) are due to serve HLOSs and a Statement of financial resources available in July 2007. This is consistent with the new procedure set out in Schedule

and from Network Rail's Strategic Business Plan (SBP) due to be published at the end of October 2007. This impacts on the timing of the work and also suggests that the type of work will be different from previous reviews, that is focused on reviewing and challenging the SBP performance targets rather than relying mainly on historic performance. In reviewing the TOC benchmark we will take account of the performance trajectories in franchise contracts.

TOC payment rates

14. The TOC payment rate is generally set out in column I of Appendix 1 of Schedule 8 and includes components for:

- the modelled impact of one train operator's lateness on other train operators' lateness; and
- an element reflecting passenger charter compensation payments to other train operators where these are made as a result of lateness attributed to the train operator.

15. Given the significant changes in services since the ACR2003 and the termination of passenger charter arrangements by many operators we propose that both elements be re-examined as part of PR08.

Sustained poor performance threshold

16. We introduced the SPP threshold at the 2005 performance regime review to provide for additional⁷ compensation in the event that Network Rail performance was very poor over a sustained period (12 months). The measure of poor performance was related to the Network Rail benchmark and, for 2006-07, was set at 25% worse than benchmark performance, with the corresponding figures for 2007-08 and 2008-09 of 22.5% and 20% respectively.

17. We recognised that there remained some uncertainty about the appropriate level for the threshold so that it correctly reflects the point at which normal compensation calculated through Appendix 1 of Schedule 8 becomes insufficient to reflect the impact of the

4A of the Railways Act 1993 (as amended). It will set out what the respective Governments want to be achieved by railway activities and we expect it will include some form of performance output.

⁷ Over and above that payable under Appendix 1 of Schedule 8.

sustained poor performance on a TOC's revenue. We said that we would consider this again in the light of any case law and/or specific industry research.

18. We agreed at the meeting with industry representatives that the industry would have to consider whether the benefits of carrying out research in the next year to inform this level would be sufficient to outweigh the costs involved. We are interested in industry views on whether such research is worthwhile, taking into account the likely change to Network Rail benchmarks to a lower level of lateness than currently.

Other issues

19. The industry meeting additionally identified the following to be considered within the scope of the work:

- any uplift of the Network Rail payment rate to take account of the difference between increases in the retail prices index (RPI) reflected in the track access contract and some aggregate increase in actual revenue. This should ensure that the payment rate is uplifted to reflect the general change in revenue where this exceeds RPI; and
- a review of the dispute process in paragraph 17 of Schedule 8, to consider improvements to its effectiveness and clarity.

Possible additional scope items

20. Table 1 sets out the timescales for this work. If you suggest additional scope items, please consider how the work would fit with these timescales and whether additional resources (for example, external research) would be needed. If you are not clear whether a particular suggestion fits with the timescales of PR08 and available resources you should still set them out in response to this letter but noting this.

21. We agree with the conclusions of the meeting with industry representatives that the structure of the Schedule 8 regime should remain. We considered this issue fully as part of the 2005 performance regime review. Therefore if your proposed change of scope implies a change to the structure of the regimes then you should set out reasons why you consider the change would enable the regime to meet its compensation and incentive objectives more effectively. Among the additional scope items that might be considered are a number of issues that have been identified in previous reviews of the performance regime:

- consideration of further research as to the appropriate lags between performance changes and corresponding revenue changes.

- appropriate basis for Schedule 8 payments in the event of very good performance i.e. application of caps on bonus payments or asymmetric payment rates (with lower payment rates above a certain threshold level of good performance);
- whether there is a difference in effect on a train operator's revenue per minutes lateness where the length of that incident of lateness is significant e.g. 3 hours compared to when it is part of a shorter period of lateness; and
- whether the regime provides sufficient compensation (e.g. through the monitoring point weightings) where the service is cancelled before reaching a major terminus station to which the majority of passengers are travelling.

Plan for carrying out the work

22. The meeting with industry representatives focused mainly on the scope of the work, but we also briefly discussed the way the work would be carried out. In particular, we think it important that the industry manage the work and contribute funds to support external research where appropriate. This is why we propose that an industry group manages the work although we propose to chair the group given the extensive interactions with other elements of the PR08 work.

