

## **Rail Delivery Group**

Response to Improving incentives on Network Rail  
and train operators: A consultation on changes to  
charges and contractual incentives

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**Rail Delivery Group response to consultation:  
Improving incentives on Network Rail and train operators: A  
consultation on changes to charges and contractual  
incentives.**

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**Introduction:** The Rail Delivery Group (RDG) was established in May 2011. It brings together Network Rail and passenger and freight train operating companies to lead and enable improvements in the railway. The purpose of the RDG is to enable Network Rail and passenger and freight train operating companies to succeed by delivering better services for their customers. Ultimately this benefits taxpayers and the economy. We aim to meet the needs of:

- Our Members, by enabling them to deliver better outcomes for customers and the country;
- Government and regulators, by developing strategy, informing policy and confronting difficult decisions on choices, and
- Rail and non-rail users, by improving customer experience and building public trust

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# 1. Overview

This paper sets out industry responses, collated by the RDG, to the questions posed in the Office of Rail and Road's (ORR) consultation on improving incentives on Network Rail and train operators.

A great deal of our response is based on the RDG Structure of Charges Review and the extensive engagement facilitated by RDG through the PR18 working groups. The Structure of Charges Review was prepared and delivered by RDG in 2015/16 with view to limiting the need for a major focus on charges and incentives in PR18. Given the issues that arose with ORR's approach in PR13 industry wanted to proactively manage the situation and invested £500,000 to ensure ORR could focus its activity.

In addition, there have been over 15 RDG 'Charges and Incentives Working Group' meetings – the majority of which were attended by the ORR. As we have previously stated, the RDG values this engagement, believing it to have been an important input into the development of the ORR's approach to the subject matter under discussion. In light of significant activity in 2015 and 2016, in November 2016 when ORR announced that the major focus of activity would be getting route based regulation and the National System Operator (NSO) to work in PR18 and to limit work on charges and incentives industry was hopeful that there wouldn't be significant change to the current framework of charges and incentives.

Given the degree of reform ORR is now proposing to charges and incentives industry is disappointed that despite the work above industry is still being required to provide significant input to ORR. The proposals being made by ORR add significant complexity to an already complex set of charges and incentives. Further it is difficult to provide detailed feedback without having a holistic assessment of the overall impact of the proposed framework. Although ORR has scheduled this work now it really should have been a component of the Impact Assessment work to this consultation.

Although this consultation is about the frameworks and mechanics of the charging and incentives regime, the key will be the inputs into the cost model. This will have a direct impact on the level of charges. RDG and its members know Network Rail is facing significant challenges to renew, maintain and operate an increasingly busy and congested network. The ORR's recent Network Rail Monitor highlights the cost pressure that Network Rail is facing and has identified the key factors driving current underperformance against budget. This should take priority over devising methods to allocate costs between operators. The impact of Network Rail's cost challenges on the calculation of track access charges is a very significant concern, particularly for all freight operators.

The current approach by ORR therefore significantly limits the incentive on industry to work collaboratively and invest in activities such as the Structure of Charges Review in the future. The willingness of industry to work in this way should not be taken for granted by the regulator. Moving forward RDG would reiterate that industry is aligned in wanting a charging regime that reflects the following principles that:

- the purpose of each element of the charges and incentives regime should be clear;
- the charges and incentives regime should reflect the reality of the GB rail industry and we should not assume that changes impact all parties in the same way;
- the charges and incentives regime should align with other industry arrangements;
- the next periodic review (PR18) should prioritise areas of the regime that are most in need of reform; and

- ORR should recognise the potential impact of changes to charges and incentives on industry stakeholders

This response therefore builds on these principles and the extensive work already provided to ORR and provides a high-level industry view on the questions raised. It also comments on broader issues explored by the working groups, and includes views both where there is industry agreement and, in places, where there is no settled view on the consultation's questions.

The format of our response follows the content and layout of the ORR consultation document. We confirm that we are content for this response to be published on the ORR website.

