



Association of Train Operating Companies

Response to the ORR's consultation on the Draft Determination

September 2013



Introduction

ATOC provides a national voice for Britain's passenger train companies, helping to create, inform and shape the rail environment in Great Britain. We bring together all train companies to preserve and enhance the benefits for passengers of Britain's national rail network, which jointly we do by providing the following key services:

- A central clearing house for the train operators, allowing passengers to buy tickets to travel on any part of the rail network, from any station, through the Rail Settlement Plan
- A customer service operation, giving passengers up-to-the-minute information on train times, fares, reservations and service disruption across the country, through the National Rail Enquiries (NRE)
- A range of discounted and promotional rail cards, cutting the cost of travelling by train for groups including young people, families, senior citizens and people with disabilities
- Operational and engineering expertise, promoting safety, setting standards and encouraging excellence across the sector.

ATOC's mission is to work for passenger rail operators in serving their customers and supporting a safe, reliable, attractive and prosperous railway.

Executive summary

1. CP5 represents a period of challenge and opportunity for the railway. Building on the 70% growth in passenger journeys, rising satisfaction and increased efficiency over the last fifteen years is critical to meeting the requirements of users, funders and the Office of Rail Regulation (ORR). Our response to the Draft Determination (DD) reflects this.

2. The key themes that underpin ATOC's response are as follows:
 - Support for the overall approach set out in the DD, recognising that gains in Network Rail's efficiency and affordability can be delivered through the ORR providing increasing scrutiny and challenge of Network Rail (NR) as a monopoly supplier;
 - Strong endorsement for the ORR's commitment to ensure that NR's asset management and information is improved;
 - Once regulatory outcomes are agreed and made explicit, they must be delivered by NR and tightly regulated by the ORR. Trade-offs between these outcomes must be a last resort option, not an alternative to firm commitments;
 - The ORR can go further in the Final Determination, to provide more explicit recognition of train operators as core customers of NR, and to state that meeting our needs is central to NR's successful delivery of its CP5 outputs;
 - A number of the elements of CP5 have been addressed in a piecemeal fashion, with train operators left to work out for themselves the potential impact on their business from the cumulative effects of individual consultations and initiatives. We have engaged extensively with the ORR to explain the resulting regulatory burden in a constructive way, and built the mechanisms to allow immediate engagement on key CP6 decisions. The ORR has provided valuable reassurance to the ATOC Board of its intention to address this point, and we would wish to see this now embedded in the documentation; and
 - Continued engagement with the ORR Board to build improved understanding and provide sharper focus as to how regulation can support better services for end users. There are significant opportunities to develop mature and sustainable relationships across

the industry.

3. We recognise that the DD is focused primarily on NR outputs. Our response focuses on issues that have a direct impact upon the business of train operators, and their ability to deliver required industry outcomes.

The Periodic Review process and industry engagement

4. TOCs are the primary customers of NR, requiring an efficient, highly-performing network to deliver their timetables and thus meet passenger and funder requirements. The DD does not yet place sufficient emphasis upon this status as a customer, or make explicit the important role and responsibilities of industry parties in delivering these outcomes. We have not yet seen the explicit customer relationship expressed in NR submissions to the ORR. We would expect the price review process and the Final Determination to set a tone that mirrors market conditions, setting out the context of the monopoly role of NR in delivering customer service.
5. There have been improvements to industry process and involvement during the PR13 process, for example in engaging with ATOC and TOC representatives through ORR and NR working groups. However, both the volume and timing of industry consultation did not take into account wider industry resourcing or non-PR13 priorities to deliver ongoing commitments to passengers and funders. The periodic review process has steadily become a significant rail event in itself, rather than a mechanism to set NR's revenue requirement.
6. We remain concerned specifically that the ORR's approach to developing the framework for track access charging in CP5 has not been holistic and has resulted in disconnects across the overall package. We have reflected this in our ongoing dialogue with the ORR Board and in responses to the ORR Business Plan and individual consultations. It is vital that the ORR starts to lower the overall regulatory burden that this creates, through showing clearly how each individual proposal connects with others, and by providing coherent, consistent and incremental impact assessments of the interactions between charges, incentives and the delivery of NR outputs.

