



2018 periodic review of Network Rail (PR18)

Initial consultation

May 2016

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Summary: A more efficient, safer and better used network for passengers and freight customers

Rail passengers and freight customers want a safe, reliable and efficient railway. Our job is to support the rail industry to deliver this and to ensure that every pound of Network Rail's expenditure is well spent. This review of Network Rail will play an important part in doing this, providing the framework for establishing the funding it requires, what it must deliver and the charges it can levy on train operators.

We welcome your views on our initial proposals. These include: focusing our regulation on each of Network Rail's devolved 'routes', supporting route customers in playing a bigger role; and targeting our regulation on how Network Rail manages and operates the system as a whole, encouraging it to get more value out of the existing network by making better use of it. Our approach would also facilitate greater political devolution of transport decision-making and support new ways of handling enhancements.

Significant achievements and opportunities ahead

Our review will build on recent successes: passenger numbers are at a post-war high, freight growth has delivered substantial environmental and economic benefits, and over the last ten years, satisfaction levels have improved. Network Rail has played a significant role in these achievements: delivering record levels of investment and improving the quality, safety and reliability of the network, while reducing costs. As a result, the railways continue to make a hugely important contribution to society, with lower levels of taxpayer funding.

But with these successes come a number of challenges. The recent cost increases and delays to some major enhancements make it even more critical that the industry demonstrates that funds provided by taxpayers, passenger fares and freight charges are all being well spent. This points to the need to continue progress on efficiency, make better use of the current network and ensure that decisions to expand or improve the network are well-informed and that delivery is effective. Meanwhile, the expectations of passengers and commercial pressures on freight continue to rise. And so must standards of network performance and service quality.

There are also significant opportunities. There is continued support for major investment in rail projects, illustrated by: the emphasis placed by the UK Government on the role of rail in the 'Northern Powerhouse'; the Scottish Government's City Deal commitments for rail and recent publication of its rail freight strategy; the Welsh Government's Metro proposals; Crossrail; and High Speed 2. Longer term, there is also the prospect of improved technology, supporting growth and greater efficiency.

A period of significant change

Against this background, the industry (and Network Rail in particular) is facing a period of significant change. Some of this is led by Network Rail, notably the shift towards greater decision-making by each of its devolved routes, accompanied by its reorganisation of central functions around a 'system operator' and 'technical authority'.

This shift is mirrored in the move towards greater local decision-making by governments and regional transport authorities.

Reclassification of the company as a public sector organisation in 2014 means that it now competes directly with other public spending priorities and has a much closer relationship with the Department for Transport. This has led to Network Rail borrowing directly from the UK Government, subject to binding borrowing limits. This has affected how Network Rail manages the risk of overspending which, along with its public sector status, emphasises the importance of both its reputation as an incentive and its overall financial position.

Throughout this period of change we need to remain focused on what the network needs to deliver over time and how much this will cost. As a result of the [Hendy review](#), there has been a significant change of several billion pounds to planned enhancement work, some of which has now moved from control period 5 (CP5, 2014-2019). There are now around £9.5bn of enhancements planned for control period 6 (CP6, likely to be 2019 to 2024). When combined with planned asset sales – which would reduce future income streams (e.g. from property rents) over CP6 – and uncertainty about the performance and efficiency levels that Network Rail can achieve by the end of CP5, this may imply some tough choices.

We need to prioritise

With limited stakeholder and ORR resources, we need to focus on areas where the review can make a significant impact on outcomes for passengers, freight customers and those providing funds to the railways. We think this means further work to improve efficiency and to get the most value out of the existing network. We also need to manage risks to asset condition and safety. Reflecting this, our

proposed aim for the review is to support: ‘**a more efficient, safer and better used railway, delivering value for passengers, freight customers and taxpayers in CP6 and beyond**’.

To do this, we will establish a framework that focuses on achieving an efficient cost of operating, maintaining, renewing and enhancing the network for current and future users and taxpayers, while protecting the ongoing safety of the network. We will also support Network Rail in improving its understanding of the capacity and performance of the network, to inform decisions about how best to use and invest in the network.

Our proposed approach

This implies an ambitious agenda to deliver benefits for passengers and freight customers, requiring a step-forward in how we regulate Network Rail, as well as your ideas and support.

We propose to **regulate at a route-level**, supporting both the changes being made by Network Rail and a greater focus by routes on the needs of their customers. This includes making greater use of reputational incentives by formally and transparently recognising the achievement of route management teams in delivering improvements.

Alongside this shift towards routes, we propose to adopt a **tailored approach to the regulation of Network Rail’s system operator role**: its timetabling, capacity management, analysis and long-term planning functions. This would support it in making improvements to achieve better use of the network and also protect the ability of train operators to move passengers and freight across route boundaries. This could facilitate further traffic and revenue growth within the current network, improving overall value for money.

This will require us to **improve how we measure what Network Rail delivers for passengers and freight customers**, including at route-level and by the system operator. The industry has been looking at how best to align the measurement of operational performance with what matters to passengers, something that we will look to build on as part of our monitoring of Network Rail. We will also ensure that our monitoring of maintenance and renewals provides effective oversight of asset quality and safety.

We will build on the work already underway to **improve the information available on what drives cost on the network**, explore how changes to track access charges might support industry-wide cost reduction, and look for incremental improvements to the incentives on all parties to deliver reliable train services and minimise the disruption from engineering work.

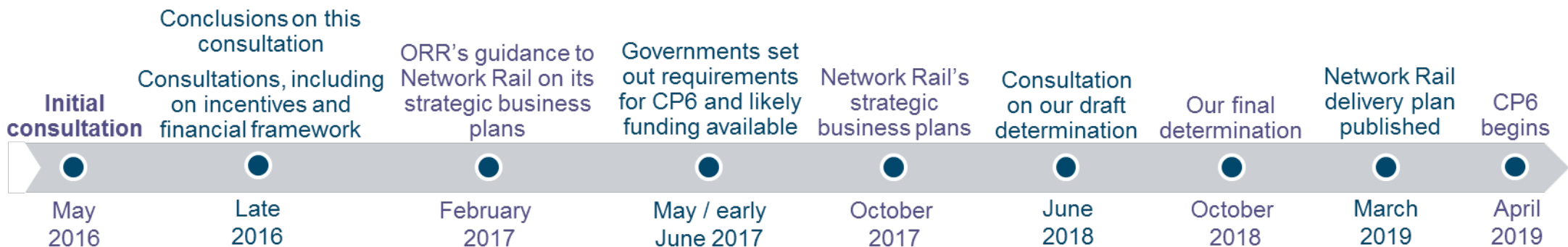
Finally, we set out some options for **a more flexible approach to investment in the network**, which would allow governments to choose from a menu of options for the regulatory treatment of

enhancements. This will: support those governments wanting a more direct role in the monitoring and delivery of improvement projects; allow routes and local funders to take a larger role, within the funding constraints; and support alternative funding models, including private funding. We will also be available to those governments and other funders who want us to play an active role in the scrutiny of projects.

Next steps

This is an exciting and important opportunity, and one that implies significant change, not just for Network Rail’s routes and system operator but also for train operators, stakeholders and us. To be successful, we need the thoughts, ideas and involvement of the whole sector. This includes Network Rail, train operators, governments and other funders and customer representatives. This will be key to enabling us to deliver a review that is firmly rooted in the practicalities of the industry and which can make a real contribution to ensuring that the railway supports users, taxpayers and the economy, both now and in the future.

Figure 1: Draft high-level milestones



1. Introduction

Purpose of this document

1.1 This document is our first major consultation on the 2018 periodic review (PR18). PR18 will determine:

- Network Rail Infrastructure Limited's (Network Rail's) outputs and funding in control period 6 (CP6, which we expect to run from 1 April 2019 to 31 March 2024). This will feed through into the service passengers and freight customers receive and, together with taxpayers, ultimately pay for;
- the charges that Network Rail's passenger, freight and charter train operator customers will pay for access to its track and stations in CP6; and
- the wider 'regulatory framework', including the financial framework for Network Rail and the incentives to encourage it and train operators to perform well.

1.2 This document reflects both our work over the last year and the significant wider debate on Network Rail's structure and broader issues. Its purpose is to:

- generate a discussion on how PR18 can support better outcomes for passengers, freight customers and taxpayers;
- seek views on our proposed priorities and objectives and the broad scope of the review;
- enable stakeholders to comment on our proposed high-level approach to PR18 and contribute views and ideas on the potential policy framework that could support this; and

- explain the proposed process for PR18, including how we would engage with stakeholders, to enable them to plan their involvement.

Structure of this document

1.3 The structure of the rest of this document is as follows.

- **Chapter 2:** Context for the review: the current issues facing the railway which are relevant to PR18.
- **Chapter 3:** Our proposed priorities and objectives for PR18, which take account of the context.
- **Chapter 4:** Our proposed high-level approach to PR18 to deliver our objectives.
- **Chapter 5:** Developing the high-level policy framework to implement our proposed approach to PR18. This seeks views on key issues that we will need to decide on relatively early, to inform subsequent decisions.
- **Chapter 6:** Process and engagement for PR18.
- **Annex:** References.

Working papers and other documents

1.4 We will shortly be publishing five working papers and a note concluding on our [August 2015 system operation consultation](#). A brief overview of these working papers is set out in Figure 1.1 below, along with links to them and other relevant documents.

1.5 The working papers are intended to share some of our early thinking and provide an opportunity for interested stakeholders to comment on more detailed issues, options and proposals. This engagement will help inform our thinking, particularly ahead of formal consultation on more detailed proposals.

1.6 We have also produced a separate [glossary](#) that explains the key terms used in this document. We will update this over the course of the review as further documents are published.

Timetable

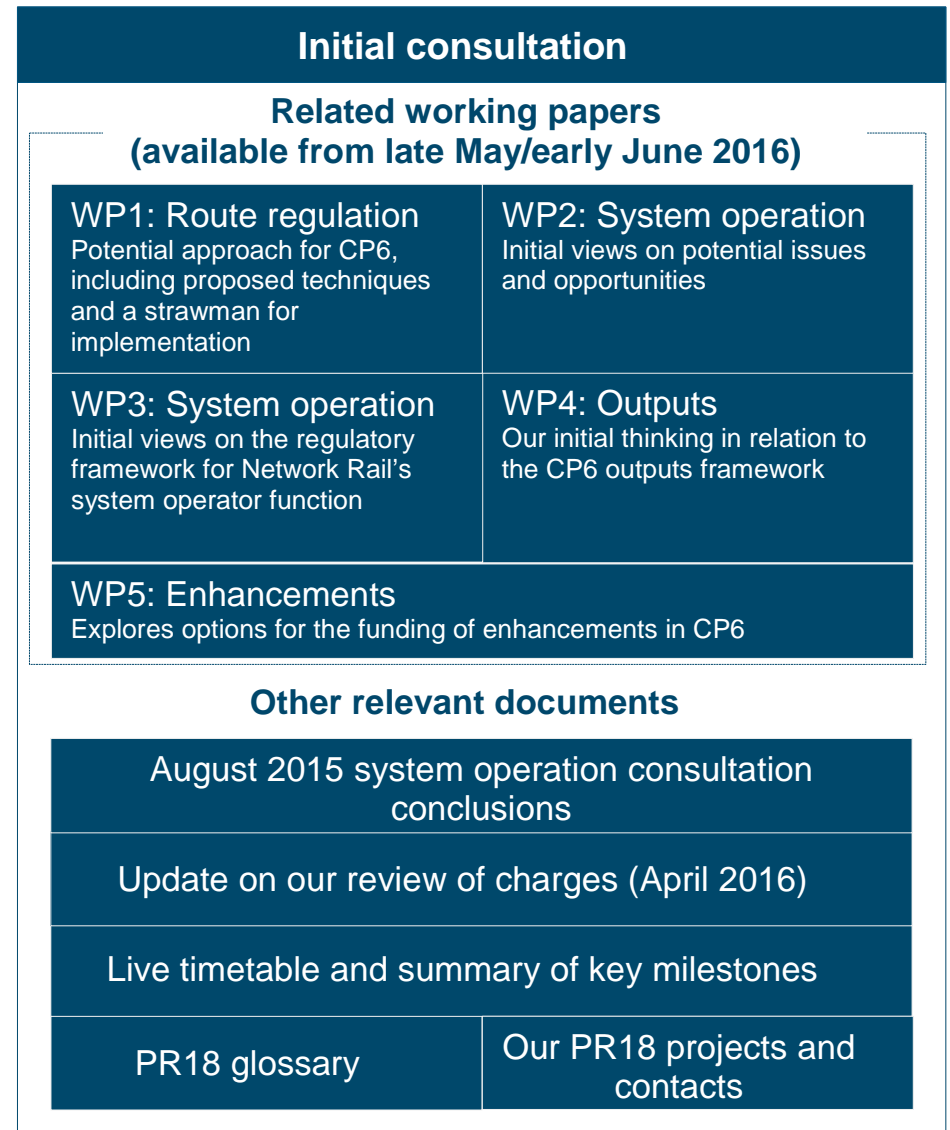
1.7 The three main phases of PR18 are described in chapter 6. Our [draft timetable](#) for the review sets out the timing of milestones in more detail. This includes our ‘final determination’, which will set out our final overall decisions on PR18 (in October 2018). The [draft timetable](#) (with an overview of the key milestones) is available on our website. We will keep this up to date, including following engagement with stakeholders on this consultation.

