



OFFICE *of*
RAIL REGULATION

**Periodic review 2008
First consultation document**

August 2005

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Chairman's foreword

Network Rail's current funding settlement – its 'regulatory contract' setting out the revenue it can raise and what it has to deliver in return – runs until March 2009. It is for the Office of Rail Regulation (ORR), operating independently of Ministers and in accordance with its statutory duties, then to re-set the terms of the regulatory contract for the following control period, which we expect to run to 2014.

The way in which this is done will have a significant impact on the development of railway services over the next decade and beyond. Rail users and taxpayers will rightly expect ORR to carry out the review in an open and consultative way, and reach decisions which accord with ORR's aim of 'enabling the railway to be safe, well maintained and efficient'.

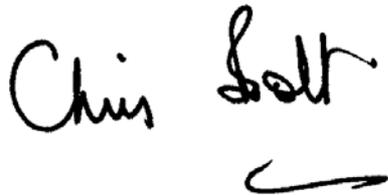
Because many passenger rail services are dependent on public financial support, the Secretary of State for Transport (in respect of England and Wales) and Scottish Ministers have a central role in setting out the funding available to support rail services and, in broad terms, the pattern and quality of services they wish to see delivered. The Railways Act 2005 requires them to present this information to ORR in a formal way. ORR must then review Network Rail's outputs, the cost of delivering them in the most efficient way, and the implications for charges payable by train operators to Network Rail for using the infrastructure. If at the end of ORR's review there is a mismatch between the outputs the Secretary of State or Scottish Ministers are seeking and the funding available, the Act gives to ORR the task of determining which rail outputs should be delivered.

If this process is to work effectively, all interested parties – Government, other funders such as the Welsh Assembly Government, Passenger Transport Executives (PTEs) and Transport for London (TfL), passenger and freight train operators and representatives of their customers, Network Rail, railway suppliers, and ORR – will need to work closely together. So it is important that everyone understands how the process will work, the overall timetable, and the points at which their contribution will need to be made.

One purpose of this document is therefore to set out for consultation our proposed timetable for the review. But sound decisions will depend on a robust analysis of the costs, revenues and other benefits of delivering the reasonable requirements both of

public sector funders and other users of the rail network such as freight users. So the document also sets out how funder requirements will link into the process, and outlines the information we will be seeking from Network Rail to enable us to assess the implications for their future outputs of those requirements and the efficient level of costs required to deliver them.

The procedure established by the Act should help to deliver outcomes that better reflect the requirements of rail users and taxpayers in terms of rail outputs and value for money. But it will only succeed if everyone works within an agreed framework to deliver it. So we look for your views on the issues raised here, and your commitment to make this Periodic Review a success in setting a robust medium term framework for the railway.

A handwritten signature in black ink that reads "Chris Bolt". Below the signature is a simple horizontal line with a slight curve at the end, resembling a flourish or a checkmark.

Chris Bolt
Chairman, Office of Rail Regulation

11 August 2005

Executive summary

The 2008 Periodic Review (PR2008) will set Network Rail's access charges from April 2009. It is the first review since the Government published its White Paper, *The Future of Rail*, and the subsequent Railways Act 2005 (the 2005 Act). It will also be the first to take place following the transfer to the Office of Rail Regulation (ORR) of policy and enforcement responsibilities in respect of rail safety regulation, scheduled to take place early in 2006.

Although PR2008 will not be implemented until April 2009, there are good reasons to start it now, not least because of the new processes introduced by the 2005 Act and the long lead times involved in producing robust analysis to inform the review.

Objectives of the document

This document aims to:

- set out the context for the review and its proposed objectives;
- set out the steps in the process, proposed milestones and the factors affecting the timetable, in particular, Network Rail's planning process and the delivery of output specifications by the Secretary of State and Scottish Ministers;
- consider the scope of the review, including the determination of Network Rail's outputs, expenditure and financing, within the overall framework of available funding and desired outputs set by funders; and
- help stakeholders plan their involvement and their work.

It is the first in a series of ORR consultation documents, which will ensure that the review is conducted in a rigorous, open and consultative manner.

Context of the review

The review will take place within the context of:

- changes brought about by the 2005 Act, including new provisions concerning access charges reviews with a duty on the Secretary of State and Scottish

Ministers to provide a statement of the required outputs and available funds, and the transfer of responsibility for safety regulation to ORR;

- developments in the main industry planning processes, such as Route Utilisation Strategies (RUS); and
- progress on related ORR workstreams, e.g. the structure of costs and charges (SOCC) review.