7. We are seeking a robust, credible and lighter-touch approach to CP6, where key principles and non-contestable decisions can be agreed early, and key areas of debate or problem solving are begun well in advance. We wish to work with the ORR and NR to consider options and develop this before the formal CP6 processes commence.
8. Several key issues, including the capacity charge, volume incentive and the performance regimes, are still unresolved at a principles level at the time of this consultation. The interaction between the capacity charge and the performance regime needs to be integrated in such a way that NR is encouraged to optimise the use of the network and accommodate growth. Interaction of the performance regime with the volume incentive must be reviewed holistically before the Final Determination, as agreed recently with the Rail Delivery Group (RDG). This should avoid creating the potential for perverse incentives and to ensure that industry parties are clearly sighted on how to work together to make best use of the network while delivering a high level of performance. There are important and valuable lessons to be learned from this that will support a more effective process in the future.
9. The DD does not provide recognition of issues around the quality of the NR Strategic Business Plan consultation and its timescales. The plans were received by TOCs very late in the process, at final draft stage, and thus with little time for interpretation or comment. ATOC has discussed the unsatisfactory nature of this with NR and the ORR, and wish to work in close collaboration to prevent any repetition for CP6.
10. We consider that in parallel to the development of the Final Determination and the NR Delivery Plan, the ORR needs to set out an improved approach to its engagement, monitoring and enforcement activity before the start of CP5. Train operators have a significant role to play in underpinning the delivery of NR's outputs in CP5, and we expect strong support from the ORR to ensure the delivery of our obligations to passengers and funders. With major projects to be delivered, such as Midland Main Line electrification, the ORR should support them through ensuring that NR's outputs are aligned with rolling stock, franchising and depot provision.
11. Once PR13 is largely concluded, it is essential for the ORR to engage with



the industry to review the success of the process. This includes reviewing the suitability and effectiveness of processes conducted for ORR by NR. Given the complexity and breadth of PR13, and the recommendations for changes made in the Nelson report on PR08, we would look to the ORR to consider the overall programme in a wide and participative review subsequent to the implementation of CP5 and before the PR18 process commences

12. We look forward to continued engagement between ATOC and the ORR to progress the longer-term development of the industry, working in partnership to ensure that there is alignment, understanding and ongoing constructive challenge. The publication of the Long-Term Regulatory Statement provides focus on clarity of outcomes, while we anticipate that this will be progressed through the ORR's strategic business objectives and detailed planning for CP5.

Network Rail outputs

13. We consider that the overall approach adopted in the DD is correct. It sets challenging efficiency targets and clear, measurable outputs.

14. The ATOC Board and TOCs continue to look to the ORR to provide increasing and effective scrutiny of NR as a monopoly supplier, using its full range of powers and influence to hold NR to account for the quality and standards of service that it delivers. For NR, in our view, CP5 must deliver infrastructure efficiencies that mirror and support those derived through competitive franchising and market-driven train operations. We consider that the ORR's approach to monitoring and enforcing NR's outputs should be proportionate, not unduly onerous, but deliver sufficient information on actual and projected outputs to enable effective scrutiny to ensure that they are delivered during CP5. The ORR's requirements for reporting from NR should be targeted at securing the information required to support the ORR's analysis and to provide assurance to customers and funders that this is feasible.

15. ATOC is strongly supportive of the ORR's commitment to improve NR's capability for and delivery of asset management and quality and to do this at a route level, which we see as crucial to facilitate partnership working, alliancing, and generally better engagement between TOCs and NR. Confidence in this area will be fundamental to the successful

delivery of NR's regulated outputs, as well as supporting the evolving industry partnerships envisaged to improve the overall affordability and value for money required by all parties with an interest in the railway.

