2 September 2011

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Dear Richard

Periodic Review 2013 – First Consultation

Introduction
Thank you for the opportunity to comment upon the ORR's objectives, scope and processes for undertaking the PR13 periodic review and also to comment upon the issues and potential approaches to address them set out in your consultation document.

This letter draws together the response of FirstGroup and all of its rail operations: First ScotRail, First TransPennine Express, First Capital Connect, First Great Western and Hull Trains.

FirstGroup is supportive of, and has contributed to, the ATOC consultation response on PR13. In particular, we agree with ATOC's suggestion that it is important for the objectives of PR13 and the guiding principles of the review process to be established and clearly communicated early on in the process, especially to give guidance on how PR13 is going to fit in with and complement the other changes underway in the rail industry at present. We support the key objectives set out in the main part of the ATOC response and so do not seek to repeat all of the points made in our own response.

We set out our response to the detailed consultation questions in an appendix, with our overall comments on the issues raised by the PR13 review set out below.

Objectives and Approach
We broadly agree with the overall objective set by ORR for PR13 and support the intention to adopt an outcome / output based approach which seeks to use market / incentive based mechanisms.

However, care is needed in how ORR intends to develop its approach to delivering the objective given the emerging changes in the industry in response to the McNulty RVfM report. The devolution programme within NR and the resultant engagement between owning groups and NR on how to deliver greater cooperation, to drive both efficiency and improved outputs at a route level, is exploring many of these issues at present. It would be unfortunate if the PR13 process results in an approach which cuts across or delays the innovative approaches which seem likely to be trialled in some areas during CP4. We believe that the review should seek to complement these developments and allow them to deliver the greatest level of benefits in the long term.

Many of the collaborative approaches are being developed against the backdrop of the current regulatory environment and so there is a risk that fundamental change to the existing charging matrix and incentives may also negate the incentives to cooperate being developed at present. We would advocate that these issues are carefully considered in deciding whether to propose significant change to the regulatory incentives / charges and that the intention to develop efficiency benefit sharing mechanisms, for example, can be done in a way that can accommodate bi-lateral agreements between TOCs and NR rather than seek to supersede them.

Devolution and price control separation

We support NR's devolution programme and believe that PR13 should support the setting of outputs and efficient levels of expenditure at the Route level. Much of the potential for future efficiencies appears to come from closer cooperation between TOCs and the NR Routes to find cost effective ways to deliver locally agreed outputs, plus the potential for ORR to use comparative regulation between the Routes in future reviews.

Accordingly, we would support price separation at the Route level with a view to having funders and TOCs / FOCs sharing in the Route effiency out-performance where they have contributed to its achievement, either through lower access charges or a more direct efficiency benefit share.

The question was raised about whether NR should be allowed to take a "risk sharing" or "risk bearing" approach towards financial under / out performance at a Route level, to either trade or ring fence out performance between the Routes. Our view is that NR should remain as one company financially, particularly when dealing with the financial markets to finance its activities, but that within that overarching umbrella the Routes should be held accountable for their results as far as possible. This tends towards a risk bearing approach which should focus attention of the Route management and the local operators and funders to ensure outputs are delivered as efficiently as possible. NR would still be able to present a consolidated view of the aggregate financial performance to funders but we would suggest this consolidation is only done above the Route reporting level, as opposed to trading surpluses and losses between the Routes.

As was noted in both the RVfM report and the consultation the Routes should be large, robust and independent enough to operate as sizeable operations on their own, so we question the need for separate risk buffers at the Route level. We accept that there will be some loss of portfolio risk sharing, but if, on investigation, this is a particular issue for certain large scale but very infrequent events then there would always be the option of letting NR corporately covering this risk through a separate fund or reserve to be allocated to any Route that suffers that unforeseen / unbudgeted event.

Financial Structure

The consultation considers a couple of issues in this area not covered by the detailed questions.

