

Richard Gusanie
Office of Rail Regulation
One Kemble Street
London
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2nd September 2011

Dear Richard

Periodic review 2013: First consultation

In response to ORR's recent consultation relating to the Periodic review I am pleased to provide you with Alliance Rail's response below.

If you have any questions relating to our response, please feel free to contact me.

Yours faithfully

Ian Yeowart

Chapter 3 (our objective for PR13)

Q1 Do you agree with our proposed objective for the review? If not, what issues would you add or subtract?

Alliance Rail Holdings (Alliance) is content with the objective of the review.

Chapter 5 (high-level timetable)

Q2 Do you have any views on our proposed timetable for the review? Do you need further information to plan your involvement with PR13?

Yes, there is very little detail on the implementation timescales. It would be helpful to the industry to provide more detail on the implementation of the review notices and how any mistakes (if any) will be rectified.

Chapter 6 and annex B

Price control separation and Network Rail devolution

Q3 Do you think that our approach to the disaggregation of Network Rail financial (and other) data to operating route is appropriate? Is the information we are requiring Network Rail to produce set at the right level?

Generally, yes, however we would like to see the total operational expenditure identified. So for example, the costs associated with NR headquarters and the costs of the operations planning functions should be identified. In addition, we also believe that expenditure associated with the development and delivery of enhancements should be separated out so that comparisons can be made to assess their value for money.

Do you have views on the information train operators should produce?

The requirement, level and detail of information that may be supplied by a train operator are something that will vary depending upon the scope of devolution. We are of the view that this is something that should be agreed between operators and Network Rail.

Q4 Which aspects of the price control should be separated for England & Wales and Scotland, e.g. should the efficiency assumption be separate?

Alliance recognises that Network Rail are progressing their proposals for devolution and concession. We believe that in order to regulate effectively that price control is carried out at each devolved unit level.

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Q5 Do you think there should be further separation of the price control for Network Rail's operating routes and, if so, which aspects of the price control should be separated?

Yes as above. We believe the current price controls are suitable.

Chapter 6 and annex C

Outputs

Q6 Is the current approach to defining obligations in terms of outputs the best approach? What outputs should be defined? Should there be a move to more use of outcome based obligations. Would another approach be appropriate such as specifying inputs or intermediate measures?

Alliance believes that the current approach in determining outputs provides a useful level of indicators on the success of Network Rail. However, the industry restructuring should be reflected in the new outputs. So for example we support outputs that are based on the developed units. We also would like to see additional measures relating to efficiency, customer satisfaction and to proactive capacity creation.

Q7 What are your views on how we should compile and present 'scorecards' of Network Rail's performance in CP5?

These should be split by each devolved unit to provide visibility of its performance. Greater focus should be placed on efficiency and the customer satisfaction of Network Rail. We would also question the usefulness of the outputs on network capability and station scores.

The current obligation for Network Rail is to maintain network capability as at 1st April 2004. Unfortunately, this encourages inefficiencies in perpetuating unnecessary infrastructure assets and layouts. We would like to see protection of the network but not if that part of the network is not necessary.

With regard to station scores, we do not believe that these are particularly useful and should be reviewed.

Q8 Should we make more use of 'whole system' outputs over which Network Rail does not have full control, or focus on more narrowly defined outputs which the company is fully responsible for?

In order to make Network Rail accountable and for greater visibility of performance the outputs should reflect areas where Network Rail has direct control.

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Q9 How should output obligations be defined in the context of devolved Network Rail routes with separate price controls?

The existing output obligations are generally suitable. However, we also recognise that a devolved route may become too insular or too close to its main customer(s). It could be difficult for multi route or small operators to get engagement in a route where there is a large customer. For this reason, we believe that customer satisfaction outputs should be introduced on a route-by-route basis.

Q10 How should the balance between the number of output obligations and their individual significance be struck?

The key focus of the outputs should reflect the developing industry restructuring. So for example, there is a need to have devolved outputs that promote efficiency, growth and customer satisfaction.

Q11 Should Network Rail's output obligations include a specific safety requirement, different from its legal obligations?

We believe that where legal obligations exist these should not be the subject of duplication by specifying outputs unless there is a valid reason for doing so.

Chapter 6 and annex D

Incentives

Q12 Do you have views on how the effectiveness of the existing financial incentives can be improved?

There should be more disaggregation at a devolved route level so that individuals can see what they are being judged against. Currently there is little link between the incentives and individuals behaviours. Greater visibility of the incentives will lead to changes in behaviour.

Q13 Do you have views on how the effectiveness of Network Rail's incentives to make best use of capacity could be improved?

