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Dear Rob,

Network Rail Schedule 8 benchmarks in CP5

Purpose

In May 2013, we wrote to the industry about Network Rail Schedule 8 benchmarks for CP5¹. In particular, we invited stakeholders' views on our proposed set of principles, processes and timescales for the work in setting the Network Rail Schedule 8 benchmarks for CP5. Following careful consideration of the consultation responses, this letter sets out Network Rail's conclusions on the issues discussed in the consultation.

We welcome ORR's draft determination, which was published on 12 June 2013. Decisions around the draft determination need careful and detailed consideration. We recognise that the content of the draft determination may impact workstreams to set Schedule 8 benchmarks. Following our detailed review of the draft determination, it may be appropriate that some of the conclusions and timescales set out below are 'tweaked' at a later stage. We will be in touch with the industry as and when necessary.

Introduction

We received 11 responses² to the consultation letter, from the following stakeholders:

- Arriva Trains Wales (ATW);
- Association of Train Operating Companies (ATOC);
- East Midlands Trains (EMT);
- First Group;
- Freightliner;
- GB Railfreight (GBRf);
- Greater Anglia;
- Northern Rail;
- Transport for London (TfL) and London Overground Rail Operations Limited (LOROL);
- Transport Scotland; and
- Virgin Trains.

¹ Available on our PR13 webpage : <http://www.networkrail.co.uk/publications/delivery-plans/control-period-5/periodic-review-2013/pr13-closed-consultations/>

² Non-confidential responses are available on our PR13 webpage : <http://www.networkrail.co.uk/publications/delivery-plans/control-period-5/periodic-review-2013/pr13-closed-consultations/>

We would like to take this opportunity to thank those stakeholders which responded to this consultation. We value this feedback, and stakeholders' views have influenced our thinking in a number of ways, as set out below.

Structure of letter

The remainder of this letter is structured along the same lines as our original consultation letter. In particular, we consider the following issues, in turn:

1. Workstreams for setting Network Rail Schedule 8 benchmarks in CP5;
2. Establishing principles for Network Rail Schedule 8 benchmarks in CP5;
3. Developing PPM trajectories by TOC to underpin Network Rail Schedule 8 benchmarks;
4. Converting PPM trajectories by TOC to Schedule 8 benchmarks;
5. Proposed process and timescales;
6. Other issues raised by stakeholders; and
7. Next steps.

We consider each of the consultation questions in turn. We begin by summarising the responses to each question, and then set out Network Rail's conclusions.

Workstreams for setting Network Rail Schedule 8 benchmarks in CP5

Consultation Question 1
Do you agree that Network Rail should lead the work to set Network Rail Schedule 8 benchmarks for CP5? Do you have any suggestions in relation to industry engagement around this process?

Summary of consultation responses

Among the responses received, there was a general acceptance that Network Rail is best placed to lead the setting of Network Rail Schedule 8 benchmarks for CP5, with more than half of respondents supporting Network Rail's proposal to lead the technical work. However, some stakeholders emphasised that this would place Network Rail in a position of having a significant degree of influence in setting its own benchmarks. Responses, in particular, emphasised the need for Network Rail to conduct the work in an accurate and transparent manner, and ORR to undertake a thorough review of the process.

Many responses highlighted the advantages of Network Rail leading on the work. Respondents stressed that Network Rail has the required knowledge and expertise to lead on setting the benchmarks, which in turn, will help to deliver an efficient and timely process.

In contrast, both Northern Rail and ATW were against the proposal of Network Rail undertaking the technical work to set the benchmarks. Northern Rail considered that, although ORR would be overseeing the process, the risk of inaccuracies in the Public Performance Measure (PPM) and Average Minutes Lateness (AML) relationship along with the changing processes for the Joint Performance Improvement Plan (JPIP) target setting could mean that the benchmarks do not meet the 92.5% target. ATW noted that, as this work is of a highly technical nature, varying practical experience and understanding of the regimes across TOCs may result in a shortfall in scrutiny of the outcomes. ATW also noted that, since devolution, TOCs have been working more closely with Network Rail routes and therefore the majority of engagement should be through the route teams rather than the central body.

Virgin Train's preference was for ORR to lead the process. However, it stated that if this was not an option and Network Rail was to take the lead, then there must be increased emphasis on an open and pragmatic approach. Transport Scotland suggested the Rail Delivery Group (RDG) could take a strategic lead. ATW regarded the National Task Force (NTF) as an appropriate body to undertake the work.