On the idea that the Network Grant should be replaced by increased charges coming to NR via operators, we would not see a particular benefit if operators are just a conduit for passing through a fixed contribution to NR's income requirement. There would need to be some element of variability over the charges or control over the timing of payments (say linked to delivery of HLOS outputs) to affect NR decision making or increase TOC / FOC influence over NR. For this change to strengthen the customer / supplier relationship we would suggest that the Network Grant would need to be disaggregated with a clear link between the charges and the underlying activity they are funding, if the operators are expected to help drive more efficient approaches to delivery.

On the subject of introducing unsupported debt or even equity into NR we think that such a change would act against the current willingness of NR to consider and push forward with structural changes such as Devolution and alliancing. To attract external funding it seems likely that NR would need to provide certainty as to what funders are investing in, which would limit the options for further changes. Debt funders are conservative and we would expect them to demand contractual certainty over the level of risk and income that NR could expect, which would make NR more reluctant to change structures or would risk giving NR a stronger position in its contractual rights as appeared to be done at Railtrack's privatisation to attract investment. There will no doubt be a role for external investment in managing the infrastructure in the future, but we suggest that the industry should change its structures first and build up a track record of performance based on the devolved Route based structure, before going to the market to attract funding.

Overall First believes that the periodic review has come at a good time given the appetite for significant change in response to the challenge set by the RVfM report. We are very happy to be fully involved in the periodic review process and would be happy to help work through the issues it is raising.

Please do not hesitate to contact me if you would wish to discuss any of the points raised in this response in more detail.

Yours sincerely

Hugh Clancy
Commercial Director, Rail

Appendix - Consultation question responses

Objective for PR13
Do you agree with our proposed objective for the review? If not, what issues would you add or subtract?
FirstGroup response: The objective and the general measures set out to achieve it are broad based and respond to the key issues in a focused and appropriate way. We do not propose any additions or subtractions from the overall objective. We also welcome the market and incentive based approach and the plan to specify outcomes / outputs to be delivered in the Control Period. As highlighted in our main response we would urge that the final recommendations for how to deliver the objective take into account the changes already underway to deliver improved efficiency and closer cooperation between TOCs and NR. The recommendations should aim to complement the emerging processes not replace them. Some specific comments on Chapter 3 are: • Para 3.12 (c) - In aiming for the railway to have "levels of efficiency comparable with the best railways internationally" we would recommend that the measures to be used for this comparison are agreed up front and that they are carefully assessed to ensure they are appropriate measures for UK Rail and do not drive unintended consequences; • Para 3.10 (c) – setting price signals to encourage efficient use of capacity (especially if franchised TOCs are to be exposed to changes in charging regimes) is only effective if the franchising specification allows TOCs to flex their outputs to respond to those signals. If the franchise specification is fixed the price signals just become an additional cost to deliver a fixed output; • Para 3.12 (b) – there appears to be a potential conflict between making more efficient use of capacity whilst aiming to give FOCs increased flexibility.

High level timetable
Do you have any views on our proposed timetable for the review? Do you need further information to plan your involvement in PR13?
FirstGroup response: The timetable seems reasonable for the process set out in the consultation and builds on the well understood timetable used for PR08. Our one comment concerns the suggestion that ORR may recommend weakening or removing the 18.1 / Sch 9 franchise protections around exposure to changes in the charging regime, in order to incentivise greater involvement from franchised TOCs in the periodic review process. If this is an output that ORR wants from PR13 then this change and the details of how it would apply to current franchises needs to be communicated early enough to ensure the TOCs can contribute fully to the PR13 process itself from the viewpoint of their changed risk profile. As we comment elsewhere such a move would significantly increase the level of risk for TOCs and we do not support such a change, but if introduced it might trigger a change to the

overall timetable.