Next steps

1.8 This consultation closes on **10 August 2016**.

1.9 At the end of each chapter, we have included a question box inviting comments on the points we have discussed. We also welcome any other points that stakeholders wish to make. We have produced a [pro forma](#) containing the questions, should you wish to use this to respond to us. Details on how to respond are set out in paragraph 6.39.

Figure 1.1: Associated PR18 documents (with weblinks)



2. Context for the review

- 2.1 PR18 takes place at a time of significant change for the railway, and Network Rail in particular. This chapter sets out what we see as the context for the review, the main opportunities and constraints.
- 2.2 While the legal framework for the periodic review is unchanged, our approach to regulating Network Rail needs to reflect the changing context; not least the reclassification of Network Rail in 2014 and lessons learnt on how best to deliver enhancements.

Growing demand from passengers and freight customers

- 2.3 Network Rail's network is increasingly busy, with train kilometres up by nearly 25% since 2005-06. Capacity improvements have benefitted passengers and freight customers and allowed more services to run, but passenger numbers and freight volumes are forecast to grow even further.
- 2.4 A busier network increases the challenge for Network Rail across its roles: there are more constraints on the time available to maintain and renew the infrastructure; timetabling additional services is more complex; greater passenger numbers need to be accommodated at stations and when boarding trains; and capacity constraints limit the expansion of services despite the strong demand for them.
- 2.5 Meanwhile, passengers are funding an increasing proportion of the costs of running the railway, with the balance met by

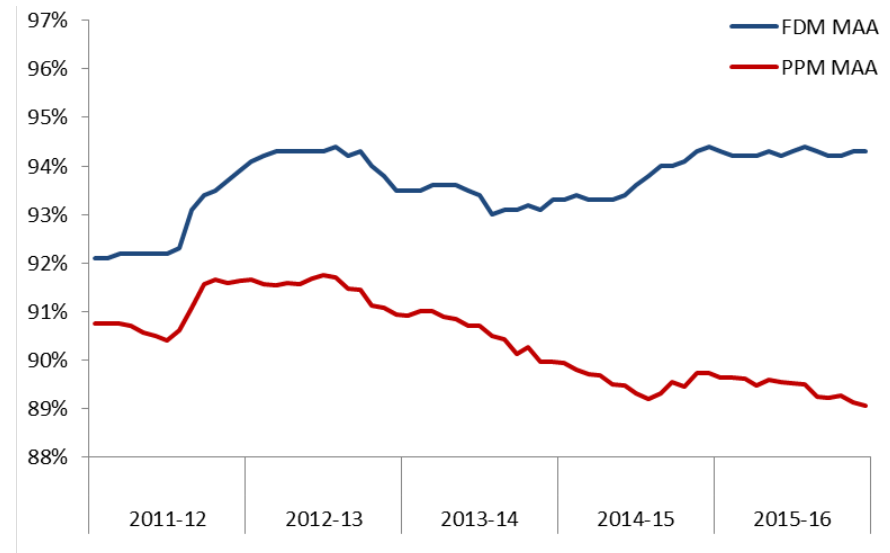
taxpayers. Understandably, there is a focus on fares, value for money and the level of service that passengers expect in return.

- 2.6 The freight sector also continues to evolve, responding to the shift towards intermodal freight and the relative decline in coal and steel volumes. This raises issues around how the network might offer the operational flexibility that freight customers increasingly need.

Performance and efficiency

- 2.7 Between 2004 and 2012 Network Rail made significant improvements in its financial performance and efficiency, but these have since declined. Similarly, network performance for passenger and freight operators improved over the same period, but since then overall passenger performance has fallen to a ten year low.

Figure 2.1: Public performance measure and freight delivery metric since 2011-12 (Source: ORR and Network Rail)



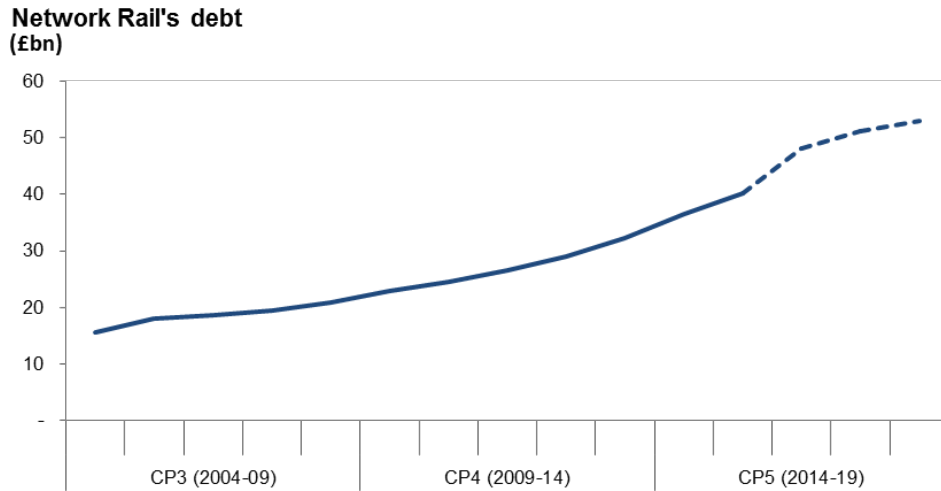
- 2.8 Although Network Rail has successfully delivered many major improvement projects, there have been some high-profile examples where it has undertaken work in ways that had unintended and significant adverse consequences for passengers (e.g. the 2014 Christmas engineering works).
- 2.9 Similarly, its ability to deliver major enhancements has been questioned following significant increases in costs for some projects. This led to us finding, in 2015, that Network Rail was in breach of its network licence with regard to systemic weaknesses in the planning and delivery of its enhancement programme. It also led to [the Hendy review](#) of Network Rail's CP5 enhancements portfolio. This review of the timing, scope and scale of a series of major projects confirmed that completion of the investment plans would go beyond CP5 into CP6, requiring a commitment of several billion pounds in CP6. In total, £9.5bn of expenditure on enhancement projects is now forecast to be incurred in CP6. All of these are planned to start their development in CP5. Also, £2.5bn of CP5 renewals work is now planned to be delivered following CP5.
- 2.10 These issues also raised questions about the roles of ORR and the Department for Transport (DfT) in setting the CP5 enhancements portfolio in England & Wales. In response, Dame Collette Bowe has completed a [review](#) of the process governing the planning of enhancements, setting out recommendations for how Network Rail, ORR and DfT should manage this. Separate arrangements will be agreed with Transport Scotland.
- 2.11 This has a number of implications, including the need: for the regulatory framework to adapt and reflect lessons learnt; and to encourage Network Rail to deliver more effectively with the

resources it has, where it can have the most impact for users. More generally, the expectations for the company will need to be realistic and informed by the likely level of performance at the end of the current control period in 2019.

Reclassification and public spending

- 2.12 With effect from September 2014, Network Rail was reclassified as a public sector organisation. This led to some important changes, including greater involvement by the UK Government in the company and the treatment of Network Rail's debt as public sector debt. This has had a number of significant consequences.
- 2.13 First, the company is now subject to different and less flexible financial constraints, notably through the UK Government setting a binding borrowing limit in England & Wales and, separately, in Scotland (in consultation with the Scottish Government). Given the cost pressures Network Rail has faced in CP5, these constraints have led Network Rail to defer renewals spend, defer and re-scope some enhancements projects and start an asset disposal programme. They have also increased the need for strong financial discipline within the company.
- 2.14 Looking ahead, Network Rail's debt is forecast to increase to £51bn by the end of CP5 (based on projections from our last review – PR13, see Figure 2.2 below). This debt is used to fund capital expenditure that is added to Network Rail's regulatory asset base (RAB). This would increase the RAB to £71bn by 2019. As previously discussed in our [2013 long term regulatory statement](#), the financial sustainability of this debt is an issue, particularly as the funding needed to service the debt will likely also grow.

Figure 2.2: Network Rail's historic and forecast debt



- 2.15 Second, funding of the railway now has the same impact on public finances as, say, spending on education or health. This has increased UK Government involvement in a range of spending decisions that were previously left to the company (and overseen by ORR) and sharpens the focus on how rail investment compares to the other alternatives.
- 2.16 In light of the wider fiscal constraints on governments, this is likely to reduce the scope for new substantial capital investment to accommodate growing demand, on top of the substantial levels of investment currently planned over the next decade. Network Rail also needs to fund maintenance and renewals activities over time, and to do so in ways that achieve 'minimum whole life cost' of its assets. There is a link here between the funds available today and the costs borne by future passengers, freight customers and taxpayers.

- 2.17 These factors make it increasingly important to get the most out of the existing network and to target the limited capital spending where it will have the greatest impact.
- 2.18 More generally, these changes raise questions about the nature of the incentives Network Rail faces. In particular, the significant public and political scrutiny on the company increases the importance of reputation in prompting it to act. And while financial performance and efficiency remain important, the financial incentives to improve them are now different.

Political and operational devolution

- 2.19 In November 2015, Network Rail reorganised itself to put a stronger focus on its already devolved route businesses (referred to as 'routes' in this document), increasing the discretion that route managers have over operational decisions. This has been accompanied by the reorganisation of some central functions, including the creation of a directorate undertaking 'system operator'¹ functions, one focused on providing support services to routes (pooling certain resources for the company as a whole) and a 'technical authority'.
- 2.20 While we have increasingly focused our attention on routes since PR13, our regulatory approach in CP6 will need to reflect these

¹ The centrally based system operator function within Network Rail covers activities such as timetabling, capacity allocation and long term planning. Our use of the term 'system operator' in this document relates to this function.

more recent changes in how Network Rail operates. We also need to respond to the opportunities for greater route-level engagement that increased devolution brings for customers and local stakeholders.

- 2.21 Separately, political devolution could lead to a greater formal role for each of the national governments and also for regional authorities in transport decision-making (such as Transport for the North and Midlands Connect). This is in addition to the already well developed and evolving role of Transport for London. While these devolution matters are for government, the outcome has the potential to affect the periodic review and could increase the need for flexibility to adapt to new funding models. We will work with these bodies to facilitate any increased role for them.