Network Rail conclusion

We fully recognise that leading the technical process of setting Network Rail Schedule 8 benchmarks must be conducted in an open, accurate and pragmatic manner. We also understand some TOCs' concerns around Network Rail leading on the technical work, and that this could be perceived as giving Network Rail undue influence over the results of the exercise.

However, we would emphasise that TOCs will be consulted throughout the process and that, ultimately, the decision on the level of the benchmarks rests with ORR as part of its PR13 final determination. The Schedule 8 Benchmarks Subgroup³ – which includes TOC representatives and ORR – will help facilitate this, and we will continue to provide regular updates to the Group and seek its input and feedback. Network Rail routes will be expected to engage openly with TOCs in developing their respective PPM trajectories which will underpin the Schedule 8 benchmarks. In addition, Network Rail's central teams will be in touch with TOCs to gather views on the models used to translate these trajectories into Schedule 8 benchmarks. This engagement will be by means of face-to-face meetings, teleconferences and/or email. In addition to this, and as set out in the consultation letter, we will consult formally on proposed Schedule 8 benchmarks, later in the summer. This will provide a further opportunity for TOCs to make representations to Network Rail and ORR in relation to:

- The PPM trajectories developed by routes, working with TOCs;
- The technical work used to translate these PPM trajectories into Schedule 8 benchmarks; and
- The proposed benchmarks themselves.

We would also stress that, whilst ORR will not be leading the day-to-day work, it will have a fundamental role in scrutinising and auditing the work. Ultimately, of course, the final decision on the level of the benchmarks rests with ORR.

As emphasised by many TOCs in their consultation responses, Network Rail possesses the necessary expertise and knowledge 'under one roof' to undertake this work. We believe that this puts Network Rail in the best position to ensure correct benchmarks are set, which will ultimately guard against inappropriate risk for all industry parties in CP5. If this exercise was to be led by an alternative organisation, we feel that this advantage would be lost. In addition, we do not consider that the timescales involved would permit another party to complete the work accurately and meet the deadlines involved, especially in light of requirements to access, manipulate and analyse the relevant data in the timescales required.

We also note that the issue of Network Rail leading the process has been discussed at both the Schedule 4 and 8 Working Group and the Schedule 8 Benchmarks Subgroup. In both fora, the proposal for Network Rail to lead the work attracted widespread support. We would remind stakeholders that these are open fora, and any party is welcome to attend these meetings (stakeholders are welcome to contact us using the details above if they wish to participate).

³ The Schedule 8 benchmarks subgroup was set up to discuss the technical work surrounding the calculation of the Schedule 8 benchmarks, and to ensure transparency in relation to this work.

We also note that Network Rail undertaking the work is consistent with the process undertaken in earlier price controls, and is in keeping with the wider PR13 process whereby Network Rail has consulted on and recalibrated access charges, which have then been reviewed by ORR.

We recognise Northern Rail's concerns that the benchmarks may not meet the 92.5% HLOS targets. However, we would like to assure Northern Rail and other stakeholders that we will make every effort to ensure that the benchmarks accurately reflect the HLOSs. Furthermore, ORR will review the process and the final outputs to provide further assurance that the benchmarks are correct.

Whilst we recognise that this work is of a highly technical nature, as set out above, ORR will be conducting a thorough review of the process and outputs.

ATW requested that the majority of engagement be through the route teams rather than through the central Network Rail teams. We agree with this suggestion, and are encouraging route teams to actively engage with TOCs as part of this process. However, the development of models to convert the PPM trajectories into AML benchmarks is being undertaken centrally to ensure consistency, and therefore there will inevitably be a level of central engagement throughout this process.

We understand the attraction of having a cross-industry body – such as the RDG or NTF – oversee this work, as suggested by some stakeholders. However, we would stress that NTF is closely involved in discussions around setting industry performance targets as part of the wider PR13 process, and we very much welcome its involvement in that regard. We consider, however, that the development of TOC-level PPM trajectories is best achieved locally by means of engagement between Network Rail routes and TOCs. In addition, the process of converting PPM trajectories into Schedule 8 benchmarks is a complex and technical exercise. We do not believe that either of these exercises fit with the broader and more strategic objectives of either NTF or RDG. It should also be borne in mind that setting Schedule 8 benchmarks is first-and-foremost a regulatory exercise. As such, we believe that this work is most appropriately undertaken by Network Rail, with appropriate oversight and engagement from ORR throughout the process.