Network Rail devolution and price control separation
Do you think our approach to the disaggregation of NR financial and other data to operating route is appropriate? Is the information we are requiring NR to produce set at the right level? Do you have views on the information train operators should produce? *Which aspects of the price control should be separated for England & Wales and Scotland e.g. should the efficiency assumption be separate?* *Do you think there should be further separation of the price control for NR's operating routes and, if so, which aspects of the price control should be separated?*
FirstGroup response: We support ORR's proposal to apply price control over the efficient level of expenditure at the devolved Route level. As the expenditure levels are necessarily linked to the outputs to be delivered at the route level, we believe that, where practicable, the CP5 outputs should also be built up and regulated at this Route level. The existing price controls between station and track access or between passenger and freight operations should be retained – the separation of costs / revenues between these activities should help identify opportunities for efficiencies and help devise relevant incentives for improvement. Whilst not advocating a similar price control separation for the separate activities within the rest of NR's operations, we support the level of information being sought from NR at the Route level (as shown in Annex B) disaggregated into: • Income; • Support and operations; • Maintenance; • Renewals; and • Enhancements. This greater granularity of data not only helps ORR in determining the efficient level of expenditure but also allows TOCs (and the NR Routes) greater visibility of the projected cost of operation for these activities when seeking ways to work collaboratively with NR at the Route level to reduce industry costs. The question of whether different efficiency assumptions should apply for England & Wales and Scotland, or even between the Routes within England & Wales, should be explored. It would seem likely that different Routes would have different levels of potential for efficiencies based on the mix of different infrastructure and operations on those route networks. We are not sure whether the current level of understanding of opportunities for efficiency savings are sufficiently well developed to allow a robust application of differential efficiency assumptions by Route, but the issues around the idea should be investigated. The logic that has led to the separation of the RAB and notionally separate debt calculations for England & Wales and Scotland in PR08, to allow calculation of the separate revenue requirements for each, could be extended to the individual Routes. Whilst at present there is largely one funder for the England & Wales part of NR that might not always be the case and with the recommendation in the RVfM report to

explore closer cooperation, joint ventures or even vertical integration between operator and Route it would be expected that different levels of efficiency and expenditure should in time result in different revenue requirements and charges at a Route level. We are not advocating a subdivision of the RAB at this time – very little will be decided in CP5 on the basis of a somewhat arbitrary splitting of the historic RAB. However, it might be worth considering splitting all further renewals and enhancement investment into Route level RABs to start to form the basis of Route level charges in the future, to be based on the level of investment in those routes.

The RVfM report suggested that the transparency of financial information should extend to TOC data to help provide route level whole industry P&L accounts; and to enable annual comparative benchmarking of TOC costs. Whilst we are working with ATOC to see how high level whole industry P&Ls may be provided at a business sector or route level, we would strongly question the real need for or benefit of benchmarking of TOC cost data.

Unlike the periodic review of NR's expenditure which is required in order to ascertain the level of funding NR requires to deliver its outputs, under the current franchise agreements the transparency of TOC financial data is not going to impact on the TOC's funding. That is set through the franchise bidding process based on the outputs and requirements set by the DfT, with DfT selecting the bidder which demonstrates the best risk adjusted economic value in its bid, as represented by the net subsidy requirement or premium. Cost is just one factor in arriving at the net subsidy / premium and the franchisee is incentivised to manage the net value, so a separate external focus or target upon just the cost line would not be aligned with the way the franchise operates. This could restrict its ability to optimise VfM, if cost constraints led to missing out on opportunities to grow passenger revenues.

Furthermore, the costs included in the franchise bid are largely determined by the franchise specification and even for the new franchising model there seems limited ability for the TOC to change the service outputs to drive cost savings. Benchmarking of TOC costs seems likely to be largely a benchmarking of the differences between their franchise specifications or inherited differences relating to the type of rolling stock or type of operation. Many costs are fixed for the franchise length (eg rolling stock leases) whilst others would change only over long periods of time. The question about whether TOCs should provide commercially sensitive financial data to ORR for benchmarking really comes down to what real purpose it would serve – TOCs are already financially incentivised to optimise the net profitability of the franchise, including controlling costs, and we do not believe sharing cost information will materially improve upon our existing incentives.