23. The industry group should have a similar makeup to the meeting we held with industry representatives in January 2007, that is, it should include representatives from Network Rail, ATOC, train operators or owner groups, DfT and Transport Scotland. While it is important that the group is as comprehensive as possible in coverage of the industry it needs to be limited so as to ensure that the meetings are productive (although I recognise that we might in particular consider additional representatives of non-franchised passenger operators and of local funders). The group will need to meet in June to consider the final plan of work however, regular meetings to manage the process are likely to start in September 2007. We also intend to consult more widely with each train operator at particular stages of the work (as with this letter).

24. Table 1 shows the current key milestones in the project (although major changes to the scope of the work in response to this letter could affect these timings).

Table 1: Key milestones in the PR08 passenger performance regime work

Date	Milestone
January 2007	Meeting with industry representatives.
February 2007	Confirmation of inclusion of work on performance regime in Advice to Ministers and framework for setting access charges.
April 2007	Letter consulting on work of review of passenger performance regime.
July 2007	Secretary of State and Scottish Ministers publish their high level output specifications (HLOSs) and statements of public funds available (SoFAs).
October 2007	Technical work initiated.
October 2007	Network Rail publishes its strategic business plan (SBP).
February 2008	We publish our assessment of Network Rail's SBP.
March 2008	Consultation on revised Schedule 8s ⁸ .
April 2008	Network Rail provides revisions to the SBP if necessary.
June 2008	We publish our draft determinations for CP4.

⁸ The revised freight Schedule 8s will be consulted on at the same time.

Date	Milestone
October 2008	We publish our final determinations for CP4.
December 2008	Final access charges (price lists/charge schedule) are audited and approved. Review notice is served starting implementation of PR08 (including implementing changes to Schedule 8).

Application to non-franchised passenger operators

25. We intend this review of passenger performance regimes to inform possible changes to non-franchised passenger operators as well as franchised operators, (where the contractual re-opener provisions allow such changes). It would therefore be useful to have a specific representative for these operators on the industry group.

Next steps

26. Following responses to this letter we (and where possible the industry group) will consider the responses and then confirm the work in a final workplan in September 2007, including the form of any technical work to be undertaken.

Yours sincerely



Iain Morgan



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List of recipients

Bob Holland, Arriva Trains Wales
Alec McTavish, Association of Train Operating Companies (ATOC)
Steve Banaghan, Central Trains Ltd
Robert Smith, Centro
Cath Proctor, Chiltern Railway Company Ltd
Chris Gibb, Cross Country Trains Ltd
Ed Cullen, Department for Transport
Elaine Holt, First Capital Connect Ltd
Alison Forster, First Great Western
Mary Dickson, First ScotRail Ltd
Ian Yeowart, Grand Central Railway Company Ltd
Jonathan Metcalfe, Great North Eastern Railway Ltd (GNER)
David Leather, Greater Manchester Passenger Transport Executive
Brian Raven, Heathrow Express
Mark Leving, Hull Trains Company Ltd
Mark Hopwood, London Lines (c2c, Silverlink & Gatwick Express)
Patrick Verwer, Merseyrail Electrics 2002 Ltd
Neil Scales, Merseytravel
Kieran Preston, Metro
Garry Raven, Midland Main Line Ltd
Tim James, National Assembly for Wales
Paul Plummer, Network Rail Infrastructure Ltd
Bernard Garner, Nexus
Heidi Mottram, Northern Rail Ltd
Andrew Chivers, One Railway Ltd
Roy Wicks, South Yorkshire PTE
Charles Horton, Southeastern Trains
Chris Burchell, Southern Railways
Stewart Palmer, Stagecoach South Western Trains Ltd
Ron Culley, Strathclyde Partnership for Transport
Vernon Barker, TransPennine Express
Richard Wallace, Transport for London
Jonathan Pugh, Transport Scotland
Charles Belcher, Virgin Trains Ltd



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