REGULATION: WHEN LESS IS MORE

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Thanks you for inviting me to an early meeting of this group. I hugely welcome the launch of the Association of Railway Executives. There are lots of good things about the current structure of the industry. But one thing which the industry is at risk of losing is the sense of a community across the sector – and the shared understanding and expertise that you get when you have worked on both trains and track. And stations – and customers – and rolling stock maintenance and asset management, - and all the things management trainees were exposed to as part of their development on an integrated railway. I hope that the networking, development, and interchange you get from the ARE will help to compensate for that. It's really important that you, as the current and future leaders of the industry are able to take a system-wide view of the railway as you strive to make it better.

Here's a curious thing: a regulator that wants less regulation. How can that be?

In this session I'm going to set out how ORR sees the future of the industry, and how regulation can contribute. I hope we'll have a while for some discussion.

First, let's reflect on what has been achieved. Since the dreadful collective nervous breakdown at the turn of the century, rail has seen a huge recovery. You all know the stats – passenger numbers up, Network Rail's like-for-like costs down 40 per cent in a decade, a transformation in freight productivity, satisfaction and punctuality levels at or near record highs. This is a great success. It shows that rail is increasingly important to economic activity and the nation more generally, and it shows the rate of progress that can be achieved.

The big challenges are familiar too. Costs are still too high. The industry struggles to get new technologies in, even where they improve businesses' efficiency and give customers a better deal. The industry is far too dependent on government for investment. Yet it's not all that clear where government money goes or what taxpayers are getting for it. And as long as suspicions linger about whether or not government secures value for money for its spend on rail, there will be the temptation for government and its officials to try to specify more tightly what you must do and what you can't do.

It's about a year now since I took over at the ORR and as well as the industry's successes and challenges, there are a few things that, compared with other industries, just strike me as very odd. The oddest is that whereas in other regulated sectors you – the industry's executives – would have the space to invest, innovate, change the way you deliver to improve efficiency, customer service, growth and profits, in rail you're tied up in knots. Now that may suit some people – driving a hard bargain with the Department for Transport every time they want a change in the detail of a franchise is one kind of business model, and some people in this industry are really good at it. But I don't get the impression that's what people across the industry really want – especially if the price you have to pay is micromanagement, constraints on your commercial flexibility and the suppression of new ideas on how to serve customers and grow your business.

There is another way – and it's a vision of an industry less dependent on and less constrained by government and regulation. An industry which takes many more of its own decisions; which raises a much larger proportion of its own investment, within limits sets its own prices, and is able to offer funders a much bigger range of priced options for delivering their objectives for economic growth and connectivity.

You are the people who run the businesses that deliver the railways. I am in absolutely no doubt that you want to be able to get on with it. You need to know that as regulator we want to see you succeed in delivering better services for customers and better value for taxpayers.

The right kind of regulation can help the industry to move towards a position in which businesses are much more empowered. We see that in other regulated industries such as water, telecommunications and energy – in a sense what we want to do is to help rail to become more like other regulated businesses, where the overall touch of government and regulation is much lighter.

That requires a decisive shift from where we are now. And yet the paradox is that we must develop the regulatory levers and the regulator's role in the short-term in order to help get us to where we want to be in the long term.

So why?

Let's think for a few minutes about why we have regulation – what is it for. The role of regulation in this sector is easy to express –

- First, we ensure the sector is safely managed and operated, and that the safety and health of its employees is safeguarded;
- Second, the provision of the network is a monopoly, and many service providers are also near-monopolies. The sector is regulated in the public interest, to protect consumers and businesses against monopolistic behaviours which can lead to higher prices and worse service.
- Third, regulation safeguards the basic interests and expectations of consumers – for example that they get the information they need to make sensible choices, and get the benefits of the railway as a network;
- Fourth, in a sector where there is so much public money, regulation is there to ensure that taxpayers are getting value for their money; and transparency on what that money is buying and where it is going.

All of this is about making sure that the public interest is met, and is critical in giving your businesses the legitimacy and public confidence to operate in an industry in which competition is relatively weak and there is substantial public money.

With the exception of the amount of public money at stake, all of that is exactly the same as the role of the regulator in other regulated sectors.

Does that mean lots of detailed intervention and micromanagement? No. In ORR's view, it absolutely should not. You don't see that in other sectors. And even when large amounts of public money are at stake, and require commercial and operational judgement and innovation, there's not much evidence that civil servants and regulators know best.