Setting outputs

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?

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

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

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

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

FirstGroup response:
We welcome the introduction of the first stage of the periodic review process being the submission of an industry wide developed Initial Industry Plan (IIP) setting out what the industry as opposed to just what NR believes should be the outputs that Funders should be seeking in CP5. The previous HLOS process appeared to have a pre-disposition towards infrastructure investment rather than whole systems solutions to delivering the required outputs, and we hope that the current process delivers a more holistic approach to setting the outputs.

As in the current debate with DfT over the level of franchise specification, we prefer to be set target outputs or outcomes to achieve, leaving NR and the wider industry flexibility in how best to achieve those outputs, rather than regulating on the inputs to be delivered. There is already experience of setting an industry wide outcome rather than NR controlled outputs in how CP4 set an Industry outcome of improved performance as measured by PPM. This has driven a greater degree of co-operation within the industry in aiming to achieve the targeted outcome, and moved NR's attention (to some extent) away from just focusing upon its own delay minutes to considering the impact on the end customer from all delays and cancellations as measured in PPM. (There is still a way to go in this regard as it is still clear that the Schedule 4 regime dominates the decision making at NR Control Centres, with the focus still primarily on delay minute attribution with little attention on cancellations).

This type of output / outcome based approach may be useful in delivering improvements in other areas, such as passenger information during disruption where a similar type of industry wide cooperation to deliver the defined output could be as successful as the National Task Force has been in driving forward performance improvements.

In other areas it is harder to set realistic outcome based targets – whilst improved customer satisfaction (NPS) would be a desirable outcome, its achievement is not sufficiently within the control of NR to enable it to be a hard target to achieve in CP5 – the end result is dependent upon too many factors such as fare increases which are not within NR (or even TOC) control.

As indicated earlier, we would support the disaggregation of output targets to Route level where that is practical, and expect NR's plans to achieve these targets to be built up from Route level plans.

The number of outputs to be targeted should remain broadly the same as in CP4, although some like the availability metric should be reviewed to see if it is measuring the right thing to deliver the desired outcome.

Improving incentives
Do you have views on how the effectiveness of the existing financial incentives can be improved? *Do you have views on how the effectiveness of NR's incentives to make best use of capacity could be improved?* *Do you agree that we should include a regional efficiency benefit sharing mechanism calculated at the NR route level? Are there further issues about how a regional efficiency benefit sharing mechanism should be introduced which you want to highlight?* *What are your views on exposing franchised train operators to changes in NR's costs at a periodic review?* *Do you believe that NR should share in TOC revenue and/or costs? Are there further issues about introducing a revenue/cost sharing mechanism which you would highlight?* *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?* *Are there further new incentives which you believe should be introduced and what would the benefits be?* *Are there other interactions between incentives (and the wider regulatory framework) which we need to take into account?*
FirstGroup response: On current incentives we are of the view that the incentive to outperform the control period efficiency target by retaining the out-performance to the next CP / for 5 years is a strong incentive which does seem to motivate NR. We believe that the aim of the Schedule 4 & 8 regimes is appropriate and is required going forward. These regimes give important financial signals to reflect the impact of NR's activities upon operators and to help incentivise improved performance (Sch 8) or better designed and communicated possession plans (Sch 4). These regimes have been important to TOCs in developing their franchise financial plans and so any move to weaken or remove them would need to be adjusted for through franchise payments. That said, the regimes currently do seem to drive sub-optimal behaviour between TOCs and NR, particularly around attribution of delay which has become an expensive mini-industry, so some improvements in how to get the mechanisms focused upon the objective not the detailed measurement / apportionment of the system should be targeted – can we get most of the benefits without the current high costs of operating delay attribution? On Sch 4 we do question whether the regime is fully understood at the Route