## **2. Chapter 1: Introduction and Context**

### **Page 3, Supporting Notes: Summary of proposed changes to the charging structure**

Supporting note 3 notes the ORR's proposed approach for fixed cost mark-ups is to levy these where the market can bear for franchised, open access and freight operators using the cost allocation work Network Rail has commissioned by Brockley Consulting. The Brockley Consulting study, which is a useful piece of work, focussed on the long run cost that could be saved if trains were taken off the network, the capability of the network is downgraded and expenditure is avoided.

The impact assessment suggests ORR wants to use some of this thinking to replace some of the existing lump-sum fixed charges with freight-style mark-ups. This would see the costs that each passenger train operator pays (or saves) when it varies services increase to a level that sits well above the current variable usage charges. This would only work if the net benefit of the additional (or avoided) cost that Network Rail is likely to see in the face of changes in traffic levels during CP6 is much greater than the income it will get (or lose) through changes in variable usage charges.

At this stage it is therefore difficult to provide further comment or provide a view on the variabilisation of fixed cost. Moving forward industry expect further detail on:

- How ORR will guarantee Network Rail is adequately funded for its activities and will not be any variability of income to cover its fixed costs?
- How Network Rail will be able to manage a changed billing process needs to be understood including the transaction costs associated with any change?
- How ORR will deal with variation in traffic resulting from issues like possessions, cancellation and reactionary delay?
- How the market can bear test will work?
- Setting of efficiency targets for CP6.

### 3. Chapter 2: Infrastructure costs

#### Fixed Cost Charges

**Q1: Do you support our proposal to levy fixed cost charges on all operators, including open access operators, to the extent that they can bear them (option 2)?**

RDG supports an approach that ensures DfT is agnostic to decisions about granting franchise or open access rights on the network by creating an environment of revenue neutrality. Having said that it is important to understand the overall level of potential charges and their impact – this was the purpose of the Structure of Charges Review because industry wanted to give ORR a firm basis for presenting its proposals as well as sufficient time to provide an assessment of magnitude. The magnitude of the issues is missing from these proposals, particularly because industry anticipates significant increases in maintenance and renewal costs in CP6.

Further, it is impossible to fully understand the potential impact of the ORR proposal until there is clarity on DfT's policy on Public Service Obligations (PSO) Levy and more importantly, the method by which ORR will calculate the market can bear test.

The market can bear test will be hugely important to freight and open access operators in this review and so some early indication of how ORR intends to make the assessment, and the process of consulting and working with industry will be vital. Uncertainty about the total level of access charges that will stem from uncertainty about how and when the market can bear test will be assessed, is a significant concern because of the impact it can have on end users and hence demand for rail services.

#### Fixed cost freight charges

**Q2: Do you support our proposal to simplify the current charging regime by having a single freight mark-up charge?**

RDG supports simplification of the charges regime.

The ORR proposal however seems to simplify the process and then complicate by suggesting the addition of a geographic application of the market can bear test. This appears at odds with the ORR's approach to the VUC for example where there is agreement that a 'geo VUC' would be overly complicated and difficult to administer. RDG does not support proposals to add a geographical basis for the same reasons as the VUC. In addition, freight typically sells a portfolio of commodities to customers across the network so geographic disaggregation will not align the market segments freight sells to.

**Q3: Do you support the recommendation to apply Network Rail's cost allocation methodology (discussed in this chapter) to freight mark-up charges?**

RDG supports the cost allocation work to increase understanding of fixed cost drivers and improve transparency but believes more work needs to be done before this can be translated into charges. Network Rail supports using this work to inform the maximum level of freight mark-up charges, where the market is able to bear a mark-up.

Freight operators do not support ORR's proposal to translate this work into charges. Operators consider that much more work needs to be done on how the methodology would be used, how it

would impact on different users, and specific ranges the ORR might apply, before it could be considered for setting charges.

