

ORR Annual Report

06-07



OFFICE OF RAIL REGULATION

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FORMAL REPORT TO THE SECRETARY OF STATE AND SCOTTISH MINISTERS

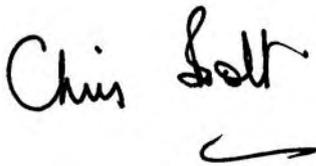
To the Secretary of State for Transport and the Scottish Ministers

I enclose the report of the Office of Rail Regulation (ORR) for the year ending 31 March 2007 as required by section 74 (1) of the Railways Act 1993 and the Scotland Act 1998 (Transfer of Functions to the Scottish Ministers etc) Order 1999.

I confirm that during the period ORR

- (a) made no references to the Competition Commission; and
- (b) received no general directions under section 69(2) of the Railways Act 1993.

Chris Bolt

A handwritten signature in black ink that reads "Chris Bolt". The signature is written in a cursive style. Below the signature is a horizontal line with a small upward curve at the right end, resembling a checkmark or a flourish.

Chairman, Office of Rail Regulation
June 2007

CHAIRMAN'S FOREWORD

As the Eddington review demonstrated, effective transport systems play an important role in supporting economic performance. The Office of Rail Regulation, the independent safety and economic regulator for Britain's railways, has a central role to play in helping to deliver safe, high performing, efficient and developing rail services. But achieving this aim also requires Network Rail, train operators and other suppliers to work in partnership, with a clear strategy and stable funding from Government

ORR's work over the past year has therefore had a number of different strands, and we work closely with a number of other bodies in the industry.

We have worked with Government to ensure that the framework for decisions on railway outputs and funding established in the Railways Act 2005 works effectively. For example, our independent advice to Ministers on Network Rail's initial business plan will be an important input to their decisions this summer on what they want railways to deliver over the next five years and the public funding available to achieve that.

We have also worked closely with the Rail Accident Investigation Branch, not least following the tragic accident at Grayrigg, to ensure that the industry takes appropriate action to improve further its safety record.

Much of our activity is directed at Network Rail, which has a central role – in partnership with train operators – in delivering a safe, high performing and efficient railway. Day to day performance has improved, although there are no grounds for complacency. The key challenge for the industry going forward will be how to meet the continuing strong increase in passenger and freight traffic, against a background of increasing passenger concerns about value for money and crowding.

This report covers my third year as ORR Chairman, but the first in which we have been responsible for safety regulation. The Board plays a key role in setting the strategic direction for ORR's activities, in overseeing the work of the executive and in taking key decisions. It has had a number of difficult decisions to make during the year, including fining Network Rail for breach of its licence and fining English, Welsh and Scottish Railway for breaches of competition law. We also took the decision at the end of the year to refer the passenger rolling stock leasing market to the Competition Commission.

During the year, one new non-executive member was appointed to the Board, and three members of the executive team were also appointed to the Board. I pay tribute to the commitment of the executive team, led by Bill Emery, and of the non-executive members of the Board. I am confident in our ability to meet the challenges of the coming year.

Chris Bolt
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CHIEF EXECUTIVE'S REVIEW

2007 was our first year as the combined independent safety and economic regulator for railways in Great Britain. The transition of safety responsibilities from the Health and Safety Commission/Executive to ORR was accomplished seamlessly on 1 April 2006. A priority for the merged organisation has been to encourage joint working across the office and we have done this in a number of key areas. Overall we achieved our business plan objectives while making significant savings on our budget.

Despite the tragic accident at Grayrigg, the year as a whole saw continued improvement in rail safety. The new Railways and Other Guided Transport Systems Regulations came into effect in April 2006 and we worked with the industry to ensure smooth implementation. We made sure we considered reports and recommendations from the Rail Accident Investigation Branch effectively. Meanwhile our targeted programme of inspection continued and we developed topic strategies and policy approaches on key safety issues. Our safety regulation responsibilities cover all railways in Great Britain.

The national rail network saw further improvement in the performance it delivered to its customers. The public performance measure stood at 88.1% at the end of the financial year, above Network Rail's year-end target of 87.6%. We continued to monitor and press for further improvements through effective partnerships between Network Rail, train operators and their suppliers. Network Rail continued to deliver against its efficiency targets, and we welcome the company's commitment to it adopting a more proactive role in developing and improving the railway with its industry partners. There were still some areas of inconsistency in Network Rail's performance, and we followed these up with appropriate action. Our National Rail Review now gives an independent assessment of industry performance and key industry issues every quarter, and we were pleased to be able to report sustained higher levels of customer satisfaction.

The national railway continued to attract more passengers and freight traffic, and provision of extra capacity in an efficient way is now its biggest challenge. The periodic review of Network Rail's outputs, funding and access charges, due to be completed in 2008 will help address this. During the year, we issued our review notice, requiring Ministers in London and Edinburgh to set out what they want from the railway, and the funding available to deliver it. We gave advice to Ministers to inform this.

We challenged Network Rail's efficiency and delivery plans set out in its initial strategic business plan. We published caps for freight access charges to give greater certainty to freight operators and customers.

In the generally publicly specified, privately delivered railway, incentives, market mechanisms and decentralisation can and should be fostered. This is a key element of our work on the periodic review. We have also worked closely with the industry to improve industry codes and contracts, particularly the Network Code and stations and depots codes.

Using our competition law powers, we issued our decision on the complaint against English, Welsh and Scottish Railway in the market for rail haulage of coal. We received a complaint from the Department for Transport about the rolling stock leasing market, and in April 2007 decided there were sufficient grounds to refer the market to the Competition Commission for a full investigation.

It has been encouraging to see the rail industry committing to improving its sustainable development performance, and we have now published our own policy to facilitate this and monitor industry performance.

We carried out our first survey of rail industry stakeholders in the autumn of 2006. Generally the feedback we received was very positive, with some suggestions for how we can improve. We are already acting on these.

We are committed to a programme of ever more focused and effective regulation, and to best practice in regulation. An example of this in action was our review of the regulatory requirements on insurance, which will eliminate unnecessary costs and bureaucracy. We remain committed to reducing the cost of regulation to the industry, applying an "RPI-2 per cent" ceiling to our running costs.

We were pleased that the office retained its Investors in People accreditation following a thorough independent assessment of our new organisation.

Our progress in 2007-08 reflects the support of our stakeholders for independent regulation, and the dedication and hard work of our staff. I am grateful to them all.



Bill Emery
Chief Executive

A CALENDAR OF SOME KEY EVENTS FOR ORR IN THE REPORTING YEAR

April 2006

The new ORR. On 1 April, in addition to our role as economic regulator, ORR became the health and safety regulator for the railway industry. A few days later we published the ORR Corporate Strategy 2006-09, Business Plan 2006-07, our health and safety enforcement policy and our economic enforcement policy and penalties statements.

ROGS. The new safety regulations for railways in Great Britain, the “Railways and Other Guided Transport Systems (Safety) Regulations 2006” (known as ROGS) came into force. We published guidance on the new regulations.

Licence breach – inaccurate information on capability of Network Rail’s infrastructure. We issued a Notice, in accordance with section 57C of the Railways Act 1993 of ORR’s decision to impose a penalty on Network Rail Infrastructure Limited in respect of a breach of condition 7 of its network licence. We levied a fine of £250,000.

May 2006

PR08. We issued a timetable for the Periodic Review 2008 (PR08). PR08 will set Network Rail’s outputs, revenue requirement and access charges for the five years from 1 April 2009 to 31 March 2014 (control period 4).

June 2006

Rolling stock market. We received a complaint under the Enterprise Act 2002, from the Department for Transport (DfT), alleging that features of the market for the provision of rolling stock to passenger train operating companies (TOCs) prevent, restrict, or distort competition.

July 2006

Railway safety 2005. We published the annual report on railway safety 2005.

Open access. Our decision of 23 March 2006 to approve access rights for open access operators on the East Coast Main Line was upheld in a judgment by Mr Justice Sullivan rejecting the challenge by Great North Eastern Railway Limited (GNER).

Stations code. Following consultation with the industry, we published the final version of the stations code, an improved contractual framework for station access.

August 2006

National rail review. We introduced the new series of quarterly national rail reviews to monitor Great Britain's rail industry, the National Rail Review and Network Rail Monitor - quarter 1 2006-07.

September 2006

Annual assessment. We published the annual assessment of Network Rail 2005-06.

PR08. We issued a consultation letter on the Network Rail initial strategic business plan 2009-14: Issues and Options.

October 2006

Sustainable development. We published a consultation document on ORR's sustainable development and environment duties.

November 2006

Rolling stock market. We published a consultation document on the findings of our market study and on a draft reference to the Competition Commission on the leasing of rolling stock for franchised passenger services.

Competition case decision. We announced our decision that English Welsh and Scottish Railway Limited had acted anti-competitively in respect of certain aspects of the market for the supply of coal for the electricity generation industry.

December 2006

Closure procedures. We published ORR's procedures for reviewing closure references and a summary of responses to ORR's earlier consultation on closure procedures.

January 2007

New structure at ORR. We announced the appointment of three new board members from the executive team, and a new ORR directorate structure.

February 2007

Grayrigg. We began our investigation into the derailment of the 17:15 London to Glasgow Virgin Pendolino train at Grayrigg, Cumbria, on Friday 23 February, which resulted in the death of a passenger.

Level crossings. We published our policy position statement on level crossings.

PR08. We published our Advice to ministers and framework for setting access charges - an important milestone in the PR08 process.

March 2007

Business Plan 2007-08. We published our business plan 2007-08 together with the results of our stakeholder survey.



I. INTRODUCTION AND VISION

INTRODUCTION

- I.1 This annual report covers the 2006-07 reporting year and describes ORR's achievements in delivering the objectives set out in our Corporate Strategy 2006-09 and Business Plan 2006-07 (Corporate Strategy), published in April 2006.
- I.2 The report follows the structure of the Corporate Strategy with chapters 4 to 8 reflecting the key activities in that document:
- Improving health and safety performance;
 - Securing improved efficiency and performance;
 - Securing robust plans for 2009 and beyond;
 - Improving and aligning relationships and incentives in the industry; and
 - The new ORR.

Vision

- I.3 Our long-term vision for the main-line railway industry, set out in the corporate strategy, is a successful partnership of Network Rail, operators, suppliers and funders, working together to meet the needs of passengers and freight customers, and deliver a safe, high performing, efficient and developing railway.

- 1.4 We also have responsibilities across the wider Great Britain railway industry (including the London Underground, light rail, metros and heritage railways) for safety and competition regulation, and will approach these consistently with our statutory duties and our vision for the main-line railway.
- 1.5 Over the 2006-09 period, our continued focus will be:
- (a) securing continuous and sustained improvement in safety, performance and customer service;
 - (b) pursuing relentless improvement in the industry's efficiency and value for money; and
 - (c) enabling the railway to grow and develop to meet the requirements of funders and the aspirations of stakeholders.

Our aim remains:

- 1.6 to apply independent, fair and effective regulation to enable the railway to be safe, well-maintained and efficient, and to ensure that it provides value for money for users and for its funders.
- 1.7 We believe our strategy remains robust, but we are beginning initial work on our next corporate strategy, which we expect to cover the period 2009-14.

Stakeholder relations

- 1.8 ORR has a wide range of stakeholders including: rail users; funders of the railway; the railway industry and the general public. We have always seen effective relationships with these stakeholders as key, with information flowing in both directions. We consult extensively on significant policy initiatives, and proactively seek views on what we are doing.
- 1.9 In autumn 2006, to test our stakeholder relationships, we carried out a survey of key industry stakeholders. The responses indicated broad satisfaction with our approach and also asked that we:
- (a) ensure that we maintain (and are seen to maintain) a strong and effective challenge of all aspects of Network Rail's performance and efficiency;
 - (b) be more visible in the action we take to help the industry to move forward;
 - (c) plan and target our consultations better as part of a more effective dialogue with stakeholders; and
 - (d) play a more strategic role in the industry and provide direction where needed.

I.10 Stakeholders also asked us to maintain, and even step up, our communications with them and wanted us to streamline our consultations (e.g. simplify them and reduce the number).

Focused and effective regulation

I.11 We are committed to the five principles of good regulation – proportionality, accountability, consistency, transparency and targeting. Where we believe regulation will add value, or is required to provide assurance to stakeholders, we will regulate. Where it is appropriate for the industry to do things, we will focus on getting the framework and incentives right.