Industry structures and incentives

- 2.22 For PR18 to support improvements for users and taxpayers, it needs to reflect the structure of Network Rail and the wider industry arrangements. This represents a significant challenge, given the scope for change at the moment, for example:

- the [Shaw report](#) into the future shape and financing of Network Rail, published in March 2016, has made recommendations to the UK Government on the future of Network Rail (see Box 2.1 below). Some of these relate to how we regulate Network Rail (and are broadly consistent with our proposed approach to PR18), whereas other aspects are for others to consider – in particular, Network Rail and the UK Government, who each expect to respond to the report later this year;

- by CP6, Network Rail plans to have raised £1.8bn from its assets in England & Wales, including potential disposals of its commercial estate and freight sites. This would imply an increase in total track access charges to offset the fall in Network Rail's annual property income. The company is also considering a range of options (including different management models and disposals) for some of its stations, telecoms assets, and for its electrical distribution and traction power supply assets;
- the deep alliance between Network Rail's Scotland route and the ScotRail franchise aims to deliver better outcomes for passengers, and raises the question of how the regulatory framework can best support this; and
- the Welsh Government is considering new models for delivering services on the Valley Lines, which might include changes to how this infrastructure is owned and/or operated.

- 2.23 While there will be challenges in developing a regulatory framework that is sufficiently flexible, there could also be opportunities for changes that unlock benefits. One such example relates to the funding arrangements for the railway, where the UK Government has:

- announced that a greater proportion of industry funding in England & Wales will be channelled through franchised train operators (rather than directly to Network Rail); and
- set out its interest in exploring how franchised train operators might be exposed to a wider set of changes in network charges.

- 2.24 This could improve incentives on train operators to work with Network Rail to reduce system-wide costs, and also would increase engagement in periodic reviews, improving scrutiny.
- 2.25 Further, following a [review](#) by the Competition & Markets Authority (CMA), there is work underway to consider how open-access passenger operators might play a larger role in delivering rail services. One part of this would involve reforms to the charging framework which, when combined with a proposed government-set levy on open access operators, would mitigate the adverse financial impacts of open-access entry on government funding while increasing the benefits of competition for passengers.

Box 2.1: The Shaw report

The [Shaw report](#) recommended that rail infrastructure management be centred on the needs of passengers and freight customers. In particular, this should come through strengthened route-level devolution within Network Rail, supported by a strong national system operation function and independent regulation. As part of this, it suggested the creation of a devolved route in northern England and a 'virtual freight route', which Network Rail is considering.

It also made recommendations on: how the role of government in the railway could be clarified, including through a long-term rail strategy; how enhancements planning could be improved; alternative ways to pay for the growth of the railways, both through smaller scale route-level investments to fund additional capacity and a potential role for private sector finance. It also drew attention to the need to develop the skills and diversity of its workforce.

Technological change and High Speed 2

- 2.26 The availability of new technology is likely to be a significant feature of CP6 and beyond. In particular, the deployment of new technology by Network Rail and the industry, including the European Rail Traffic Management System (ERTMS), traffic management and other systems (which Network Rail refers to collectively as the 'Digital Railway'²) could, in time, increase the capacity available on the network and bring other benefits.
- 2.27 The industry is currently developing business cases for the 'Digital Railway', which will inform decisions on the pace and the extent of the roll-out. These decisions will include whether ERTMS should be specified and funded outside of the periodic review process. But however it is specified and funded, these decisions will have major implications for Network Rail's approach to maintaining and renewing its signalling equipment in CP6 and also affect decisions on the most appropriate way to increase capacity.
- 2.28 High Speed 2 (HS2) could also affect Network Rail in CP6, including the outputs that Network Rail will be able to deliver with the current network during the construction phase. It has potential implications for the deliverability of Network Rail's renewals and enhancements programme, given the shared supply chain with HS2. More generally, it will have implications

² 'Digital Railway' includes initiatives based around ERTMS (which includes the European Train Control System (ETCS), Traffic Management and GSM-R) and further systems (such as C-DAS).

for how to maximise the benefits from connecting the two networks, to best support the UK economy and provide value to passengers and taxpayers.

Views sought and questions

This chapter sets out the main issues and opportunities that we consider set the context for the next periodic review. We invite stakeholders to comment on whether they agree or whether they consider there are additional significant points (and if so, to explain how these might affect the review).

3. Focusing the review where it can have most impact for passengers and freight customers

3.1 This chapter invites views on a proposed set of priorities for our review of Network Rail, reflecting the context of the previous chapter.

3.2 The approach we take to the review must be guided by our [statutory duties](#) and, given the limited resources and time available to stakeholders and to ORR, the most important priorities. We think this prioritisation should reflect where:

- we are well-placed to make a difference to the interests of passengers and freight customers, either directly or by facilitating change or action by others; and
- impacts are more significant, including where risks are high and need to be managed to sustain current successes.

Our proposed prioritisation

3.3 In order to consider how we might focus our work, we have identified six high-level outcomes relating to what Network Rail delivers, and which our review could support. We set these out in Figure 3.1. While the review will contribute to all of these outcomes, we set out below our proposed prioritisation.

Figure 3.1: High-level outcomes delivered by Network Rail

A network that is...		
More efficient	Better used	Expanded effectively
Taking cost-effective decisions on operating, maintaining and renewing the network.	Finding ways of improving performance and accommodating more services on the current network.	Informing decisions on enhancements, and delivering agreed projects in a safe, timely and cost-effective way.
Safer	Available	Reliable
Maintaining, and finding ways to improve, safety standards on the current network and as it is enhanced.	Taking effective decisions around possessions, mitigating the overall impact of these on end users.	Taking effective decisions to limit delays and cancellations, and their impact on users.

Proposed high priority areas

A more efficient network

3.4 There is a challenge for Network Rail to demonstrate that it is as efficient as it could be, as inefficiency ultimately results in higher costs for passengers, freight customers or taxpayers. This is in even sharper focus given constraints on public spending, the costs faced by passengers and the need to support the competitiveness of rail freight.

3.5 There is also an opportunity for us to change our regulatory approach to support improvements in both how we set efficiency assumptions and monitor financial performance. This would build

on Network Rail's own initiatives to move greater responsibility to its eight route businesses, by making greater use of comparison between routes to inform realistic cost allowances, increase the role of route customers, and make best use of reputational incentives to drive improvements. It will also be important to increase transparency around the cost drivers of the network and improve the link between these and what train operators pay.

A better used network

- 3.6 While there are £9.5bn of enhancements now planned for CP6, the constrained fiscal environment suggests there may be limited public funding available for further major projects. This makes it increasingly important to get the most out of the existing infrastructure in order to accommodate increasing passenger and freight growth, improve overall value for money and support the wider economy.
- 3.7 There is also potential for changes in how we regulate to support better timetabling, to improve performance and encourage growth within the current network. This would involve work to: strengthen incentives on Network Rail's 'system operation' functions to maintain the benefits of a national network; look for improvements in how we measure performance; and explore changes to the charges for using the network aimed at improving how Network Rail and train operators make use of the network.

A network that is expanded effectively

- 3.8 Enhancement projects will continue to account for a substantial proportion of the costs of the network. Under Network Rail's current structure, any inefficient spending impacts on taxpayers and users. It is therefore important that the process for specifying

and funding new enhancements is well informed, so that investment is targeted where it can have most impact and delivery is efficient and manages any necessary disruption.

- 3.9 The lessons of PR13/CP5 and the recommendations of the [Bowe Review](#) make clear the need for improvements in how enhancements are specified and delivered. Network Rail and DfT have now agreed a memorandum of understanding relating to enhancements. In addition, we have been working with DfT, the Scottish Government and Network Rail to identify options for handling enhancements in future, including how projects can be scrutinised in a manner that best reflects a government funder's view on the best way to protect taxpayers' interests. These options include a government specifying, funding and scrutinising enhancements separately from a periodic review. This could support greater alignment between network enhancement and franchising decisions.
- 3.10 To deliver this additional flexibility around the timing of enhancements decisions, the linkages with the wider regulatory framework need to be managed. For example, changes to the enhancements pipeline might affect the timing of renewals activity and the funds available for maintenance activity, while the delivery of projects will affect the service levels received by train operators, passengers and freight customers.
- 3.11 We think developing and refining these options is an area where significant further work is needed. This will need to be an area of focus in PR18, so that the periodic review and the approaches to enhancements work effectively together. For example, there will need to be a clear mechanism for how outputs set in PR18 might need to be revised if, during CP6, new enhancements are

specified and delivered in a way that affects them. Likewise, there will need to be clarity on how Network Rail will manage enhancements within its funding and debt limits and how it will identify the appropriate level of renewals for CP6. These arrangements also need to complement the existing [investment framework](#) that supports government, train operator and third-party investment in the network.

Proposed areas for continued focus

A safer network

- 3.12 Great Britain has one of the safest railways in the world; a position that requires continued focus and attention to maintain.
- 3.13 At this stage, we do not anticipate significant stand-alone safety-related projects to be delivered through the periodic review, unless specified by the Secretary of State (on behalf of Great Britain as a whole) in his high-level output specification (HLOS). But throughout the review, we will maintain our focus on safety to ensure that Network Rail is sufficiently funded to manage (and, where appropriate, reduce) safety risks, including in areas such as occupational health and worker safety. This includes ensuring there is adequate spending on safety-critical maintenance and renewals.
- 3.14 Reflecting this, safety will play a significant role in determining our approach.

Proposed areas for incremental improvement rather than fundamental review

A network that is available and reliable

- 3.15 Network Rail makes a number of important trade-offs when planning and undertaking maintenance and renewals activity, including how best to balance the requirements of passengers and freight customers with its need to access the network for engineering works. There are two broad aspects to this:
 - the possessions and performance regimes in track access contracts (referred to as ‘Schedules 4 and 8’) provide the principal financial incentive to encourage appropriate decision-making by Network Rail and train operators; and
 - the ‘regulated outputs’ that we typically set in respect of network availability, punctuality and avoiding cancellations to encourage Network Rail to improve.
- 3.16 Feedback on the possessions and performance regimes indicates that most (but not all) stakeholders think that the broad structure of these regimes is fit for purpose. We have considered this feedback and we do not propose major changes to these in PR18. Instead, we propose to focus on incremental improvements. This could still lead to some important changes, including a review of the linkages with passenger compensation following [our response](#) to the Which? super-complaint. This more focused review should reduce the burden on industry in this area.
- 3.17 Similarly, with the framework for outputs (and for monitoring delivery of these), we see this as an area for incremental improvement and simplification, rather than wholesale redesign. This would include changes to ensure outputs more closely

reflect what matters to passengers and to take account of the role of route scorecards (which Network Rail has begun to use as a way for its routes to agree priorities with train operators and for progress to be measured against these).

Proposed aim for the review

- 3.18 In summary, we propose to focus our work on areas that particularly impact upon the overall efficiency of the network and on changes that will support improvements in how we make use of the existing network. This will benefit passengers and freight customers, by putting downward pressure on cost and by supporting additional services and performance, against a background of an inevitably constrained budget for additional enhancements.
- 3.19 We also think we can update our regulatory approach to support Network Rail to deliver these improvements: namely, through more targeted regulation at a route and system operator level.
- 3.20 Further, we are looking at options for greater flexibility in the approach to enhancements. In practice, this means that some funders may choose to take a larger role in ensuring that these projects are effectively scoped and delivered efficiently. There is, however, an important role for ORR here, not least in making this work alongside the periodic review process and monitoring. This shift in focus also serves to highlight the importance of good quality information around the options for enhancements (to inform those looking to fund improvements) – an important element of Network Rail's system operator role.

3.21 Finally, safety will continue to play a significant role in determining our approach, particularly in our assessment of whether there are sufficient levels of maintenance and renewals.

3.22 Consequently, our proposed aim for CP6 is:

“A safer, more efficient and better used railway, delivering value for passengers, freight customers and taxpayers in control period 6 and beyond”

3.23 To deliver this aim in line with our proposed focus for the review, we have developed the following objectives:

- to establish a framework that encourages Network Rail to:
 - ensure the ongoing safety of the network;
 - improve the efficiency of operating, maintaining, renewing and enhancing each of the routes in CP6 and beyond; and
 - improve its understanding of the capacity and performance of the network.
- to support government funders and operators to make better informed decisions about expansion and use of the network.