#### **Stations Charges:**

**Q4: Long term charge: Do you support our recommendation that the methodology for LTC at managed stations be recalibrated?**

We do not consider this to be a priority for this review.

**Q5: Qualifying expenditure: Do you agree with our recommendation that we support the work to make QX charges more transparent at both managed and franchised stations?**

We do not consider this to be a priority for this review.

## **4. Chapter 3: Short run Variable Charges**

#### **Variable usage charge:**

**Q6: Do you support our recommendation not to make fundamental changes to the VUC for PR18?**

RDG members support the ORR's approach to base charges on wear and tear costs assessed mainly by an engineering model VTISM, and not to make fundamental changes to the methodology. However, the industry is aware that OM&R costs of managing the infrastructure network in CP6 might increase significantly and is concerned about the prospect of this being reflected in increased VUC.

**Q7: Do you have any suggestions for 'recalibration' style changes to the VUC you would like to see considered for PR18 implementation?**

No, as noted above RDG is content with the current ORR proposals although it is important that minor recalibration changes can result in considerable changes in charges and care is needed so the process doesn't generated unintended consequences.

#### **Capacity Charge:**

RDG is disappointed ORR's thinking has not developed further by this stage of the process. The original intent behind the capacity charge was to neutralise the increase in Network Rail's Schedule 8 costs of accommodating additional traffic on the network. This removes Network Rail's apparent financial disincentive to allow additional traffic on to its network. ORR now appear more concerned with the incentives that the capacity charge gives to train operators with respect to the number of trains that they run. From an overall industry point of view there doesn't appear to be a coherent set of incentives to encourage Network Rail to find additional capacity.

**Q8: Do you support our recommendations not to replace the CC with adjustments to Schedule 8 benchmarks?**

RDG accepts that ORR does not wish to take this proposal forward. However, it is important that ORR does focus on how to reconcile the relationships between incentives for growth with incentives for performance on a mixed use railway.

**Q9: Do you think we should (a) retain the existing CC (but remove the caps on open access, freight and charter operators); (b) remove the existing CC and recover lost revenue through fixed cost charges; or (c) do you have alternative proposals?**

It is also not clear in ORR's work if the primary driver for the Capacity Charge is to recover costs or incentivise growth. This needs to be clearer. RDG therefore does not support the two proposals from ORR.

Option 1 (referred to as (a)) in the question is not supported by the industry. ORR suggests that the implementing regulation (2015/909) applies to the Capacity Charge, meaning that it cannot be capped or phased in for CP6. RDG believes the implementing regulation applies when calculating direct costs for the purpose of setting the charges for the minimum access package. ORR state that costs recovered by the Capacity Charge do not fall within the scope of the minimum access package so it does not make sense that it applies to capacity charge costs. The Capacity Charge should therefore be treated as a mark-up meaning there is no need to apply the capping and phasing rules with the added benefit it will give added flexibility to our approach moving forward.

Option 3 (referred to as (b)) in the question is not supported by the industry. This option in effect 'gives' up on any attempt to neutralise Network Rail's Schedule 8 costs of additional traffic, and therefore would put Network Rail at a financial disadvantage if it accommodated more traffic than anticipated. RDG freight members however, would support this ORR proposal.

In response to part c) of the question - an additional three proposals were discussed by industry. To help demonstrate the options we have compared ORR's proposals to the alternative proposals. We have assessed each proposal against the RDG Structure of Charges Principles. We have not assessed ORR's Option 2 (adjustments to Schedule 8 benchmarks) as ORR dismissed this option in its consultation document. RDG notes however that freight members typically don't support approaches that rely on wash-ups.

(£0 on baseline traffic)

Traffic below a baseline would only pay the Capacity Charge according to ORR's affordability test. Traffic above a baseline is a direct cost to Network Rail, and so operators would pay this at the full CP6 rate. This would be achieved through an annual wash-up for above baseline traffic.