Network Rail is a very reactive organisation that does not look at ways to make best use of its existing assets or ways to encourage better use of capacity. The volume incentive does not really work as an incentive as it is not something that is visible. Alliance believes that measures could be developed that look at incentivising Network Rail to make better use of what it has got.

Additionally we also believe that operators could also be incentivised to work better together and make better use of drivers, rolling stock and capacity. For example on routes where capacity was scarce, an incentive could be given to those operators who would be willing to couple trains together rather than operate short trains.

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Incentives could also be given to operators who introduced trains that had inter-fleet compatibility (e.g. couplings). This could aid recovery during times of perturbation.

Q14 Do you agree that we should include a regional efficiency benefit sharing mechanism calculated at the Network Rail route level?

Alliance is concerned about the way in which this incentive could drive behaviours in the devolved routes of a large operator and Network Rail. We will require further details on the practical considerations and impact.

Are there further issues about how a regional efficiency benefit sharing mechanism should be introduced which you want to highlight?

Q15 What are your views on exposing franchised passenger train operators to changes in Network Rail's costs at a periodic review?

This would create uncertainty for franchise operators and may well lead to franchise bidders to price in that uncertainty into their bids. It could also lead to franchises failing. Constant review of pricing mechanisms and process is unwelcome and does nothing to instil long term confidence.

Q16 Do you believe that Network Rail should share in train operator revenue and/or costs? Are there further issues about introducing a revenue/cost sharing mechanism which you would highlight?

We believe it would be inevitable that operator and Network Rail behaviours would be driven by a desire to minimise revenue loss and costs. This may negatively impact on other users on a route by giving preferential treatment to operators who have revenue share deals. For this reason, we believe that any such proposal would need to have additional regulation and measures in place.

Q17 We would welcome your views on possible bespoke arrangements for enhancement efficiency benefit sharing and whether there is a need for additional measures to increase the contestability of expenditure?

Alliance believes that efficiency benefits could be provided in renewals as well as enhancements. We also believe that enhancement costs should be actual costs within the industry rather than costs that import significant profit for Network Rail. Network Rail enhancement teams are difficult to deal with if you are looking to invest in the network. In addition to efficiency incentives, the enhancement organisation requires incentives to drive a proactive customer focused approach.

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Q18 Are there further new incentives which you believe should be introduced and what would the benefits be?

The enhancement organisation is unresponsive and costly. This needs incentivising to make certain that potential third party funding in the rail industry is not lost.

Q19 Are there other interactions between incentives (and the wider regulatory framework) which we need to take into account?

Getting the incentives right in devolved units is going to be difficult. It is possible that devolved incentives and a greater partnership approach could lead to unfair treatment of small and multi route operators. Careful consideration should be given to the impact on behaviours by a different approach to incentivising.

Chapter 6 and annex E

Financial framework

Q20 What are your views on the duration of the control period?

Alliance does not have any particular strong views, however we recognise that a level of uncertainty could be removed from the industry if control periods were longer.

Q21 Do you think that we should retain the single till approach rather than moving to a dual till approach?

Yes.

Q22 Do you think that our overall approach to risk and uncertainty in PR08 was appropriate and are there any improvements that could be made for PR13?

The approach taken was appropriate. Where improvements could be made, relate to the possibility that mistakes were made in the review notice, and its implementation. There needs to be a mechanism whereby the review notice can be amended when and if errors have been identified.

Q23 Network Rail faces a number of risks. At this stage, do you have any views on how general inflation risk and input price risk should be addressed?

These risks are faced by all commercial organisations, and one would expect that Network Rail is sufficiently mature to address these matters in the way that all others do.

Q24 We plan to retain the same high-level approach to amortisation in CP5 that we introduced in CP4. What are your views?

We are content with the approach taken.

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Chapter 6 and annex F

Structure of charges

Q25 Do you consider that our charging objectives remain appropriate?

Yes

Q26 What are your views on the geographical disaggregation of variable usage charges?

We would see little benefit for doing this and believe that a national variable charge is acceptable.

Q27 What are your views on introducing a charge levied to reflect network scarcity?

We do not believe that this proposition will work as it is intended to do so. In effect scarce capacity will inevitably be in poor paths. To charge a premium for paths that would be sub optimal would be perverse.

What would be the ORR's view that competitive pricing applied to all paths and not just the scarce ones?

Q28 What are your views on a reservation charge (assuming it would be set to be financially neutral for freight operators)?

Reservation charges may be valid if there is a genuine business need. We would not be supportive of reservation charges that are cost neutral or are set so low that paths are reserved with no intention of ever being used.

Q29 Should passenger open access operators pay charges that exceed variable costs. How should charges be calculated?