I.12 We have adopted a policy of “focused and effective regulation”, aiming for an ever better approach to regulation and we consulted on this at the end of November 2006. Key elements are:

- (a) where appropriate, relying on industry parties to deliver a public interest outcome, with ORR focusing on ensuring that the right frameworks and incentive structures are in place. We will monitor the outcome, and take regulatory action if public interest outcomes look unlikely to be delivered;
- (b) encouraging decentralisation of decision-making in the railway industry where this is practicable and supported by good data to enable informed decisions;
- (c) encouraging industry parties to take greater responsibility for the development and operation of industry processes, within a framework we set or endorse;
- (d) being clear about when we will be more directly involved and how we will intervene;
- (e) looking for ways of improving our regulatory processes, and making them more efficient, transparent, timely and effective; and
- (f) committing to reducing our costs in real terms year by year (currently we apply an “RPI-2 per cent” ceiling for our running costs).

I.13 We believe this approach is consistent with the Government’s ‘better regulation’ agenda.

I.14 During the year, we took a number of steps to develop our more focused and effective approach. These included;

- (a) implementing the Railways and Other Guided Transport Systems (Safety) Regulations 2006 (ROGS) which replace regulatory approval of new infrastructure and equipment with a responsibility on individual companies to ensure safety verification;
- (b) consulting on improvements to the industry incentive frameworks as part of the periodic review of access charges;

- (c) consulting on our criteria and procedures for the approval of access agreements, proposing simplification of the process for routine applications with the industry taking greater responsibility for its contractual relationships, and limiting our focus to those applications that raise significant issues;
- (d) encouraging the industry to take responsibility for improving contractual relationships through the Economic and Contractual Framework Industry Steering Group (ISG); and
- (e) further simplifying licensing and exemption arrangements.

Other regulators

I.15 We have continued to work with other regulators sharing information and best practice through the Joint Regulators Group, which met four times over the course of the year, and the working level sub groups (e.g. the concurrency working party, the price controls group, and the economists in the competition group).

Parliamentary committees

I.16 In July 2006 we provided oral evidence to the Transport Select Committee Inquiry into passenger rail franchising following our written submission in June. In February 2007, we gave both written and oral evidence to the House of Lords' select committee on regulators.

I.17 We appeared before the Public Accounts Committee (PAC) on 8 January 2007, alongside the Department for Transport and Network Rail. The PAC was considering the National Audit Office report on the modernisation of the West Coast Main Line, and in particular the action taken since 2002 to turn the project round.

Olympic Delivery Authority

I.18 The London Olympic Games and Paralympic Games Act 2006 gave ORR a legal duty to "facilitate the provision, management and control of transport facilities related to the Olympics and to consult the Olympic Development Authority (ODA) as to how to do so".

I.19 We take this duty very seriously and during 2006-07 put mechanisms in place to ensure that we discharge it effectively. These include an ongoing programme of liaison meetings with key ODA staff, and arrangements to ensure that the Authority is consulted on relevant policy and operational matters (for example relevant track access applications). We have also established a regular dialogue with the dedicated Olympics team within Network Rail. In February 2007 we responded formally to the ODA's consultation on its Olympic Transport Plan.

Rail industry relationships

- I.20 During the year we continued to develop our relationships with the railway industry. We held a number of seminars and workshops on key issues. Our chief executive and directors continued with their programme of regular meetings with passenger TOC owner groups and freight operating companies.
- I.21 We continued to hold regular meetings with Network Rail and other key industry stakeholder groups and through the Railway Industry Advisory Committee (RIAC) to receive advice on railway health and safety issues. RIAC also enables consultation with the railway trade unions. Representatives from relevant unions have attended meetings and given their views on the policy topics.

Department for Transport

- I.22 The main focus of our relations with DfT in 2006-07 was moving from implementation of the 2004 Rail Review and Railways Act 2005 into the new arrangements for setting Network Rail outputs and access charges. The approach to this is set out in chapter 4. We continued our constructive engagement with DfT on a range of issues, with regular meetings with senior officials, Ministers and the Secretary of State.

Devolved governments

- I.23 We have worked hard to facilitate implementation of the transfer of funding and specification responsibility for railways in Scotland to Scottish Ministers working closely with Transport Scotland on this and other matters. We now have an office in Scotland with a number of members of the railway inspectorate based there. Our Board held its first meetings outside London in Glasgow in October 2006 and in Cardiff in March 2007.
- I.24 The funding and specification arrangements for railways in Wales are different from those in Scotland. We do however work closely with the Welsh Assembly Government on rail issues in Wales.

European affairs – contributing to the development of new EC legislation and policies

- I.25 We continued to provide input to the development of European rail policy, working closely with DfT and the railway industry. We monitored the development of the proposed Third Railway Package, which consists of measures covering passenger market liberalisation, train driver licensing and international rail passengers' rights. We developed negotiating positions to assist DfT in briefings for the EC Commission and European Parliament.

- I.26 We attended and contributed to the Developing European Railways Committee, chaired by the European Commission, and participated in relevant sub-groups of the Committee associated with implementation of EU transport policies such as the role of the regulatory bodies, charging, insurance matters, and access to rail-related facilities.
- I.27 We also kept under review other developments in Europe that could have an effect on ORR's policies and/or on the industry, providing contributions to DfT and other Government departments as required. Areas of interest included proposed measures covering the provision of public transport services and public service contracts, the development of freight-oriented networks and the mid-term review of the European Commission's transport policy.
- I.28 In our role as Safety Authority, we support the work of the European Rail Agency (ERA) to develop a more integrated European railway. We participated in most of the working groups and task forces that ERA had set up to take forward this work. These covered areas such as safety certification and authorisation, development of common safety methods, targets and indicators and national safety rules. We also hosted a meeting of ERA representatives to discuss certification of maintenance workshops.
- I.29 We worked closely with DfT on the ERA's work programme and on European health and safety initiatives, such as the move to greater cross-acceptance of rolling stock across the EU. We also liaised with industry stakeholders on the implications of ERA's work and with National Safety Authorities to exchange best practice. For example, we met the newly established French Safety Authority in September 2006.
- I.30 ORR runs the secretariat for the International Liaison Group of Government Railway Inspectorates (ILGGRI). In November 2006, we hosted the ILGGRI plenary meeting in London. Agenda items included a discussion on safety certification assessment criteria, a presentation from DfT on railway safety issues for the future, level crossing safety and the future of the group.

International affairs – general

- I.31 During the year we received a number of visits from representatives of other countries including China, Japan, Germany, Bulgaria, Romania, Netherlands, Italy and France, who were all interested in Great Britain's rail and regulatory experience. We worked with other European economic and safety regulators on issues of common interest, such as access to rail related facilities and services and charging. We participated in the third British-Japanese Rail Cooperation visit to Tokyo and Kyushu.

Regional and local funders

I.32 We continued to work closely with Passenger Transport Executives in the English conurbations. We also worked with Transport for London to facilitate the greater involvement of their London Rail division in setting the strategy, funding and specification of rail services in London.

Passenger Focus

I.33 Passenger Focus representatives gave a useful presentation to the ORR Board in February 2007 and during the year we worked closely with Passenger Focus to further understand passenger priorities. We used the results of the National Rail Passenger survey in our Network Rail Review.

Rail Freight Group

I.34 We have continued to engage with the Rail Freight Group and other representatives of rail freight users on the development of our policies on freight.

Health and Safety Commission/Health and Safety Executive

I.35 ORR and HSC/E have established new working arrangements enabling us to co-ordinate our activities and to share information relating to the regulation of health and safety. During the year we worked closely with HSE to identify health and safety topics of relevance to the railway industry and to feed the rail perspective into HSE's policy development work where appropriate. New enforcement arrangements for rail-related activities have been in operation since 1 April 2006 and we have jointly taken steps to ensure that we do not duplicate effort in the boundary areas.



2. IMPROVING HEALTH AND SAFETY PERFORMANCE

INTRODUCTION

- 2.1 The general trend in improvement in railway safety continued, with key areas such as level crossing fatalities and railway employee injuries reducing. The number of train incidents remains similar to last year, but the number of those involving malicious action has reduced again. The companion Railway Safety Statistical Report 2006 gives detailed information on the railway industry's safety performance.
- 2.2 Our new role as health and safety regulator began on 1 April 2006 following HM Railway Inspectorate's transfer from the Health and Safety Executive (HSE). ORR is now responsible for health and safety regulation policy across all railways in Great Britain. We are also responsible for enforcing the Health and Safety at Work etc Act 1974 and other relevant statutory provisions for rail related activities.
- 2.3 This chapter sets out the key health and safety activities we undertook during the year - other than our European activity, which is described in chapter one.

Intervention and inspection

- 2.4 The proactive inspection of compliance and risk control in the industry remained at the heart of our activity over the course of the reporting year. The principal focus was on Network Rail and we examined key risks arising from the operation of the mainline network. We also continued to pursue strategic themes to achieve long-term improvements in safety performance.

- 2.5 We improved coordination of our inspection activity with the principal mainline train operators. We achieved greater consistency through inspecting common topics across different operators and through a standardised approach to safety performance and feedback. This will allow us to determine more precisely the appropriate resource we need to apply to different duty holders in future years.
- 2.6 The numbers of enforcement notices issued by ORR increased - 28 compared to 22 in 2005-06. Complaints have generally decreased over the past four years, although they were up on 2005-06 (644 from 593). Details of the numbers of enforcement notices issued, prosecutions heard and complaints received over the past five years are in the casework activity table in Annex B.

Incident Investigation

- 2.7 This is the first full year of operation since the Rail Accident Investigation Branch (RAIB) became responsible for investigating incidents on Britain's railways. RAIB's remit is to carry out a no blame investigation into railway incidents and to determine root cause. We remain responsible for investigating incidents to determine whether any breaches of health and safety law occurred and for taking enforcement action as appropriate. Cooperation on site between ORR and RAIB where both parties have been investigating has been good as demonstrated clearly at Grayrigg. Cooperation in handling physical evidence has also been excellent.
- 2.8 During the reporting year we began a review of the categories of incident that we will normally investigate to enable improved targeting of our resources. We continued to apply the Work Related Death Protocol, cooperating with the police, prosecutors and other enforcement agencies.
- 2.9 Over the course of the year, RAIB informed us that they were investigating 43 incidents. They published 34 reports with 207 recommendations. RAIB is required to address its recommendations either to ORR, as the National Safety Authority, or to other public bodies or authorities. We consider recommendations addressed to us, and where appropriate ensure they are acted upon. In addition, we are required to report back to RAIB on the measures taken to implement RAIB recommendations.
- 2.10 We closed 21 recommendations covering a range of areas such as rolling stock modification, changes to points design, and safety management systems (SMS) relating to TOCs and also Network Rail. These often required a review of internal procedures. There were also a number of recommendations relating to consideration of changes to the Rule Book as well as recommendations directed to the Rail Safety and Standards Board (RSSB) requesting it to initiate research projects on behalf of the Railway Industry Group.

Grayrigg

2.11 We are investigating the circumstances of the derailment at Grayrigg in Cumbria on 23 February 2007. RAIB are leading with the technical investigation and they published their initial report on 26 February 2007. The British Transport Police are investigating whether there are grounds for criminal charges and we are investigating any breaches of health and safety law.

Hatfield

2.12 The final Independent Investigation Board report on the Hatfield train derailment was published on 24 July 2006. HMRI's investigation into this derailment was carried out under the supervision of this Investigation Board which could only publish its final report once all legal proceedings and any subsequent appeals had concluded. From 1 April 2006 any investigation authorised by HSE was treated, post transfer, as having been authorised by ORR.

2.13 During the course of the trial in 2005, Balfour Beatty Rail pleaded guilty to health and safety offences and was fined £10 million by the court. Network Rail (formerly Railtrack) was found guilty of health and safety offences and fined £3.5 million. Both companies were ordered to pay £300,000 each in costs. Balfour Beatty appealed against the level of the fine and on 5 July 2006 the Court of Appeal ruled that the fine should be reduced to £7.5 million. Even with this reduction, Balfour Beatty's fine was the largest ever imposed in the English courts for health and safety offences on the railway.