16. We consider that there is a strong requirement for improved asset management policies for depots that recognise their importance in delivering reliable, modern fleets and the consequential impact on operational performance. This principle should be extended to NR's overall renewals policy. Recognising that the rail industry is a long-term business, the ORR should ensure that a strategic view is taken of modern equivalence that supports long-term decision making and the needs of current and future operators, passengers and stakeholders.
17. We are not supportive of full-cost risk-sharing between NR and TOCs, through Route-based Efficiency Benefit Sharing (REBS), primarily because TOCs do not have the necessary control of those risks and costs and hence are unlikely to enter into voluntary arrangements. This is an uncontrollable element of the proposed settlement that has yet to be demonstrated by ORR to provide an effective incentive for either party that will drive further industry efficiencies.
18. As the largest whole-industry efficiency gains are likely to be delivered through partnership working, alliancing, and through the franchising process, we believe that the ORR's support, expressed through the DD, will help the industry as a whole to move forward and learn from experience as to the most effective delivery methods. The ORR's approach to setting outputs (rather than outcomes) must be flexible enough to respond to changing market and organisational requirements, and allow the optimal combination of NR, operators and funders to deliver solutions that are both effective and affordable, and appropriate to the specific circumstances being addressed.

Charging proposals and incentives

19. The ORR has put forward a new proposal for the indexation of track access charges which would introduce uncertainty and complexity into the process without any clear additional incentives or levers that TOCs are able to influence. We do not see merit in this approach. Transferring additional inflation risk to train operators, franchised or open access, from NR, is not supported by the operating community.



We consider that the simple, RPI-based indexation approach that has operated since privatisation is both transparent and implementable, especially in the context of any changes to the franchising process and the potential exposure of TOCs to changes in charges at future periodic reviews.

20. We have been engaging with the ORR to address the most effective means of ensuring that the involvement of NR in the volume wash-up for Electric Current for Traction (EC4T) does not result in unintended outcomes. We believe that, particularly for the Southern DC ESTA, a correction factor based around the outturn trend in CP4 will be necessary if the ORR proceeds with its proposal that some of the wash-up should be retained by NR. The ORR's Final Determination must provide a straightforward and transparent mechanism to incentivise NR to minimise transmission losses and to maintain the electrification infrastructure effectively, irrespective of whether EC4T consumption is modelled or metered. We consider that NR's contribution in this area could have a significant effect on reducing both the industry's costs and carbon footprint, and therefore that securing meaningful engagement from NR is a key requirement for train operators and our stakeholders.
21. We welcome the ORR's approach on EC4T metering, recognising that the industry is best-placed to work together to encourage and adopt appropriate techniques. We consider that partial fleet metering should significantly reduce or eliminate operators' overall wash-up exposure, when, as proposed, 30% of fleets are metered, and that the ORR should take a decision on this as soon as possible to encourage the development of business cases that support further metering. We believe that the ORR should take into account industry proposals on how exposure to the wash-up is calculated, and that this should be approved in advance of the commencement of CP5.
22. Chapter 16 of the DD sets out a number of issues relating to track access charging. As outlined above, we consider that the importance, complexity and interdependence of charging, incentives and the business model for train operators requires a measured, inclusive process to determine the principles and framework for CP6.
23. We consider that there has been substantial progress made with respect to the modelling of the variable elements of Network Rail's cost base.



We support the use of the VTISM tool for track damage indicators, and believe that similar approaches could be adopted with merit for electrification, signalling and civils renewals, alongside maintenance for the subsequent Periodic Review process. The ORR should make provision of transparent, disaggregated and appropriate cost modelling tools a required output to provide confidence in the future structure of charges.

24. While recognising that there are no plans to introduce additional geographic disaggregation in CP5, this is clearly an issue for the future. We consider that the forthcoming charges review should address this issue both with respect to track condition issues and vehicle types to provide proper signals to NR, operators and fleet owners where there are opportunities for whole-industry value engineering.