Capacity Charge rebates

As discussed at the November RDG Schedule 4/8 and Capacity Charge group all operators would pay the full, CP6 rates on all traffic. However, operators would receive a 'rebate' each period, equal to baseline traffic CP6 rate. This is netted off each operator's Capacity Charge payments each period. Operators effectively pay the full CP6 rate on above baseline traffic only.

Market-based wash ups

All operators would be placed into a ‘market’, according to ORR’s affordability test. For each market, a weighted average Capacity Charge rate would be calculated, based on the full CP6 rates of each operator/service code within that market. Similarly, a level of baseline mileage would be defined for each market. Annually, actual mileage would be compared to baseline mileage. No Capacity Charge is payable on baseline mileage. Traffic above baseline is charged at the full CP6 rate, split amongst all operators within that market.

RDG and its membership have provided four alternative approaches to date. Moving forward we would like to work collaboratively with ORR to consider them and consider.

|  | ORR Option 1 | ORR Option 2 | £0 on baseline traffic | Capacity Charge rebates | Market-based wash ups |
|--|--------------|--------------|------------------------|-------------------------|-----------------------|
| There should be, as far as possible, a <b>predictable and stable</b> charging regime for all operators   | ✓✓           | ✓✓           | x                      | x                       | x                     |
| Trains of a <b>similar nature</b> operating on the same parts of the network should have their various access charges set on a <b>consistent basis</b> | ✓✓           | ✓✓           | ✓✓                     | x                       | ✓✓                    |
| Network Rail’s <b>incremental Schedule 8</b> costs of traffic growth above the control period baseline should be <b>neutralised</b>                    | ✓✓           | xx           | ✓✓                     | ✓✓                      | ✓✓                    |
| Any Schedule 8 cost consequences of running additional traffic should be <b>reflected in that part of the network</b>                                  | ✓            | xx           | ✓                      | ✓                       | ✓                     |
| There needs to be an <b>effective and transparent</b>  | ✓            | xx           | ✓                      | ✓                       | ✓                     |



|   | ORR Option 1 | ORR Option 2 | £0 on baseline traffic | Capacity Charge rebates | Market-based wash ups |
|---|--------------|--------------|------------------------|-------------------------|-----------------------|
| <b>transmission mechanism</b> to incentivise Network Rail to balance appropriately the costs and performance consequences of additional traffic |              |              |                        |                         |                       |
| Any alternative to the Capacity Charge should be workable and internally consistent – there should be <b>no ‘special arrangements’</b> for CP6  | x            | x            | ✓✓                     | ✓                       | ✓✓                    |
| There should be no ‘over-recovery’ of Schedule 8 costs  | xx           | ✓            | ✓                      | ✓✓                      | ✓✓                    |
| The administrative burden should be proportionate   | ✓✓           | ✓✓           | x                      | ✓                       | x                     |
| Legality of option  | xx           | ✓            | ?                      | ✓                       | ✓                     |

**Key:**

xx Actively goes against principle  
 ✓ Partially achieves principle

x Does not achieve principle  
 ✓✓ Fully achieves principle

**Traction electricity charge:**

**Q10: Do you support our recommendation to keep the loss incentive mechanism?**

Our members have mixed views about whether to keep the loss incentive mechanism in its current form although we consider there would be merit in ORR discussing its proposals further with the industry before it concludes its position. Operators do not support the retention of the loss incentive mechanism in its current form whilst Network Rail considers that there would be merit in ORR discussing its proposals further.

Through the cross-industry Traction Electricity Steering Group (TESG), the issue of traction electricity system losses has been discussed ahead of the publication of this consultation. For reasons previously outlined at TESG, the industry agrees with ORR’s assessment that the loss incentive mechanism has not been effective in its primary purpose of promoting reductions in system losses, or in incentivising increased levels of on-train metering. In addition, some in the industry think it has been ineffective in incentivising increased levels of on-train metering.