Potters Bar

2.14 Responsibility for the investigation into the Potters Bar derailment (in which seven people died) and support to the Independent Investigation Board transferred to ORR in April 2006. Our investigation into breaches of health and safety law remains open and we will decide whether to take action against any party in due course.

2.15 Following the derailment at Grayrigg, Mr Justice Sullivan, sitting as Assistant Deputy Coroner for Hertfordshire, adjourned the Inquest into the deaths of those who died at Potters Bar pending further advice from the Secretary of State for Transport as to whether an Inquest remains the appropriate way forward.

Public Inquiry report recommendations

2.16 The Health and Safety Commission's Public Inquiry recommendation process charted progress on the implementation of the 295 recommendations made in the Inquiries into Southall, Ladbroke Grove and Joint Inquiry into Train Protection Systems. Of the original 295, three recommendations remain which are now monitored by ORR:

Joint Inquiry Report Recommendation 22

Pilot schemes using ETCS or ETCS elements should be carried out.

Action on: Railtrack, TOCs, Rolling Stock Companies (ROSCOs).

Target for completion: Not specified.

Progress: Plans for the full fitment of the European Rail Traffic Management System (ERTMS) are still under review. Pilot project work on ETRMS, led by Network Rail, is under way on the Cambrian line with implementation due in 2009.

Joint Inquiry Report Recommendation 25

The selective fitment of GSM-R radio in advance of ETCS fitment to trains should be considered. For this purpose lines should be identified for the early fitment of ground and track equipment, to be followed by train-borne equipment (para 11.27).

Action on: Railtrack, TOCs, ROSCOs

Target for completion: January 2004

Ladbroke Grove Rail Inquiry Part I Report – Recommendation 51

There should be a national system of direct radio communication between trains and signallers (para 12.29).

Action on: Railtrack, TOCs.

Target for completion: June 2003

Progress on both recommendations: Project work on GSM-R continues and trial use is scheduled to begin in a pilot scheme in Strathclyde from October 2007. National implementation of GSM-R is expected to be completed in 2012.

Implementation has been delayed by technical challenges in developing the required equipment. We will continue to monitor progress on these recommendations by attending National ERTMS Programme meetings.

Channel Tunnel Rail Link

2.17 Section 2 of the Channel Tunnel Rail Link (CTRL) comes into operation in the latter half of 2007. Much of the infrastructure is covered by the requirements of European Directives on interoperability - which limits HMRI involvement. However, there are some parts that fall within the scope of the Railways and Other Transport Systems (Approval of Works, Plant and Equipment) Regulations 1994 (ROTS) and approvals for these will be completed in time for the projected opening dates.

2.18 We have been liaising with Network Rail (CTRL) Ltd who will be the infrastructure manager for the new railway to ensure that the necessary safety authorisation is in place for the operation. Testing and commissioning of the new railway started on 14 January

2007 and from then ORR took over health and safety responsibility for enforcement from HSE's Construction Division.

Important legislative changes

- 2.19 The Railways and Other Guided Transport Systems (Safety) Regulations (ROGS) came into force on 10 April 2006. ROGS implements some of the requirements of the European Union's Railway Safety Directive (2004/49/EC) and replaces:
- (a) The Railways (Safety Case) Regulations 2000
 - (b) The Railways (Safety Critical Work) Regulations 1994; and
 - (c) The Railways and Other Transport Systems (Approval of Works, Plant and Equipment) Regulations 1994
- 2.20 ROGS represents a significant change in the way that safety on Britain's railways is regulated and the regulations will have a significant impact upon industry's own safety-related processes. The aim is to simplify and consolidate the legislative framework for railway safety and to reduce bureaucracy for railway duty-holders.
- 2.21 ROGS requires railway operators and railway infrastructure managers on the mainline railway to maintain a Safety Management System (SMS) and hold a safety certificate (or 'authorisation' for infrastructure managers) indicating that the SMS has been accepted by ORR. The authority to accept or refuse an application for a safety certificate/authorisation, or to revoke one already in existence, is delegated to H M Railway Inspectorate (HMRI) – now of course part of ORR. To help with implementation we have established an Industry Liaison Group and have held a number of training sessions for HMRI Inspectors on the safety certification/authorisation assessment.
- 2.22 We have also developed arrangements for inspecting and validating duty holders' SMSs. One key aspect of ROGS SMS is the requirement for duty holders to have in place a Safety Verification (SV) scheme for introducing new or altered equipment that is novel to the transport system and is likely to give rise to a significant new risk or a significant increase in an existing risk. We have developed guidance on SV and arrangements for the inspection of duty holders' SV arrangements.
- 2.23 We have established plans to monitor and evaluate the regulations and have recruited an independent contractor to take forward the work. The monitoring and evaluation exercise should provide data to enable ORR to determine whether the approach is correct and, ultimately, that standards in safety have been maintained or improved.

2.24 With the coming into force of ROGS, the Railways and Other Transport (Approval of Works Plant & Equipment Regulations) (ROTS) were revoked and HMRI's role is changing. ROTS projects are on schedule to be closed out by the end of the mainline transition period - October 2008. As the level of our involvement in ROTS decreases, the level of our involvement with SV under ROGS is planned to increase. We will be proactively inspecting a sample of SV schemes and providing support to industry whilst the new regulations bed in.

Building relationships (stakeholder engagement)

Railway Industry Advisory Committee

2.25 The Railway Industry Advisory Committee (RIAC) was set up in 1978 by the Health and Safety Commission. RIAC met three times during the year. The committee provides advice to ORR on railway health and safety issues, exchanges information and comments on proposed new regulations and guidance. We are currently reviewing RIAC's effectiveness, looking at membership, working groups, and a clear identification of ORR's requirements.

Network Rail

2.26 HMRI's work under its Network Rail Delivery Plan is to ensure that Network Rail is maintaining and, as appropriate, improving its health and safety performance. We undertook a mix of permissioning, inspection and engagement work with Network Rail involving liaison with managers, monitoring, collecting qualitative and quantitative information, providing informal and formal advice, and enforcement. Our work focused on the hazards of Network Rail's operation, and particularly: level crossings operation and use; signalling asset integrity; track integrity and employee safety.

2.27 We also considered the three strategic themes HMRI has been pursuing with Network Rail since 2004. These are:

- (a) risk control - aiming at health and safety management based on risk, not just compliance with standards;
- (b) competence - because this is critical to safety, particularly in areas where risk has not been, or cannot be, engineered out; and
- (c) asset management - the need to guarantee the safety performance of infrastructure assets, and to develop an overall policy governing the allocation of resources to and between them.

- 2.28 Throughout the year we worked closely with Network Rail, recognising good safety management and performance, whilst also taking action to address areas for improvement. Clearly this annual report can only highlight a sample of our work during the year. Further detail can be found in "Annual Assessment of Network Rail", published separately¹.
- 2.29 Our work on track worker safety concentrated on Network Rail's planning and supervision of its workers. We undertook a series of inspections at work sites analysing the immediate and underlying causes of the safety problems we found, before asking Network Rail's managers to put improvements in place. We will check that the improvements are continued through more inspection in 2007-08.

Train and freight operating companies

- 2.30 We have been working with the train and freight operating companies to ensure that good working relationships are maintained. We aim for a consistent approach so that for example, safety performance is discussed routinely with relevant senior managers.
- 2.31 We have considered how we might encourage safety benchmarking with the TOC owner groups, freight companies and other stakeholders. This work will continue next year.
- 2.32 To help the rail industry meet the new requirements placed on it by ROGS, we led a project involving the Association of Train Operating Companies (ATOC) to agree a template which could be used by rail companies for submitting safety certificate submissions to ORR. ATOC has agreed to share the template with any duty holder who is proposing to submit an application for a safety certificate or authorisation.

London Underground Limited

- 2.33 Our inspection programme for London Underground has targeted management of risks in the platform/train interface, SPADs, emergency procedures and safety critical communications. We have also focused on assessing track, signal and rolling stock maintenance, as well as track worker competence in the infrastructure maintenance companies responsible for maintaining the London Underground network through the Public Private Partnership contracts.

Light rail and tramways

- 2.34 The tramway and light rail industry has established a number of professional groups to improve consistency in standards. The industry has developed arrangements for ensuring initial integrity and for meeting the requirements of ROGS. During the reporting year we

worked with the industry on the development of guidance and tramway-specific standards. In November 2006, we published guidance for tramways which is available on the ORR website²

2.35 We worked closely with the promoters of tram systems in London, Manchester, Edinburgh and the Docklands Light Railway on a number of new, extension and expansion projects. The industry continues to innovate and we have scrutinised several proposed people-mover systems over the year as well as providing advice on an ultra light rail system at Heathrow Airport Terminal 5.

Heritage railways

2.36 We continued to apply proportionate and targeted regulation to the heritage railway sector. During the year we worked with the Heritage Railway Association (HRA) to produce guidance to promote better safety management performance. This included guidance on maintaining of steam locomotive boilers, the essential elements for a Safety Management System, shunting and the use of rail mounted cranes.

2.37 Even with the generally lower levels of risk at heritage railways, there has been an unprecedented number of serious incidents during the year, two of which resulted in loss of life. A guard was killed whilst coupling a locomotive to a carriage on the Gwilli Railway in July and an insurance company engineer was killed inspecting a crane on the Bodmin and Wenford railway in August. Another incident involved a serious health risk from asbestos exposure.

2.38 There are extended transitional arrangements for ROTS under ROGS for tramway and heritage operators. New heritage and tramway projects can continue to be submitted to HMRI under ROTS until 1 October 2008 with anticipated approval and bringing into use under ROTS by 1 October 2010. Currently, 14% of open ROTS projects are heritage or tramways. We are currently in discussion with the HRA to agree the requirements for the application of Safety Verification in this sector, when it comes into force in 2010.

Contractors

2.39 We published our strategic aims for contractors in the rail industry on 10 August 2006. They are to ensure that major clients (essentially Network Rail and London Underground Ltd) have robust and effective procurement and control processes for contractors, and to continue to improve contractors' own safety management systems.

¹Annual assessment of Network Rail 2005-06, ORR, London, September 2006

²<http://www.rail-reg.gov.uk/upload/pdf/rspg-2g-trmwys.pdf>

2.40 Our focus in 2006-07 was on infrastructure and train operators. However we held regular meetings with the key contractors' representative bodies, such as the Infrastructure Safety Liaison Group and the Rail Industry Contractors Association .

Channel Tunnel Safety Authority

2.41 The merger of HSE Rail with ORR in April 2006 included transfer of the Channel Tunnel Safety Authority (CTSA) UK Secretariat. CTSA is an independent bi-national body whose responsibilities are set out in the Treaty of Canterbury between the UK and France and which reports through the Channel Tunnel Intergovernmental Commission to both the UK and the French Governments. It does not report to ORR.

Topic strategies

2.42 In April 2006 representatives from all sections of the rail industry attended an ORR Stakeholder Engagement Forum on the rationale, development and prioritisation of the topic strategies. The strategies identify HMRI's operational policy, strategic aims and, at high level, potential work streams, for ensuring that risks associated with these fifteen topics are controlled. We reviewed and revised the strategies in the light of the feedback we received. They were published on the ORR website in August 2006³.

2.43 The topic strategies have been used throughout the year to influence development of an ORR risk based regulatory framework and intervention strategy. This has involved a wide range of work, for example from ORR policy development and influencing our approach to European Rail Agency inputs; through to development of HMRI inspection plans and joint working initiatives with the rail industry stakeholders. The topic strategies are kept under review to ensure they continue to reflect current industry performance and developments. This assists in maintaining a realistic risk profile focus within, and between, strategies.

Policy positions on key risks e.g. level crossings

2.44 Considerable effort during the year was focused on improving safety at level crossings, misuse of which now represents the single largest source of risk of train accidents on the mainline network.

³See <http://www.rail-reg.gov.uk/server/show/nav.1340>

- 2.45 Aside from the work of the Inspectorate, we continued to take an active part in national forums such as the National Level Crossing Safety Group. In collaboration with industry parties, we developed a statement of the group's policy position on level crossings which was published in February 2007. Toward the end of 2006, in response to both industry demands and recommendations from RAIB, we started a thorough review of our guidance on level crossings (the Railway Safety Principles and Guidance Part 2 Section E). We expect to complete the review in 2007-08. In addition, we have been working with other government departments, including the Department for Communities and Local Government, to explore how some of the safety problems at level crossings, for example those arising from increased road traffic due to new retail and housing developments, can be avoided at the planning stage.
- 2.46 Following on from the work done on the level crossing policy position statement, we are reviewing several other risk areas, including irregular working and stations, to establish whether additional policy position statements would be beneficial.

