

Summary of Network Rail's response to ORR's Periodic Review 2013 First Consultation

Introduction

In May 2011, the Office of Rail Regulation (ORR) fired the starting gun for its five-yearly Periodic Review, in preparation for the next control period (CP5), which is likely to run from 1 April 2014 to 31 March 2019.

The purpose of the Periodic Review is to:

- establish the outputs that Network Rail is to deliver in CP5;
- determine how much revenue Network Rail needs to operate, maintain, renew and enhance the network in CP5; and
- determine the access charges that Network Rail can levy on train operators for the use of the rail network in CP5.

Because the review will conclude in 2013, it is referred to as PR13. We submitted our detailed response to ORR's first PR13 consultation on 2 September 2011. This note summarises key aspects of our response.

Background

PR13 comes at a time of real change for the industry. The recently concluded Rail Value for Money (RVfM) Study identified a number of issues and has challenged the industry to improve its value for money. The RVfM Study says that if the industry can become more efficient, it has a strong future and continued investment in the sector can then be justified.

In response to the RVfM challenge, industry leaders have set up the Rail Delivery Group (RDG). RDG's purpose is to drive through changes that would be difficult without cross industry support. We strongly support RDG and the fact that the industry is proactively driving its own future.

In addition to our participation at RDG, we will also be getting on with some significant changes of our own, in particular:

- **devolution** to our ten operating routes which started earlier this year;
- closer working with train operators through **alliancing** arrangements;
- changing the way we manage projects by **engaging earlier with suppliers** and opening up more of our **capital work to competition**; and
- consideration of the potential to let **infrastructure concessions** for parts of the network while retaining an effective system operator role at the 'centre'.

These changes amount to a significant change programme, requiring cultural as well as organisational change. They will also be taking place alongside potentially significant changes to the regulatory and contractual framework in PR13. In our view, it is very important that the changes made in PR13 are consistent with, and support, the wider industry reform agenda.

PR13 will involve extensive participation and engagement between ORR and the industry. Each of the various stakeholders will be making their own suggestions to

ORR about what should change and Network Rail will need to continue to provide compelling arguments and top quality evidence to ORR during the review.

High-level points from our response

This is an exciting time for the industry and our response outlines, particularly in the context of current industry reform, the importance of making appropriate changes to the regulatory and contractual framework, which we believe will support this change.

We propose, in particular, that the framework for CP5 should be mindful of:

- the need to provide the necessary **shared incentives** to drive the right behaviours to deliver the full scale of cost savings identified in the RVfM Study;
- allowing the industry to operate in a **more commercial** way;
- delivering cost savings by **developing partnerships** built on mutual success; and
- giving **greater flexibility** to train operators and Network Rail to determine the most cost-effective way of driving up revenue.

Our specific suggestions

PR13 provides an excellent opportunity to create a comprehensive regulatory and contractual framework, which puts the industry in the best position to deliver what passenger and freight customers need.

The following list highlights some of the key issues for consideration in our response:

- In order to deliver efficiently, Network Rail and its suppliers need to be able to plan with a **reasonable degree of certainty**. We stress the importance of an **‘Early Start’** arrangement so that we know what funding we have for long-lead areas of expenditure at the beginning of CP5.
- We argue that the effectiveness of the regulatory regime can be enhanced by a number of measures, stressing the **importance of at least retaining the option for us to introduce risk capital** (which could include, for example, raising debt that is not backed by a government guarantee).
- We propose that the regulatory framework needs to include a **mechanism which facilitates investment** for the long-run benefit of the network and reduces future costs.
- **Rights to object to network and station change**, which should be **criteria-based**, need to be separated from compensation, which should be based on a fair reflection of costs. We argue that this would help enable the proposer to make changes which increase whole-system optimisation, without being held up unduly, while objections are dealt with.
- We propose that we should have **separate expenditure and output projections** for each of the ten operating routes, but with **flexibility for Network Rail to manage the output and financial risks as a group of routes** (although we recognise that funding and outputs for Scotland should continue to be managed separately).
- We argue that the review should **promote mutually beneficial alliance arrangements** including bespoke cost and revenue sharing arrangements

between the parties, which we consider should sit 'on top' of the generic track access charges, including Schedules 4 and 8.

- We propose that the **existing charging regime should broadly be retained** rather than being allowed to become more complex (including the same variable track access charges for each route and retention of Schedules 4 and 8, albeit with some simplification).
- We note that the consultation does not fully explore the issues with the current restrictions on Network Rail's activities beyond the 'core' railway, and propose that **the current licence requirements on the regulatory ring-fence should be reviewed**. We consider that this is potentially an area of reform that needs to be in place to 'allow' the company's plans to compete in markets, so that we can test ourselves against, and learn, from others (as well as opening our current activities up to competition).
- There are other aspects on which ORR consulted, such as outputs and the financial framework, where its proposals are in their early stages and the '**devil will be in the detail**'. An example of this is how our success will be measured in CP5. Many areas of our response highlight and welcome the need for further engagement and discussion on such matters with ORR and the industry.

All these aspects are significant in their own right. In our view, it is important that ORR makes sure that there is consistency between all elements of the regulatory framework, and provides clarity, in particular on how outputs; incentives; access charges; and the financial framework fit with industry reform and the high-level industry objectives.

Looking ahead and next steps

In our view, it is **essential that PR13 supports the industry** in making the changes necessary to meet the long-term challenges ahead. We recognise that this will require considerable effort across the industry.

PR13 is key to delivering the kind of railway that Network Rail, train operators, passengers and the British economy needs. We are working hard and collaboratively with ORR, train operators and funders to make PR13 a success.

The **Initial Industry Plan** (IIP) will be published at the end of September 2011. It will set out how the industry can deliver a more efficient and better value railway, and how the railway can play a key role in driving sustainable economic growth.

As we prepare the **Strategic Business Plan** (SBP) for publication in January 2013, we must continue to improve the robustness of our CP5 plans and the underpinning evidence. During this period, the level of engagement with ORR will increase as it reviews the IIP and assures itself that we are on track to deliver a robust SBP.

It will be important that DfT, Transport Scotland and ORR are transparent about their plans for **franchise reform**, particularly in relation to the 'no net loss/no net gain' provision in franchise contracts. We consider that this will be crucial in ensuring that all industry stakeholders are able to respond to the same incentives and work together to achieve a better, more affordable railway. As a number of refranchises are due to take place, there is a unique opportunity to make important changes in the new agreements.

We anticipate that ORR will, in **November 2011**, publish a further consultation. The aim of this will be to conclude on some of the incentives and access charges issues, in time for its **February 2012 Advice to Ministers**. This will also inform governments

of potential major changes to the regulatory and contractual framework, allowing them to take this into account during the refranchising process.

Our full response to the PR13 consultation is on Network Rail's website.

If you have any questions about our response or PR13, please feel free to contact [Peter Swatridge](#).