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8th February 2012

Dear Richard,

Periodic Review 2013 – Consultation on Incentives

This letter represents CrossCountry's formal response to the ORR's Consultation on incentives for PR13. Please note that whilst we do not wish to respond to all of the questions listed in the consultation document, we would like to raise a number of comments against issues that directly affect CrossCountry and the current Cross-Country franchise.

Part A – The PR13 objective

CrossCountry recognise and accept the importance of aligning Network Rail's incentives to wider industry outcomes, as this should help to minimise the 'gap' that exists between Network Rail and its ultimate customers (ie. passengers), which can currently lead to fundamentally differing priorities between industry parties. Bringing Network Rail closer to its ultimate customers through an effectively structured regulatory regime should encourage it to manage the network and make decisions that are more aligned with passengers' interests. However, and as CrossCountry mentioned in our response to the ORR's May 2011 Consultation, we remain of the view that for PR13 the ORR's priority should be to continue to focus on incentivising Network Rail through regulation of defined outputs rather than the delivery of outcomes. The reason for this is that if the regulatory framework is effectively aligned, and Network Rail meets its regulated outputs as remitted, then corresponding improvements to wider industry outcomes should automatically follow suit. If this is the case, then direct monitoring and maintaining delivery of outcomes (rather than just outputs) would perhaps be unnecessary.

Furthermore, monitoring and enabling Network Rail's delivery of outcomes in CP5 would no doubt be more difficult to administrate than monitoring just the outputs (Questions 3.4 and 3.5), and whilst CrossCountry agree with the logic that Network Rail are in a central position to lead cross-industry working towards meeting wider industry outcomes, we still believe it is probably unfair, and unrealistic, to hold Network Rail responsible for issues that are outside of its control yet might still affect certain outcomes. The passenger satisfaction outcome, for example, can be driven by a number of different factors (for example fares or fleet performance issues) which may be outside of Network Rail's control. We would therefore much prefer that Network Rail was held specifically to account for its delivery on committed outputs that it has direct influence over.

Notwithstanding any concerns we may have about perverse incentives that exist within the current regulatory regime (see below), the ability to hold Network Rail to account for its direct failure to meet specific targets through regulatory action is effective, mainly because the link between output and measure is clear. In the event of Network Rail failing to meet industry *outcome* targets, the reasons behind the non-compliance may not necessarily be straightforward, meaning that remedial actions could be difficult for Network Rail to accurately target.

Part B, Chapter 4 – Aligning Network Rail and Train Operators incentives to increase efficiency.

The consultation document addresses the option of exposing operators to changes in Network Rail's fixed costs at subsequent Periodic Reviews (Question 4.5), by exposing operators to changes in a proportion of Network Rail's operating, maintenance and renewal costs. CrossCountry have two concerns with this suggestion; firstly it should be noted that operators currently bid for franchises against fixed assumptions, and are already exposed to large amounts of financial risk within the course of the franchise period (for example the impact on revenue from wider economic conditions). Adding a further risk element to a franchise's economics is likely to reduce its overall value, and hence the acceptability of this is an issue that the ORR must discuss directly with the franchising authorities due to the presence of the current Schedule 9 protections.

Furthermore, and whilst accepting that this workstream is still work-in-progress, it is perhaps still unclear to CrossCountry where operators could actually have a significant role in reducing Network Rail's costs other than through bespoke Schedule 4 / 8 agreements. As discussed at the ORR's workshop last September, by far the largest component of Network Rail's operating expenditure consists of its own signalling costs, which will only be addressed fundamentally in the long-term by Network Rail's signalling modernisation strategy. Furthermore, the bulk of Network Rail's efficiency improvements in maintenance will probably come through improved management of its own internal supply chains and by widening the niche market amongst suppliers that is driving up the cost of components. Neither of these problems are something that operators can directly influence.

Notwithstanding this, CrossCountry could see the logic behind developing an efficiency sharing mechanism if this will encourage closer alignment and development of initiatives between Network Rail and operators, but understandably CrossCountry are concerned that if this is arranged on a route-level basis then where would this then leave nationwide operators, whose exposure to each route is more limited. Would efficiency benefits then be disaggregated on a pro-rata basis? Furthermore, in order to accurately administrate an efficiency mechanism on a route-level basis there understandably needs to be a significant amount of analysis conducted on route-based costs first, and CrossCountry do not believe enough work has been completed to enable an accurate mechanism of this sort to be initiated for CP5, and it should perhaps therefore be left for development in CP6 instead.