Industry research and development programmes

- 2.47 Throughout the year we have contributed to the various forums established to oversee and develop a research programme for the mainline industry funded by DfT and managed by Rail Safety and Standards Board (RSSB). We have also established an internal forum for identifying safety research needs across all rail sectors. This forum will ensure that relevant research is being undertaken by industry parties and will, where necessary, commission research itself.
- 2.48 As an input to the Periodic Review, we commissioned work to identify options for targeted investments which might be appropriate to address specific areas of safety risk and which would deliver benefits efficiently whilst not in themselves being required by safety obligations. Following analysis of these options by Network Rail, we advised DfT and Transport Scotland on a number of possibilities for improvements in safety at level crossings.

Interpretation of ALARP/SFAIRP principles

- 2.49 Since April 2006, we have worked together closely with the RSSB to inform their Safety Decisions Programme and the planned publication of RSSB's 'Taking Safe Decisions: How Britain's railways take decisions that affect safety'. Part of our work included providing written responses to comments received in RSSB's consultation with industry stakeholders about issues such as So Far As is Reasonably Practicable (SFAIRP). In the longer term, we intend to factor this work into a broader review of ORR's integrated economic, health and safety regulatory strategy.



3. SECURING IMPROVED EFFICIENCY AND PERFORMANCE

INTRODUCTION

3.1 Our analysis has shown that the industry has continued to perform well overall during the year, although there are areas where continued management attention is needed. Passenger train punctuality improved to reach 88.1% (PPM), the highest level for at least 7 years. Network Rail stabilised delays for which it is accountable within the regulatory target, but failed to deliver any improvement on the previous year. We were pleased to note improvement in performance in Scotland but the Western route continues to lag behind the rest of the network and we have maintained an investigation into progress on this route since early in the year.

Monitoring and reporting

3.2 We developed our approach to monitoring of performance in the early part of the year and this was endorsed by the ORR Board in May 2006.. The plans presented to the Board have been implemented and have delivered improved monitoring of industry, and particularly Network Rail, performance through:

- (a) unifying our regular monitoring publications under a new overarching document: the National Rail Review. This was launched in August 2006 as a vehicle for ORR to comment broadly on the GB rail industry, including from a health and safety perspective. Two further editions were published in November 2006 and February 2007;

- (b) reviewing and improving mechanisms for monitoring Network Rail in particular, in liaison with Network Rail and other stakeholders; and
 - (c) continuing diligent and thorough analysis of data.
- 3.3 We published our regular assessments of Network Rail's performance in the quarterly Network Rail Monitors and the annual assessment of Network Rail's performance. We surveyed stakeholders on the usefulness of both of these publications and gathered positive responses as well as useful ideas for improvement which are now being implemented.
- 3.4 We also reported industry statistics in National Rail Trends (quarterly) and published the National Rail Trends yearbook in June 2006. We carried out a review of National Rail Trends, as outlined below.

Regulatory policy, enforcement and approvals

- 3.5 In April 2006, we published our economic enforcement policy and penalties statement. The policy described our approach to enforcement of obligations in licences held by Network Rail, train operators and others, including our approach to financial penalties. It complements our safety enforcement policy, also published in April.
- 3.6 Earlier in 2006, we found Network Rail had breached its network licence by failing to address discrepancies between the actual ability of the rail network and that described in industry documents. During the reporting year, we monitored Network Rail's delivery of its recovery plan. The company achieved all its milestones, although delivery of the July 2006 milestone was late.
- 3.7 We also found Network Rail in breach of its obligations on land disposal (see below) in October 2006. Network Rail had informed us that it had disposed of some land at East Grinstead without our consent. This represented a breach of Condition 26 of its network licence. However, we recognised that the actions leading to the disposal followed an erroneous misinterpretation of an earlier ORR decision about the land concerned, and that Network Rail had not sought to profit from the disposal. Following evidence from the company showing that it was taking steps to ensure that such an unauthorised disposal would not occur again, and since there was no evidence of a continuing or prospective breach, we decided not to issue an enforcement order or financial penalty.
- 3.8 In the first part of the year, we assessed Network Rail's business plan for the remainder of the current control period (to March 2009) and concluded that it was generally on course to deliver the outputs required by the access charges review 2003.

- 3.9 We issued three consents for Network Rail to carry out activity outside its core business. These included Network Rail owning some locomotives for the trial of ERTMS on the Cambrian route, extension of our consent to Network Rail's property related activities to 31 March 2009 (the end of the current control period), and payment of rebates to DfT and Transport Scotland relating to previous funding arrangements.

Focused and effective regulation

- 3.10 We reviewed aspects of our approach to regulation of Network Rail in the light of our focused and effective regulation agenda. We developed channels of communication between the economic and safety sides of ORR and examined ways of coordinating knowledge and action. We reviewed Network Rail's network and station licences to ensure they were fit for purpose and decided to make changes to licence conditions in two phases. The first phase, containing relatively straightforward changes, was completed on 12 April 2007. The second phase, which involves more complex changes, is being taken forward alongside the Periodic Review 2008 and work on the incentive framework for Network Rail and the outputs it must deliver from April 2009 is in progress.
- 3.11 We also examined a specific area of regulation - land disposal. Network Rail is required to seek our consent before disposing of land to ensure that land which could be used for the railway is not lost. We consented to nine cases during the year, two subject to conditions. Network Rail withdrew one case before a decision had been reached. The consultation process is currently managed by us. As part of our aim of ensuring that the industry leads wherever possible and that we focus on the key regulatory issues, we have started a staged process of passing more responsibility for running the process to Network Rail. In connection with this, we asked the independent reporters to examine Network Rail's processes for dealing with land disposals.

Asset management

- 3.12 We monitored Network Rail through the year as it completed five of the six tasks detailed in the compliance framework of the Guidelines to Licence Condition 24, the Asset Register. We were observers to the consultation with external stakeholders (Task 4) and to the development of processes that ensure asset information is kept up to date (Task 5). Network Rail identified 24 key areas where its information was inadequate and it is now acting to address these. With the Independent Reporter (Asset Management Consultants Limited (AMCL)), we are reviewing the identified gaps to ensure that nothing has been missed. We will then audit the asset information to ensure that it is fit for purpose.
- 3.13 For much of 2006, AMCL (the industry's independent asset management and business planning reporter) was involved in a comprehensive evaluation of Network Rail's asset

management policies and processes. AMCL produced its draft final report at the end of 2006, and the final version was completed by the beginning of February 2007⁴. This is the first such review of any railway company in Britain, and AMCL's view is that Network Rail's asset management performance is developing with an increasing level of maturity. It notes a strong management drive and concludes that Network Rail's asset management compares favourably with other major infrastructure owners. It makes a number of important recommendations for continuing development and further improvement, and Network Rail is addressing these.

- 3.14 One of the key areas identified in which real progress needs to be made is in the further development of Network Rail's asset policies. Good progress has been made towards establishing a consistent approach to maintenance and renewal activities in each of the key asset groups, but both the AMCL report and our own assessment work on Network Rail's Initial Strategic Business Plan (published in June 2006) for the 2008 periodic review, show that there is significant scope for improving and refining those policies and therefore achieving a considerably more cost effective, value for money railway.

Licensing

- 3.15 This year we implemented the conclusions of our 2005-06 licensing review, amending the licences of 50 operators to reflect the shorter, more focused model licences we introduced in January 2006. We also delivered our business plan commitment to review the policy and procedures for approving operators' public liability insurance, which we inherited from the Strategic Rail Authority (SRA). In line with our focused and effective regulation principles, we have now replaced the complex old system of individual approvals with a more flexible general approval. We are continuing to develop a risk-based approach to monitoring compliance with these new arrangements. We will also undertake further work on our proposal to give operators greater discretion over the insurance cover they buy, while encouraging the industry to explore cost saving joint insurance initiatives.
- 3.16 We continued to discharge our licensing and related functions in accordance with regulatory best practice and our published guidance. During the year we closed 40 cases, handled over 100 wide ranging queries on licensing matters and further improved our published guidance. Details of licences and exemptions granted and revoked during the year are in Annex B. Significant cases included Société Nationale Des Chemins de fer Français's (SNCF) application to run freight services using their French train operator licence. We also granted

⁴The AMCL report is on our website at <http://www.rail-reg.gov.uk/upload/pdf/exp-amcl-060207.pdf>

licences to the new South West franchisee and gave notice that we intend to grant a passenger train operator licence to new open access entrant Grand Central. As in previous years, we granted licence exemptions mainly to heritage railway operators and to maintenance companies operating non-passenger trains within possessions.

Sustainable development

3.17 In October 2006 we consulted on how we could more effectively discharge our sustainable development and environment duties. To support this work we hosted an industry workshop in November 2006 to encourage discussion of both the proposals identified in our consultation document, and any wider sustainable development issues that affect the railway industry. We also held discussions with a number of bodies on specific issues that they wished to draw to our attention. We received a substantial number of responses to this consultation, from a wide range of railway and non-railway organisations. We published our final conclusions which included our policy on sustainable development in April 2007, and will be working closely with the industry to implement our proposals during 2007-08.

Rail statistics

National Rail Trends

3.18 By the end of the year most of the recommendations in the Review of National Rail Trends (May 2006) had been implemented. The remainder will be either incorporated in the 2006-07 yearbook or, in the case of some more complex recommendations that require significant new data sources to be developed, during the course of 2007-08. Full internal processes and instructions relating to the publication of National Rail Trends have been reviewed and updated for all data sets.

Rail statistics steering group (RSSG)

3.19 The group which includes Network Rail, Transport for London, Transport Scotland, Department for Transport, Association of Train Operating Companies and Passenger Focus met for the third time in early February 2007. Its purpose is to lead the industry in setting standards for data management and quality, continually improving data in a cost effective manner and providing easy routes to high priority data of known reliability. A detailed project plan to deliver the vision of the RSSG is being developed.

Website

3.20 The rail statistics section of the ORR website has been updated and enhanced to make it easier to navigate and find the required data and the first version of the Data (Information) Catalogue is now on the website, having been produced with input from industry organisations.



4. SECURING ROBUST PLANS FOR 2009 AND BEYOND

INTRODUCTION

- 4.1 2007-08 was an important year in the development of a framework to ensure that the industry in general and Network Rail in particular has robust plans for 2009 and beyond. Important milestones were achieved towards the successful completion of the periodic review in October 2008, which should enable us to achieve our objective:
- to ensure an outcome to the review which secures value for money for users and taxpayers, by determining the level of Network Rail's access charges and outputs in a way that balances the interests of all parties*
- 4.2 We continued with preparatory work for the periodic review but also entered the formal phase with the provision of a notice to the Secretary of State and Scottish Ministers requiring publication of the outputs they want to be achieved by the railway and the public funds they have available to support those outputs. We also concluded on some important elements of the financial and incentives frameworks and set caps on freight charges.

Periodic review

- 4.3 PR08 will determine Network Rail's outputs, revenue requirement and access charges for control period 4 (CP4), which runs from 1 April 2009 to 31 March 2014. We will publish our final determinations in October 2008, with final levels of individual access charges approved by us in December 2008 following calculation by Network Rail.