Objectives for the review

On the basis of the context of the review and ORR's statutory duties, we propose that the overarching aim of the review should be to:

- ensure an outcome to the review which secures value for money for users and taxpayers, by determining the level of Network Rail access charges and outputs in a way which balances the interests of all parties.

We have also proposed a number of more specific, challenging but realistic, objectives.

Proposed timetable

The timetable for the review will differ from previous access charges reviews because the 2005 Act introduces a number of important new stages, which in turn mean that ORR will need to consult on these stages and allow time for that consultation.

The main phases in the timetable will be:

- a preparation phase, which will run from now until when ORR issues its notice of an access charges review, expected to be early in 2007;
- a formal review phase, which begins with ORR issuing its notice of an access charges review and ends with its final conclusions in October 2008; and
- an implementation phase, which begins after ORR issues its final conclusions. This phase is not considered in this document, but will be covered in a future consultation.

A key aspect of the timetable is the requirement for both the Secretary of State and Scottish Ministers to provide an output specification for the railway and a statement of public funds available.

Output specification

It is the responsibility of the Department for Transport (DfT) and the Scottish Executive to produce output specifications, so we are not consulting on the content of these. We do, however, need to ensure that:

- the specifications can be costed, in order to establish whether they can be delivered within the funds available;
- the specifications are in a form which can be turned by ORR into an appropriate output specification for Network Rail;
- in the event that ORR considers that the public financial resources will be inadequate to secure the achievement of everything that the Secretary of State and/or Scottish Ministers want to be achieved, ORR is able to determine how much of what is wanted should be achieved; and
- ORR is able to notify the Secretary of State and/or Scottish Ministers, as required by the 2005 Act, if at any time it appears to ORR that the implementation of the review will likely adversely affect certain interests specified in the Act, including ORR's assessment of the cost of the actions to be taken by facility owners in respect of obligations under access agreements.

We shall also need to consider how the requirements of funders other than DfT and the Scottish Executive, such as freight operators and other public sector funding bodies, are to be incorporated in establishing the revenue requirement and output targets for Network Rail.

Challenge for Network Rail

Network Rail will need to make a soundly based, clearly argued and fully quantified case in the review on its proposed outputs, expenditure and financing, within the overall framework of available funding and desired outputs set by funders.

There are four areas where Network Rail will need to make significant improvements in its analysis for the review:

- asset management strategy;
- robust, geographically disaggregated activity and outputs forecasts;
- disaggregation by type of work; and
- scope and quality of unit cost data, including better benchmarking.

Network Rail will need to develop its understanding of cost drivers, output and cost trade offs, as well as its related analytical tools, to do this. Network Rail is already addressing these concerns, including its work on the development of an infrastructure cost model to help answer 'what if' questions about a range of infrastructure use, capability and capacity choices. It will be essential that there are clear milestones in Network Rail's development programme, which provide for delivery of the necessary information within the timetable for the review.

Financial framework

The importance of the financial framework for Network Rail is highlighted by the fact that around half of its revenue relates to its allowed rate of return and amortisation allowance. In developing the appropriate financial and incentive framework for the next control period, we will consider the:

- overall approach to incentive based regulation;
- approach to determining amortisation of the regulatory asset base (RAB) and the rate of return on the RAB; and
- role of managerial and corporate incentives.

This work can start immediately and it is proposed that broad principles should be established well in advance of the formal phase of the review.

1. Introduction

Aims of the consultation document

1.1 This is the first Office of Rail Regulation (ORR) consultation document on the Periodic Review 2008 (PR2008). It aims to:

- set out the context for the review and proposed objectives;
- set out the steps in the process, proposed milestones and the factors affecting the timetable, in particular, the Network Rail planning process and the delivery of output specifications by the Secretary of State and Scottish Ministers;
- consider the scope of the review, including the determination of Network Rail's outputs, expenditure and financing, within the overall framework of available funding and desired outputs set by funders; and
- help stakeholders plan their involvement in the work.

1.2 It is the responsibility of the Department for Transport (DfT) and Scottish Executive to produce their output specifications, so ORR is not consulting on these, although this document does consider the principal issues that might affect the review process.

