RDG PR18 working group: route-level regulation, charges and incentives

Note of meeting held on 16 September 2016 at RDG's offices

Attendees: Bill Davidson (chair), Elizabeth de Jong, Richard Evans (all RDG); Raj Patel (GTR); Lee Shuttlewood (SWT); Chris Hemsley, Emily Bulman, Alex Bobocica, Vlada Kolosyuk (all ORR); Dan Moore, Rob Whittleston, Mark Thompson (all DfT); Ben Worley, Alexis Streeter (both Network Rail);Nigel Jones (DB Cargo); Lindsay Durham (Freightliner); Richard McClean, Jonathan Cooper (both Arriva).

Agenda:	Lead
1. Options for the infrastructure costs package (for charges)	**ORR**
2. Aligning industry incentives (route-level efficiency benefit sharing mechanism (REBS))	**ORR**
3. Aligning industry incentives (alliancing, TOC exposure, bespoke funds). This item was cut short due to extensive discussions on item 2. A further update will be provided alongside item 4, as part of the next working group meeting (10 October 2016)	**DfT**
4. Public service obligation (PSO) levy options: this item was not taken, and will instead be covered at the next RDG PR18 charges and incentives working group meeting on Monday 10 October (RDG offices 14.00 to 16.00)	**DfT**

Item 1: Emerging options under the infrastructure costs package

1. There was general agreement that the work to better understand network costs was beneficial and could inform decisions across a range of industry parties (e.g. funders, franchising authorities, Network Rail) and provide useful information for planning and funding purposes.

2. However, some participants had reservations around how useful it would be to pass this better understanding into charges and how much impact that would have on operator decisions / behaviour.

3. Some participants thought that Option 2, together with reform to the access regime for non-franchised passenger operators, could facilitate more competition in passenger services.

4. Of the four options discussed, there was little support for Option 3 or Option 4 because a reliable measure of capacity utilisation does not currently exist and more general difficulties with implementation in time for CP6.

5. Emphasis that the design of the market can bear test (and market segmentation) is crucial in order to make Option 2 work. The DfT work on a PSO levy and economic viability test should also be kept under consideration in the detailed design of this option.

Item 2: Aligning industry incentives (REBS)

6. There was a discussion around the purpose of developing mechanisms to align industry incentives. A number of attendees felt that having a well-developed incentives mechanism without clear levers to change Network Rail's behaviour would ultimately undermine the performance of the mechanism. The governance arrangements that are established for the engagement between Network Rail's routes, operators and system operator are vital in this regard as these should set out how the parties communicate and how they resolve issues. This point has been raised in the RDG response to ORR's working paper 1. There was a call to have a separate session to discuss what these levers might be.

7. Some attendees expressed a view that it was too early to talk about reforming REBS or creating an alternative mechanism because it is not clear how the route-level regulation is going to be implemented.

8. A key enabler for any such policy was getting more engagement from operators in the process as envisaged under devolution; hence TOCs/FOCs should have input to the Route SBPs, input to the Route delivery plans and Route scorecards, and regular progress discussions as part of the Network Rail route/operator meetings. In this way operators and Network Rail's routes would feel more jointly involved and informed about REBS and hence more likely to impact behaviour.

9. There was a general agreement that ORR's suggested ideas for reform were appropriate for further development. The discussion included the following:

   - reset baselines: these need to be reset more frequently (every 2 years?) and linked to Network Rail's immediate business plan.
   - changing the sharing percentages – it was suggested that the asymmetry should be increased or that the downside exposure should be reduced.
   - changing the scope of expenditure costs covered by REBS – there was agreement that there was a need to reduce scope, perhaps down to opex?
   - removing the optionality of REBS – there was agreement that if the mechanism was well-designed then there would be no need for this because operators would want to opt-in.

Item 3: Aligning industry incentives (alliancing, TOC exposure, bespoke funds)

10. There was substantial discussion on what constitutes a Deep Alliance, and how this relates to the ultimate objective of improving and better aligning incentives to deliver efficiencies. It was widely agreed that Deep Alliances are not a 'catch all' solution of a single design, and instead a bespoke approach should be taken.

11. In some instances, in particular in areas with complex route geography, it was considered that a more achievable solution may be a series of commercial cost:benefit arrangements entered into between the TOC and Network Rail, falling short of a joint organisational structure as with a full Deep Alliance.

12. There is currently little incentive on operators to pursue a reduced VUC rate as franchise durations are a barrier to a successful business case. There was some discussion around how the Residual Value mechanism may be able to support operator investment, but further clarification is required. Some participants also queried the role of the ROSCOs, and whether they should play a more active role in delivering track friendly trains.

13. The existence of funds to deliver infrastructure efficiencies was broadly welcomed as a good thing by participants, whilst cautioning that similar attempts had been made in the past. Clear guidance would be essential to ensure appropriate proposals could be produced.

14. It was agreed that DfT would provide a further update at the next working group meeting on the 10 October 2016.