- 4.4 During the year we increased our work on PR08. We undertook a range of consultations during the year. In June we published a consultation document on the future structure of charges, which, amongst other things, outlined our intention for Network Rail to take greater responsibility in calculating specific access charges. We agreed with the industry to bring forward key elements of the freight charges review and determine caps for freight charges to provide the industry with increased certainty to support its planning. We consulted on our proposals in December. We also consulted on our proposals to introduce a reservation charge.
- 4.5 In July, we consulted on the incentives framework that Network Rail and the wider industry face. This included our proposals for Network Rail's high-level financial framework. In September we consulted on a range of other issues related to the treatment of risk and uncertainty in CP4 and we published our decision on the approach to amortisation of Network Rail's regulatory asset base (RAB), which we consulted on in December 2005. Also in September we published a consultation on Network Rail's initial strategic business plan (ISBP) which the company published in July.
- 4.6 To complement the work that Network Rail has been undertaking, we have put in place a number of workstreams to allow us to assess the scope for Network Rail to make efficiency gains over CP4. In particular we have:
- begun work to benchmark Network Rail with overseas rail infrastructure comparators, using "top down" econometric and data envelopment analysis (DEA) techniques;
 - undertaken work to examine the efficiency of specific Network Rail activities, such as possessions, and we commissioned a study by AMCL to assess Network Rail's asset management practices; and by BSL to benchmark signalling projects with examples from overseas;
 - commenced work to assess the scope for "frontier shift" efficiency savings, including lessons to be learned from total factor productivity analysis;
 - had an ongoing involvement in a selection of Network Rail's own efficiency workstreams (for example, commenting on terms of reference and reviewing outputs);
 - assessed evidence submitted to us on Network Rail's efficiency by stakeholders and asked Network Rail to respond to this evidence; and
 - undertaken work to consider efficient levels of unit costs.

- 4.7 In February 2007, we published our advice to Ministers and framework for setting access charges. This important document started the formal phase of PR08. We asked the Secretary of State for Transport and Scottish Ministers to provide us with their 'high-level output specifications' (HLOSs) setting out what they want to be achieved by the railway in CP4, and their 'statements on public financial resources available' (SoFAs), setting out how much money they are making available for the achievement of the outputs they want. This document also included our assessment of Network Rail's ISBP and our view on the possible range for Network Rail's revenue requirement in CP4. It also included our guidance to Network Rail on what we consider it needs to do to develop a robust strategic business plan, which it will submit to us in October 2007. The document provided our decisions on key aspects of Network Rail's financial framework and confirmed our decisions on caps for freight charges in CP4. It also gave an update on progress with the development of the incentives framework and the structure of charges.
- 4.8 We have engaged closely with the industry on PR08 over the year. We held a number of well-attended and useful workshops on PR08. We continued to participate in the working groups established by DfT and Transport Scotland to take forward key issues relating to the development of their HLOSs and SoFAs.

Signalling review

- 4.9 To help us assess the detail of Network Rail's signalling renewal proposals we undertook a review of Network Rail's signalling renewal workbank and the internal processes employed to prioritise specific items. We also investigated signalling renewal costs in other European countries.
- 4.10 Both of these work streams are close to conclusion. When the details have been received and assessed they will be shared with Network Rail so that it can include any lessons learned in its future strategy.
- 4.11 We carried out a review of Network Rail's technology strategy for signalling to help in our assessment of Network Rail's Strategic Business Plan for CP4. We concluded that the strategy was broadly effective. The continued introduction of condition monitoring and data logging is now regularly enhancing investigations into incidents and helping to understand underlying causes of equipment failures.
- 4.12 We have not fully accepted Network Rail's financial justification for the wider use of axle counters. However we recognise that axle counter technology can offer advantages over track circuits particularly with regards to compatibility with track requirements, electrification bonding and route acceptance of new trains. We believe that before widespread introduction takes place Network Rail must demonstrate that axle counter reliability is

acceptable and current concerns about the time required at the end of possessions to restore axle counter sections can be settled.

- 4.13 We have supported the industry through the year towards a determination that ERTMS can be justified as an economically viable option for re-signalling. This is a significant milestone for the rail industry with potential consequences for train operating companies and train builders as well as those involved in the signalling supply industry.

Possessions review

- 4.14 The industry's possessions review has continued through the year. Network Rail has committed itself to reducing the disruptive effects of engineering work on the operational railway - especially at weekends. The review is monitoring Network Rail's progress towards implementing many productivity improvements, essential for making the most effective use of available possessions. As part of that work we funded and managed a benchmarking exercise comparing Network Rail's productivity on a number of key engineering activities with that of similar activities on other railways, primarily within Europe. The resulting report focuses attention on areas where Network Rail currently performs well, as well as others where improvement is clearly needed.
- 4.15 Under ORR's guidance, the review established a process to explore the relative cost and benefits of engineering costs, train operator costs and revenue effects with different possession patterns. Again we funded and managed the initial study, and the approach is gradually being extended to other test-case routes so that Network Rail can develop a robust possessions strategy that represents the optimum balance between the need to maintain and renew the infrastructure and to run trains upon it.
- 4.16 The management and delivery of possession activities has been very poorly measured in the past. The review team developed a suite of performance indicators which became operational with effect from period 10. We intend to adopt a measure of network availability as an important output for the next control period.
- 4.17 The possessions review reached a key milestone when ORR hosted a well-attended industry seminar in October. This reported on each area of work and the emerging conclusions. These were written up as an interim report by the possessions review steering group in December. Many aspects of the work - most particularly the development of a robust possessions strategy for CP4 and the final agreement of a suitable network availability measure - are critical inputs to PR08, and we will continue to play our full part in the process and press for tangible progress in all areas.

Structure of charges

- 4.18 In June 2006, we published a consultation document on the structure of track access and station long term charges⁵. In this document, we set out our charging objectives, and the arrangements for the transfer of responsibility for the development of charging methodology and charges proposals to Network Rail, subject to our audit and approval. The document provided Network Rail with guidance for the development of charges. It also consulted on the potential introduction of two new charges: an environmental charge, and a scarcity and/or reservation charge.
- 4.19 In December 2006, we published two further consultation documents on structure of charges, one covering freight charges, and the other reservation charges. Our freight charges document⁶ consulted on caps for freight variable usage charges, and caps for a new charge for freight only lines. We also set out our views on how changes to network capability should be treated. Our reservation charges document⁷ confirmed that we do not propose to introduce a scarcity charge for CP4, due to the practical difficulties involved in calculating an appropriate charge. It also sought views on two possible models for a reservation charge, one covering the network as a whole, and the other applying to congested areas only.
- 4.20 As part of our Advice to ministers and framework for setting access charges document, published in February 2007, we confirmed our conclusions on freight charges caps, set out our views on Network Rail's initial proposals on structure of charges methodology, and explained our next steps for the development of a reservation charge.

Regulatory financial framework

- 4.21 As part of PR08, we have been working closely with Network Rail, DfT and Transport Scotland throughout the year to develop our thinking on the appropriate high-level financial framework for Network Rail in CP4. In our July consultation paper on the incentive framework⁸, we set out a number of options for amending the financial framework with a view to improving the incentives on the company to strive for continuous improvements in performance and efficiency. These options recognised that no fundamental changes to the company's financial structure are currently envisaged.

⁵ Periodic Review 2008 – Structure of track access and station long term charges – June 2006 – ORR, available on our website at <http://www.rail-reg.gov.uk/upload/pdf/291.pdf>

⁶ Periodic Review 2008 – Consultation on caps for freight track access charges – December 2006 – ORR, available on our website at <http://www.rail-reg.gov.uk/upload/pdf/310.pdf>

⁷ Periodic Review 2008 – A reservation charge: consultation on issues and options – December 2006 – ORR, available on our website at <http://www.rail-reg.gov.uk/upload/pdf/311.pdf>

⁸ Enhancing incentives for continuous improvements in performance, Office of Rail Regulation, July 2006, can be accessed at <http://www.rail-reg.gov.uk/upload/pdf/298.pdf>

4.22 Following further analysis of the practicalities of the various options, together with advice from consultants, we have reached agreement with Network Rail and Government on an overall approach that we believe should achieve our objectives whilst also addressing the needs and concerns of others. In brief, this involves encouraging Network Rail to raise unsupported debt from CP4, providing it with an allowed return that reflects its risk-adjusted cost of capital and ensuring that financial surpluses are used efficiently to deliver whole-industry benefits. Our full conclusions are set out in our February Advice to Ministers and framework for setting access charges document⁹.

Incentives framework

4.23 In July we published our consultation document on the incentive framework for Network Rail and the wider industry as part of our PR08 process. This followed extensive consultation with a wide variety of stakeholders, including an industry workshop earlier in the year, and advice from consultants. A particular objective of this workstream is how the incentives facing Network Rail and train operators can be better aligned for the benefit of the industry as a whole.

4.24 As part of our February Advice to Ministers and framework for setting access charges document, we concluded in principle on the intention to establish an explicit volume incentive for Network Rail in CP4, with incentives to meet higher than anticipated demand through non capital intensive solutions. We also concluded that there was merit in enabling Network Rail and other industry participants to 'fine tune' the delivery of the HLOSs in light of emerging information and in establishing an efficiency benefit sharing mechanism, whereby train operators share in aspects of Network Rail's efficiency outperformance.

4.25 In areas where we, as regulator, do not have direct powers, in particular in relation to the franchise regime, we have been working closely with Government and train operators to establish the appropriate way forward.

Investment framework

4.26 If rail services are to develop so that the needs of users are better met, it is essential that there is an effective framework for delivering infrastructure investment, including schemes sponsored by third parties (i.e. non-government funders).

⁹ Periodic Review 2008 advice to Ministers and framework for setting access charges , Office of Rail Regulation, February 2007, can be accessed at <http://www.rail-reg.gov.uk/upload/pdf/316.pdf>

- 4.27 In October 2005 we published our conclusions on a policy framework for investments, which aims to facilitate investment in the railway by addressing a number of barriers to the delivery of efficient investment. We have implemented the framework by establishing clear roles and responsibilities and, where appropriate, new approaches to enable these barriers to be overcome. These are set out in our Investment Guidelines, published in March 2006.
- 4.28 As the policies and processes set out in our March Investment Guidelines received general support from the industry, we have continued to implement the framework throughout 2006-07. During the year, we have:
- (a) established and approved model terms for Network Rail's contracts with third party promoters. The final batch of model terms was approved in September 2006;
 - (b) carried out and published (in December 2006) our first Annual review of investment activity by Network Rail (including its involvement in schemes promoted by third parties);
 - (c) published (in December 2006), an emerging conclusions letter on a proposed Rebate mechanism which enables third party investors to recover a fair proportion of costs from other beneficiaries; and
 - (d) published an update of our investment guidelines in March 2007, covering the approach to schemes promoted by third parties, self-financing schemes, and arrangements for major schemes promoted by Government.
- 4.29 We have provided guidance and interpretation on ORR's policy framework for investments to Network Rail, funders and scheme promoters throughout the year. We have confirmed our intention to add expenditure on several major investment schemes to the RAB, subject to certain conditions being met.

PR08 – assessment of enhancements

- 4.30 We have also applied our investment framework to our assessment of Network Rail's proposed enhancements for CP4 as part of our assessment of Network Rail's proposed expenditure for the PR08. By applying the framework we have ensured that a consistent, transparent approach has been followed to assessing a portfolio of schemes valued at over £8 billion in CP4, including the Thameslink Programme, proposed new rail links to major airports in Scotland and major route upgrades.
- 4.31 Our assessment used top-down benchmarking of schemes as well as detailed, bottom-up cost analysis for a sample of schemes. As well as assessing Network Rail's cost estimates for the schemes, we reviewed the proposed arrangements for delivery of schemes, particularly the proposed risk allocation. This is important as the risk allocation (including the basis of pricing) has a direct impact on the outturn costs of schemes as the risk allocation largely determines the incentives for efficient delivery.



5. IMPROVING AND ALIGNING RELATIONSHIPS AND INCENTIVES IN THE INDUSTRY

INTRODUCTION

- 5.1 We have continued to draw on the growing experience of participants in the privatised industry structure to improve the core contracts and better to align the incentives on different parties. This will help the industry to develop and improve further with minimal need for regulatory intervention.
- 5.2 As well as the initiatives covered in the PR08 we have encouraged development of the network code and stations code. We have welcomed Network Rail's successful approach to the development of Route Utilisation Strategies, a responsibility transferred from the SRA following the Railways Act 2005, and an important step in developing a coordinated approach to industry planning where all stakeholders can play an appropriate part.

Track Access

Access applications

5.3 Under the Railways Act 1993 (the Act), we are responsible for the fair and efficient allocation of capacity of railway facilities through our determination of the terms of the access agreements under which train operators gain access to the rail network, stations and light maintenance depots. The Act provides for applications to be made on an agreed basis between an applicant and Network Rail (or any other facility owner) under section 18. When the applicant has not reached agreement with the facility owner, it can apply under section 17, which gives ORR the power to determine the form of the access contract and direct the facility owner to enter into it. The Act contains similar provisions covering the approval of amendments to existing agreements (details of directions and approvals are set out in the table in Annex B).