Network Rail thinks that the loss incentive mechanism could have provided an incentive for modelled operators to adopt on-train metering. However, Network Rail is also aware of additional factors that influence the decision to adopt on-train metering, for example franchise agreements.

The consultation document states that ORR's proposed retention of the loss incentive mechanism is to provide "incentives to ensure that the forecast losses are reflective of likely outturn". Whilst RDG members agree that there are benefits to improving industry's understanding of EC4T, it is also important that any incentive mechanism is able to feasibly promote its stated objectives. There is concern that at best, ORR's expected outcomes are not realistic, and at worst that the mechanism creates a perverse incentive. The issues outlined below need to be addressed in any mechanism moving forward:

- Forecasting losses to set an 'accurate' Distribution System Loss Factor (DSLFF) is extremely complex. It is well accepted that at present, errors in modelled consumption rates contribute to a greater amount of the end of year EC4T wash-up than errors in the DSLFF. There are also other possible contributing factors to the wash-up including errors with grid supply point and on-train metered data. Therefore, it is extremely difficult to begin to effectively analyse wash-up data as a means of understanding losses until on-train metering levels are significantly higher than at present.
- Losses are known to vary by year and by ESTA, which further inhibits the ability to 'accurately' forecast losses on a network wide basis using wash-up data or other methodologies. In any case, under present provisions under the Traction Electricity Rules, DSLFFs are set for the duration of the control period, which is important in providing certainty to metered operators. This would prevent any changes to DSLFFs within a Control Period even if industry was able to determine a more robust forecast for losses.
- In the prevailing situation where the end of year EC4T wash-up corrects an overcharge to operators, the loss incentive mechanism generates a net financial loss for modelled operators, and a net gain to Network Rail. Therefore, operators and Network Rail have opposing incentives to accurately forecast losses: if the DSLFF is set too low there is a loss to Network Rail and a gain to modelled operators, and vice versa if the DSLFF is set too high. This seems to strongly contradict ORR's intention to share risk, and the industry's general aim to better align incentives.

### **Electricity asset usage charge:**

**Q11: Do you support our recommendation that the EAUC not be altered, beyond recalibration, in PR18?**

RDG members support the ORR's approach.

## **Coal spillage charge:**

### **Q12: Do you support our recommendations to abolish the CSC?**

RDG members support the removal of the CSC. Moving forward Network Rail believes contractual measures should be used be if a major coal spillage were to occur. Freight operators however, point out there is already a clause in the model track access freight that deals with environmental damage.

## **5. Chapter 4: Contractual incentives regime**

### **Q13: Passenger compensation: What are your views on the options of passenger compensation recovery and improving the transparency of compensation relating to Network rail actions?**

Reform of passenger compensation arrangements and keeping them separate from Schedule 8 are a priority for industry. As ORR helpfully points out in Box 4.1, passenger compensation and Schedule 8 perform very different functions. While Schedule 8 provides a useful a framework and data set for attributing delay that can be used to inform a passenger compensation regime that is where the relationship should end.

RDG supports greater transparency for passengers in understanding the causes for delay and the subsequent compensation they receive to mitigate any impact of that delay. A system that does that should reflect the following features.

- It should ensure passengers are properly compensated, i.e. compensation should not be a token response to the impact of delay;
- If ORR concluded Network Rail should contribute to compensation, Network Rail will need specific ring fenced funding to cover compensation costs (for NR caused delay);
- Payments should be not discretionary where the delay/repay system is in place;
- Passenger compensation arrangements need to be included in Track Access Contracts; and
- TOC-on-TOC related compensation should be left with operators to manage (assuming no change to Schedule 8 TOC-on-TOC measures in CP6).

### **Q14: Approach to settling benchmarks: Do you support our recommendation to only make changes to delink passenger operator benchmarks and Network Rail benchmarks for freight operators from past performance (but to leave the approach to other benchmarks unchanged)?**

No. RDG believe there are a number of issues that can be taken forward by ORR and DfT to significantly improve and align the contractual incentives faced by TOCs and NR and more should be done in this area.