Establishing principles for Network Rail Schedule 8 benchmarks in CP5

Consultation Question 2

Do you agree with each of the principles set out? If you do not agree with any of the principles, it would be helpful if you could explain why and suggest alternatives, if appropriate.
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Responses to this question demonstrated broad support for the proposed set of principles for Schedule 8 benchmarks. However, a number of comments were made in relation to each principle. These are set out, along with Network Rail's position, below.

(i) CP5 Schedule 8 benchmarks should reflect expected CP5 performance by TOC.

Summary of consultation responses

There was widespread support for the proposed approach of setting separate performance trajectories by TOC. First Group and Greater Anglia suggested the possibility of the trajectories being further disaggregated below TOC level. The intention for this being to reflect the different geographical nature among TOCs' Service Groups, and allow the benchmarks to focus on the worst performing Service Groups. Transport Scotland was supportive of establishing PPM performance trajectories by TOC, but noted the timescales for setting benchmarks are in advance of the work to establish the Caledonian Sleeper franchise, and at the start of the ScotRail refranchise process. It noted that this would need to be considered in discussions on setting Schedule 8 benchmarks with the current TOC.

Network Rail conclusion

Network Rail understands the idea and motivation for further disaggregating trajectories below TOC level. We would stress that developing and applying performance trajectories is necessarily a somewhat approximate exercise, not least because project timescales could change significantly between now and the end of CP5. Therefore, predicting performance usually becomes less robust at more 'granular' levels. As such, we consider that developing performance trajectories below TOC level would, in the majority of instances, give rise to 'spurious accuracy'. Hence, whilst we recognise that it may be appropriate to develop and apply performance trajectories below TOC level in some isolated circumstances where major enhancement projects impact differentially on different Service Groups, we would expect this to be the exception rather than the norm.

In circumstances where sub-TOC trajectories are to be put in place, the TOC would be expected to work closely with the Network Rail route and be heavily involved in the development of these trajectories. Consistent with this, we consider that the onus should be on the TOC to agree with the route that the PPM trajectory should be set below TOC-level.

We note Transport Scotland's concerns about the Caledonian Sleeper franchise. Whilst we do not believe that it would be appropriate to develop a separate performance trajectory for the Sleeper services, as set out in more detail below, we recognise that it may be appropriate for a separate benchmarking exercise to take place for this important service at a later stage. We note that the Caledonian Sleeper comprises its own Service Group, which means that any changes can be isolated relatively easily.

(ii) For the financial year 2014-15, Schedule 8 benchmarks should be consistent with PPM performance trajectories contained in the JPIPs 2013-14 (published in March 2013).

Summary of consultation responses

The proposal to use the PPM performance trajectories set out in the JPIPs as the basis of the Schedule 8 benchmarks for the first year of CP5 was generally viewed positively. However, First Group expressed concern that not all figures have been agreed to date, and that the step between actual and planned performance could be large. LOROL and TfL stressed that benchmarks should take account of improved performance following completion of performance-enhancing projects during CP4.

Among TOCs, only ATW stated that the benchmarks for 2014-15 should not be linked to the 2013-14 JPIPs. It argued that the JPIPs are conservative, and that using them for purposes of setting Schedule 8 benchmarks could lead to a less challenging set of benchmarks.

GBRf stated that benchmarks should not be set at a higher level than Network Rail has previously achieved. Freightliner suggested that Schedule 8 benchmarks should be set over the long term rather than being reset every 5 years.

Network Rail conclusion

We believe that Schedule 8 benchmarks for the first year of CP5 should be consistent with the performance set out in the JPIPs. The JPIPs are objective and widely-understood. We believe that JPIPs offer the most realistic assessment of likely outturn performance in the first year of CP5. As such, we believe that they provide the most suitable foundation for CP5-entry Schedule 8 benchmarks. We are pleased that the majority of respondents agreed that this is the appropriate approach.

We appreciate the point made by First Group that in a small number of circumstances, the JPIPs do not contain an agreed position for the year 2014-15. In these circumstances,

Network Rail routes and TOCs will need to agree the PPM level for the first year of CP5 as part of the wider process of developing whole-CP5 trajectories (see below).