Passenger track access agreements

5.4 In June 2006, we issued directions to Network Rail and Northern Rail Limited under section 22A of the Act to amend Northern's track access contract in order for it to retain rights to operate services on the Oldham Loop.

5.5 During the year we considered a section 18 application from First Greater Western for a new contract containing the rights necessary to operate the services specified in its new franchise. We approved the application and directed Network Rail to enter into the contract in December 2006.

5.6 In addition, we approved extensions of the agreements between Network Rail and South West Trains and First Capital Connect.

5.7 In January 2007 we directed Network Rail, under section 17 of the Act, to enter into a track access contract with Grand Central Railway Company Ltd containing rights to operate three services per day in each direction between London and Sunderland. This followed our March 2006 decision on the potentially competing applications for access rights to operate additional passenger services on the East Coast Main Line from Grand Central, GNER and Hull Trains. We also approved rights for GNER to operate five additional services in each direction between London and Leeds and for Hull Trains to operate two additional services in each direction between London and Hull. GNER challenged our decision through a judicial review which was heard in the High Court in July 2006. In his judgement issued on 27 July 2006, Mr Justice Sullivan rejected GNER's challenge and upheld our decision.

5.8 In January 2007, we approved a new track access contract between Network Rail and

North York Moors Railway to run a scheduled steam service between Glaisdale and the seaside town of Whitby between spring and autumn.

- 5.9 At the end of the year we were considering an access option between Network Rail and Transport for London. The proposed access option would reserve capacity between New Cross Gate, Crystal Palace and West Croydon following the northern extension of the East London Line. We were also considering an open access application from Wrexham Shropshire Marylebone Railway under section 17 of the Act, seeking rights to operate a service from Wrexham to Marylebone.
- 5.10 In July 2006, we initiated a consultation aimed at drawing out any operators with aspirations to operate services on any part of the network affected by the Department for Transport's Midlands franchising programme. The purpose was to provide the industry with a shared understanding of the likely conflicting requirements for capacity and the potential trade-offs in the affected area. We published the results of this capacity assessment on 18 January 2007.

Freight agreements

- 5.11 During the year, we considered and approved a number of supplemental agreements covering changes to Network Rail's track access contracts with EWS, Freightliner Limited, Freightliner Heavy Haul Limited, Advenza Freight Limited, Direct Rail Services Limited, GB Railfreight Limited and South West Trains Limited, as well as approving new contracts for Amec Spie (UK) Limited and Fastline Limited.
- 5.12 We held discussions with a port and terminal developer who proposed to secure future long-term access rights under an access option.
- 5.13 We rejected two applications during the year: one under section 22A to grant Freightliner Heavy Haul Limited spot bid rights for access to Hunslet Sidings, and section 17 application from EWS for a 25-year access option which was intended to secure and protect freight capacity in the London area. EWS formally withdrew its application made under s17 for access to Royal Mail's depot at Willesden and the associated section 22A application for access to Network Rail's network.
- 5.14 At the end of the year, we were considering separate applications to direct Network Rail to enter into a five-year access contract with SNCF and Fastline Limited. Work was also underway on the section 17 applications made by Freightliner Limited and Freightliner Heavy Haul Limited for long-term (up to ten years) access rights on Network Rail's network. Additionally, we were considering an application to direct EWS to enter into a long-term access contract with Roadways Container Logistics Limited for access across EWS controlled network at Kingsbury Sidings and Birch Coppice.

SI 6A - I of the Railways Act 1993

5.15 In October 2005, the DfT commenced sections 16A – I of the Railways Act 1993, giving powers to ORR to issue directions in relation to the provision, improvement or development of railways facilities. While sections 16A – G contain the process for submitting applications and the provision of representations, section 16H requires ORR to prepare a code of practice to which we shall have regard when exercising our functions under those sections, and which we shall publish in such manner as we consider appropriate. After consulting stakeholders on a draft code of practice in August 2006 we issued our code of practice in November 2006¹⁰.

Criteria and procedures for the approval of passenger and freight track access contracts

5.16 Following a consultation with stakeholders, in May 2006 we published updated versions of our criteria and procedures documents for the approval of both passenger and freight agreements. These documents reflect changes to ORR policy and legislation that have taken place since the publication of the previous editions of the criteria and procedures documents.

5.17 We are currently consulting the industry on proposals for a wider review of our criteria and procedure documents, to see if we can make our consideration of track access applications more focused and effective.

Appeals

5.18 During the year we determined three appeals against decisions made by the Access Disputes and Timetabling Panels:

- (a) Network Rail appealed against a ruling that TransPennine Express was not liable for the payment of certain costs arising from a vehicle change application under Part F of the Network Code;
- (b) Grand Central Railway Company Limited appealed against a ruling that it was not entitled to be a party to a separate appeal before the timetabling panel in relation to proposed timetable services on the East Coast Mainline; and
- (c) EWS and Freightliner Heavy Haul made a joint appeal against a panel determination that Network Rail was entitled to impose two late notice possessions upon them.

In all three cases ORR determined that the appeals should be upheld.

¹⁰ ORR's Code of Practice for the application of Sections 16A to I of the Railways Act 1993, November 2006: Office of Rail Regulation.

- 5.19 We are currently dealing with an appeal from First Capital Connect against an access disputes panel decision that works being carried out by Network Rail on the East Coast Mainline do not fall within the definition of "Major Project" under the Network Code.
- 5.20 On 5 February 2007 we received our first appeal under the Railways Infrastructure (Access and Management) Regulations 2005 from GB Railfreight Limited against Freightliner's refusal to allow it access to its terminal facilities at the Port of Southampton.
- 5.21 In addition, we also received our first appeal under The Railways (Access to Training Services) Regulations 2006 from Grand Central Railway Company Limited against the refusal of GNER to allow it access to its train cabs for training purposes.

Access options

- 5.22 On 15 January 2007 we published a consultation document setting out our proposed policy for considering applications seeking the approval of access options under sections 17 or 18 of the Railways Act 2003. This consultation closed on 23 March 2007.

Network Code

- 5.23 Work on the reform of the Network Code has been taken forward in two phases and has been underway since autumn 2003. Phase 1 of the reform work was completed on 10 January 2005 (in the case of Part F on 1 April 2005). Phase 2 conclusions were published in December 2005, when we remitted the industry, through the Economic and Contractual Framework Industry Steering Group (ISG), to develop the identified areas for change to the Network Code.
- 5.24 During 2006-07 the following work was completed in relation to the Network Code:
- (a) on 24 May 2006 we repealed the residual conditions of Part H (Operational Disruption) following full establishment of the Railway Operational Code under Part HA. The Network Code was formally amended to reflect this change on 12 January 2007
 - (b) on 7 June 2006 we approved amendments to Part K (Information) which took effect on 21 June 2006 along with the revised Part K itself. On 12 March 2007 we also published a notice providing clarification of how industry parties should deal with certain issues relating to the provision of information, largely in relation to confidentiality, cost and accuracy
 - (c) on 5 October 2006 we approved amendments to Part J (Changes to Access Rights) to make the existing transfer and surrender mechanisms clearer, more transparent and more efficient and effective. Subsequent work is continuing to address specific issues raised by the industry in respect of the current operation of Part J
 - (d) on 27 October 2006, we approved amendments to both the Access Dispute

- Resolution Rules and Part B (Performance Monitoring) to reflect changes to the way in which the Access Dispute Committee and Delay Attribution Board are funded;
- (e) on 22 December 2006 we approved the following amendments which took effect on 12 January 2007:
- Part D (Timetable Change) – a number of amendments were approved to encourage greater collaboration between industry parties on the development of industry timetables; and
 - Part G (Network Change) – this was amended to include a process for dealing with large and complex projects, to clarify when a network change proposal may be implemented, and to enable train operators to block a network change if it would affect identified future use;
- (f) amendments to the Delay Attribution Guide were approved on 22 December 2006, principally to remove references to Infrastructure Maintenance Companies (IMCs) that are now incorporated within Network Rail. The revised version of the guide came into effect on 28 January 2007;

5.25 ISG has also:

- (a) been reviewing Part E (Environmental Protection); and
- (b) undertaken, with appropriate support, to review the compensation arrangements for restrictions of use with a view to consolidating compensation payments through Schedule 4 of a track access agreement only. Currently compensation payments associated with renewals are paid through Schedule 4, but in relation to enhancement works they are paid through Part G of the Network Code. This review will inform changes that will be implemented through PR08.

Stations and depots

Stations access casework

5.26 The stations and depots team is responsible for approving both new access agreements and amendments to existing agreements for stations and light maintenance depots. These cases are determined using mechanisms similar to those applying to track access. All access casework is progressed in line with ORR's Section 4 duties.

5.27 As a result of a failure to agree access charges at Glasgow Prestwick Airport, First ScotRail applied to us in April 2006 to direct an access contract under section 17 of the Railways Act with the station facility owner, Glasgow Prestwick Airport Limited. We issued two draft decisions and our final determination was made in May 2007.

5.28 Merseyrail opened Liverpool South Parkway station in June 2006. For us, this involved the approval of two new access agreements and a set of customised access conditions, reflecting the non-standard role of Merseyrail, the Merseyside Passenger Transport Executive.

5.29 We have had two applications for major station refurbishments requiring section 22 approval; Aberdeen and St Albans stations.

Review of the structure of station long term charges and of the targets for Network Rail's responsibilities at stations.

5.30 Network Rail is working to prepare its infrastructure cost model to inform the PR08. Over the year, we have had a number of important discussions with the company, concerning the right structure for charges at stations. A number of interesting ideas have been put forward and the work we commissioned in August 2005 has proven to be very useful on this.

5.31 The model will also support negotiations between train operating companies and Network Rail to achieve a more efficient and effective division of responsibility for the maintenance, repair and renewal of specific station assets.

Stations Code

5.32 We have continued to work with the industry to prepare implementation of the code, which is a more streamlined, efficient and effective contractual structure for stations. In July last year we completed the work on drafting the code. There have been meetings of the cross-industry stations code implementation group to resolve common issues and to share experience and best practice. We will continue to encourage the industry to implement the code at the earliest opportunity, and to work with them and with DfT, to remove any barriers to that. The TOCs and Network Rail are now working hard to complete their station particulars in preparation for joining the code and we are preparing for lodging all 2500 new agreements on our public register. The framework agreement for the new stations code has been available since 23 March 2007. To date it has been signed by Network Rail and 20 train operating companies. Accession to the new stations code will now be a phased process for which Network Rail is responsible. Network Rail is currently preparing a project plan to manage the next steps.

Depot access casework

- 5.33 Though there have been few depots cases opened during the period, the cases that have been submitted are relatively complex, involving customised access conditions and agreements, a wholesale transfer of York Leeman Road and Cleethorpes depots from Northern Rail to Siemens and the installation of new, TOC-owned equipment necessitating changes to the relevant access contracts.
- 5.34 Work on developing a new depots code was put on hold this year while we concentrated on achieving agreement on a new stations code. Building upon the achievements and experience of developing the stations code, the team will, in the coming year, re-start work on producing a new depots code.

Route utilisation strategies

- 5.35 Network Rail has responsibility under its network licence for the development and maintenance of Route Utilisation Strategies (RUSs) for the entire network (a task previously undertaken by the Strategic Rail Authority). In 2006-07 Network Rail completed production of its first two RUSs, covering the South West Main Line and Cross London routes, and commenced development work on several more. An ORR representative attended most of the stakeholder management group meetings as an observer. ORR may issue a notice of objection to a RUS if it is not fit for purpose and may also issue a review notice if new factors emerge that would materially affect an established RUS. It was not necessary to issue any such notices during the year.

Implementing EU Directives

- 5.36 We contributed to a series of questionnaires and studies commissioned by the European Commission to inform their report to the European Parliament and the Council on the implementation of the First Railway Package published in May 2006. These covered matters concerning the opening up of access to ancillary services, licensing requirements for train operators and maintenance arrangements.
- 5.37 We supported the implementation of the second railways package¹¹, which covers safety matters, the alignment of the high-speed and conventional interoperability requirements, freight market liberalisation, the establishment of a European Rail Agency and accession to the Convention concerning International Carriage by Rail (COTIF). We focused our

¹¹ Directives 2004/49/EC (amends Directives 95/18/EC and 2001/14/EC), 2004/50 (amends 96/48/EC and 2001/16/EC) and 2004/51/EC (amends Directive 91/440/EEC), Regulation (EC) No. 881/2004, 2003/0269 (CNS).

efforts on negotiating with the DfT and the European Commission (EC) to secure a proportionate approach to its transposition into domestic law.