Having said all this, as CrossCountry understand it the delivery of efficiency savings is the primary driving force behind the devolution process, as management decisions are devolved down to a localised level so the performance between individual routes can be effectively benchmarked. It is therefore probably best that it is left to individual routes and operators to negotiate their own Alliancing arrangements as they are best placed to identify where potential efficiency savings could be achieved through closer working. In that case, it could be argued that developing further mechanisms to stimulate efficiency savings should be unnecessary – as efficiency savings should naturally be realised through the Alliancing process anyway, otherwise would it not be the case that devolution will have achieved very little?

Possessions and Performance Regimes

Before any discussion about bespoke Schedule 4 / 8 regimes can be undertaken it must first be understood how Schedule 4 and 8 are viewed within the industry, compared to what both regimes are actually designed to deliver. CrossCountry accept that Schedule 4 and Schedule 8 perform effectively as compensatory regimes, but in our experience the incentive effects on planning possessions and improving performance are minimal. As long as these regimes are viewed only as compensatory mechanisms (and we believe that Network Rail view them as such), then can we start assessing whether the benchmarks are set at the correct level and whether the regimes function accurately.

On that note, CrossCountry have not seen any evidence that either regime actually goes as far as incentivising behaviour within Network Rail (Question 5.1), other than in encouraging Network Rail to book possessions early due to the Notification Discount Factors that are applied, and this in itself may actually be having a somewhat negative effect. Whilst CrossCountry consider that Schedule 4 acts as a correct and reasonable compensation for the revenue consequences, we consider the discount for advance booking, particularly for two years' notice, to be excessive. The present level is based on the assumption that a large proportion of passengers are able to change travel to another date, so their revenue is not lost. CrossCountry do not believe this actually represents behaviour in a competitive market with other transport modes and, more significantly does not reflect the cumulative damaging effect of multiple possessions on weekend travel. CrossCountry is typically impacted by more than one possession every weekend, greatly limiting the ability of potential passengers to choose another date, even if they are minded to do so. Equally as importantly, we also believe the present level of discount incentivises Network Rail to book an excessive number of possessions two years in advance when they are relatively cheap, which are then not efficiently used.

Not surprisingly, CrossCountry do not then agree with the suggestion that compensation rates could deliberately be set below the full cost of disruption to operators, to try and minimise the impact of possessions through greater co-operative working (Question 5.3). CrossCountry already have mechanisms in place that enable us to work closely with Network Rail's Engineering Access Planning (EAP) department to minimise the footprint of engineering disruption by the co-ordination of possessions, and we have stated our committed intention to minimise the impact of disruption through single-line working or other innovative train planning solutions in our JNAP. This is an agreed commitment.

CrossCountry do not therefore see any need to overhaul Schedule 4 for CP5 as it works fairly well as a compensatory mechanism, if not in incentivising behaviour. In our experience possession planning behaviour at Network Rail is actually driven through bilateral agreements or joint working initiatives such as the JNAP and CrossCountry's 'Rules-of-the-Revenue'.

On the subject of performance, CrossCountry also do not agree with the suggestion that Schedule 8 is currently over-compensating operators for service disruption, and CrossCountry raised a number of comments in the ORR's May 2011 consultation emphasising that the risk to franchised operators from poor performance is far greater than to Network Rail, not least because of the scale of monies involved with Schedule 8 - which are of much greater significance to operators than to Network Rail. Additionally, operators face a greater risk than Network Rail as the operator's direct revenue, corporate reputation, and franchise commitments to the franchising authority are all at risk from poor performance, which Schedule 8 does not take into account. These factors all provide a greater incentive than Schedule 8 for the operator to perform, yet there doesn't seem to be any evidence of Schedule 8 driving Network Rail behaviour to deal with the root causes of poor performance, which only appears to be achieved through ORR intervention in the event of non-compliance with regulatory outputs. On this evidence it could be argued that Schedule 8 has little impact as an incentive regime.

Regarding bespoke Schedule 4 / 8 regimes, CrossCountry agree that operators should be free to discuss bespoke regimes with Network Rail at route-based level, but the basic regime should continue at a national level to provide financial security to nationwide operators. Furthermore, in terms of management of nationwide interests, CrossCountry's breadth of operations means that we (alongside freight operators) are a natural carrier of 'knock-on' delays around the rest of the country. CrossCountry have the highest TOC payment rates which reflect the high cost of TOC-on-TOC delays. If the biggest risks are to be found in deteriorating performance on cross-country routes, then it is even more important that Network Rail are able to manage these routes and the investment that is needed on them in at a national (or similar) level.