The current charging regime has developed over a period of years, and has been tested thoroughly in a High Court action brought by GNER in 2006.

ORR is aware that the 'fixed charge' paid by passenger franchised operators is an 'artificial construct' and merely a way of passing through grant funding. This was initially developed to make Railtrack (as it then was) more responsive to its paying customers. Network Rail is much changed from Railtrack, and whether the need to retain this 'artificial construct' remains is for the industry to consider. However, 'moving the money around' in this way will not bring any additional funds into the industry.

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The biggest issue for passenger open access operators is volume, and ORR will note that the most successful open access operator has at least a service every two hours. Less than this leaves an operator vulnerable to unfair pricing competition from an operator on the flow with volume.

Further comment is made at the end of this response.

Q30 What are your views on the proposals to improve incentives to reduce traction electricity consumption?

We are fully supportive of this approach.

Q31 Should we put a cap on certain freight charges in advance of our determination and should these be linked to other changes?

No comment

Q32 Do you have views on the interactions between these possible changes and when they should be implemented – for example whether some changes should only be introduced after other changes have 'bedded in'?

This consultation has provided so many different proposals and options that it is extremely difficult to form a view. There are really too many options that have been put out for consultation to be able to give a definitive view. In addition to answering these questions, we have also added a number of our own comments and questions in relation to the consultation document – these are provided below:

Additional comments and questions

1 Alliance notes that ORR has considered in Annex D20 (page 38-39) that incentives may be used in relation to the Environment and Carbon pricing. We would welcome this approach providing that it does not lead to prohibitive costs. In addition we would not want to see obligations imposed that do not apply to the industry competition – on the roads for example. .

2 Alliance notes that there is little detail on the implementation stage and how this would work. In the last regulatory review the review notice contained errors that could not be amended. Could ORR advise how it will implement the review, and if errors occur, if the process will allow the notice to be amended?

3 Financial Framework (6.4) Duration of Control Period (pages 59)

Alliance recognises that there are industry costs associated with the review and implementation of each control period. We therefore would be supportive of either maintaining the status quo or moving to longer control periods. We would not be supportive of shorter control periods as we do not feel that this would add anything and it would increase the industry costs and introduce uncertainty.

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4 Network Grant (6.50) / Access Charges

We note that ORR believes “that Network Rail should receive all of its track access charge income as charges rather than network grant”. Alliance believes that subsidy presented as charges paid via train operators is not helpful to the industry. The level of subsidy should be visible as the contribution that Government makes to the industry. We believe that this would help highlight the industry costs and help focus industry players to get costs under control.

5 Open Access (6.6.1)

ORR is suggesting changes to the structure of charges and considering making Open Access pay higher track access charges with a view to enabling more competition. The same result could be had by making the franchised operators pay only variable charges. The result of either approach coupled with the removal of the ‘not primarily abstractive’ test could indeed create more competition for capacity.

We would suggest that if all operators paid only the variable charges then there could be potentially more opportunity for open access competition on routes that do not currently attract open access for example the North and South Trans-Pennine routes and other routes away from London.

However the current tests and moderation of competition policy has seen the range of new direct destinations evolve as part of the process, with only the apparent reluctance of the ORR to grant sufficient volume to open access applicants hindering further expansion.

If all operators paid the same the likelihood of development beyond the ‘core’ is remote, and indeed if paying the same charges as others then one would expect open access operators to major only on the significant flows, York – London for example. This would undoubtedly increase competition for some but would it expand the network and be beneficial ‘off the core’ and to UK plc as a whole?

A more interesting possibility could be a change to franchise policy whereby all long distance operators buy ‘bundles’ of paths, so instantly introducing competition on major flows by limiting the amount of ‘paths’ an operator could hold. This would then still leave the way clear for further competition from smaller, niche operators.

Alliance notes the ORR is soon to consult further on passenger open access charging, and if the outcome is a fully accessible network then Alliance would be supportive of that view. If operators are paying the same price then they must have the same access to all flows, and not be artificially restricted.

6 Scarcity charges (6.62)

We do not believe that this concept works as the “scarce” paths are likely to be suboptimal and should not be more costly.

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7 Charges for open access operators (page 98)

Alliance would be supportive of opening up the rail network to greater competition. We note that the MVA/ITS consultancy study due at the end of July 2011 has not yet been released, we will comment in more detail once we have access to this.

8 Station charges (page 99)

A key part in developing new open access services relates to station access charges. We have found that information for Network Rail's managed stations was easy to access and promptly delivered, whereas information provided by franchised operators was mostly reluctantly provided (and sometimes then only after intervention by ORR) and often incomplete. Alliance would like to see station access charges that have greater visibility and charges that are regulated.

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