- 5.38 We continued to assist DfT in the preparation of the transposing regulations of the COTIF Convention and the accompanying guidance document, seeking in particular to influence the implementation of COTIF's uniform rules for contracts for the use of infrastructure in order to ensure that the impact on model contracts is minimised. The implementing regulations entered into force on 1 July 2006.

Competition casework

- 5.39 The Competition Act 1998 (CA98) is applied and enforced by the Office of Fair Trading (OFT). ORR, by virtue of section 67(3) of the Railways Act 1993 exercises these powers concurrently with the OFT in respect of agreements or conduct concerning the supply of services relating to railways. ORR is also a national competition authority (NCA) for the purpose of applying Articles 81 and 82 of the EC Treaty, where there is an effect on trade between Member States.
- 5.40 Last year we reported that in March 2006 we had issued a supplementary statement of objections against English Welsh and Scottish Railway Limited (EWS) that it had abused its dominant position in the market for the carriage of coal by rail in Great Britain, contrary to Chapter II of the CA98 and Article 82 of the EU Treaty of Rome. That case concluded this year with the issue of an infringement decision on 17 November 2006.
- 5.41 EWS abused its dominant position by entering into contracts with exclusionary effect, discriminatory pricing against Enron Coal Services Limited and predatory pricing practices against Freightliner Heavy Haul. The fine of £4.1m reflects the seriousness of the infringement but also takes into account EWS's cooperation in accepting our findings. Our decision included directions to EWS and co-parties to the infringing contracts requiring each to remove or modify certain terms so as to remove their exclusionary effect. E.ON (a co-party) has appealed against our Directions to the Competition Appeals Tribunal. Proceedings are ongoing.
- 5.42 In addition to this case, we have also considered 60 requests to investigate complaints about the supply of railway services. 57 of these complaints were closed after an initial review because the conduct being complained about did not merit a full investigation using our formal powers under the CA 98. Three complaints were transferred to another ORR team because they were better placed to deal with the concerns being raised under regulatory powers.

5.43 In response to the various concerns we received during the course of the year on ticket prices we published a guidance note on our website¹²

Mergers

5.44 We provided advice to the OFT on the competition effects of two rail passenger franchise acquisitions, South West Trains and the London Rail Concession. We also submitted written evidence and attended oral hearings at the Competition Commission as part of its inquiry into the acquisition of Marcroft Holdings PLC by EWS Railway Holdings Limited

Market studies

5.45 This year we undertook a full market study of the leasing of rolling stock for franchised passenger services initiated by a submission made by the Department for Transport in June 2006. We consulted on our preliminary findings in November 2006, inviting responses by 28 February 2007. As well as detailed responses from all three rolling stock companies¹³ and the DfT, we received responses from fifteen other interested parties including the Association of Train Operating Companies (ATOC), train operators and industry associations. During the consultation period we also held meetings with all key parties and had further written exchanges with them on points of detail. On 26 April 2007, we confirmed our preliminary findings and decided to make a reference to the Competition Commission (CC) under section 131 of the Enterprise Act 2002 (EA02) for an investigation into the leasing of rolling stock for franchised passenger services and related maintenance services in Great Britain

5.46 We also undertook a short primarily desk-based review of the market for the provision of rail liability insurance. Our findings are included within ORR's consultation 'Insurance Review', November 2006. In this we note that the market for rail insurance has matured in the years since privatisation and although there have been periods of market concentration with cover available through only a very limited number of providers, new entry has occurred more recently with evidence of high levels of switching between insurers by operators. We also conclude that the provision of rail insurance in Great Britain is only one segment of a competitive international market and the barriers to entry and exit appear to be low. In summary there appeared to us to be no grounds to suspect that this is a market not working well. We do not propose, therefore, to undertake a longer and more detailed market study of this area at this stage.

¹² <http://www.rail-reg.gov.uk/upload/pdf/competition-briefing-note-fares.pdf>] entitled "Regulating Rail Passenger Fares -The Role of Competition Law

¹³ The three ROSCOs are currently known as Angel Trains Ltd.; HSBC Rail; and Porterbrook Leasing Company Ltd. They are respectively referred to as Angel, HSBC and Porterbrook, throughout the rest of this report.

Concurrency

- 5.47 Concurrency refers to the powers to apply competition law in particular sectors, exercisable by the OFT or by the relevant sectoral regulator. ORR has concurrent powers with the OFT, as has the Office of Communications, the Office of Gas and Electricity Markets, the Director General of Electricity Supply for Northern Ireland and Director General of Gas for Northern Ireland, the Director General of Water Services and the Civil Aviation Authority.
- 5.48 As well as concurrent powers to apply and enforce CA98, the relevant sectoral regulators also have concurrent powers to make market investigation references under section 131 of the EA02.
- 5.49 Regulators and the OFT work closely together at both an operational level and more formally through the Concurrency Working Party to ensure that the legislation is applied and enforced consistently across sectors and that good practice is shared.
- 5.50 During the year we continued to monitor competition law developments in the European Union and in the UK, particularly those with a possible impact on the railways in Great Britain. We continued to work through the Concurrency Working Party and the European Competition Network to contribute to the development of competition policy and procedures. We welcomed the recent review of concurrency carried out by HM Treasury and the Department of Trade and Industry and considered that the joint report published in May 2006 provided a number of useful indicators of how the practice of concurrency could operate better in the future. We are currently working with other concurrency colleagues and the OFT to implement a number of its recommendations. Our response to the report can be found on our website¹⁵.



6. THE NEW ORR

INTRODUCTION

- 6.1 With the transfer of responsibility for rail health and safety regulation from the HSC and the HSE on 1 April 2006, ORR more than doubled in terms of staff numbers, became a regional organisation with a presence in 22 locations up and down the country, and relocated London-based staff to a new building. We also needed to implement a new funding structure covering the costs of our railway health and safety functions.
- 6.2 The considerable challenge was to bring the two organisations together whilst still delivering the health and safety and economic regulatory programmes on which our stakeholders depend.

Corporate Governance

- 6.3 We strive to meet best practice in corporate governance arrangements. A statutory Board (see Annex A) leads ORR. At the start of 2006-07 this consisted of eight members: six non-executive directors (including the Chairman); and two executive directors, Bill Emery (Chief Executive) and Michael Beswick (Director Rail Policy). Chris Stokes' period of appointment expired on 4 July 2006. He was replaced by Richard Goldson OBE on 2 October 2006. Three more directors from the executive team were appointed to the Board in January 2007: Linda Williams (Chief Inspector of Railways), Michael Lee (Director Access Planning and Performance) and John Thomas (Director Competition and Regulatory Economics). The Board held ten formal meetings in 2006-07 and held one away day and one joint meeting with all the executive team. Minutes of Board meetings are published on our website.

- 6.4 The Board has three standing committees: Audit, Remuneration, and Safety Regulation. It also has a Periodic Review Committee that oversees the work programme leading to the PR2008. Two other committees were established during 2006-07 on specific pieces of work: these were the EWS Competition Case and the Review of Markets for Passenger Rolling Stock Leasing.
- 6.5 Jeremy Chittleburgh, a qualified accountant and a partner in Chiene + Tait, was appointed as an independent member of the Audit Committee on 20 February 2007.
- 6.6 The Board, its meetings and committee meetings are governed by the Board's rules of procedure. These were substantially reviewed and updated in November 2006 and are published on our website. The Board and standing committees also review their performance annually to ensure that we continue to exercise efficient and robust decision-making.
- 6.7 The Board's rules of procedure include strict guidelines on conflicts of interest. A register of Board members' interests is published on our website and members declare interests on agenda items at the start of every Board and committee meeting.

Human resources

- 6.8 We have a fully committed and competent workforce capable of delivering our business plan objectives. The organisation has been reaccredited against the new standard for Investors in People and has successfully retained the designation. This reflects the priority we have given to developing and implementing a new learning and development strategy and programme meeting the needs of the new organisation. This programme is aimed at supporting the integration of safety and economic regulation by providing staff with an awareness of each other's work and the knowledge to make an informed contribution across the whole organisation.

People profile

6.9 The table below shows the profile of ORR people as at 31 March 2007.

	SCS*	Level 1	Level 2	Level 3	Level 4	Total
Total Staff	14	22	81	174	48	339
Male	9	17	61	116	22	225
Female	5	5	20	58	26	114
White	14	21	37	53	13	138
Ethnic Minority	0	1	3	19	5	28
Unknown	0	0	41	102	30	173
Disabled	0	0	2	3	2	7
* Senior Civil Service (excludes Chairman and non executive directors)						

Recruitment

6.10 Recruitment activity during the year has been very significant, with nearly 100 recruitment schemes (both internal and external) being successfully completed.

6.11 There are robust systems in place to ensure that recruitment is carried out on the basis of fair and open competition and selection on merit in accordance with the Civil Service Commissioners Recruitment Code. ORR did not make any applications for exceptions to the Code. The table below shows the number of appointments made through external recruitment during the year:

	SCS*	Level 1	Level 2	Level 3	Level 4	Total
Total appointments	3	1	14	34	12	64
Male	2	1	5	19	8	35
Female	1	0	9	15	4	29
White	3	1	14	28	11	57
Ethnic Minority	0	0	0	6	1	7
Disabled	0	0	0	0	0	0
* Senior Civil Service (excludes Chairman and non executive directors)						

Business planning and finance

6.12 ORR is a non-ministerial Government department funded through a licence fee and through a levy charged to railway service providers. The totals of expenditure and income have to be planned through the Treasury and accounted for to Parliament. The chief executive, Bill Emery is the Accounting Officer for these funds. The table below sets out our resource requirements (actual and planned from 2003-04 to 2008-09)

	03-04 Outturn £'000s	04-05 Outturn £'000s	05-06 Outturn £'000s	06-07 Forecast £'000s	07-08 Plan £'000s	08-09 Plan £'000s
Administration costs						
Economic	14,549	13,010	12,927	12,800	12,700	12,400
Transition			1,841			
Safety				17,200	18,100	17,800
Licence fee income	14,547	13,009	12,926	12,799	12,699	12,399
Safety levy				17,199	18,099	17,799
Net resource costs to HMG	2	1	1,842	2	2	2
Capital	339	228	4,271	1,150	500	500

Monitoring and reporting against business plan activities

6.13 Our senior team continued to receive monthly reports on the office's progress in delivering business plan activities. Monthly progress reports were also presented to the Board.

Performance indicators

6.14 We believe that performance indicators are an integral part of assessing how we are performing against our aim and objectives. During the reporting year, we developed and monitored some initial performance indicators for the new ORR. As shown on the table below these included economy measures (primarily looking at the cost of inputs). Several of these measures first appeared in the WS Atkins report (for HM Treasury) on the efficiency review of utility regulators¹⁴. We have included comparative data from the time of that report (1999-00) to show progress and changes against the enlarged organisation for 2006-07 and 2007-08.

¹⁴ External efficiency review of the utility regulators by WS Atkins Management Consultants

Economy measures					
(2007 prices)	OLD ORR	NEW ORR		VARIANCE	
	1999-00 Actual	2006-07 Forecast	2007-08 Budget	1999-00 to 2006-07	2006-07 to 2007-08
Total Expenditure £m	16.7	30.8	30.8	84.3%	0.0%
Staff numbers	160	328	333	105%	1.6%
Accommodation costs/person (£000s)	9.4	9.5	8.8	0.7%	-7.5%
Accommodation costs/total costs (%)	9.0	10.1	9.5	11.9%	-6.1%
Support costs/total costs(%)	30.5	20.4	18.2	-33.0%	-11%
Support staff/total staff (%)	18.8	16.2	16.7	-13.8%	3.3%
Consultancy cost/total costs (%)	21.2	8.5	11.4	-59.9%	33.6%
Average Staff Costs/head (£000)	41	61	57	49.5%	-5.5%
Staff turnover (%)	18.7	9.9	-	-47.3%	-
Sickness absence (%)	7.6	3.9	-	-48.8%	-

6.15 We also developed specific efficiency measures (primarily looking at delivery against timescales, volume; and quality outputs). Examples are provided in the table below. Some further efficiency measures have been developed and we will monitor and report on these during 2007-08. We are also committed to a year on year efficiency reduction of 2% in real terms in the costs of the organisation.