Reasons for starting the process now

1.3 In December 2003, the then Regulator published his conclusions¹ on the Access Charges Review 2003 (ACR2003). This review set Network Rail's outputs and passenger track access charges for the third control period (CP3) which runs from April 2004 to March 2009. The PR2008 will cover the fourth control period (CP4) from April 2009. Although it will not be implemented until April 2009 there are good reasons for starting the process now. These include:

- the Railways Act 2005 (the 2005 Act) has introduced significant changes to the review process which will need time to develop;

¹ This document must be read in conjunction with the ORR 10 March 2004 publication: *Access Charges Review 2003: Regulator's approval of Network Rail's proposed financing structure*, which is available at www.rail-reg.gov.uk/upload/pdf/184.pdf.

- the 2005 Act does not prescribe the process in detail. There are several options and depending on which approach is taken there will be implications for the whole process and what will be expected of stakeholders at different times;
- ORR's role and responsibilities have changed. We want to ensure stakeholders understand these changes and potential implications, and give stakeholders the opportunity to consider the impacts on themselves;
- some of the work involved in the new process will have long lead times so the sooner a start is made, the better; and
- it is possible that some issues, such as parts of Network Rail's financial framework, could be resolved earlier rather than later, taking the pressure off the later stages. Such issues should be progressed.

Structure of this document

1.4 The remainder of this document is structured as follows.

- Chapter 2 sets out the context for the review, in particular the changes introduced by the Act and the characteristics of Network Rail and the industry as a whole that affect the review;
- Chapter 3 sets out the proposed objectives of the review;
- Chapter 4 describes the main steps in the process and the issues influencing the timetable. It also sets out ORR's proposed timetable;
- Chapter 5 considers the principal issues relating to the specification of outputs and statement of available funding in terms of how they might affect the review process;
- Chapters 6 and 7 look specifically at how the review affects Network Rail:
 - Chapter 6 sets out areas in which better information will be required from Network Rail if it is to deliver a robust case in its submissions to ORR; and

- Chapter 7 considers some of the principal issues to be addressed in determining the financial and incentive framework for Network Rail.

Responses to this consultation

1.5 We welcome responses on any aspects of this document. These should be sent in electronic format or hard copy, by no later than noon on Friday 4 November 2005, to:

John Larkinson
Office of Rail Regulation
1 Waterhouse Square
138-142 Holborn
London
EC1N 2TQ

Email: john.larkinson@orr.gsi.gov.uk

- 1.6 ORR would particularly welcome views on whether this document provides stakeholders with enough information to begin to plan their involvement in the review.
- 1.7 It is expected that responses will be made available in ORR's library, published on its website and may be quoted from. Respondents should indicate clearly if they wish all or part of their response to remain confidential. Where a response is made in confidence, a statement summarising the submission, but excluding the confidential information, should accompany it, which can be treated as above. ORR may also publish the names of respondents in future documents or on its website, unless a respondent indicates that they wish their name to be withheld.
- 1.8 Copies of this consultation document may be seen on ORR's website (www.rail-reg.gov.uk) and in its library.

2. Context

Introduction

2.1 The review will take place within the context of:

- changes brought about by the 2005 Act, including new provisions concerning access charges reviews and the transfer of responsibility for safety regulation to ORR in early 2006;
- developments in the main industry planning processes, such as Route Utilisation Strategies (RUS); and
- progress on related ORR workstreams, e.g. the structure of costs and charges (SOCC) review.

Impact of the 2005 Act and ORR's duties

2.2 PR2008 will be the first full periodic review since the White Paper and passage of the 2005 Act. These introduced some important changes to the conduct of access charges reviews. As we identified in our Corporate Strategy document in April 2005, this means that PR2008 will be conducted in a significantly different way.

2.3 Changes introduced by the 2005 Act include the following.

- ORR has to give formal notice of an access charges review to the Secretary of State and Scottish Ministers. ORR then has to conduct an access charges review “in the manner that it considers is most likely...will make the best and most practical contribution...[to what Secretary of State and Scottish Ministers want to achieve]”.
- The Secretary of State and Scottish Ministers have a duty to provide ORR with information on required outputs and available public funds for the review period. The White Paper referred to a high level output specification, and hence HLOS is generally used.