Customer Information Strategy

25. We note that the current proposals for industry funds do not include a specific provision for delivery of the core elements of the Customer Information Strategy that were set out in the Initial Industry Plan and the Industry Strategic Business Plan. These directly complemented the requirements of the Secretary of State for Transport's HLOS. The industry, through ATOC/National Rail Enquiries, has made the case for the important passenger benefits that can be achieved by improving and progressing customer information through delivery of a 'Core' set of interventions that will secure a robust architecture for the flow of information to customer-facing channels of communication. We recommend strongly that the ORR includes a specific funding route to achieve these outputs in the Final Determination, with clear expectations that these will deliver the continually-evolving quality improvements to enable all industry parties to meet passenger, industry and regulatory expectations.

Performance

26. The HLOS documents for England, Wales and Scotland both set out a requirement for PPM performance of 92.5% by the end of CP5, with additional metrics in England and Wales. We believe that the Final Determination and the Delivery Plan must also show how it will support those TOCs whose performance already exceeds this target. We believe



that the planning process should be based around challenging, but consistently-achievable targets for each train operator that address operator and passenger expectations for improvement beyond this. Achieving consistency and better right-time performance will remain the goal of operators responding to customers and stakeholders.

27. TOCs will continue to work with NR to agree performance trajectories through the JPIP process and ensure delivery of targets against a background of significant enhancement and renewal volumes in CP5. We are concerned that the appropriate trade-offs are made to ensure best use of capacity, protect journey times and provide opportunities to meet passenger requirements in terms of consistent service delivery, frequency, stopping patterns and connectivity.

28. We support the ORR's view that the most recent evidence for the impact of poor performance on passengers should be broadly reflected in the Schedule 8 payment rates for CP5. ATOC and train operators took care to take an evidence-based approach in concluding our support for the ORR proposal, although we subsequently did not see this evidence fairly represented in the consultation process that ORR delegated to NR. We wrote formally to Cathryn Ross to register our concerns and discussed the issue constructively with NR. We recognise that the performance regime interacts with the capacity charge and the volume incentive, and that the ORR should take into account the views of the industry. The ORR should recognise that the growth of the industry requires a sustainable framework within which additional services and capacity can be provided. We consider that the opportunity for the whole industry to engage on the optimal structure of access charges and incentive regimes will provide a stronger underpinning for the next Periodic Review, recognising that behavioural and cultural issues should be embedded in the future economic regulatory framework.

Enhancements and funds

29. The ISBP in Scotland proposed two enhancement schemes (Carstairs remodelling and electrification of the Edinburgh South Suburban line) that were viewed by the industry (NR, TOCs and FOCs) as being necessary to support growth, performance and resilience. We look forward to working with the ORR and Scottish Ministers to identify how network-wide improvements such as these can be prioritised and



delivered.

30. Continued industry activity to define the governance of the industry funds in CP5 needs to be concluded before the Delivery Plans are finalised and the commencement of the regulatory review period. While this process continues, we look to the ORR to ensure that the final position reflects an industry-led consensus, delivering outcomes that are flexible, proportionate and which provide both transparency and the ability where better-value solutions exist to secure these outcomes through TOC or third-party leadership.
31. In recognising that enhancement activity is continuous, rather than defined by Control Period, the ORR has set out a framework for defining the scope of CP5 projects which reflects the reality that some are at relatively early stages of development within the investment framework. We consider that where scope changes are material, especially where more efficiencies are delivered, that operators need to be involved in working with NR and the ORR to decide upon the most appropriate changes to the output framework and we welcome the approach of leaving some of the scopes and budgets open for another year to ensure that they secure best value for operators, users and funders.

Specific ORR consultation questions

32. The ORR has set out a number of key areas upon which it seeks responses from consultees. These are:
- (a) its proposed approach to the volume incentive in CP5 (as set out in paragraphs 19.46-19.79 above), including the approach to setting growth baselines and a ceiling and floor on payments;*

As outlined above, we consider that this needs to be considered in parallel with the setting of the performance and engineering access baselines (Schedules 4 and 8), and the capacity charge – to ensure that the correct signals are available to the industry to optimise and encourage use of the network.