We also note First Group's point that using the JPIPs could mean that Schedule 8 benchmarks become somewhat divorced from actual performance. However, we would stress that the JPIPs are, to a considerable degree, based on actual performance. Therefore, Schedule 8 benchmarks will be implicitly related to actual performance, and we would not expect any 'mismatch' to be significant. We also consider that setting benchmarks on the basis of expected CP5-entry PPM (rather than actual CP4-exit PPM) has compelling incentive properties. In particular, it should encourage Network Rail to deliver strong performance in the final year of CP4 in order to put itself in a position to deliver and exceed its targets from the outset of CP5. We also note that the timings of PR13 do not lend themselves to establishing benchmarks on the basis of actual performance, since actual performance will not be realised until after the benchmarks have to be decided under the timescales of the review.

In response to the point made by LOROL and TfL, we fully expect routes to take account of enhancement activities, in establishing PPM trajectories, including the possibility that they will have positive performance implications once complete. As such, these will feed through to Schedule 8 benchmarks.

Network Rail does not agree with ATW's view that JPIP figures should not be used as they are conservative. The JPIPs provide an agreed and realistic assessment of expected performance. As such, using the JPIPs as the basis for Schedule 8 benchmarks ensures that the Schedule 8 regime remains financially neutral on expectation. This is extremely important. By setting benchmarks at expected levels – thereby keeping the performance regime financially neutral on expectation – Schedule 8 does not impose an additional cost burden on the taxpayer. At the same time, since payment rates in the passenger regime are the same above and below the benchmark, the incentive properties of the Schedule 8 regime are not diminished by setting benchmarks at expected performance levels. We also note that no alternatives to the JPIPs were suggested as the basis for CP5-entry Schedule 8 benchmarks.

We appreciate FOCs' point that benchmarks should be set over the long-term. A separate process, being led by ORR, is being undertaken to set freight Schedule 8 benchmarks. We would emphasise, however, that the incentive regimes are very different for franchised passenger and freight operators. In the context of franchises of finite length in particular, we believe that it is important that benchmarks are reset periodically in order to ensure that the financial flows throughout the performance regime are contained at reasonable orders of magnitude. This supports the notion that certain performance levels are 'paid for' by DfT and Transport Scotland at each periodic review.

(iii) For the financial years 2015-16 to 2018-19, Schedule 8 benchmarks should be consistent with Network Rail routes' whole-CP5 PPM performance trajectories. These will be developed working with TOCs, agreed by Network Rail's central performance team and be consistent with achieving 92.5% PPM by 2018-19, as required by the HLOSSs.

Summary of consultation responses

LOROL and TfL stressed that the process should deliver challenging targets for all parties and that there should be no disadvantage to TOCs that have a smaller presence on a particular route. These points were echoed by other respondents.

First Group stated that, *"it is possible that there may need to be a divergence between the PPM trajectory and the Network Rail benchmarks. Increased traffic may be a risk to PPM, but the Schedule 8 effects are compensated through the Capacity Charge. It would also not be appropriate to adjust benchmarks due to improvements in PPM due to investment in new rolling stock"*.

It was also noted by First Group that assumptions should be clearly documented and consistent across the network (for example between FCC and Southern for Thameslink). It suggested that each TOC should be provided with a breakdown (a 'waterfall chart') of the extent to which the key factors affect the PPM trajectory.

Virgin posed the following questions:

"Is the HLOS 92.5% PPM target an industry wide measure, allowing for variations between TOCs, or is it intended that each individual TOC should attain this level?"

"What is the status of the work to determine this longer-term trajectory for West Coast, and how will NR demonstrate the objectivity with which NR will approach this?"

Network Rail conclusion

We acknowledge LOROL's and TfL's point that TOCs with a smaller presence on a route should be treated fairly, and believe it is extremely important for suitable benchmarks to be set for all TOCs. This should be achieved by Network Rail routes working closely with TOCs on a 'lead route' basis. If any individual operator has specific concerns, it should not hesitate to take this up with the relevant route and, if necessary, also contact Network Rail central teams at the earliest opportunity.

We understand First Group's point about the interaction between Schedule 8 benchmarks and the Capacity Charge. The concern appears to be that, since the Capacity Charge compensates Network Rail for increased Schedule 8 costs associated with traffic growth above 'existing' levels, setting Schedule 8 benchmarks that also reflect traffic growth risks a 'double recovery' of costs by Network Rail. However, this needs to be seen in the context of Network Rail's single till funding arrangements. In particular, Network Rail's revenue requirement is based on delivering its performance obligation *given an assumed level of traffic growth*. Importantly, Capacity Charges associated with both 'existing' traffic and forecast 'additional' traffic are netted off the revenue requirement to calculate the level of FTACs / Network Grant as part of each periodic review (any income that Network Rail expects to receive through the Capacity Charge is taken off of its fixed funding). Thus, there is a commensurate *reduction* in Network Rail's FTAC / Network Grant income, which ensures that no double-recovery takes place.