- ORR must estimate how much it would cost in terms of public resources to meet the HLOS and notify the Secretary of State and Scottish Ministers if this exceeds funds available. The Secretary of State and Scottish Ministers have the right to revise the requirements and/or funding in such circumstances.
- If at any time during an access charges review ORR believes it is likely that implementation of review will adversely affect passenger or freight train operators, ORR must notify the Secretary of State and Scottish Ministers.
- If the funds available are not sufficient to meet the desired outputs in the HLOS, ORR is to determine what part of the desired outputs should be achieved.
- ORR can be asked to provide information, advice and assistance to the DfT and Scottish Ministers.
- Responsibility for rail safety regulation is transferred from the Health and Safety Commission (HSC) and Executive (HSE) to ORR. ORR's safety responsibilities will derive from the Health and Safety at Work etc Act 1974 (HSWA 1974) and subordinate legislation. ORR's approach to the review will seek to ensure that safety risk does not increase and that all reasonably practicable opportunities to reduce risk are embraced.

ORR's duties

- 2.4 The 2005 Act revised ORR's public interest duties as set out in section 4 of the Railways Act 1993. ORR must exercise its functions (other than its new safety functions which derive from the HSWA 1974) in accordance with its duties. Annex A contains ORR's duties as amended by the 2005 Act. The review will engage all ORR's duties and hence require ORR to achieve an appropriate balance between them.
- 2.5 In previous charges reviews, ORR worked closely with the Health and Safety Executive (HSE) to ensure safety requirements were fully reflected. From early 2006, responsibility for safety regulation will transfer to ORR, but safety considerations will continue to be integral to the review process.

Developments in industry planning processes

2.6 The review will take place within the context of the ongoing development of Government transport policy. During the review period:

- Regional Planning Assessments (RPAs) will be carried out in England and Wales, together with a Scottish Planning Assessment (SPA) and Transport for London (TfL) corridor studies. RPAs and the SPA are produced by Government, with the aim of forming a basis for planning rail services over the medium- to longer-term;
- RUSs are being produced, together with a Freight Utilisation Strategy (FUS). Network Rail is responsible for RUSs (and the FUS), which should promote the effective and efficient use and development of the available capacity of the network, consistent with the funding likely to become available. RUSs are produced as a Network Rail licence obligation, and ORR has issued guidelines on how Network Rail should develop RUSs;
- new franchise specifications will be produced and these franchises will enter the tender/bid/award phases. The DfT specifies franchises in England and Wales, with the Scottish Executive specifying the Scottish franchise;
- a number of Network Rail/train operating company (TOC) processes will have matured, for example, the development of performance trajectories, Joint Performance Improvement Plans (JPIPs) for each TOC and the timetable reviews for a number of TOCs. Before each franchise is let, Network Rail will produce a performance trajectory to inform the franchising process. A JPIP brings together Network Rail's and TOCs' aspirations to improve performance at the local level; and
- the recently announced 2007 comprehensive spending review will have been completed or be close to completion. The proposed timetable for the review in this document takes account of expected comprehensive spending review timings.

2.7 RPAs do not have a formal (in a contractual or licence sense) status, but will provide useful regional analysis and highlight stakeholder issues and ORR would expect to draw on that analysis in its work. It will be for the Government

to decide how much of the RPA programme to translate into its RUS objectives, franchise specifications, or HLOS.

- 2.8 RUSs have a more formal status because they are produced under Network Rail's licence, which requires it to have "due regard" to RUSs when carrying out its activities, but there is no contractual impact on TOCs unless a RUS is contractualised through the allocation of capacity or a franchise specification.
- 2.9 Franchise specifications clearly have crucial contractual implications for TOCs and Network Rail and a key issue for the review process will be to consider how far franchise agreements determine the HLOS and how far they might be modified as the result of an HLOS and the periodic review.
- 2.10 Clearly, all the processes can provide useful information to each other and it will be important that the impact on the review is considered by all stakeholders involved in these processes.

Progress on related ORR workstreams

- 2.11 ORR is already considering or progressing a number of workstreams which are of particular relevance to PR2008². These include:
- the SOCC and freight charges reviews;
 - disaggregation of Network Rail's expenditure and revenue allowances;
 - possessions; and
 - signalling.

Structure of costs and charges and freight charges review

- 2.12 ORR has recently published its emerging conclusions on the SOCC review. The key conclusion is that we do not intend to implement changes to franchised passenger track access charges in April 2006. The main reason for this is because Network Rail's estimates of cost variability are not sufficiently robust at present to justify revising charges, for both passenger and freight operators.

² *Structure of Costs and Charges Review: Emerging Conclusions*, Office of Rail Regulation, July 2005 is available at www.rail-reg.gov.uk/upload/pdf/socc_emer_view_lett.pdf.