(b) its proposals for certain aspects of the route-level efficiency benefit sharing (REBS) mechanism (as set out in paragraphs 19.10-19.22), comprising:

- (i) its proposed approach to setting REBS baselines;*
- (ii) the method for calculating and reporting REBS in CP5;*
- and*
- (iii) which parts of Network Rail's income and costs should be included in REBS;*

Our key issues are identified above – we consider that REBS should allocate risk to those able to influence and manage it. REBS baselines need to be transparent, and operators require assurance that there will be clear challenge and monitoring to identify genuine efficiencies and changes in scope. We believe that, in principle, all NR's controllable OMR costs should be identifiable within the REBS baselines.

We consider that the ORR should set out, clearly, how it will manage the process of REBS benefit allocation, bearing in mind that the CP4 process has been difficult. We also recognise that as the refranchising programme commences there is likely to be a much more bespoke approach to cost management between NR and TOCs.

(c) whether the alternative proposal on the capacity charge for freight operators proposed by the Rail Freight Operators' Association should be adopted as a substitute to retaining the existing capacity charge in CP5 (see paragraphs 16.110-16.116). It also seeks views on:

- (i) whether this mechanism should be adopted only for freight operators or whether it should also be adopted for passenger open access and/or franchised passenger operators; and*
- (ii) what the implications of its adoption for these operators would be;*

The RDG has been working to develop an industry position that meets the requirements of TOCs, FOCs and NR to deliver the CP5 performance targets and maximise effective use of the network. ATOC members are supportive of the principles set out in the RDG work.

(d) whether, for Network Rail to retain the benefit of an efficient renewals underspend, it should need to show that it has successfully implemented a package of improvements on asset management and improved its reporting systems (see paragraph 12.101 in the financial framework chapter);

Given the DD's emphasis on improving asset management and information, we consider this to be a very sensible requirement on the part of the ORR. This will improve assurance as operators work ever more closely with NR.

(e) whether a value based methodology for adjusting for the non-delivery of outputs would be appropriate (see paragraph 12.107 in the financial framework chapter);

We consider that, although this has significant theoretical merit, this should only be adopted if the ORR can demonstrate its incentive properties and its transparency to operators. The changes to the regulatory regime for CP5 are already significant and we would not wish to increase complexity unless there is a clear business case.

(f) in order to improve transparency and provide better incentives on Network Rail without overly complicating the financial framework, it are proposing to remove the internal/Network Rail investment framework and use an amended version of the RAB roll forward process to improve the incentives on Network Rail, as discussed in paragraphs 12.136-12.147;

This proposal appears to reflect a desire to simplify the funding and financial framework for NR. While the Final Determination will deliver the outputs specified in governments' HLOS documents, we consider that the potential for leveraging in third-party funding and encouraging capital investment in the network needs to be reflected in providing clarity to potential public and private investors as to the cost of capital.

(g) Network Rail's cost of capital for CP5 and in particular the pre-tax cost of capital that will be used for investment framework



schemes, as discussed in the impact of financial framework on financial parameters chapter (chapter 13);

The current proposal reduces the pre-tax cost of capital for investment framework schemes. We note the reduction from 6% to 4.91%, recognising the significant changes that have taken place in the financial markets since the start of CP4. We consider that the Final Determination should reflect the likely trajectory of the cost of capital through CP5, recognising that although NR's revenue requirement is based around an assumed rate of return, the cost of finance may be lower – even for third parties – and that therefore the level should reflect a realistic assessment of likely costs going forward. We look to the ORR to ensure that the Final Determination reflects a realistic estimate of the cost of capital to ensure that the overall cost of the industry is optimised.

(h) its approach to financial monitoring in CP5, as discussed in the monitoring, enforcement and reporting chapter (chapter 23)

We have identified the ORR's requirement to monitor both the financial and delivery performance of NR as a key building block for the confidence in NR and the industry that will drive the industry forward.

Conclusion

33. The Draft Determination represents an important milestone in the process to set industry outputs going forward. We support its general direction while raising the specific concerns identified above.

Enquiries

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