How we will deliver our aim and objectives

3.24 As we develop our proposals in more detail, we propose to place particular emphasis on the need to identify opportunities to:

- encourage a greater role for Network Rail's train operator customers and stakeholders, and ensuring decisions are focused on the interests of current and future end users and taxpayers;

- develop a framework that is suited to regulating Network Rail as a public sector organisation;
- facilitate devolution of transport decision-making to regional funders and realise the opportunities presented by devolution of responsibilities to Network Rail's routes; and
- ensure that funders can take informed choices, including by improving the understanding of costs and the capability of the network.

3.25 We have noted above how the priorities link to key aspects of our proposed work programme. This work is discussed in more detail in the next chapter, and is also summarised in Figure 3.2 below.

3.26 In each case, we will need to develop options and detailed impact assessments. This will include understanding the costs of transition and implementation, which will inform the thinking on which changes to make and how quickly they might be implemented. For example, in some areas, we may only be able to make limited progress during PR18 or by the end of CP6, with further progress to be made subsequently.

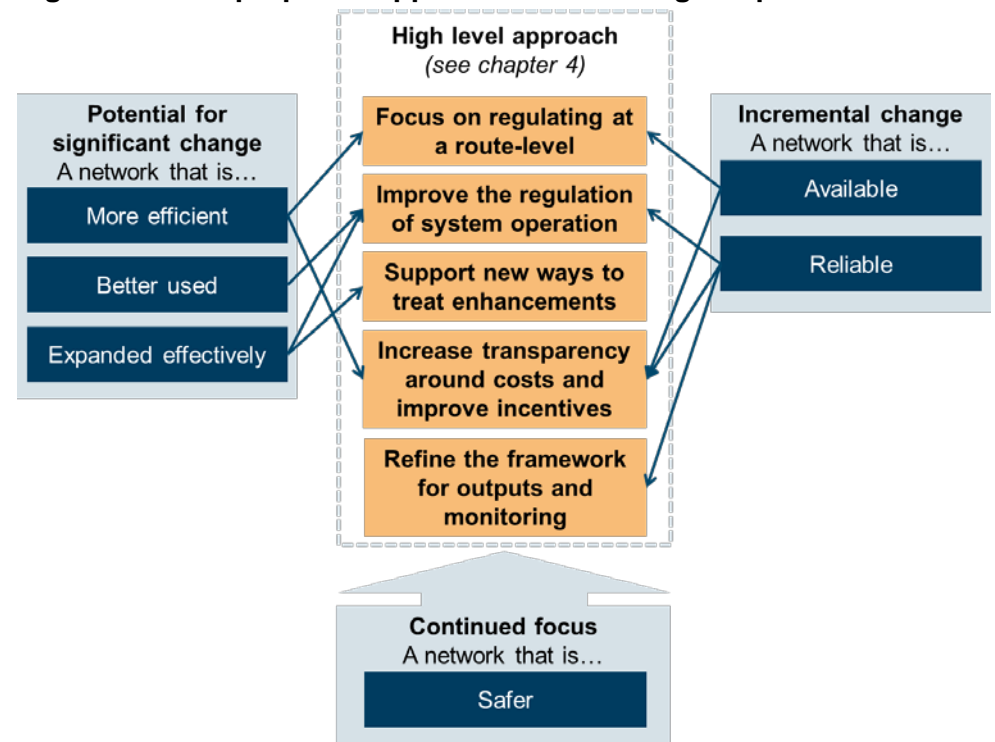
3.27 Consistent with our statutory duties, we think that this programme of work will allow us to deliver improved outcomes to:

- passengers, through: the potential for lower costs to translate into lower fares; improved management of the network providing for additional services to be accommodated; and incremental improvements to the management of performance;
- freight customers, through: safeguarding network-wide coherence; improved timetabling and system management;

and working with governments to ensure that the benefits of freight are reflected in the overall costs they face;

- taxpayers, through: lower network costs; and improved information about when and how best to fund additional investment in the network; and
- the wider economy and society, through: lower network costs and a better used, more reliable, railway that supports economic growth and delivers environmental benefits through reduced road congestion.

Figure 3.2: Our proposed approach to delivering our priorities



Views sought and questions

We welcome views on the proposed relative priorities for the review, as well as any other areas that should be prioritised (in which case, we would particularly value views on what should not be prioritised as a consequence).

4. Our proposed approach to the review

- 4.1 This chapter discusses our high-level approach to delivering our aim and objectives for the review. In particular, how we propose to:
- focus on regulating at a route-level;
 - improve the regulation of system operation;
 - refine the framework for outputs and how these are monitored;
 - increase transparency around costs and improve incentives; and
 - support new ways to treat enhancements.
- 4.2 To do this, we propose to make a number of changes to how we regulate Network Rail which, taken together, mean that this review is likely to be significantly different from previous ones. We will also consider the extent to which the regulatory framework needs to reflect the pace of the roll-out of the 'Digital Railway', recognising that this is currently uncertain.

A focus on regulating at a route-level

- 4.3 Network Rail is now organised around eight route businesses, which are supported by a system operator function and centrally-based business units providing services to them (e.g. major projects, procurement, HR, etc.).

- 4.4 This presents an opportunity to improve how Network Rail is regulated, by focusing more at route-level (going beyond our existing approach of regulating Scotland separately from England & Wales). This would allow us to put greater reliance on comparison between the route businesses, rather than having to rely on comparisons with other overseas networks. It would also improve understanding (by Network Rail, ORR and others) of key cost drivers and enable the most effective approaches across the company to be highlighted and used more widely.
- 4.5 Route-based regulation would also provide a response to the challenge of providing effective incentives for a large, publicly owned business. In rail, the reputations of businesses and individuals matter. We can use this pride in the railway to recognise those who are innovating and improving efficiency, while also providing an additional stimulus for those in under-performing areas to raise their performance. This can usefully supplement the information and incentives that are created through financial incentives and monitoring.

How this could work

- 4.6 A focus on route-level regulation could involve a range of different techniques, employed by us and/or Network Rail. As part of the periodic review we could:
- **request that business plans and submissions to ORR come from each route.** This would allow routes to take different approaches, and submit evidence that reflects the challenges and opportunities at a route level, within an overall structure set by Network Rail centrally;

- **encourage greater involvement by train operators and stakeholders in informing route plans**, so these can be based on better evidence and more closely reflect the priorities and interests of their end users (within funding constraints);
 - **facilitate scrutiny by train operators and stakeholders** at a local level, complementing our role in the assessment of asset policies and efficiency;
 - **use data to benchmark each route’s performance**, which would provide better information to check and challenge route-level business plans. We would not expect these techniques to be definitive – in part due to the currently limited data and some of the differences between routes – but they could allow us to target our scrutiny where it will have most impact and to provide a basis for better informed conversations with route managers; and
 - **set outputs and funding at a route-level**, which would allow us to use comparison of route-level plans and performance to provide greater assurance on whether output targets would be realistic, fair and deliverable, as well as reflecting the involvement and evidence from stakeholders (as discussed above).
- 4.7 In CP6, following the periodic review and our determination, our monitoring and the incentives we set Network Rail could involve:
- **greater use of comparison between the routes**, building on the monitoring already taking place at route-level;
 - **publication of scorecards** to report routes’ relative performance in a range of areas – allowing government and devolved funders, operators and users to understand better the performance of routes and hold route managers to account – supporting reputational effects and highlighting good practice;
 - **management incentives** could allow the link between the performance of route teams and the rewards they receive to be strengthened; and
 - **information coming directly from routes**, with our detailed scrutiny being focused more on those with weaker justification for their costs and activity levels, and less effective systems for collecting and managing robust data.
- 4.8 It may not be practicable to apply all of these techniques fully in the current review. For example, it may be the case that some of them can only be rolled out in full over a longer period. But we think that applying at least some of them in this review is likely to deliver benefits for customers, just as they have done in the regulation of airports and the water, gas and electricity distribution networks.
- 4.9 Route-level regulation should not mean an overly burdensome review involving eight times as much work. We will need to work differently. We will need to see, in a transparent way, the information that a route should be using to manage its activities, but using the above techniques could allow us to place greater reliance on route comparison and greater customer engagement, so that our detailed scrutiny is increasingly targeted and risk-based.
- 4.10 Our ability to do this would be increased by:
- **Network Rail supporting this shift in regulation**, including through changes to working practices and culture, and improvements in benchmarking data. Our ability to take

a more focused approach in PR18 will depend on the quality of the available data to enable effective comparisons. Another key change will be to find ways to increase routes' accountability for their own results. This might involve them providing certain information directly to us. Indeed, the Shaw report noted the importance of routes submitting full and separate regulatory accounts. This might mean that the role of the 'centre' changes somewhat, focused more on providing challenge and assurance and helping to make decisions on the use of scarce resources, leaving more decisions to route managers; and

- governments providing the flexibility (in their high-level output specifications (HLOSs)) for **route-level outputs to be determined by us**, which would facilitate route-level variation and allow each route team to have its own set of realistic regulatory targets, against which it is held to account. This in turn provides for the needs of route stakeholders and current and future consumers to be better reflected in the setting of these targets, and for these to reflect the best available evidence at the time. We recognise of course that it is for governments to decide how they specify their HLOSs, and that the approach taken in Scotland might need to be different to reflect that the Scottish HLOS relates to a single route.
- 4.11 We will need to do more work to develop these ideas, and note that Network Rail has provided significant support for the concept of moving more responsibility towards its routes. We think that there is a significant opportunity here to increase the effectiveness of regulation, so that our oversight can complement that undertaken by the 'centre' of Network Rail and its board; providing better assurance without necessarily increasing the

overall costs of that regulation. Our subsequent working paper on route-level regulation will look at some of these issues in detail.

Improving system operation

- 4.12 The rail network has supported a substantial increase in both passenger journeys and freight volumes. Recently, this has been possible through the lengthening of passenger and freight trains, significant investment in infrastructure and efforts to make better use of the available network capacity.
- 4.13 Investment in the network and rolling stock inevitably comes at a significant cost. This emphasises the importance of Network Rail making the best possible use of the existing network, building on the significant growth in the use of its network over the last decade.
- 4.14 At present, the effectiveness of Network Rail's system operation functions is not subject to specific regulation or monitoring by us; rather, our regulation mainly focuses on Network Rail's infrastructure management functions. We also have a set of incentives that arguably place significant weight on certain aspects of passenger and freight performance (e.g. public performance measure (PPM) and freight delivery metric (FDM)), whilst providing limited stimulus to accommodate additional traffic or to identify better ways to use the current network.
- 4.15 For CP6, we think that our regulation of Network Rail should identify the 'system operator' activities that Network Rail undertakes centrally, and involve a tailored and more focused approach to these functions. This would mitigate the risk of increased devolution to routes leading to incoherent planning and

poor service provision to those crossing between route boundaries.

- 4.16 Routes currently play a key role in undertaking some important aspects of operating the system, notably the operation of signalling and leading the response to most disruption. As this role is not expected to change, we would not expect our regulation of the central system operator to include these activities. This means that when we determine route-level outputs and the related monitoring framework, we will need to consider how these route-level system operation activities should be captured.

How this could work

- 4.17 While there is a range of different approaches we could take, our approach to regulating Network Rail's centrally based system operator might involve a combination of the following.
- **A set of performance measures or outputs.** These might include some quantitative measures (e.g. national or system-wide operational performance, scale of timetable conflicts) and customer-facing measures (e.g. operators' satisfaction with timetabling processes).
 - **Financial incentives on the system operator,** reflecting key aspects of overall performance and facilitating any changes by Network Rail to more closely link system operator performance to the remuneration of relevant staff.
 - **Financial information about the system operator,** including data about its costs and assets and how these might be expected to evolve over time. With the main priority of the system operator being to realise the value of

the network, our focus could be on the value it adds, while retaining an appropriate level of scrutiny on its costs.

- **Greater transparency about performance,** to allow train operators, stakeholders and funders to challenge how well the system operator functions are being delivered, enhancing reputational incentives.