We agree with First Group that benchmarks should not be adjusted as a result of the introduction of new rolling stock. As discussed in detail, below, we believe that TOC benchmarks should remain constant over the course of each control period.

We note First Group's request for assumptions underpinning the PPM trajectory to be clearly documented. We expect routes to express assumptions clearly. However, we would also note that different Network Rail routes are approaching this exercise in different ways, and that the working relationship between routes and TOCs is not homogenous. As such, it would not be appropriate to impose a specific structure on routes' work to develop PPM trajectories, or how this work is presented and documented. However, we urge routes and TOCs to work closely together at the earliest opportunity to agree any specific reporting arrangements.

In response to First Group's request that a waterfall chart is presented showing the makeup of the CP5 PPM trajectory, we believe that this could be a powerful way of explaining the work and could help the challenge process. As noted above, we would encourage TOCs to work closely with Network Rail routes to agree any specific reporting outputs, and that this could form part of that suite of outputs.

In response to Virgin's questions, the targets set out in the HLOSs are on an industry wide basis – they do not apply to any particular TOC or route. As to developing a set of trajectories specific to the West Coast, we would encourage close working with the LNW route to achieve

this end. If there are any specific concerns, these should be taken up with the route at the earliest possible opportunity, and also raised with central Network Rail contacts if appropriate.

(iv) Schedule 8 benchmarks should be set on the basis of the most recent data and relationships between Schedule 8 AML and PPM and/or delay minutes (with the choice of PPM and/or delay minutes being decided on the basis of statistical and operational criteria, working with ORR).

Summary of consultation responses

First Group suggested that cancellation minutes should be taken account of separately because deemed minutes and actual minutes may not follow the same pattern. It emphasised that deemed minutes form a significant proportion of overall performance minutes. It also stressed that the TOC-on-TOC element of the benchmarks need to be treated separately when constructing Schedule 8 benchmarks.

Virgin expressed concern that Halcrow's work has not removed unrepresentative data, which therefore skews the results.

Northern Rail noted that there would be increased risk for future trajectories and changes in attribution practice that have yet to be formally measured and re-benchmarked.

Greater Anglia requested clarity as to how information from 2013-14 will be incorporated into the process, as the PR13 recalibration period does not include information from this year.

Network Rail conclusion

Work is ongoing to model the relationships between PPM and performance minutes. These will be used to translate PPM trajectories into Schedule 8 benchmarks. We are developing a standard methodology and model – one for each TOC – in order to ensure consistency and comparability across operators. Our analysis to date has focussed on relationships at Service Group level. Whilst we have sought to keep the analysis as simple as possible, we have designed the models to be sufficiently flexible to be able to capture a number of important features, including:

- 'Non-linearities' in the relationship;
- 'Structural breaks', whereby the relationships 'shift'. For example as a result of a timetable changes; and
- Sensitivity to 'outlier' observations.

Early results are encouraging. We are currently in the process of arranging meetings or teleconferences with operators to discuss these models and agree the appropriate relationships on the basis of them. We plan to share models with TOCs before or shortly after meetings, and have undertaken the analysis in Excel, so that stakeholders can readily examine and check the calculations and results themselves.

We are grateful for comments – especially from First Group – in relation to separately modelling deemed and actual lateness. We are pursuing this, and are seeking to isolate these relationships as well as the 'aggregate' relationship between PPM and performance minutes (AML plus DML). We would caution, however, that the final choice must be on the basis of careful statistical testing, coupled with operational considerations.

The point raised by First Group in relation to the TOC-on-TOC element of the benchmarks is important. We consider that it is appropriate that the Network Rail benchmark adjustment will assume that TOC-on-TOC delay remains constant. This was the approach pursued in PR08,

and rightly ensures that Network Rail is held neutral to TOC performance improvements under the Star Model.

We acknowledge Virgin's concerns about the Halcrow data. This should be taken up directly with the consultants. We would emphasise, however, that the approach of including all data has been adopted across the board i.e. for all TOCs and in relation to both TOC and Network Rail benchmarks. This issue was discussed extensively at the Schedule 4 and 8 Working Group in 2012. We recognise, however, that the relationships that we are deriving to convert PPM into AML could be sensitive to 'outlier' observations. In undertaking the regression analysis to convert PPM to AML, we will conduct careful sensitivity tests and ensure that the relationships are robust.

