

Stagecoach Rail
Friars Bridge Court
41-45 Blackfriars Road
London
SE1 8NZ

Richard Owen
Office of Rail Regulation
One Kemble Street
London
WC2B 4AN

8 February 2012

Dear Richard

Periodic Review 2013: consultation on incentives

This response is submitted on behalf of Stagecoach and its two train operating companies, Stagecoach South Western Trains and East Midlands Trains. The consultation document raises a significant number of issues. We have provided a summary response and specific responses to those questions posed which we believe may impact upon the Alliance that SSWT and Network Rail Wessex are currently developing.

We generally support the views that ATOC have given in their response to the consultation in that we are not convinced of the rationale for significant changes to the existing incentive framework. The challenge as we see it, and as set out in Sir Roy McNulty's Value for Money report, is to reduce the cost of the rail industry. His report highlighted that train operating companies were some 5% more efficient than European comparators whilst the UK Infrastructure Manager was some 50% more expensive than comparators. PR13 must therefore concentrate on the monopoly provider of infrastructure, Network Rail, and how costs are to be reduced in order to deliver value for money for customers and funders and bring benefits to passengers. TOCs can and will participate in this but need corresponding levers and incentives in their franchise agreements, which are not part of this consultation.

The McNulty report set out some pointers towards how this might be achieved including through the letting of direct concessions and trials of vertical integration. Since 2001, in our document "*A platform for change*", we have set out our belief that vertical integration can bring about improvements in safety, performance and costs of the railways and we would reiterate our belief that such arrangements offer the best way forward. ORR is aware of the steps we have taken with SSWT and Network Rail Wessex towards a ground-breaking Alliance, which we are confident will bring benefits to the industry. ORR should consider the incentives Network Rail needs to encourage it to further embrace these new methods of working and a move towards concessions.

ORR has a key role to play in ensuring that Network Rail has clear, deliverable outcomes to bring down the cost of the railways to passengers and taxpayers. ORR must also be able to demonstrate that it is capable of monitoring and using the incentives framework to the benefit of train operators and their customers.

In response to some of the specific areas on which the document seeks comments, our views are set out below:

Q4.1 What are your views on the proposed principles for efficiency sharing arrangements between Network Rail and train operators? To what extent do you think they will improve the incentives on train operators to work with Network Rail to reduce its costs?

Q4.2 What are your views on our proposed design of a route-based efficiency sharing mechanism, as described in chapter 4 and in Annex B? To what extent do you think they will improve the incentives on train operators to work with Network Rail to reduce its costs?

We believe that the best efficiency gains for the industry will be delivered through bespoke Alliances arrangements between TOCs and Network Rail. TOCs will be able to bring more commercial and innovative approaches to the table and areas of duplication will be reduced. We believe that this type of collaboration will also lead to improved operational performance and customer satisfaction. For these initiatives to develop, it is essential that the TOCs are financially incentivised through the implementation of efficiency schemes and that savings are not recovered through the Schedule 9 'Change' mechanism in their franchise agreements. We support an alternative approach whereby the taxpayer benefits when incremental profits arising from an Alliance exceed agreed limits.

Where bespoke arrangements are not implemented, we support in principle the default route-level efficiency benefit sharing (REBS) mechanism which incentivises TOCs to work with Network Rail to identify and help implement opportunities to increase Network Rail's efficiency and to drive down costs. Greater alliance between TOCs and Network Rail would ensure both parties work closer together to bring a tighter control on costs whilst trying to maximise the benefit for both parties. However, this ultimate goal can only be achieved only if Network Rail's costs are transparent to TOCs, so that the baseline can be identified and efficiency targets set at a level which is achievable. We believe that further work is necessary in developing a default REBS mechanism including:

- A methodology to enable TOCs to be satisfied that the targets ORR sets are both achievable and, with the help of the TOC, capable of being exceeded. TOCs will feel aggrieved to be financially prejudiced if targets are set at a level which acts as a barrier. Any REBS mechanism must therefore lead to a collaborative and not an adversarial approach.
- A means to ensure that efficiencies produced by the REBS mechanism are not subject to the Schedule 9 Change mechanism to enable existing TOCs to retain the benefits; we believe that a failure to secure this will significantly reduce the extent to which efficiency opportunities will be realised.
- Whilst undesirable, if efficiencies are subject to the Schedule 9 Change mechanism, a methodology must be identified to assess at the time the CP5 determination is made the reasonable adjustment that needs to be made to franchise premia profiles etc. We see this as a particularly problematic area.
- We strongly support the view that the Schedule 4 and Schedule 8 regimes should be included within the scope of the REBS mechanism. If appropriately incentivised, we believe this will lead to improvements in operational performance and possession planning for the benefit of passengers.