Our view – and our vision – is that for rail to improve its efficiency, progress and grow, it needs a regulatory framework which gives the public assurance that the railways are safe, reliable and efficient. It needs to protect customers, businesses and funders against the effects of monopoly power, and release the potential and entrepreneurship of leaders, managers and innovators to transform the industry.

How do we move towards this?

Well first of all, as a regulator, we need to perform our existing role in an exemplary way. We need to keep the pressure up on Network Rail to deliver its regulatory deal on enhancements, performance and other commitments. That includes excellence in asset knowledge and management – which is fundamental to getting costs, performance and safety right.

Through PR13 we need to keep up pressure to reduce costs to no more than a competitive market would allow; and ensure that costs and charges are transparent. ATOC have said we should be relentless on this, and I agree with them. And in an industry with a good recent safety record, we need to be sure the industry's management and culture has safety fully embedded within it.

We will continue to use our existing statutory levers such as guidance, audit and inspection. But we will also need to develop the way we regulate to make sure that that we are doing everything we can to help the industry to transform, without unnecessarily intervening in the operational and commercial decisions you are best placed to take.

These areas we need to develop are:

1. bearing down on **monopoly performance** and taking a more forward looking approach to performance risk;
2. focusing on the **key enablers** (such as asset management) which unlock future performance and efficiency;
3. incentivising **collaborative whole-system approaches** – between Network Rail, train operators, the supply chain and ROSCOs; I'm pleased to be following Tim O'Toole's speech at the last ARE gathering – I see the Rail Delivery Group and the whole industry work it has generated as being a key catalyst for this;
4. effective **benchmarking** to encourage efficiency;
5. greater **transparency** across the whole industry, particularly on costs, with greater disaggregation of data and information;
6. **competition**, We already see the benefits of competition in the supply chain and in freight, and in the market for franchises. Over time we would expect to see more competition in the provision of infrastructure services currently performed by Network Rail, and between passenger train services; and
7. maximising the potential benefits of **localism**, with greater devolution on the specification and delivery of services closer to the end user.

This is all very well, but there is no point in just talking about a transformed, more commercially-led industry in 10 or 20 years' time. What happens right now, after the Government's Rail Command Paper?

The Command Paper tells a very similar story to the one I've just outlined. The Government has set out a bold vision for Britain's railways – and has also recognised that this won't be achieved without fundamental change in the way the industry is regulated.

The Command Paper spells out the need to move towards a more unified regulatory structure for the railways, with an immediate focus on bringing together those areas of regulation which impact upon the passenger experience. And longer term, it sees ORR moving to the heart of whole industry performance, taking government out of day-to-day industry business.

So why is all this change necessary? The efficiencies we all want to see from CP5 will require a whole industry approach, with contributions from all parties, not just Network Rail. Joint-working, for example through alliances, makes a unified approach to regulation a pre-requisite, so that we have a uniform approach and avoid duplication. In CP5 and beyond, better efficiency and customer responsiveness will also need people like you to be freer to make business judgements about what you offer your customers and how you deliver it. That will take time, but the timing of the Periodic Review and refranchising gives us a very rare opportunity to make a start. But that window to change things will not last for long.

Transparency is a key to improvement, both through greater efficiency using benchmarking, and by increasing accountability for performance and expenditure of public funds. This is also a key driver for a less regulated industry. The more transparent the industry makes itself to the public, the less need there will be for regulatory interference.

Conversely, the lack of transparency at the moment breeds suspicion and undermines what I believe is a generally good story of rising efficiency and performance. So within the next few weeks we will be launching work to put the industry's information under the microscope – and will point the way to future transparency.

To conclude, it is important that we as the regulator perform our role effectively and develop it in the way I've outlined to achieve this vision of a more commercially led railway, with less intervention from the regulator and Government. Our recent capability review shows we are fit for purpose and ready to take on the role government has set out for us in the years ahead.

My challenge to you as the industry's current and future leaders is to use the opportunity presented by the Command Paper, franchise reform, and the Periodic Review to really move the needle. The opportunity is to get a regulatory framework which frees you up to innovate, invest, collaborate, transform value for money and customer experience. We want you to be making the judgements and to do the right things, rather than for the regulator and government to mandate solutions. And we want to work with you in getting that transformation right.

Thank you.

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