/ engineering access planning level as we often see decisions taken which do not reflect the incentives to seek to minimise disruptive possessions. This may be because the access charge supplement (ACS) effectively holds NR harmless for the expected level of disruption, although it seems more likely that this factor is also not properly understood at a local level. The incentives will only be effective if taken into account at the decision making stage. We would question whether the Sustained Planned Disruption (SPD) threshold has been set at the right level. The enabling criteria are currently set at a level where they are almost never met, despite sustained periods of disruption which generate losses and costs not captured by the Sch 4 formulae. This needs to be addressed to provide NR with a reason to seek to minimise the impact on the affected operators and to provide a reasonable incentive to the TOC to willingly cooperate with NR to help develop efficient access planning on major projects. To date this effect has been largely neutralised by 18.1 / Sch 9 adjustments funded by DfT, but will be a real concern to new franchises.

We would question the effectiveness of the sizeable Volume incentive payable at the end of the Control Period. An incentive operating at such an aggregate level is unlikely to be targeted enough in driving changes or investments in the areas where extra capacity is most needed and we would echo ATOC's comments that it seems insufficiently understood or capable of being influenced at a local level to be particularly effective.

An incentive to encourage NR to make best use of capacity is required as without it the largely fixed nature of NR's charges gives no financial incentive to accommodate growth. The only volume related element is also only intended to cover the increased operating costs from that extra activity whilst the capacity charge was set to compensate for the increased difficulty in delivering performance targets against a busier network. There may well be an argument for providing an explicit variable element of NR's income explicitly linked to encouraging volume growth, but this needs not to be seen as either too complex to drive appropriate decisions at a local level or too untargeted (like the current Volume incentive) that it can be achieved by increased volumes on the less congested parts of the network.

The HLOS approach setting specific capacity related outputs does incentivise NR to deliver enhanced capacity where it is most needed, but there is not a financial incentive to ensuring that it is used to best advantage. Rather than the HLOS process being seen as driving infrastructure outputs, in CP5 there seems an argument for giving NR and operators HLOS outcomes to jointly develop and deliver increased capacity in the most efficient and effective way.

The CP4 Efficiency Benefit Sharing mechanism has not been effective due to the decision by DfT to assume that this change should be part of the 18.1 / Sch 9 adjustment, which removed all incentive for franchised TOCs to actively help deliver improved NR efficiency. Any CP5 financial incentive to change behaviour will need to retain this financial benefit for the TOCs rather than flow through to DfT this time. There also was an issue that the benefit share was set at too aggregate a level so that it was not apparent that the actions of any one TOC would have a meaningful impact on whether the improved efficiency would result in a benefit share.

Accordingly, we support the proposed move to creating regional efficiency benefit sharing mechanisms, where there should be a greater link between cause and effect from TOC involvement. We think it important that the level of efficiency benefit sharing is linked back to the ability / efforts of the operator to help improve the Route efficiency and so should reward the active participation of operators in helping deliver improvements. This might mean that some initiatives get taken forward only on a bespoke bilateral basis where a more significant cost saving initiative is being taken forward with individual operators rather than all benefits getting pooled irrespective of the level of effort or risk invested in a change. We could see the regional efficiency benefit schemes forming just the base proposition for a Route ensuring that all customers have an interest in seeing the Route becoming more efficient, but with opportunity for greater co-operation to be developed on top of this base level.

Moving towards making the sharing mechanism working in both directions creates a need for greater certainty that the operator can influence change within NR. The operator would need to have stronger powers to control cost risk and that would be difficult to impose as part of a regulated settlement, but would seem to be an option to be developed bilaterally between operator and the Route as part of an alliancing discussion. The operator also would need to be satisfied that the baseline costs and targets for a Route were accurate and deliverable, which may be difficult given the lack of historic cost reporting at a Route level.