- 4.18 We will also need to consider how regulation can best support Network Rail's initiatives to improve its analytical and timetabling capability. This might involve different forms of oversight, such as monitoring the delivery of improvement projects or measurement of the 'maturity' of certain key processes.
- 4.19 We will shortly be publishing two working papers on how our regulation in this area might develop, on which we welcome thoughts and ideas from stakeholders. We will also publish a conclusions note from our August 2015 consultation on system operation at the same time.

Refining the framework for outputs and how these are monitored

- 4.20 The outputs framework (including the associated arrangements for monitoring outputs) plays an important role during a control period. It encourages Network Rail to improve outcomes for passengers and freight customers, and provides for transparent oversight of its performance in key areas, including efficiency and its maintenance and renewals activities.
- 4.21 We will review the outputs framework, with a view to making changes to reflect the greater focus on Network Rail's routes and system operator role. This is likely to focus on:

- **increasing the involvement of train operators and other local stakeholders in setting outputs**, so outputs better reflect the needs of customers and those funding the railway;
- **improving how the experience of passengers is reflected in output measures and monitoring**. This would build on recent work led by the industry to consider the case for measuring operational performance in ways that reflect all delays to services (at all stations) and take account of the number of passengers on each service. It would also cover other areas where Network Rail is responsible for delivery (e.g. network availability); and
- exploring the appropriate **outputs for system operation** activities.

4.22 In terms of monitoring, we are exploring the following:

- **increased transparency**, so that train operators and stakeholders can increasingly hold routes and the system operator to account, supported by our own oversight;
- linked to the above, the role of **route scorecards** in the framework; and
- whether our approach to **monitoring maintenance, renewals and asset condition** reflects the risks that spending constraints might present for renewals volumes, in terms of the implications for longer term efficiency and safety.

4.23 More generally, we will look at the overall balance of the outputs framework in light of route-level regulation. This may include stepping back from more detailed monitoring where a route has demonstrated that it is effective in a particular area. Similarly, we

will need to look at the extent of our role as Network Rail becomes increasingly accountable to its train operator customers, as they, in turn, take a bigger role.

4.24 At this stage, we do not propose to focus on reforms to the measurement of freight performance, as the feedback we have received indicates that FDM is broadly fit for purpose.

4.25 Our subsequent working paper on outputs will set out our initial thinking on how the outputs framework might be improved for CP6. This is intended to initiate a dialogue with stakeholders on different approaches.

Increasing transparency around costs and improving incentives

4.26 Access charges and the incentives around performance and possessions affect the decisions that Network Rail, train operators and funders make, influencing both the cost of maintaining and renewing the network and how efficiently network capacity is used. They can therefore play an important role in improving outcomes for passengers, freight customers and taxpayers.

4.27 The potential for governments to channel more funding through train operators (rather than through direct grants to Network Rail) and to increase franchised operators' exposure to Network Rail's costs provides the potential for a range of improvements in how charges affect behaviours.

How this could work

4.28 We have been working with stakeholders to explore options for improving the structure of charges, both through our own engagement with them and by drawing upon the work led by the Rail Delivery Group (RDG). We consulted in December 2015 and in April 2016 published an [update](#) setting out our view that there are three broad ways to deliver improvements for CP6 and that these would be the focus of our work in this area. These are to:

- **develop a better understanding in the industry of what drives infrastructure costs** (i.e. those relating to the costs of providing and investing in the network), including improving information about where these costs fall and what activities/types of use causes them to be incurred;
- **improve the current short-run variable charges** (i.e. those relating to the costs of operating and maintaining the network). This could address known weaknesses with existing short-run variable charges and could involve considering options to link charges more closely with the costs faced by routes; and
- **explore how charges might better reflect infrastructure costs** and how they vary over time and by use. This could lead to higher charges in costly locations – where operators cause these higher costs to be incurred – and lower charges in less costly areas and for operators who are not causing costs to be incurred.

4.29 Our update confirmed that we were not proposing to take forward options that directly link charges to the relative value of capacity in different parts of the network (to users and society). But we will need to ensure that the overall charging structure sends sensible

signals to make best use of scarce parts of the network, whilst also facilitating use of those parts of the network where there is spare capacity.

4.30 Linked to this, we noted in our [December 2015 consultation](#) that open access operators currently pay short-run variable charges, but do not pay fixed track access charges. As a result, while franchised services contribute to both short-run variable costs and a proportion of fixed costs, open access operators only contribute towards short-run variable costs. We noted that this indicated a need to consider whether some open access operators should make a greater contribution to network costs. The CMA's work in this area (see paragraph 2.25) is also relevant to this. Our proposals on the structure of charges in late 2016 will consider this further.

4.31 We will continue to work with industry to refine and evaluate detailed options for individual charges (including the capacity charge) within these prioritised areas, and will look for opportunities to simplify or abolish charges that do not deliver sufficient benefits.

4.32 We will also continue our work to identify incremental improvements to the incentives for possessions and performance ('Schedules 4 & 8'). This reflects the views received earlier this year from stakeholders, which indicated that our focus should be on improving these regimes rather than considering fundamental changes. This will also include consideration of any changes to Schedule 8 relating to the super-complaint on passenger compensation, on which we issued our [report](#) in March 2016.

Supporting new ways to treat enhancements

- 4.33 There are a number of changes that highlight the need to consider new approaches to the treatment of enhancements in this review. These include:
- **the problems that have been experienced in the delivery of some PR13 enhancements**, where the forecast cost of some schemes has increased well beyond the levels expected at the time of PR13. This has led to the whole programme of projects in England & Wales being reviewed for its deliverability, with material changes proposed to the timing of some major enhancement projects as a result;
 - linked to the above, **a number of projects specified by government and included in PR13 were not well developed** at the time of the review. This led to the setting up of the ECAM³ mechanism to address the associated cost uncertainty, but ECAM itself has been the subject of recent debate;
 - **the impact of reclassification on the financial framework for Network Rail**, which has meant the UK Government has imposed binding borrowing limits on

³ The [Enhancements Cost Adjustment Mechanism](#) (ECAM) involves ORR assessing – within the control period – whether Network Rail's cost estimate for each project is fully justified, whether it has sufficiently considered opportunities for more cost effective delivery in line with best practice and whether the scope of the project has been developed in line with Network Rail's governance with input from key stakeholders.

the company. This reduces Network Rail's ability to manage the consequences of over-spends or changed funder requirements on individual projects through issuing additional debt;

- moves towards **political devolution and the increased diversity of funders**, whereby national and regional governments, transport authorities and other third parties could play a larger role in identifying and funding enhancements;
 - the establishment of a [memorandum of understanding between DfT and Network Rail](#) that clarifies each party's role in enhancement projects in England & Wales;
 - the potential benefits from **aligning major enhancement, franchising and rolling stock decisions**, which could point towards moving away from a five yearly specification of enhancements using the periodic review process. Instead there could be a 'pipeline' of enhancements with decisions to commit to specific enhancements at a variety of decision points, for example at the same time as decisions on franchises.
- 4.34 DfT has highlighted potential benefits from changes to take the funding of enhancements outside of a periodic review and has asked us to explore the implications. This could help to address the alignment point above and provide a more flexible approach to the funding of enhancements.
- 4.35 To explore this option and, more broadly, decide on the overall approach to enhancements in PR18, it is useful to review what criteria should apply and what the main questions are which need to be answered in terms of:

- the different decisions affecting enhancements;
- what the pros and cons of alternative approaches might be; and
- what the role of ORR and other parties should be.

4.36 Possible criteria include whether the overall approach:

- supports the planning and delivery of enhancements;
- supports the necessary interactions between enhancements and the rest of Network Rail's business for planning, delivery and monitoring purposes, and hence also for the assessment of financial risks;
- promotes efficiency in the costing and delivery of enhancements and a clear and robust process for RAB additions;
- works for a variety of both current and future funders, public and private, and facilitates different funding models;
- promotes transparency around the planning, delivery and financial aspects of enhancements; and
- supports clarity of roles between all parties.

4.37 Working to these criteria would protect the interests of users and funders and should build trust and confidence in the overall process in the future.

4.38 The main questions and issues that would need to be considered could be grouped under three headings: planning; financial; and regulatory. We have set out below what think these may include.

Planning

- It would need to be decided how different **enhancement projects might be treated** – for example: would all projects covered by the [Hendy review](#) be funded within PR18, with

only new projects be funded outside PR18? And would the concept of ring-fenced funds be retained and funded within PR18?

- What should the **role of Network Rail's routes in the enhancement planning process be**, in light of the potential for them to have more responsibility for decision-making and our proposals for a shift towards route-level regulation?
- For projects to be funded within PR18, DfT and Transport Scotland would commit to these in their HLOSs. But for other projects to be funded outside PR18 we would need to decide who **commits to enhancement projects and by when**. One model could be that DfT commits to projects at the same time that franchises are re-let, but there may be other trigger points. The Welsh Government, regional authorities and sub-national transport bodies will have their own perspectives on this.
- Once projects are committed (in, say, a development or delivery sense), **should Network Rail publish all of its commitments in a delivery plan**, whether or not these are part of the periodic review and however they are funded? Currently all PR13 funded projects milestones are published but not the milestones for many [investment framework](#) projects.
- There is currently a **change control process** around the Network Rail delivery plan – would this process need to be altered under different funding scenarios?

Financial

- How does the decision to fund within or outside a periodic review **affect the setting of the borrowing limit and our HLOS affordability assessment?**
- **The choices around how enhancement projects are funded**, as the funding decision could be separated from PR18, but projects could be also funded through grant funding instead of the current debt funding. This would mean projects were paid for upfront rather than through their cost being spread over time.

Regulatory treatment

- The delivery of enhancement projects needs to be monitored and, if necessary, enforced in line with Network Rail's licence. **Does whether projects are funded within PR18 or not affect how that process works?**
- There needs to be **clarity around the link to RAB additions, and the charges train operators pay**, which are partly based on the RAB. RAB additions are made on the basis of efficient costs. Previously, the ECAM process set a baseline efficient cost and a mechanistic underspend/overspend framework was applied when determining the value to add to the RAB. We are currently discussing with DfT ending the ECAM process in England & Wales and using the [Hendy review](#) as an efficient baseline, which would help to meet the [Bowe recommendations](#) on clarity of roles. If in the future enhancements were to be initially funded outside PR18, but the costs were still added to the RAB, we would need to establish a process to decide whether – and, if so, how much of – a project's costs should be added to the RAB.

- There needs to be clarity around how the decision to fund projects within PR18 or not **links to Network Rail's business as a whole**. For example, the timing and scale of projects will affect the setting and delivery of other outputs, the financial risk Network Rail faces and the forecasting of deliverability. This in turn affects how we monitor delivery by Network Rail against a number of its regulated outputs, including network performance and asset condition.
- We need to decide **what happens to the current investment framework** which already provides for enhancements to be funded outside of a periodic review.
- As Transport Scotland may not change its approach to funding some or all enhancement projects in PR18, are there **any issues around how different approaches from different funders would work together?**

4.39 We welcome views on the issues discussed in this section, including whether we have missed any material points. More detail on the topics covered will be provided in our forthcoming working paper on enhancements.

ERTMS and related technology

- 4.40 Under its 'Digital Railway' programme, Network Rail is coordinating its approach to ERTMS and related technologies, working with the industry. This programme would involve significant industry change, but has the potential to offer greater capacity, better connections and greater reliability.
- 4.41 The 'Digital Railway' programme raises significant cost implications. Network Rail is proposing that ERTMS be rolled out much sooner than it planned in PR13. The funding requirements

for this mean that governments will have a key role in deciding the extent and timing of the roll out. As with enhancements, this suggests that different options for the treatment of the 'Digital Railway' need to be developed to allow flexibility for governments to decide the most appropriate way to fund elements of the 'Digital Railway'.

- 4.42 Working with Network Rail, DfT and Transport Scotland, we have developed some broad regulatory options for treating the 'Digital Railway'. In general terms, these are analogous to the options identified for enhancements, with funders either taking decisions in parallel to the periodic process (when evidence and funding allows decisions to be made), or as part of the periodic review process. It may well be the case that sufficient clarity will not exist about the timing and funding of the 'Digital Railway' programme for it to be included in our determination for CP6. If so, the impact of these decisions will, therefore, need to be handled through 'change control' processes, or a bespoke set of arrangements.