With regard to TOCs the first step would be to align Schedule 8 benchmarks with those targets contained in the franchise agreement. For example – if the benchmark is based on TOC-on-Self delay (as contained in the franchise agreement) it is clear because it is contracted to government. This should be converted into the train operators' Schedule 8 benchmarks.

With regard to FOCs, Network Rail believe the freight benchmarks have previously been calibrated at a level which reflects a realistic, attainable, level of performance, based on historical actual results.

This makes the regime is cost-neutral if performance remains on benchmark throughout the control period. Further work will be done in the coming months to analyse current FOC performance that will assist the industry in setting a fair benchmark in the future.

Freight members believe the freight benchmark needs to take into account the increase in Delays per Incident ("DPI") as their evidence suggests that the current adjustment mechanism (based on a congestion factor multiplier calculated by Arup for CP5) is not creating the right incentive. Since the start of CP4 evidence from freight members suggest:

- All freight operator self-minutes has decreased 47%;
- All freight operator third-party delay per 100 miles has reduced 4% from 2.46 minutes to 2.36 minutes; and
- All freight operators delay per incident (DPI), based on number of third-party minutes per incident, has increased by 49%.

Network Rail notes that DPI has partly increased because overall freight traffic patterns have shifted southwards in the past 2 years. There are significantly fewer coal trains serving northern power stations, while intermodal and construction traffic based on the southern ports and quarries has seen a slight increase. There have also been some very large incidents attributed to the FOCs such as the recent Lewisham derailment.

Freight operators consider that they have little control over how incidents are managed. However Network Rail considers that freight operators do have some control over the impact of their incidents, in terms of standby locos, mobile fitters and train crew resourcing / route knowledge.

With regard to NR benchmarks RDG believes the benchmark must be consistent with the funding level received by NR and the benchmark has to be realistically achievable.

**Q15: Measure of passenger operator performance: Do you support our recommendation to change the measure of passenger operator performance to one based on the delay caused by other operators?**

There are clear divisions within the industry but there are also broad agreements and shared concerns in a range of areas. To focus the debate RDG has set out the following to assist ORR with its decision-making.

*Shared industry agreement*

There is broad agreement across industry that Schedule 8 is structured to leave operators in a financially neutral position from marginal revenue losses to one party driven by performance incidents caused by others. Schedule 8 uses a liquidated damages process that is simple to apply at the point of action and ensures that all delay incidents are "owned" by someone. Schedule 8 flows money from "perpetrators" of delay incidents to "victims" of delay incidents. It is benchmarked so no money flows when performance is at the target level but industry parties are incentivised to improve their performance, such that they reduce their payments (or increase their income) through Schedule 8. The delay attribution process generates delay causation data that is invaluable in underpinning the development of effective performance improvement and asset management strategies.

*Shared industry concern*

There is also shared concern across industry in a number of areas. With regard to performance metrics it is not clear that the Network Rail AML benchmarks align properly with Performance Targets (currently set in terms of PPM) or whether TOC-on-Self AML benchmarks reflect the operator's performance trajectory. With regards to payments it is not clear that the Network Rail Payment rates accurately reflect the actual marginal revenue impact of deviation from target performance levels or that operator payment rates accurately reflect the actual "Star Model" payments that Network Rail make to "victim" operators for reactionary delay associated with operator incidents. The money flows in Schedule 8 create tensions between industry parties in the delay attribution process.

### *The importance of Joint Working*

Despite rising levels of reactionary delay being a matter of shared concern, Schedule 8 contains no specific incentives to drive joint working between industry parties in this area. This appears counter to overall approach to devolution and the emphasis from government that has joint working as a priority.

RDG supports the collaborative work to support the PDFH review of delay/revenue elasticities, greater industry involvement in the process to recalibrate benchmarks and NTF, Route and Operator Performance Strategies that all focus strongly on joint working between industry parties aimed at reducing reactionary delay. It is within this context that ORR's proposal needs to be considered because there are clear areas of disagreement and clear gaps in ORR's proposal.