The suggestion that NR could share in growth in train operator's revenues seems to be another way of addressing the volume incentive issue. However, it appears that the areas in which NR could most readily influence growth in passenger revenue are also the areas in which the industry relies upon NR's impartiality (i.e. in flexing the timetables or allocating capacity) or from areas like improving operating performance or minimising disruptive possessions which should come from other incentives already. Therefore, whilst not against the idea on principle, we do not see any particular benefit from making NR incentivised to grow TOC revenues and can see some threat to the impartiality that operators expect from the network operator if NR has a contractual interest in the financial performance of some operators but not all.

On the exposing franchised TOCs to changes in NR's costs at periodic reviews, we understand the attractiveness to a regulator of having the customers fully interested in the review process but can see some downsides for ORR in making such a change. The main one, as noted in the Annex, is that the TOCs would find their financial interests aligned with making NR's targets easier rather than moving towards a more customer - supplier relationship. It would also place a greater constraint on the ORR's ability to make significant changes to the charging regimes which might be required to create new incentives, as the ORR would have to take into account the impact of their decisions upon TOCs ability to plan their business – operators would

be looking for a more consistent approach to charging between control periods without the large swings between fixed and variable charges seen in the past. Ideas like the pre-agreed cap on freight charge increases would be more limiting if applied to all NR's customers rather than just a sub-section of the market. Overall we support the extension of efficiency benefit sharing to operate at a Route level and believe that this would incentivise greater co-operation between TOCs and NR to reduce industry costs. However, as highlighted in the covering letter, we feel that great care is needed in designing how these efficiency benefit sharing arrangement will interface with any bespoke agreements between individual operators and NR / local Routes. This is needed to ensure both that operators are rewarded for greater co-operation to reduce costs or improving outputs through alliancing or bespoke agreements whilst other operators, perhaps without a strong overlap with a particular Route, still can help and share in improving Route efficiency.

Financial framework
What are your views on the duration of the control period? *Do you think that we should retain the single till approach rather than moving to a dual till approach?* *Do you think that out overall approach to risk and uncertainty in PR08 was appropriate and are there any improvements that could be made for PR13?* *NR 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?* *We plan to retain the same high-level approach to amortisation in CP5 that we introduced in CP4. What are your views?*
FirstGroup response: We do not see any compelling reason to move away from the 5 year control period duration. Whilst it does result in a significant amount of work to set the framework and funding for the control period, we feel that agreeing the HLOS outputs and SoFA funding envelope for the 5 year period does provide the industry with a good degree of planning certainty which other sectors would envy. We agree that the increased likelihood of needing change mechanisms and the mismatch with the parliamentary cycle weigh against a move towards longer periods. We do not see a reason to move to a dual till approach to separate out "commercial" from "railway" activities. We would not want further degrees of fragmentation on top of the NR devolution to Routes and we would be wary of effectively creating a separate commercial property focused entity within NR which could operate independently of the shared wider industry objectives being developed in response to the RVfM report. The approach to risk adopted in CP4, specifically to inflation and the provision

of a “Re-opener” mechanism, seems well considered and appropriate. There could be an argument to try to make the inflation index more aligned to the specific price inflation faced by NR, such as an increased weighting for commodity prices. However, in considering this issue we would point out that the current approach of using RPI is consistent with indexation elsewhere in the industry, specifically for fares regulation and franchise premia / subsidy, and this consistency provides most of NR’s customers with a form of hedge against RPI inflation rather than expose them to the risk between RPI and commodity price inflation. On re-openers we think that in practice the major events trigger should cover most issues. It probably should be kept at the overall NR level rather than at the Route level (although be capable of being flowed through to the Routes if relevant) unless there is a move towards separate ownership of any route through a concession or sale, where a separate mechanism would be necessary. We have no strong views on the approach to amortization. However, we would question how increasing efficiency in renewals / enhancements in factored into this calculation of the long run average capital expenditure required to maintain a steady state network, as improving efficiency will just reduce amortization and leave a larger RAB to fund. Is this intended to be another indirect incentive for NR, allowing it to raise more income as it gets more efficient?