Views sought and questions

We would like to know if you agree with the overall approach that we have set out for the review.

We would also welcome additional suggestions and proposals for how we might adapt our regulation to the current context. It would be helpful if you could arrange your comments around the following: route-level regulation; system operation; outputs & monitoring; charges & incentives; approaches for enhancements; and ERTMS and related technology.

5. Developing the high-level framework for the review

5.1 We need to decide what the high-level approach described in chapter 4 would mean for the review and the determination that we will set Network Rail for CP6. We welcome ideas and thoughts from stakeholders on this. To inform thinking, in this chapter we set out a potential way we think this could work.

A potential framework for our determination

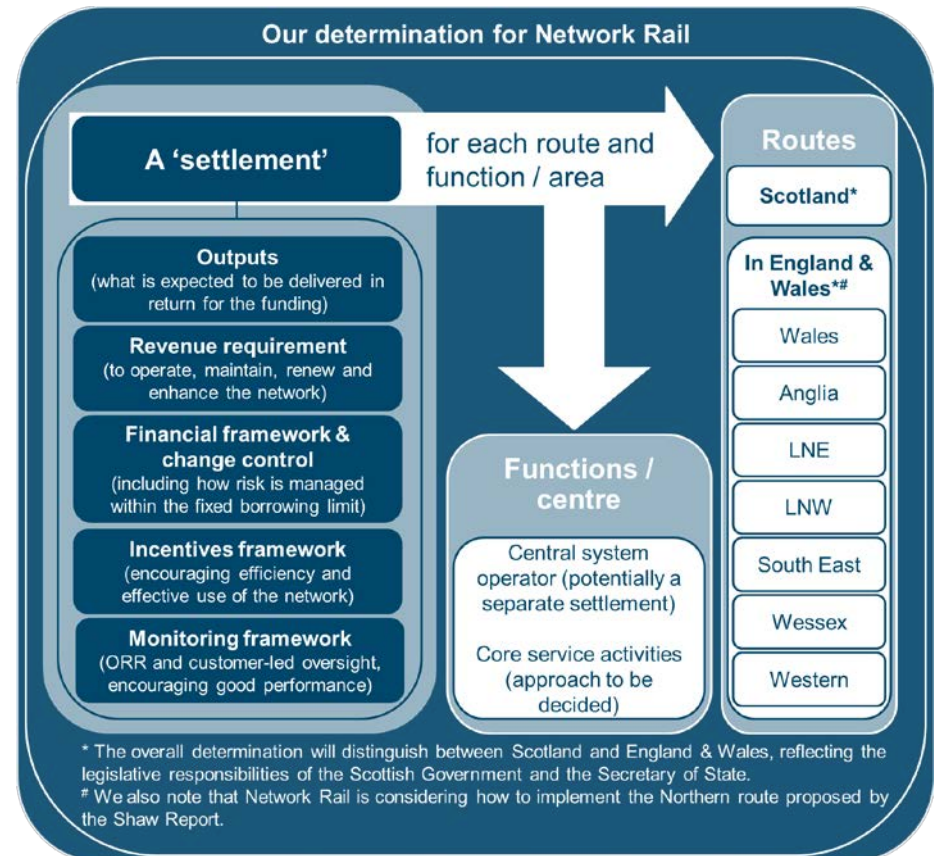
5.2 To implement our approach, our determination for Network Rail could comprise:

- **a separate ‘settlement’ for Scotland and each of Network Rail’s routes in England & Wales**, including specific financial arrangements (i.e. forecasts of efficient cost, assumed required revenue, debt and regulatory asset base) and a set of outputs. The settlement for Scotland would continue to reflect the separate legislative arrangements and the distinct role of the Scottish Government.
- **a tailored and more focused approach to our regulation of Network Rail’s system operator functions**, which might involve a full separate ‘settlement’ or be limited to separate outputs and increased transparency; and
- **the framework for monitoring and holding Network Rail to account** at the relevant level (e.g. route, system operator or overall). This would fit with how Network Rail is now structured, providing for clearer accountabilities for the

management within the company. It would also align with a more customer-led approach by Network Rail’s business units and allow us to monitor and publicly report on the performance of each route / function against its settlement.

5.3 Although comprised of separate settlements, we would still establish a single determination for Network Rail as a whole (in one document, as in prior reviews), reflecting that it is ultimately a single regulated company. This is summarised in Figure 5.1.

Figure 5.1: A potential framework for our determination



5.4 Within this potential framework, there would be many issues and implications to be considered, including what these separate settlements would mean in practice. Many of these are likely to apply to any alternative proposals that may be suggested. We will work with Network Rail, governments and stakeholders, to identify and consider these, including:

- the appropriate way to regulate the ‘core service activities’ that would remain the responsibility of the ‘centre’ of Network Rail. These include the ‘technical authority’ and ‘corporate core’, and the route support functions (i.e. the ‘Route Services Directorate’, ‘Infrastructure Projects’ and ‘Digital Railway’). These terms are described on page 10 of [Network Rail’s response](#) to the Shaw report consultation;
- the fact that Network Rail remains a single company, corporately accountable for all its activities, which the framework would need to reflect;
- the role of Network Rail centre in relation to the routes and the system operator, such as: control of the money flows within the company; the centre’s oversight role for plans developed by the routes and system operator; how responsibility would be allocated for national outputs (such as for freight performance); and more broadly, how the centre can support our approach; and
- how provisions in track access contracts may need to change (for clarity, train operators would still only need one track access contract with Network Rail to use multiple routes).

5.5 Recognising the important issues that need to be considered if this potential approach was adopted, the rest of this chapter looks at each of the five key elements of a settlement (as per

Figure 5.1) and considers some of the implications. Our forthcoming working papers on route-level regulation, system operation, outputs, and enhancements will provide more detail on these issues.

Outputs

5.6 Our proposal to regulate routes and the system operator function separately has implications for how outputs would be determined during the review. Our subsequent working paper on outputs will, among other things, look at:

- setting outputs at a route level, including how our role would need to change to reflect Network Rail’s closer engagement with train operators and its stakeholders (this is also discussed in paragraphs 6.25-6.29). This could include us specifying the minimum number of key output areas needed to assure network capability and enable route comparisons, providing for train operators and key stakeholders to then inform levels and any additional output areas (subject to funding constraints);
- improving the measurement of the performance delivered to passengers, so that it reflects more closely the impact of Network Rail’s delivery on outcomes for passengers;
- how we might develop better output measures for the centrally based system operator; and
- whether it is necessary to set outputs for Network Rail’s central core and the route support functions.

Revenue requirement and duration of CP6

- 5.7 We intend to continue to use the ‘building block’ approach to set Network Rail’s funding. This approach is explained further on our [website](#).
- 5.8 In line with the Railways Act 1993, we will set Network Rail’s funding requirement separately for Scotland and for England & Wales. Within this overall determination, we propose to set separate requirements for individual routes, with routes having separate regulatory accounts, and debt and RAB apportioned to them (consistent with the suggestion in the Shaw report).
- 5.9 In making any route-level expenditure assumptions or in setting outputs, we would make more use of comparison and benchmarking between routes. This could involve qualitative assessments between routes as well as some statistical analysis, where suitable data exists (taking account of differences between routes). We will need to establish how these processes complement the role undertaken by the centre of Network Rail to scrutinise route plans and ensure that they are consistent with the company’s resources (e.g. its funding and centrally held assets that are shared across routes). Our working paper on route-level regulation will set out our ideas on this.
- 5.10 Given Network Rail’s recent difficulties and the fact it is a public sector organisation, we will need to decide whether our efficiency assumptions should be based on what a fully efficient company might be expected to achieve, or reflect a realistic level of challenge for what Network Rail might reasonably be expected to achieve in practice. Either way, this choice will have implications

for the charges faced by users and the incentives and motivation of Network Rail’s staff.

- 5.11 We would also need to make route-level assumptions on income. We would expect each of the following to be recognised at a route level:
- income received from access charges;
 - receipts/payments under Schedules 4 and 8;
 - property and other income (i.e. the ‘single till’ income); and
 - any network grant.
- 5.12 At present, net income from activities such as commercial property offsets some of Network Rail’s other costs and leads to lower access charges (the ‘single till’ approach). We have not identified any convincing reasons to depart from this approach for this review. We note that the potential disposals of assets mentioned in paragraph 2.22 will affect the level of this income.
- 5.13 Further, we have not identified any convincing reasons to depart from a five year control period over which to set the revenue requirement. Subject to considering any views from the Secretary of State, Scottish Government and other stakeholders, we therefore expect CP6 to run from 1 April 2019 to 31 March 2024.

Financial framework and change control

Financial framework

- 5.14 The financial framework includes our approach to incentivising and monitoring Network Rail’s financial performance. This includes, among other things:

- setting Network Rail's cost of capital (which remains important, not least because it is used to calculate the charge Network Rail levies on third parties investing in the railway, such as Crossrail);
 - deciding the approach to the management of financial risk;
 - the arrangements for making additions to the RAB, where appropriate; and
 - the financial ring-fence (which limits Network Rail's exposure to financial risk by placing restrictions on the company's ability to take part in activities that are not core to its role as operator of rail infrastructure).
- 5.15 After reclassification, Network Rail ceased issuing debt on the financial markets and now borrows from the UK Government instead. This prompted the introduction of a hard limit on Network Rail's expenditure in CP5, with separate borrowing limits for England & Wales and Scotland.
- 5.16 These limits have largely superseded the limits on the level of indebtedness that we determined in PR13⁴. But they raise challenges as a fixed nominal borrowing limit does not self-adjust to deal with major changes to capital projects or inflation. Indeed, a fixed nominal borrowing limit exposes Network Rail to inflation risk. This has not been a major issue in CP5 as inflation has been lower than we forecast in PR13, but it could be a material issue in CP6.

⁴ In addition to the binding borrowing limits in CP5, Network Rail is also subject to a financial indebtedness limit calculated as a percentage of Network Rail's RAB.

- 5.17 We expect that the borrowing limits will remain in their current form for the foreseeable future. The borrowing limits and the process for agreeing them is the most important financial issue affecting Network Rail in CP6. It is important that all stakeholders understand how the process for setting the borrowing limits affects Network Rail's planning and our determination. More generally, managing financial risk through nominal limits on total borrowing highlights the importance of maintaining sufficient flexibility in our regulatory processes and Network Rail's plans to adjust in response to change, including its own out/under-performance.

Managing uncertainty and change control

- 5.18 The regulatory framework for Network Rail needs to be sufficiently flexible to manage a range of different sources of uncertainty and risk. These include a mix of factors, some of which are largely within Network Rail's control, and some of which are not. These risk and uncertainty factors include, for example:
- uncertainty about the level of efficiency improvements that will be achieved;
 - the cost of key materials and staffing costs;
 - changes to the programme of enhancements, including their scope, timing and cost;
 - operational risks and the potential for events outside of the company's control; and
 - risks with financing costs, e.g. interest rate risk.
- 5.19 In principle, there are a number of ways to manage these uncertainties and risks. However, many of the potential tools for

managing the financial consequences of adverse changes are subject to important constraints and/or trade-offs:

- increased borrowing and government funding: these are constrained by available taxpayer funding, including the fixed borrowing limit;
- higher charges to users: these are constrained by the need to provide train operators with certainty on charging levels, the costs of making changes, and the need to include mechanisms to adjust charges in the relevant access contracts;
- reductions in the level of outputs delivered (in ways that save costs, in the short term at least): this would lead to a deterioration in the service provided to train operators, passengers and freight customers;
- reductions in volumes of maintenance and renewals: this would lead to deteriorations in asset condition and likely lead to the need to 'catch-up' on this work, increasing costs over time, or have implications for operational performance and safety; and
- delays to planned enhancements: this would limit growth and/or delay the delivery of planned improvements for passengers and freight customers.