### *ORR's proposal*

Network Rail supports ORR's Schedule 8 proposal to move to a regime where train operators pay for the actual delay/lateness that they cause to other train operators, as opposed to an estimate of that delay/lateness. Train operators already pay for the modelled impact of their own disruption on others in the current regime. Therefore, ORR's proposal would not change what train operators pay for through Schedule 8, it would instead make this payment more reflective of the actual impacts.

Instead, Network Rail believes that it may help drive better conversations within train operators and with Network Rail. This could then lead to more informed 'high level' decisions to deal with the impact of delays and to provide a better service for passengers – for example, through better conventions for train regulation.

Operators are concerned by the revisions that ORR are proposing which they consider cuts across the core principle identified by ORR in Box 4.1 that "Schedule 8 helps operators manage risks they cannot control" despite the consensus that the regime is broadly fit for purpose. Operators are particularly concerned about the downstream impacts in terms of how operators and Network Rail work together to recover the Network. Operators are also concerned the ORR proposal will weaken the incentive on Network Rail in its role as system operator to effectively deal with operator related incidents.

ORR's impact assessment provides limited analysis of the potential impacts downstream and comments from ORR at the London Charges and Incentives Workshop reinforced that while this was considered as an improvement to an economic incentive no analysis has been done to consider how the incentive may impact downstream activity.

RDG therefore strongly urges that ORR work collaboratively with industry to review the potential downstream impacts of the approach and further consider how the regulator can better incentivise joint working to manage disruption on the network before a final decision on the policy is taken. As a first step, RDG is working with the National Task Force (NTF) to consider the potential downstream

impacts in further detail as well as potential options for increasing incentives on Network Rail to manage recovery of TOC-on-TOC reactionary delay.

#### *Industry concerns not being addressed*

The ORR proposal does not perfectly balance the “Star Model”, as operator payment rates would still be based on historical correlation and there is no proposal to ease tension in the delay attribution process and there is no proposal to set underlying performance targets for the benchmark calibration process. However, the ORR proposal improves the balance of the star model (if correctly calibrated), as it becomes less reliant on accurately calibrating the expected performance impacts as a result of operator-caused disruption. RDG is strongly of the view these issues should also be considered as part of the PR18 review.

RDG also needs to note for the record that during PR18 Working Group meetings, ORR commented that Stagecoach/Virgin supported its proposals for TOC-on-TOC, however that is not the case. Stagecoach/Virgin does support further investigation of the issue but does not support the current ORR proposal, without the results of this further investigation.

#### **Q16: Sustained Poor Performance provisions: Do you support our recommendation to limit SPP to cost compensation only?**

RDG members agree that the current approach to SPP is costly, time consuming and difficult to resolve. Having said that it is important that operators are fairly compensated for the impact of SPP.

Network Rail supports the ORR proposal but will also consider investigating further options for reform. Operators are strongly opposed to the current ORR proposal because there are periods of sustained poor performance where there is a long run impact on revenue. This is of particular concern to operators as business plans / franchise bids (depending on whether you are an OAO or a franchisee) are based on a forecast of performance. When performance falls significantly short there will be a longer-term impact on revenue.

RDG would therefore like to propose a two-stage approach to SPP that incorporates ORR’s existing proposal. For stage one, the proposal presented by ORR would be used for SPP at, for example, 10% and above the benchmark (and be subject to cost only). For stage two at, for example 25% above the benchmark, the SPP would be opened to revenue claims as well to reflect the long term revenue impacts noted above. The SPP thresholds at each stage should be based on evidence of increased costs / revenue losses that train operators experience as a result of performance being significantly different from Schedule 8 benchmarks.