- It is possible that on a Network Rail route, there may be multiple operators and that may lead one operator working under a bespoke mechanism and another operator working under the REBS mechanism. Further work needs to be undertaken to establish how two incentive regimes could work in tandem. It is our belief that where a bespoke mechanism has been adopted by the primary operator on the route, the REBS mechanism should only be applied after the bespoke sharing arrangements have been accounted for (with some form of protection for minor operators).

Q4.3 What are your views on our assessment of the role of bespoke arrangements? In what circumstances do you think bespoke arrangements are likely? What advantages and disadvantages might they bring? How should we best assess them? What are your views on the scope for excluding some of Network Rail’s costs from the default efficiency sharing mechanism?

We believe that the greatest efficiency gains will occur where the parties form a bespoke Alliance and TOCs are financially incentivised by being able to retain a significant proportion of their share of any efficiency improvements. We believe that it is likely that no two bespoke alliances will have identical features. The extent of the alignment will depend upon the partners’ appetite for risk, the extent that it is believed that synergies can be implemented and the extent that, pre-alliance, the partners are already collaborating together. There is already a theme of collaborative working in the SSWT/Wessex area, as exemplified by the success of several existing joint initiatives including the WICC and Right Time Railway working groups.

Whilst it is desirable to bring as much of Network Rail’s cost base as practicable into any Alliance, it is essential that TOCs are able to help Network Rail address that cost base; there would be little benefit, and possibly even a detrimental impact, if areas that the Alliance partners cannot directly manage are brought into any bespoke arrangement.

Q4.4 What are your views on our assessment of potential impacts of a route-based efficiency sharing mechanism, as described in chapter 4 and in Annex B?

We believe that further work needs to be undertaken over and above those issues identified if a REBS mechanism is to be introduced. Areas where further clarification will be required include:

- The arrangements for sharing renewal and enhancement expenditure efficiencies.
- How ORR will ensure TOCs are satisfied that its route-based efficiency targets are achievable.
- How ORR will treat ‘sustainability’ of efficiency initiatives.
- The methodology to be used to calculate efficiency savings.
- Determining the level of engagement that operators are required to demonstrate before efficiencies can be shared.

Q4.5 What are your views on our preliminary proposal for exposing passenger and freight operators to changes in Network Rail’s fixed costs in subsequent periodic reviews?

Whilst we see some merit in this approach to better align Network Rail’s and operators’ incentives, it will only work if the operator is confident of the deliverability of the target, the risks of entering into such an arrangement are fully transparent and documented and, as previously

mentioned, the cost base covered by the regime includes only those cost/revenue streams that the operator can influence.

It is difficult for a TOC to negotiate a baseline in an Alliance agreement with Network Rail that spans CP4 and CP5 when it does not have visibility of the level of track access charges in CP5. We would like ORR to take this into account when it makes its route level determinations, to ensure that Alliance agreements spanning the two control periods continue to be able to make efficiency savings in CP5.

Schedule 4

We agree with ORR that setting payment rates at any level below 100% compensation would not encourage TOCs to work with Network Rail to minimise the number and impact of possessions. Instead we believe that ORR must look at the way in which Network Rail treats Schedule 4 costs in order to provide greater incentive to it to plan possessions in a way that minimises the level of disruption to train services and passengers. We have observed that Network Rail treats Schedule 4 costs as capex as opposed to opex, whether the possession relates to enhancement, renewal or maintenance work. Whilst we strongly support the principle of piggybacking maintenance possessions onto enhancement possessions to minimise disruption to passengers, we believe that the incentive value of Schedule 4 is diluted when Schedule 4 payments are not budgeted or accounted for at a route level through opex.

We welcome ORR's commitment to work with the industry to look into whether changes, such as the introduction of Joint ROUs, can be made to ensure incentives are better aligned during extreme weather conditions. We do not agree with Network Rail's view that during extreme disruption, train operators have the incentive to keep a full timetable, even if undeliverable, and receive Schedule 8 payments for the delays and cancellations that result. In the experience of SSWT, running a contingency timetable provides a far more robust service for our passengers. Running a full timetable poorly carries the risk of reputational damage and Schedule 8 compensation is not guaranteed in such instances as the delay minutes generated are subject to dispute resolution negotiations with Network Rail. During extreme weather SSWT has successfully operated a snow plan timetable which has been developed over several winter seasons and now operates with very high levels of punctuality. As such, the Schedule 8 delay minutes generated are usually minimal. We believe that the introduction of joint ROUs could provide greater alignment of incentives during extreme weather conditions. We think that Joint ROUs should be declared by default if certain weather conditions are met and either party wishes to operate an emergency timetable but this cannot be agreed, and that a proportion of the full Schedule 4 compensation due to the train operator should be paid by Network Rail.

Yours sincerely,



Sam Gibbins
Track Access Manager
Stagecoach South Western Trains Limited
On behalf of Stagecoach Rail