5.20 It is therefore vital that the settlements in our determination are based on good quality information and include a financial buffer to respond to changing circumstances. So, we would not expect to set a determination that commits all of Network Rail's available funds. It will also be important to retain sufficient flexibility should Network Rail be committed to delivering further enhancements or other major projects.

5.21 However, variances outside any buffer would prompt some difficult decisions and there needs to be a shared understanding of how these decisions would be taken. At this stage, we do not think changes to the level of train operators' track access charges outside of a periodic (or 'interim') review would be appropriate.

5.22 In practice, this means that any variances outside the financial buffer would require adjustments to outputs, enhancements or funding from governments. Reflecting this, we will consider the extent to which the requirements that Network Rail is expected to deliver might be adjusted, as well as the basis for us to reopen our determination should a cost shock occur at a local or national level. (Any such reopening would be done through an 'interim review', which might apply to either England & Wales or Scotland, or both).

Out/under-performance at a route-level

5.23 The move towards route-level regulation has further implications for how Network Rail (and its routes) manage out/under-performance against the expenditure baselines we set it.

5.24 Given the limited funding available, it is important that routes have strong incentives to outperform their regulatory settlements and to grow their income (e.g. by enabling more services to run on their route). Transparency over this financial performance is important so that each route team is recognised for any additional income it generates.

5.25 Network Rail already produces route-level financial statements, which recognise income. To get the most out of a greater focus on routes, we will need to work with Network Rail to improve the accountability of routes in preparing these statements.

- 5.26 Each route will also need some protection from the risk of having to cover significant unexpected costs relative to the funding available to it (i.e. if its spending increases, income falls or a serious event occurs – like the storm damage at Dawlish in 2014). Therefore, Network Rail will need flexibility to reallocate money across the routes to ensure that appropriate decisions are taken. It will also need to have a process in place to ensure that moving resources between routes does not jeopardise the position with the borrowing limits for Network Rail in total.
- 5.27 It will be important to ensure that the impacts of moving resources between routes to deal with any financial risks are transparent, so that each route’s performance can be judged fairly. We will work with Network Rail to determine how its route-level regulatory accounts can clearly identify the financial consequences of these decisions and the reasons for making them, including the trade-offs it considered.
- 5.28 We will consult in late 2016 on how the routes can deal with financial risk in our financial framework consultation, including the role of Network Rail centre in relation to the routes and the implications of an overspend for any devolved regional funders in England & Wales. In the meantime, we welcome views on the proposal in the Shaw report for a ‘central route reserve’ mechanism to exist alongside a risk buffer within each route⁵.

⁵ Paragraph 2.70-2.73 of the Shaw report.

Capital expenditure-related change control

- 5.29 Network Rail’s capital expenditure requirements for enhancements in CP6 will be significant, including for projects not completed during CP5. In chapter 4, we set out some issues relating to the treatment of enhancements in CP6. These will be explored in more detail in our enhancements working paper. One of the options is for a government funder to choose to manage the enhancements that they fund in a continuous process that is not linked to the conventional periodic review cycle (e.g. over five years).
- 5.30 To make these new arrangements work, there will be a need to reflect the impact of the changing enhancements profile on Network Rail. We are considering how we might include provisions and agree processes to do this (and likewise for any changes associated with the ‘Digital Railway’, given the uncertainty with this), so that the targets and borrowing assumptions set for Network Rail realistically reflect what is achievable.

Incentives framework

- 5.31 The shift to route-level regulation is likely to have implications for the contractual incentives framework we set. For example, it could affect the relative benefits of different options for the structure of charges (e.g. whether charges should better reflect costs faced by each route).
- 5.32 Also, the Schedule 8 contractual performance regime may need to change. This is because Schedule 8 benchmarks are currently based on train operator performance (PPM) trajectories, which

are not route-specific, whereas we envisage that routes will be held to account on the basis of their own performance targets. The full implications of this will need to be worked through, including the choice of metrics, and we will discuss this with the industry, including the National Task Force.

- 5.33 We will work with stakeholders to identify and carefully consider the implications of route-level regulation for the incentive and contractual arrangements. We welcome thoughts on what the implications might be and will consult on proposals for the incentive framework later in 2016.

Monitoring and encouraging good performance

- 5.34 The shift to regulating at route and system operator level would provide the opportunity for a major change in how Network Rail is monitored.
- 5.35 We would expect route performance in CP6 to be measured against the funding and output levels set in each route's settlement. To support effective performance alongside greater train operator and stakeholder scrutiny, we would set incentives on routes as part of PR18. This could involve:
- annual, public reporting of route-level performance, including publication of scorecards showing relative performance, to make the best use of reputational incentives and support train operators and stakeholders in holding Network Rail to account;
 - a clearer link between route-level performance and the remuneration of senior staff within each route; and

- modifying our escalation process in which we highlight areas of concern in Network Rail's performance (the 'regulatory escalator'), to apply this more at a route-level. This would, for example, include producing our six-monthly 'Monitor' publication on a route basis, setting out our view on how we think Network Rail and its routes are doing, and engaging directly with a route when its performance falls below acceptable levels. As now, we would also expect Network Rail centre to play an important role in holding its routes to account, and if we considered it was not doing this effectively, we would raise this with it.

- 5.36 We broadly envisage similar arrangements for the system operator, which we will discuss in a forthcoming working paper.

- 5.37 To support the clearer accountabilities we want to encourage at route-level, we propose that the financial and performance information for each route (produced for regulatory reporting purposes) should be prepared and signed off by Network Rail's routes, rather than by Network Rail centre (the centre would still sign off any required statutory statements).

Financial monitoring

- 5.38 In PR13, we developed a monitoring framework to take account of where Network Rail defers or brings forward work, so that we could better understand its financial performance. This framework feeds into a financial performance measure, which also helps us to understand the financial impact of Network Rail not delivering its outputs. Both we and Network Rail consider this to have been a significant improvement over the approach used in CP4. We will review this approach in PR18, reflecting the need to improve our monitoring of Network Rail at a route-level,

including its performance against our determination and its route scorecards. We will consider the recommendations of the Shaw Review in this respect, and decide on our approach to implementing them.

Network licence enforcement and safety management system

- 5.39 Network Rail – with its routes and functions – remains a single company, and as such it will retain a single safety management system and be accountable to us through a single network licence.
- 5.40 Consistent with current practice, if we were to take licence enforcement action in CP6 for any alleged failing, we would clearly identify the part of the business responsible, to reinforce the reputational incentive to perform well.

Overview of difference between CP5 and our proposed potential approach for CP6

- 5.41 Table 5.1 gives an overview of what our potential approach to PR18 and CP6 could look like compared to PR13 and CP5.

Table 5.1: Difference between PR13/CP5 and proposed approach for PR18/CP6

Element	PR13/CP5	Proposed for PR18/CP6
Route-level regulation		
Business plans informed by route-level customer engagement	Partial ¹	More substantial
Separate outputs for each route	No	Yes
Specific funding and RAB allocations	Indicative only ²	Yes
Incentive framework applying at route level	Partial ³	Yes
Transparency over resource transfers between routes	Partial	Full
Charges reflect cost at route-level	Partial ⁴	Consider scope for more
Monitoring at route-level	Partial ⁵	Yes

Element	PR13/CP5	Proposed for PR18/CP6
Regulation of system operator		
Separate business plan (informed by customer engagement)	No	Yes
Separate outputs	No	Yes
Separate funding and RAB	No	Yes
Management incentives linked to system operator performance	Partial <i>(set nationally)</i>	Yes
Transparency and monitoring	Partial <i>(set nationally)</i>	Yes
<p>¹ There was some engagement on route plans in PR13.</p> <p>² Scotland has a separate RAB, borrowing limit and is responsible for its share of Network Rail's debt. Regulatory financial statements (showing the company's performance, such as on maintenance and renewals spend) are produced at route-level.</p> <p>³ Route-level efficiency benefit sharing (which encourages train operators to work with Network Rail to bring costs down) and the volume incentive (which encourages Network Rail, at a route-level, to accommodate unexpected demand, beyond what was forecast at the time of the most recent periodic review).</p> <p>⁴ The fixed track access charge is built up on a route-basis.</p> <p>⁵ In CP5, we have held route-level meetings with all routes to discuss their performance.</p>		

Views sought and questions

We welcome views on how our high-level approach could be implemented and on the potential framework set out in chapter 5. As part of this, we invite thoughts on what it is practicable to achieve in PR18 and in CP6, and what might be more realistic to achieve in the subsequent periodic review.

We would also welcome any further suggestions and ideas on how we might improve how we regulate Network Rail.

You may wish to read and comment separately on the working papers that we will publish following this consultation document.

6. Process and engagement

Introduction

- 6.1 Although led by us, PR18 is a multilateral process involving a wide set of stakeholders, with key roles for Network Rail, DfT and Transport Scotland. Our proposal for greater focus on devolved routes and the system operator, as well as moves to increase political devolution, means the review is likely to be of greater interest to stakeholders such as the Welsh Government and regional transport authorities. We need to ensure all parties that wish to engage in the review can do so effectively.
- 6.2 This chapter:
- gives an overview of the key phases of the review;
 - sets out our approach to engagement and highlights the stages of the review where Network Rail and governments lead the process; and
 - seeks views on how the industry wants to be involved in implementing PR18 and on issues relating to Network Rail's right to object to the determination.

Main phases of PR18

- 6.3 We will need to work through a range of issues to implement our proposed approach. In particular, the move to route-level regulation means that the timetable for PR18 is likely to be different from the one for PR13. Our draft timetable will be revised and updated, particularly after further discussion with

stakeholders. Notwithstanding this, we broadly expect there to be three main phases of work, as follows.

May 2016 to late spring 2017: Setting the framework

- 6.4 In this period, we will work with stakeholders to develop the framework for PR18, including the implications of our proposed approach for both how governments set out their HLOS requirements for CP6 and for how Network Rail (including its routes and system operator function) should produce its strategic business plans (SBPs) for CP6. In September 2016, the industry will publish its advice to governments on the choices available for CP6, to inform decisions in the HLOSs and SoFAs.
- 6.5 We currently expect that in February 2017 we will issue our legal notices requiring the Secretary of State and Scottish Ministers to provide their HLOSs and SoFAs in May/early June 2017.

Late spring 2017 to October 2018: Detailed development, review and our determination

- 6.6 Following the publication by the governments of their HLOSs and SoFAs, Network Rail will complete its strategic business plan (informed by customer engagement) and we will refine the detail of our policy framework and how it will work in practice. We recognise that there may also need to be a broader industry view on what is required to deliver the HLOSs (i.e. an industry plan), which we assume would be published alongside the SBPs. We will then review the SBPs and seek stakeholders' views. In October 2018, we will issue our final determination of what Network Rail must deliver in CP6 and the funding it will receive for this.

November 2018 to March 2019: Implementation

- 6.7 We will then move to implement our determination. Network Rail will finalise its price lists (which set out specific rates for access charges) and produce its delivery plan for CP6, consulting appropriately. We will finalise proposed changes to Network Rail's access contracts with train operators and its network licence and issue the legal notices to implement these. Network Rail will then have the opportunity to decide whether to accept or reject the determination. If it accepts, PR18 will be implemented and CP6 will begin on 1 April 2019.
- 6.8 The current draft high-level milestones for PR18 are set out in the executive summary of this document. Our website sets out a 'live' version of our public timetable and a more detailed explanation of the key milestones. We welcome views on the timetable and any implications for it arising from our proposed approach to PR18.
- 6.9 We will alert stakeholders to any major changes to the timetable.