#### **Schedule 4:**

#### **Q17: Do you support our recommended prioritisation of schedule 4 issues? If you think we should reconsider any of the areas, we have de-prioritised please submit supporting evidence.**

RDG welcomes the areas ORR has prioritised for improvement as these reflect the conclusions of the RDG’s review of charges completed a year ago. Having said that Freight members will be suggesting some detailed recalibrations in their responses. RDG also noted that there are specific contractual drafting issues that need to be resolved for CP6.

**Q18: Do you wish to submit relevant evidence regarding: (a) processes associated with planning possessions; and/or (b) planning alternative arrangements to deal with planned disruption (e.g. the notification that is needed to arrange bus replacement services)?**

RDG has no comments in this area.

### **Aligning operator and Network Rail incentives**

**Q19: Do you have any views on how financial incentives could be improved to encourage collaboration between Network Rail and operators to reduce industry costs?**

**Q20: Do you have any views on the cost categories you think could be controlled by operators and whether these costs would be suitable as the basis of a potential future mechanism?**

It is essential that incentive mechanisms and targets are aligned between delivery organisations. Ideally these would be aligned through the franchise design process and the ORR periodic review process that sets the commercial model for freight and NR. More needs to be done by ORR and DfT to align incentives and targets, and there needs to be an integrated programme between DfT and ORR to address this and make explicit the choices between capacity and performance. ORR needs to pause and wait for the release of the DfT Rail Strategy and then work collaboratively with industry to develop incentive mechanisms that support the delivery of that strategy.

As well as aligned incentives, ORR needs to check that the incentives are right. Do they encourage passenger and end-user needs to be put first and reflect the trade-off between capacity and performance? The purest and most powerful incentive to align is revenue/growth in the form of perhaps farebox, freight revenue/growth, and other customer/economic benefits. This alignment has the potential to be the strongest incentive for passengers and the end users of freight services to be at the heart of the railway and a significant driver of efficiency and more consideration of how ORR will incentivise this through the scorecards will be an important consideration moving forward.

Aligned reliability and punctuality performance incentives, alongside adequate resourcing of OM&R, are key to reversing declining operational performance. Metrics in this area are being reviewed by government as part of the Gibb review of Southern with a customer weighted measure likely to be recommended. Any new performance metric should be developed with industry through RDG NTF. We recognise that a one-size fit all approach may not work - routes (NR and TOC) should be able to argue for a metric that best represents the situation (and reflect in franchise and route scorecard). Performance metrics must be set at an achievable and honest level: there is a clear trade off to make between capacity and performance.

System wide alignment of incentives will take some time to achieve as they affect commercial models for private and public companies as well as having an impact on the taxpayer. In the meantime, route scorecards are an initial important step to aligning incentives between delivery organisations. Although there has been some negative feedback about how they were introduced, there is commitment to evolving them to become properly aligned and reflective of the customer and the stages and timelines in doing so.

The focus for ORR should be to develop a mechanism that supports collaboration between Network Rail routes and operators, noting that a 'one size fits all' approach simply won't work. Solutions could

range from joint frameworks through to deep alliances. Further at the moment there only limited ability for an operator to influence OM&R costs on a route. For these reasons RDG does not believe the current REBS regime creates the necessary incentives for improved collaboration.

RDG believes the following changes could improve REBS including:

- set the baseline for no more than 2 years and use the NR delivery plan rather than the ORR determination;
- limit the items in REBS to key OMR costs that operators and NR Routes influence can (noting there is no operator influence now); and
- getting more engagement from operators in the process early through the process to develop route Strategic Business Plans, route Delivery Plans and route Scorecards.

An approach with these features will ensure there is both sufficient flexibility for the scheme to be re-baselined to reflect achievable efficiency benefits whilst developing a sense of shared ownership and collaboration. REBS is considered as one of a potential suite of mechanisms to encourage collaboration (alongside material alliances as an example) that should be used where appropriate.

In 2014 NR and freight operators jointly developed options for a FEBS (focussed on freight avoidable costs) and suggest these options are further develop for CP6.