Finally, CrossCountry's experience of the Sustained Planned Disruption mechanism is that it is currently impossible to meet the required benchmarks to trigger compensation. CrossCountry acknowledge that the ORR is currently reviewing the revenue and cost benchmarks for CP5 and this is welcomed.

Chapter 6 – Access Charges

CrossCountry support the concept of operators and Network Rail making bespoke deals regarding modifications to vehicles to reduce operating costs, as long as the investment protection is provided by retaining any charging differential between Control Periods (6.21). In principle, making this process easier should help to reduce overall 'industry costs' and should therefore be welcomed. However, there are two concerns to consider – firstly, for a national operator, route-based charging would most likely complicate this process somewhat. For example how would the modelled saving be applied between routes that have completely different network characteristics (linespeeds, track curvature etc?)

Also, another concern that CrossCountry have from experience is that Network Rail can be somewhat reluctant to wish to work towards reducing variable track access charges in line with any vehicle modifications, as their initial concern seems to be that they will be left 'out-of-pocket' for the remainder of the Control Period. This is despite the logic that the reduction in variable charges should be balanced by a reduction in maintenance requirements (from less wear and tear).

Chapter 7 – Capacity utilisation incentives

CrossCountry agree that Network Rail currently faces weak incentives to meet additional demand, as there is perhaps a perverse incentive upon Network Rail's Operational Planning department to *not* extract maximum use of network capacity due to wanting to avoid any timetable-related delays, so some form of enhanced volume incentive for CP5 could encourage Network Rail to work more proactively with operators to improve capacity utilisation. However, Question 7.1(c) addresses a more pressing issue for the rail industry, in that despite the development of new planning tools and the presence of extensively researched strategic planning documents (ie. RUSs), we still do not accurately understand what the current capacity of the network actually is. Historically this has resulted in significant amounts of money being spent on capacity enhancement projects to deliver capacity that has subsequently been found on the network, simply through improved timetabling. A key task should therefore be for Network Rail to initiate a workstream to accurately model the capacity of the existing network and developing a new metric, as the only capacity metric currently available – the CUI, is a blunt instrument and not maintained as a live measure as the timetable changes. It also does not inform timetable planning decisions on capacity allocation as they occur through the normal timetabling process.

Furthermore, and as CrossCountry noted in our response to the May 2011 Consultation, one of the ORR's stated challenges for the industry in CP5 is for 'optimising the use and development of the network'. Financial incentives (such as introducing new charges) are not necessarily the only way to incentivise Network Rail to make optimum use of capacity. CrossCountry services currently endure significant amounts of pathing time within their schedules, amounting to 48 hours of pathing time per timetable day (SX), which not only extends journey times beyond their realistic lengths (reducing the overall 'value' of the franchise), but also soaks up capacity on the network unnecessarily. The same observation applies to engineering recovery allowances. Our analysis shows that a further 31 hours of unused engineering allowances are applied to our schedules for each SX timetable day. These allowances are proven not to be used for engineering-led TSRs, and therefore contribute substantially to the inefficiency.

If making more efficient use of capacity is to be a key objective for CP5 then the timetabling issues should be addressed first. In order to be fully effective this would need a national timetable recast based on a full understanding of the relationship between capacity and performance. Our observation is that this relationship is not properly understood by Network Rail presently, resulting in a risk-averse approach to timetable planning where schedules are heavily 'padded' to compensate for network delays. This approach has the dual effect of producing an inefficient timetable plan, as well as actually contributing to network delays in some instances as train presentation at key nodes can become unpredictable as trains do not present themselves where they appear 'on the graph' because of the effects of the padding.

In summary, CrossCountry welcome the ORR's acknowledgement that there is a current misalignment in incentives between Network Rail and operators, which is driven in part by some perverse incentives that have arisen due to the regulatory structure. We are pleased to see that the ORR is actively looking for ways to improve this structure and bring Network Rail closer to the interests of passengers. The devolution process is well under way and has the potential to enable Network Rail and operators to achieve this, and also to seek out and identify efficiency improvements of their own accord. The ORR should be fully engaged as these developments progress and ensure that its regulatory changes for CP5 support the developments entirely.

CrossCountry trust that you find the comments raised here of use, and of course would be pleased to discuss further. Please note also that we have no concerns with this response being published on the ORRs website.

Yours sincerely,

James Carter
Track Access Manager