Our proposed approach to engagement

Consultation and collaborative engagement

- 6.10 Following feedback⁶ after PR13, we will make our documents more accessible (though inevitably there will be some formality,

⁶ In 2014, we commissioned an independent evaluation of PR13. This set out how we could improve for PR18, including in respect of the form, volume and number of our documents and more generally how we could better interact with those interested in the review.

particularly as we approach our final determination). We will aim for these to be:

- in plain English;
 - as short as practicable, with any detail set out in annexes for those that wish to read it; and
 - supported, where appropriate, by impact assessments to explain the likely effects of proposals and decisions.
- 6.11 We will include explanations of how we have taken into account stakeholders' views when we conclude on policy issues.
- 6.12 To support a more collaborative approach to developing our decisions in the review, we plan to make more use of 'working papers' on particular topics. These will set out our ideas and thinking, to enable discussion and further development with stakeholders. We encourage stakeholders to discuss these working papers with us and to provide less formal written responses than those that might be provided in more formal consultations.
- 6.13 Building on PR13, we will use workshops, working groups and meetings as appropriate to test ideas and discuss proposals, including those in working papers.

RDG's working groups

- 6.14 RDG has proposed to host a number of working groups, which would be jointly run with us, to support policy development and discussion on PR18 issues. While recognising that RDG does not represent all stakeholders, we think that these groups could be a useful way for us to develop our approach, together with more formal consultation.

- 6.15 We think it is important that these groups are open to non-RDG parties (where practicalities allow) and that they are transparent (e.g. with notes of the key points from discussions published, albeit unattributed to support open and frank discussions). We will work with RDG on the scope of these groups and the forward agendas, so that these align sensibly with our plan for developing policy.
- 6.16 The existence of these groups would not replace the need for bilateral and multilateral meetings and workshops, and we will continue to meet stakeholders on this basis. This will be particularly relevant for those organisations that do not attend the RDG hosted working groups. We may also need to establish specific working groups or ad hoc workshops on particular areas as the review progresses.

Optimum points for engagement

- 6.17 As the review progresses, the scope for stakeholders to influence decisions will change as the framework for CP6 becomes clearer. Engagement later in the review will focus more on detailed issues. We recognise that stakeholders' interests over the course of the review will be different and will depend on the level of detail and potential impact of the changes to their organisation. We will aim to be clear on the scope of each consultation and to indicate which stakeholder groups are most likely to be interested in them.

Staying in touch – our projects, updates and contact lists

- 6.18 Our main project areas for PR18 are described on our [website](#), along with the names of those leading the work at ORR.

- 6.19 We plan to provide regular web updates on PR18, and will notify stakeholders when these are posted. To support this, and ensure stakeholders receive the consultations they are interested in, we have set up a web-based system for stakeholders to opt-in and out of our PR18 contact lists, including provision for them to select the areas they are interested in. Please see this [link](#) to register.

Taking account of the interests of consumers

- 6.20 It is important that PR18 adequately reflects the interests of passengers and freight customers (i.e. consumers). We see our role in supporting this through ensuring:
- there is an effective process for customer and stakeholder engagement in the development of Network Rail's plans for CP6, so that these take account of consumer preferences (see below);
 - the outputs framework is framed around the interests of consumers (such as through a more passenger-focused measure of performance);
 - that Network Rail's delivery plans for enhancement projects are developed with consumers' input, reflecting the recommendation of the [Bowe review](#); and
 - that we communicate our decisions in a way that is meaningful for consumers.

Other lead parties

Department for Transport, Transport Scotland and other national and regional authorities

- 6.21 The role of the Scottish Government and the Secretary of State in setting their HLOSs means that they have a major influence on

what Network Rail will deliver in CP6. We must carry out the review in a way that we consider is most likely to ensure its implementation will make the best and most practicable contribution to achieving their HLOSs.

- 6.22 In previous reviews, wider stakeholders have been particularly interested in the enhancement schemes arising from HLOSs. How enhancements are specified and funded is something that is currently being reviewed, which could lead to at least one HLOS not including any new enhancement schemes.
- 6.23 Subject to this caveat, those wishing to influence government decisions on what they want delivered in CP6 (as determined through PR18) need to engage with DfT and Transport Scotland in good time ahead of the HLOSs (expected in May/June 2017). In respect of Scotland, following the publication of Network Rail's Scotland Route Study in July 2016 and the subsequent industry advice to the Scottish Government on the choices available for the railway, Transport Scotland plans to consult on all key outputs for CP6 for which the Scottish Ministers are responsible for specifying. This will include those relating to the capacity and capability of the network in Scotland. The results from this will help to inform the Scottish Ministers' HLOS.
- 6.24 We recognise that the Welsh Government and regional bodies such as Transport for London, Transport for the North and Midlands Connect have an important role in informing what is delivered in CP6, whether or not their role is recognised in the current statutory process for the review. Our review process will need to take account of their views and we will engage with them to ensure this.

Network Rail

Customer engagement in developing business plans

- 6.25 As noted elsewhere in this document, Network Rail's devolution to routes and the creation of a specific system operator organisation within the company provide the opportunity for closer working with train operators and stakeholders. In particular, it will support a more customer-focused engagement process to inform what routes and the system operator deliver in CP6 (within the funding constraints and taking account of the views of those bodies that provide funding for the railway).
- 6.26 The goal for this engagement is that the plans of each route and the system operator reflect the priorities and views of their passengers and freight customers in respect of what should be delivered (as well as how, e.g. the timing and length of engineering possessions carried out by a route). In other regulated sectors, like water, processes have been established that also provide for direct engagement with end users. But these processes have taken a long time to develop.
- 6.27 With stakeholders, we need to decide what depth of engagement is achievable for this review, in terms of establishing processes for routes and the system operator to take account of what passengers and freight customers want. We are conscious that developing more direct forms of engagement with end users may be unrealistic for PR18. However, there should be opportunities for engagement with those well-placed to represent the interests of end users.
- 6.28 Train operators will clearly be key to this (along with any relevant regional funders). Indeed, the involvement of franchised

operators should lead to greater alignment between Network Rail's outputs and franchise commitments. But there may be circumstances when it is particularly important to obtain (or make use of existing) evidence directly from passengers. For example, franchised passenger operators whose franchises are due to expire shortly may have a different balance of priorities to passengers. This is one of the issues that we will need to work through with stakeholders. We also see a role for passenger representative bodies both at a national and more local level.

- 6.29 In addition to this engagement process, after Network Rail has submitted its strategic business plans to us, we envisage that there would be an opportunity for a stakeholder session with each route and the system operator, at which stakeholders can question and challenge the relevant Network Rail team.

Network Rail's role in detailed policy development of charges

- 6.30 As infrastructure manager, Network Rail is responsible for calculating the access charges that train operators will pay. In PR13, Network Rail took the lead in developing detailed policy relating to access charges, within the overall framework that we set, and subject to our final agreement. We expect a similar process to take place in this review, which may involve specific working groups on charges (if not the RDG working groups).

Implementation of PR18

Engagement in the implementation process

- 6.31 The statutory framework gives us overall responsibility for implementing periodic reviews. There are typically tight time constraints for developing drafting to implement our

determination, which can limit the scope for engagement with Network Rail and train operators. In PR13, although Network Rail played a bigger and helpful role in reviewing our drafting compared to PR08, there was little appetite from train operators to be involved.

- 6.32 Given that train operators and Network Rail are directly affected by the provisions we include in their contracts to implement our determination, we would like to understand if there is more appetite for them to be more involved in this process in PR18. For example, if policy decisions are able to be finalised sufficiently early in the process, there may be the opportunity for an industry working group to review and comment on proposed drafting, and potentially lead on developing drafting on certain provisions agreed with us.
- 6.33 We would be interested in stakeholder views on this, including what the best means of achieving greater involvement would be.

Network Rail's right to object to our determination

- 6.34 Once we have commenced the formal implementation process, Network Rail will have the right to object to our determination. If it does so, this could lead to a reference to the Competition & Markets Authority (CMA), which would have to decide whether the determination (or those parts of it that relate to the referral to the CMA), if implemented, would operate against the public interest.
- 6.35 In PR13, Network Rail accepted our determination, but in doing so it included certain caveats – for example, in relation to its ability to deliver certain outputs that we had set. While legally these caveats had no status, they arguably raised a perception that Network Rail had not in fact fully accepted the determination.

- 6.36 It is crucial that Network Rail has the right to object to our determination and is able to exercise this right. This is important to ensure that: (1) if Network Rail accepts the determination, it is clearly accountable for delivering what we have specified; and (2) the checks and balances on us to deliver a fair determination work effectively. It would not be desirable or appropriate for Network Rail to accept our PR18 determination in a way that implies that it does not consider it could achieve it, as this risks undermining the periodic review process.
- 6.37 Within the existing legal framework setting out Network Rail's right to object, we plan to review the process around Network Rail's right to object, including:
- the role of routes and the system operator in any decision to accept or reject the determination (this is important to ensure their accountability for delivery of their settlements within the determination);
 - how clarity of accountability can be improved if Network Rail chooses to accept the determination;
 - the implications of reclassification for this process; and
 - the contingency arrangements in the event that there is an objection (or any other delay).
- 6.38 We welcome any thoughts on this area.

Views sought and questions

We would be grateful for comments on the proposed phases of the review, including any views on the draft timetable (available on line) and our proposed approach to engagement. We also invite high-level views on the process for customer engagement by Network Rail's routes and the system operator to inform their business plans, in terms of what is achievable for this review.

We would also welcome any views on how Network Rail and train operators would like to engage and be involved in the implementation process for PR18 and any thoughts on the process relating to Network Rail's right to object to our determination.

Responding to this consultation

- 6.39 This **consultation closes on 10 August 2016**. Please submit your responses, in electronic form, to our PR18 inbox pr18@orr.gsi.gov.uk. You may find it useful to use this [pro forma](#).
- 6.40 We plan to publish all responses to this consultation on our website. Accordingly, when sending documents to us, we would prefer that you send your correspondence to us in Microsoft Word format or Open Document Format. This allows us to apply web standards to content on our website. If you do email us a PDF document, where possible please:
- create it from an electronic word processed file rather than sending us a scanned copy of your response; and

- ensure that the PDF's security method is set to "no security" in the document properties.
- 6.41 Should you wish any information that you provide, including personal data, to be treated as confidential, please be aware that this may be subject to publication, or release to other parties or to disclosure, in accordance with the access to information regimes. These regimes are primarily the Freedom of Information Act 2000 (FOIA), the Data Protection Act 1998 (DPA) and the Environmental Information Regulations 2004). Under the FOIA, there is a statutory code of practice with which public authorities must comply and which deals, amongst other things, with obligations of confidence.
- 6.42 In view of this, if you are seeking confidentiality for information you are providing, please explain why. If we receive a request for disclosure of the information, we will take full account of your explanation, but we cannot give an assurance that confidentiality can be maintained in all circumstances. An automatic confidentiality disclaimer generated by your IT system will not, of itself, be regarded as binding on ORR.
- 6.43 If you are seeking to make a response in confidence, we would also be grateful if you would annex any confidential information, or provide a non-confidential summary, so that we can publish the non-confidential aspects of your response.

Annex: References

Organisation	Date	Title	Link
Competition & Markets Authority	March 2016	Competition in passenger rail services in Great Britain: A policy document	Link
Department for Transport	November 2015	Report of the Bowe Review into the planning of Network Rail's Enhancements Programme 2014-2019	Link
Department for Transport	March 2016	The Shaw Report: The future shape and financing of Network Rail – the recommendations	Link
Department for Transport	March 2016	Memorandum of understanding between the Department for Transport and Network Rail on rail enhancements	Link
Network Rail	November 2015	Report from Sir Peter Hendy to the Secretary of State for Transport on the replanning of Network Rail's Investment Programme	Link
Network Rail	December 2015	Network Rail Response to the Shaw Scope Report	Link
Office of Rail and Road	July 2013	Opportunities and challenges for the railway: ORR's long-term regulatory statement	Link
Office of Rail and Road	August 2015	System operation – a consultation on making better use of the railway network	Link
Office of Rail and Road	December 2015	Network charges - a consultation on how charges can improve efficiency	Link
Office of Rail and Road	March 2016	Office of Rail and Road super-complaint response report: Which? Super-complaint - compensation arrangements in the market for passenger rail services	Link
Office of Rail and Road	April 2016	An update on ORR's review of charges	Link

Office of Rail and Road

One Kemble Street

London

WC2B 4AN

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