We acknowledge Northern Rail's concerns about the risk associated with future trajectories, and will do everything we can to ensure the trajectories are as accurate as possible. If there are material changes, a recalibration exercise could take place (see below).

In response to Greater Anglia's query as to how information from 2013-14 will be incorporated into the process, we would note that this information will not be available until after the re-benchmarking exercise has been completed. However, we will seek to use the most up to date information available when carrying out the regression analysis.

(v) A re-benchmarking exercise should take place if there are material changes to timetables, for example as a result of re-franchising.

Summary of consultation responses

Transport Scotland noted that adjustments and/or re-benchmarking should not necessarily follow from the material changes highlighted, above. It argued that the proposer needs to justify why this is an appropriate course of action, rather than assume it is automatic. Similarly, Greater Anglia stated that re-franchising would not necessarily lead to the need for re-benchmarking as there is not always a change to the timetable. Any potential increase in traffic would, in any case, be dealt with by means of the Capacity Charge. First Group noted that the data from the recalibration period should be held in a manner to allow easy access for any re-benchmarking exercise, so as not to have to 'start from scratch' in situations where a re-benchmarking exercise is deemed appropriate. First Group also noted that, in practice, a re-benchmarking exercise can be undertaken by means of paragraph 17 of Schedule 8, or when new access rights are sold.

Network Rail conclusion

We agree that re-benchmarking exercises should not be automatic when a new franchise is let. We would expect a distinct event, such as a timetable change, to have taken place in order to necessitate updated benchmarks. We agree with First Group's comments that benchmark data from the recalibration period should be made available in the case of a re-benchmarking exercise. We consider that existing contractual provisions, especially those set out in paragraph 17 of Schedule 8, provide an appropriate framework under which such re-benchmarking exercises can take place. We do not, therefore, believe that a change to contractual wording is necessary as part of PR13.

(vi) If 'change control' is used in CP5 to adjust regulatory outputs, appropriate adjustments should also be applied to Schedule 8 benchmarks.

Summary of consultation responses

First Group emphasised that Schedule 8 adjustments should be limited to material changes in contractual interactions. It stressed that if there is frequent change in Schedule 8 benchmarks, this could remove incentives for Network Rail to deliver projects more efficiently.

It added that any proposal for re-benchmarking needs to justify why it is an appropriate course of action. Transport Scotland expressed similar views.

Network Rail conclusion

This principle relates specifically to the issue of changes to regulatory outputs during control periods. If regulatory performance targets were to be adjusted, we believe that it would be appropriate that such changes were also reflected in Schedule 8 benchmarks or by means of alternative financial adjustments.

Developing PPM trajectories by TOC to underpin Network Rail Schedule 8 benchmarks

Consultation Question 3

Do you have any comments on engagement between Network Rail routes and TOCs in establishing PPM performance trajectories by TOC for CP5?

Summary of consultation responses

There was a sense amongst respondents that serious engagement has only recently started, and that some Network Rail routes have engaged more than others to date. Northern Rail advised that the proposals that had been shared so far had not always been backed-up by detailed performance modelling. It also expressed concern that the trajectories would have too many variables to be considered robust, such as the impact of franchise changes. It suggested that any significant uncertainties be dealt with via a re-benchmarking exercise.

Similarly, First Group raised concerns that the models seem too simplistic and overly cautious, and that this could lead to less than challenging benchmarks.

First Group also stated that clear ownership is needed of CP5 trajectories for TOCs crossing multiple routes. It suggested that Network Rail central teams should take on this ownership. Other stakeholders emphasised that Network Rail central teams should take an active role with the routes to ensure agreed benchmarks are 'internally consistent'. On the other hand, it was suggested by Transport Scotland that Network Rail's central teams' roles should be purely to 'validate' rather than 'agree' routes' PPM Trajectories. It stressed that this would ensure local ownership of the outcomes.

Network Rail conclusion

Network Rail understands TOCs' concerns around engagement to date. Network Rail central teams have recently contacted all routes at Managing Director level to encourage prompt engagement with TOCs with regard to the Schedule 8 benchmarking exercise. It is important that Network Rail achieves the right balance between securing flexible outcomes locally on the one hand, and a level of consistency network-wide on the other. As emphasised above, if TOCs consider that they are not receiving the appropriate level of engagement in developing PPM trajectories, they should contact the route and/or Network Rail's central teams as a matter of priority so that the situation can be resolved.