Structure of charges
Do you consider our charging objectives remain appropriate? *What are your views on the geographical disaggregation of variable usage charges?* *What are your views on introducing a charge levied to reflect network scarcity?* *What are your views on a reservation charge (assuming it would be set to be financially neutral for freight operators)?* *Should passenger open access operators pay charges that exceed variable costs? How should charges be calculated?* *What are your views on the proposals to improve incentives to reduce traction electricity consumption?* *Should we put a cap on certain freight charges in advance of our determination and should these be linked to other charges?* *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'?*
FirstGroup response: We agree that ORR’s charging objectives remain appropriate.

We note the ORR's wish to move away from the network grant and to try to make the fixed charge more representative of the cost of operating the network or the Routes, rather than just a balancing figure to meet the funding requirement for the control period. This could be useful if it provided a reasonable assessment of the individual components of the fixed charge, especially in helping set the parameters for Route based efficiency benefit sharing. However, this would only be worthwhile if TOCs could be satisfied that they would be able to have some influence over NR's decision making over these components of the fixed charge.

As indicated in the section on price control separation we are broadly supportive of disaggregation of charges down to Route level. However, we would caution against using the variable track access charge as the only basis for transmitting differences in Route level efficiency to operators / funders, as the vehicle type basis for the VTA is one of the few areas where there is a strong link between the charge and the underlying cost drivers, which we wouldn't want to see being lost. Any mechanism for feeding back the benefits of more efficient NR delivery should not distort the signals being sent by the VTA charges, unless they do reflect the differential short run incremental cost for that Route.

We do not believe that introducing economic signals to influence the best use of capacity via scarcity charges will work in practice. It would be hard to introduce into the current environment with franchisees insulated from the change and even if in time the new franchises do face the economic signals they will be bidding to deliver a franchise specification which is likely to determine the vast majority of the paths to be operated. This would make the higher charges to access the congested parts of the network just a cost to build into the bid.

The similar suggestion that variable charges should move to recovering the long run incremental cost for the Route, so as to make the charges reflect the forward looking costs of providing capacity including enhancements, is also unlikely to be considered reasonable. This is because most network capacity enhancement schemes are too expensive to be justified in straight commercial grounds over a sensible timeframe – most only make their business case once social and economic benefits are included, which is why infrastructure enhancements are usually financed directly by government funding. There is also an issue about franchised operators with a short remaining franchise life effectively contributing to the cost of enhancements which will be delivered after the end of the franchise.

On the proposed options to change the charges for open access operators we would like to understand the overall package of rights and charges being proposed before we could comment, and so look forward to the separate consultation on how greater on rail competition may work in practice. Overall we would expect any move to introduce a contribution towards the fixed costs of the infrastructure to be part of a wider review which relaxed the not primarily abstractive test.

However, from a franchise point of view we are concerned that some of the justification for considering alternative charging options for open access seems to ignore the impact of the increased competition on franchisees. For example “auction values” or “opportunity cost to the franchise” talk about NR receiving the economic value of the paths awarded, which in time would pass through to the Funders, but there doesn’t appear to be any mechanism to reimburse the franchisee for the loss of value from paths awarded following a relaxation of the Not Primarily Abstractive test. This doesn’t seem to accord with providing certainty for operators to plan their business.

The proposal to review reservation charges for freight operators seems to overlap with the consultation on Part J and we would recommend the rules on allocation of freight paths is finalised before overlaying further changes in the charging regime to achieve a similar objective.

Our views on proposals to improve incentives to reduce EC4T consumption are that an incentive on NR to reduce transmission losses needs to be introduced. This is needed to enable NR to have a business case to invest in addressing the issue. We support the ATOC suggestion that NR is only allowed to recover costs for an efficient level of transmission losses with a progressively tightening target over the control period.

TOCs already have an incentive to introduce more efficient driving techniques or lighter weight vehicles, where the benefits eventually feed through the wash up process. However, with NR incentivised to address network losses there should be a stronger business case for further on train metering to establish the true scale of the problem and the opportunity for NR to address.