Efficiency measures		
Performance indicator	05-06	06-07
RAIB recommendations: total number received and responses completed to time in 95% of instances	N/A	431 received. 100% of 5 day and 14 day consultation completed to time
Licence applications and licence exemption applications: decisions made within 3 months of receipt of all relevant information	32 received 32 met	25 received 25 met
Complaints under Network Rail network licence: initial response within (a) 10 working days and substantive resolution within (b) 2 calendar months	(a) 10 met (b) 10 met	(a) 17 met (b) 17 met
Periodic Review Programme: 100% delivery of published timetable for programme of work	3 targets- 3 met	8 targets, 7 met 1 delayed due to complexity*
Track access agreements: (s17, 18 and 22): determined within 12-18 weeks depending on complexity	115 cases 102 cases met	124 cases 88 cases met **
(a) Parliamentary questions: respond within 24 hours of receipt (b) Enquiries and (c) Freedom of information cases: 90% responded to within 21 working days, providing an acknowledgement within 5 working days.	(a) 27 met (b) 131 met (c) 1232 met	(a) 33 met (b) 184 met (90%) (c) 1718 met (97% - exceeded target)
(a) Resource accounts: audited and laid prior to summer recess	(a) met	(a) N/A
(b) Invoices: 95% paid within 30 days	(b) 2500 met (95%)	b) 3730 met (90%)***

* Network Rail is further developing its possessions policy - this work will be taken forward in the expenditure assessment.

**36 cases delayed due to complexity (including 9 long running complex freight cases and Grand Central case) or delay by parties with one rejection

*** Target was met for eight months of the year

6.16 We are continuing to explore possible measures of effectiveness, looking at the outcomes of our activities. Our stakeholder survey in the autumn of 2006 provided an initial assessment of our performance and took account of views from a range of influential industry parties. We will be considering what further work can be undertaken in this area.

Project management

6.17 During the year, we developed and implemented a new corporate project management approach with associated guidance and training. We believe that this way of working has helped both to encourage the process of integration and to support the delivery of our objectives.

Risk management

6.18 We further refined our risk management processes with the implementation of a three-tier approach, monitoring and managing risk at strategic, operational and directorate level. The formal risk reporting structures supported monthly risk reviews at Directors Group, quarterly reviews at the Audit Committee and six-monthly reviews at the Board.

Audit committee

6.19 The Audit Committee is chaired by Peter Bucks a non-executive director and comprises Jane May, also a non-executive director, and Jeremy Chittleburgh an independent member. Although not members, executive directors (including the Chief Executive as Accounting officer) also attend the Audit Committee along with representatives from ORR's Internal Auditors and National Audit Office. The Audit Committee is governed by the Board's Rules of Procedure, which include the Committee's terms of reference. It reviews and advises on:

- the adequacy of our financial reporting process;
- our system of internal controls; and
- our risk management and audit arrangements.

6.20 The Committee met four times during the reporting year - in June, September and December 2006 and in March 2007.

Resource management

6.21 During the year our Directors Group met monthly to review the management accounts, receiving information on key areas of spend, budgets and forecasts. A summary of the management accounts was presented each month to the Board. Additional meetings were held on a regular basis with budget holders where the results were discussed at a more detailed level.

6.22 We implemented an upgrade to our accounting system during the year to ensure that our systems were fit for purpose within the new enlarged department and to take advantage of technological improvements. This new system has enabled us to improve substantially the quality of our financial reporting.

Prompt payment initiative

6.23 We are committed to the prompt payment of our suppliers and seek to pay all valid invoices within 30 days of receipt. During 2006-07, 90% of invoices were paid within target timescales and for eight months of the year we achieved 95% or greater.

Facilities management

6.24 Our facilities management requirements changed significantly on 1 April 2006. An early challenge was to establish efficient and effective services at our new headquarters at One Kemble Street and this was rapidly achieved. At the same time the focus shifted from managing and supplying a single-site organisation to supplying a multi-site operation with offices across Great Britain. In particular we have worked to establish efficient and productive relationships with our landlords, the Civil Aviation Authority in London and the HSE for the regional offices.

Communications

6.25 During this year Communications arranged quarterly press briefings for the publication of each quarter's National Rail Review. This has meant that the chief executive and Directors now have regular meetings with the transport journalists. As part of the merger programme, Communications organised the rebranding and the launch of the new ORR organisation. It also introduced a fortnightly electronic newsletter for all staff in ORR.

- 6.26 During the reporting year, we have published 37 press notices and 39 documents. The Chairman has given three media interviews, the chief executive has given two, and other Directors have given three interviews. The ORR library has welcomed 17 external visitors and dealt with 1196 external enquiries. In its expanded role as the library for the whole of the ORR, our librarians have experienced a 36% increase in internal enquiries from ORR regional offices.
- 6.27 The ORR website, which now incorporates the content of the former HMRI website, continues to provide a valuable resource for stakeholders. As our principal channel for consultation with the industry, the ORR website is the subject of a redevelopment project to improve usability and to ensure that the website meets national standards.
- 6.28 ORRacle, the ORR Intranet has over 400 pages providing staff with industry news, details of FOI requests, and the ability to keep up to date on our current workstreams.

Customer correspondence and freedom of information

- 6.29 ORR has a dedicated Customer Correspondence Team (CCT). The CCT handles all public correspondence that we receive, which cover a variety of railway issues. These include punctuality and reliability of train services, maintenance of the national railway network and health and safety on the railway. The section also handles Parliamentary Questions and correspondence from Members of Parliament. In the reporting year we received 1773 items of correspondence, of which 1735 (98%) received a full response within our target time of 20 working days.
- 6.30 For the same period 204 requests for information under the Freedom of Information Act 2000 (Fol) were made. 197 (97%) were completed with the 20 working day deadline.
- 6.31 The CCT can be contacted via e-mail¹⁵

Information systems

- 6.32 The Information Systems (IS) team has remained largely focused on the transfer of HMRI systems and data from the Health and Safety Executive during the reporting year. In July 2006 ORR and HMRI e-mail systems were successfully consolidated into a unified system and progressively during the year HMRI data has been identified and transferred from HSE systems.

¹⁵contact.cct@orr.gsi.gov.uk

- 6.33 We are presently working on a programme to extend our data and voice network infrastructure to enable those Rail Inspectors who remain located at HSE sites to connect their computers directly to ORR's systems. This programme of work, which we aim to complete at the end of April 2007, will encompass the replacement of desktop computer equipment in the regional office locations and the integration of telephone systems throughout the organisation.
- 6.34 Systems resilience and reliability remain a priority and the IS Team has undertaken further work during the year to maximise the availability of systems. The robustness of ORR's business continuity planning has been audited and was put to the ultimate test when we were able to recover our entire IS infrastructure within an hour following widespread power disruptions in London in mid-February 2007.

ANNEX A

BOARD AND SENIOR TEAM

ORR BOARD



Chris Bolt
Chairman
(Periodic Review Committee, Safety Regulation Committee)



Peter Bucks
(Audit Committee, Periodic Review Committee, Remuneration Committee)



Jeffrey Jowell QC
(Remuneration Committee)



Jane May
(Audit Committee, Safety Regulation Committee)



Jim O'Sullivan
(Safety Regulation Committee)



Chris Stokes
(Remuneration Committee, Periodic Review Committee)
Period of office expired on 4 July 2006



Richard Goldson OBE
(Remuneration Committee, Periodic Review Committee)
Period of office began 2 Oct 2006

EXECUTIVE DIRECTORS ON ORR BOARD



Bill Emery
Chief Executive



Michael Beswick
Rail Policy



Michael Lee
Access, Planning and Performance



John Thomas
Competition and Regulatory Economics



Linda Williams
HM Chief Inspector of Railways

OTHER EXECUTIVE DIRECTORS



Juliet Lazarus
Legal Services



Lynda Rollason
Corporate Services



Sarah Straight
Safety and Economic Policy Development



ANNEX B:

HEALTH AND SAFETY REGULATION - CASEWORK ACTIVITY TABLES

Summary of enforcement notices issued 2002-03 – 2006-07

	Improvement (IN)	Prohibition (PN)	Total
2002-03	81	22	103
2003-04	39	17	56
2004-05	13	5	18
2005-06	16	6	22
2006-07*	23	5	28

Summary of complaints received 2002-03 -2006-07

	Number of Complaints
2002-03	739
2003-04	768
2004-05	647
2005-06	593
2006-07*	644

Summary of prosecutions heard 2002-03 - 2006-07

Year	Number of prosecutions heard	Total fines	Total costs
2002-03	11	£183 500	£36 375
2003-04	23	£552 750	£119 076
2004-05	20	£14 392 600	£866 441
2005-06	2	£23 000	£3 507
2006-07	6	£943 000	£132 770

Full details of notices issued and prosecutions made this year are on our website
<http://www.rail-reg.gov.uk/server/show/nav.274>

ECONOMIC REGULATION -CASEWORK ACTIVITY TABLES

Access Contracts: 1 April 2006-31 March 2007	Track	Stations	Depots
New access agreements approved under section 18 of the railways act 1993	8	20	11
Agreements directed under section 17 of the Railways Act 1993	1	0	0
Amendments to existing agreements approved under section 22 of the Railways Act 1993	112	63	24
Amendments to existing agreements approved under section 22A of the Railways Act 1993	2	0	0
Amendments to existing agreements covered by general approval	21	42	18
Directions varied under section 144(3) of the Railways Act 1993	0	0	0

Licensing casework – 1 April 2006 to 31 March 2007

Licences granted	Date	P	NP	S	LMD	N
Fastline Ltd	24/07/06		◆			
Abbey Rail Ltd	20/09/06	◆				
Broadway Rail Ltd	20/09/06	◆				
Goldings Rail Ltd	20/09/06	◆				
Hay's Rail Ltd	20/09/06	◆				
OQS Rail Ltd	20/09/06	◆				
Orchard Rail Ltd	20/09/06	◆				
Strutton Rail Ltd	20/09/06	◆				
Westminster Rail Ltd	20/09/06	◆				
ALSTOM Transport	12/01/07				●	
North Yorkshire Moors Railway Enterprises Plc	17/01/07	●				
Stagecoach South Western Trains Ltd	26/01/07	◆	●	●	●	●
Associated British Ports	31/01/07					●
Société Nationale des Chemins de Fer Français	8/03/07		◆			
Serco Ltd	15/03/07		●			●
GB Railfreight Ltd	29/03/07					●

Exemptions granted	Date	P	NP	S	LMD	N
Eden Valley Railway Company Ltd	07/04/06	●	●	●	●	●
Trackwork Ltd	13/06/06		●			
Laser Rail Ltd	14/06/06		●			
Blyth Harbour Commission	15/06/06	●	●	●	●	●
Laing O'Rourke Infrastructure Ltd	26/06/06		●			
Dart Valley Railway Plc	11/07/06	●	●	●	●	●
Bridgen Group Ltd	13/02/07		●			
GB Railfreight Ltd	29/03/07				●	
The Deeside Railway Company Ltd	30/03/07	●	●	●	●	●

Licences revoked	Date	P	NP	S	LMD	N
Thameslink Rail Ltd	05/05/06	◆		●	●	
West Anglia Great Northern Railway Ltd	05/05/06	◆	● ◆	●	●	
Central Trains Ltd	11/05/06		◆			
Wales & West Passenger Trains Ltd	18/05/06	◆	● ◆	●	●	
First Great Western Link Ltd	30/08/06	◆	● ◆	●	●	
Great Western Trains Company Ltd	30/08/06	◆	● ◆	●	●	
South West Trains Ltd	15/02/07	◆	● ◆	●	●	
Island Line Ltd	15/02/07	◆	● ◆	●	●	●
ALSTOM Transport Services Ltd	30/03/07				●	

◆ European licence and/or a GB Statement of National Regulatory provisions

● Licences and/or exemptions granted under the Railways Act 1993

P=passenger train, NP=non-passenger train, S=station, LMD=light maintenance depot, N=network.