We acknowledge the point raised by Northern Rail that the trajectories may not be fully robust following potential impacts as a result of franchise changes. However, we consider that it is important to have a fixed set of benchmarks for the whole of CP5 (although, as set out in our conclusions to consultation question 2, it may be appropriate to take account of such changes in certain circumstances).

Network Rail understands Transport Scotland's concern that the centre should only 'validate' (rather than 'agree') trajectories, especially in light of devolution. However, Network Rail remains a single company and a reasonable degree of consistency is therefore warranted across all routes. This requirement for consistency was emphasised by other stakeholders in their responses to our consultation. In addition, we consider that it should be borne in mind

that routes' collective proposals must 'add up' to each of the HLOSs. Some of the performance improvement activities required to deliver the HLOSs are national, rather than route-based, schemes. In practice, this is likely to mean that Network Rail's central performance team will have to adjust some or all routes' PPM trajectories in order to ensure that these trajectories – and the Schedule 8 benchmarks which they will drive – are consistent with the HLOSs.

We would emphasise that separate HLOSs have been set for England & Wales and Scotland, and that these will each need to be 'achieved' independently from the constituent TOC Schedule 8 benchmarks.

Converting PPM trajectories by TOC to Schedule 8 benchmarks

Consultation Question 4
Do you have any comments about the process for converting TOC-level PPM trajectories into Schedule 8 benchmarks?

Summary of consultation responses

Some stakeholders emphasised that the final model to be used to convert PPM trajectories to Schedule 8 benchmarks must be *agreed* between the TOCs and Network Rail.

ATW stated that it is yet to see the modelling and is therefore unable to fully comment on the approach. ATW also emphasised that the correlation between PPM and AML is not necessarily precise enough for the correct amount of compensation to be paid.

First Group emphasised that any model should deal with actual lateness and deemed lateness separately. It stated that the proposed regression relationships should provide the standard methodology but there should be scope for one-off events to be taken into account, as well as a limited number of known schemes which have a material impact. First Group also stated that, if performance is forecast to get worse due to a reduction in capacity, perhaps due to long term engineering work, this should also be reflected in TOCs' benchmark figure.

Transport Scotland stated that any modelling should also be made available to funders, if they requested it.

Network Rail conclusion

Network Rail will, of course, seek to agree the appropriate model to convert PPM to AML for each TOC. In the event of disagreement, the following process will be followed (current timescales are the same as in the consultation letter, and are restated in the Annex for completeness):

- Network Rail will take a decision on the appropriate model in the first instance;
- Network Rail will then consult with the industry, as per the timescales set out in the consultation letter (see also Annex). This consultation will include the proposed benchmarks and be clear about which relationships have been used to arrive at those benchmarks;
- Network Rail will review consultation responses, and make changes where appropriate;
- Network Rail will then submit a set of (potentially) revised benchmarks to ORR for consideration;

- ORR will then consider these proposals, along with any representations from TOCs and other stakeholders, before deciding on the appropriate benchmarks to be written into the Track Access Contract; and
- Ultimately, all decisions in relation to benchmarks will be for ORR.

In response to ATW's points, we are currently in the process of arranging engagement with TOCs to share and gather views on the models. We recognise that the relationship between PPM and AML is not always exact. However, in the absence of viable alternatives, we believe that using the AML-PPM regression relationships is the most appropriate way forward. We would stress that the approach is likely to be a significant improvement relative to PR08, where it was simply assumed that a 1% increase in delay minutes would lead to a 1% decrease in AML.

As noted earlier, we welcome the comments of First Group around modelling deemed and actual minutes separately. We are pursuing the analysis along these lines, although we are keen to ensure that the approach remains pragmatic and flexible.

We do not agree with First Group's proposal that TOC benchmarks should be adjusted to take account of engineering works. TOC Schedule 8 benchmarks have always been set at a constant level – in contrast to Network Rail benchmarks, they are not subject to an 'improvement' or 'performance' trajectory. This is because TOCs possess 'natural' economic incentives to improve performance, and since their performance is regulated by means of franchise commitments rather than the Track Access Contract. We would also suggest that making adjustments to TOC benchmarks would introduce further complexity into the Schedule 8 regime. Given this increased complexity, coupled with the fact that TOCs are usually held neutral to Schedule 8 benchmarks under franchising arrangements, we are unconvinced about the merit of setting TOC benchmarks, which vary over time, in CP5. We note that this approach also ensures that the Schedule 8 regime remains financially neutral on expectation.

In relation to Transport Scotland's request, we would be happy to share any modelling work with funders, should they require it.

Proposed process and timescales

Consultation Question 5

Do you agree with our provisional proposals for timescales and processes for setting benchmarks in CP5? Do you have any further comments?

Summary of consultation responses

The proposed timescales gained general acceptance. However, it was pointed out that the July deadline will be challenging to meet, especially in relation to setting TOC PPM trajectories. Stakeholders emphasised that they should be fairly and meaningfully involved in all stages of the work.

Network Rail conclusion

We recognise that the timescales involved are challenging, but consider it important that Schedule 8 benchmarks are finalised before the end of PR13 so that the industry can plan for CP5 with certainty. We will endeavour to deliver work in a timely and accurate manner, whilst engaging closely and constructively with stakeholders.

As noted above, in light of the recent publication of ORR's draft determinations, it may be appropriate that some of the conclusions and timescales set in this letter are 'tweaked' at a later stage. We will inform the industry of any developments.

Other issues raised by stakeholders

ATW stated that, in light of devolution, we should consider whether Schedule 8 is the most appropriate regime, given that TOCs' franchise agreements provide performance targets in PPM while Network Rail is measured in terms of delay minutes. ATW therefore proposed that the industry should introduce a compensatory/incentive performance regime for CP5 that is driven by PPM rather than delay minutes, for all parties.

We recognise that some parties consider that Schedule 8 is associated with imperfections. However, we believe that Schedule 8 continues to offer the most appropriate *generic* approach to providing compensation for unplanned disruption. We therefore believe that it should continue to constitute the default compensation regime in CP5. We note, however, that it may be appropriate for local arrangements to be put in place that overlay the default regime, although any 'bespokery' would need to be consistent with our alliancing principles, and should not, for example, disadvantage any third parties.

Northern Rail stated that the process of benchmarking, based on CP4 performance levels, presents a risk that good performance in CP4 will be punished by tighter benchmarks and poor performance in CP4 will be rewarded with easier benchmarks. It argued that if benchmarks were instead based on expected end-CP4 performance levels, this risk would be negated and continuous improvement would be supported. Freightliner echoed this view.

In terms of Network Rail Schedule 8 benchmarks, the process of applying performance trajectories (which are consistent with the JPIPs) to the benchmarking period ensures that Network Rail is not rewarded for historic performance. Additionally, if Network Rail performed poorly during the benchmarking period, this would be taken account of when applying the performance trajectory. However, we recognise that for TOCs this same argument does not apply, as the benchmarks derived during the benchmarking period are simply projected forward at that level. We understand that this could be seen as a problem, however, do not consider that it is the role of the Schedule 8 regime to impose performance targets on TOCs. As stated in response to question 4, this is accounted for by means of franchise commitments and by 'natural' economic incentives to improve performance.

Transport Scotland noted that there needs to be recognition of the probability of a prolonged period of adverse weather during CP5. Furthermore, First Group considered that the assumptions regarding severe weather should be explicitly recognised.

The issue of periods of adverse weather during CP5 has been widely discussed at the Schedules 4 and 8 passenger regimes industry group. At this group, it was agreed that any periods of adverse weather during the benchmarking period should not be excluded. It should be noted that the benchmarking period includes one year with a 'bad' winter, and one year with a 'moderate' winter. We agree with First Group's comment that any adjustments, or otherwise, to take account of severe weather should be clearly documented.



Next steps

The conclusions set out in the letter form our proposals in relation to the principles, processes and timescales for the work to develop Schedule 8 benchmarks for CP5. The principles for the Schedule 8 benchmarks will then be confirmed in July. The work to develop whole-CP5 HLOS and JPIP consistent PPM trajectories is underway. During this time, Network Rail will liaise individually with TOCs to discuss this work, and the outcomes of the statistical models to convert PPM trajectories to Schedule 8 benchmarks. Following this, Network Rail will consult with the industry on the Schedule 8 benchmarks, and will then submit the proposed benchmarks to ORR for approval in September.

Yours sincerely

Joel Strange

Senior Regulatory Economist

ANNEX – Proposed timescales (as set out in consultation letter)

Draft Determination accepts NR's April proposal