- 2.13 As a consequence of this, we propose to hold all charges (with the possible exception of changes to the traction electricity charge) unchanged for the remainder of CP3 (to 31 March 2009). Revisions will be made as part of PR2008 and revised charges implemented from, or after, April 2009 at the start of CP4.
- 2.14 In the light of the findings of the current SOCC review we do not now intend to start a specific freight charges review during 2005-06 (with possible changes to charges in April 2007) as indicated in our business plan. Rather, the review of freight charges will be taken forward as part of PR2008 alongside the further work on passenger charges, as outlined above, with the intention of making changes from, or after, April 2009.

Disaggregation of Network Rail's expenditure and revenue allowances

- 2.15 One of the changes arising from the White Paper and the 2005 Act is the change to the powers and responsibilities for specifying and funding railway services, including changes to the role of the Scottish Executive, Welsh Assembly Government (WAG), the Mayor of London and the six PTEs in England.
- 2.16 ORR's recent publication "Disaggregating Network Rail's expenditure and revenue allowance and the future price control framework"³ sets out the principles that we intend to adopt when responding to these changes. The document also discusses potential modifications to Network Rail's price control and monitoring framework that may also be necessary in the light of the new arrangements.
- 2.17 In particular, we are consulting on the extent to which outputs, financial protections and monitoring tools can and should be disaggregated between England/Wales and Scotland to facilitate the new arrangements. An important issue to consider is the impact of different levels of risk-sharing arrangements between different funders.

³ *Disaggregating Network Rail's expenditure and revenue allowance and the future price control framework* available at www.rail-reg.gov.uk/upload/pdf/238.pdf

Signalling

- 2.18 The ACR2003 provided for a further review of signalling which is being taken forward in two parts. ORR will publish conclusions on the first stage of the review (covering the period up to 2009) in November/December 2005 (with draft conclusions in August 2005) and on the second stage (looking beyond 2009) during 2006/07. Clearly the latter will be a key input to PR2008.

Possessions

- 2.19 The ACR2003 also provided for a further review of Network Rail's possessions policy and associated compensation arrangements. Essentially, ORR will make an assessment of whether Network Rail's proposals for a revised pattern of access to the network (essentially longer possessions but fewer of them for any given volume of work) is efficient from a whole industry perspective. We published an initial consultation document in March, and, following an industry seminar, it has been decided that this work is to be taken forward by an ATOC led industry working group.
- 2.20 Reflecting this new approach, we do not intend to change access charges as a result of this review during the current control period, hence the conclusions of the possessions work will be taken into account as part of the review in the same way as the structure of costs and charges work.

3. Objectives for the review

- 3.1 On the basis of the context of the review and ORR's statutory duties, we propose that the ORR's overarching aim for the review should be to:
- ensure an outcome to the review which secures value for money for users and taxpayers, by determining the level of Network Rail access charges and outputs in a way which balances the interests of all parties.
- 3.2 The review will set the level and structure of access charges and incentive regimes for the period from April 2009. Subject to further consideration during the course of the review, we expect it to set outputs and charges for five years, but also to provide appropriate longer term incentives.
- 3.3 In order to discharge our duties in carrying out the review we must balance private (Network Rail, operators, freight customers, investors) with public (government funding, passenger and other stakeholder) considerations.
- 3.4 As a key principle, we intend that the review will be conducted in a rigorous and open manner with full opportunity for stakeholder input. Although there will obviously be times when information will need to be kept confidential (for example for commercial reasons) we will work to keep this to a minimum.
- 3.5 We also intend to work closely with the DfT, Scottish Executive and Network Rail to commission joint pieces of work wherever possible to avoid duplication, unnecessary cost and reduce the burden on the industry.
- 3.6 The specific objectives of the review should be set out in a way that enables subsequent measurement of the extent to which they have been achieved. They must be challenging but realistic.
- 3.7 We consider that the specific objectives should be:
- to set Network Rail's access charges which are:
 - so far as practicable, cost reflective so as to give good signals to users and funders;

- no higher nor lower than they need to be to meet the HLOS specifications and to provide passengers/freight customers with what they want at a value for money price;
- to set Network Rail's outputs:
 - with improved definition (e.g. capability, availability, reliability), to focus Network Rail planning/management and to facilitate measurement of outcomes;
 - targeted to what users and funders want from the railway;
 - forward looking, with a trajectory set in the short, medium and long term, to an appropriate level of disaggregation which challenge Network Rail to better understand the drivers of good performance in all time frames;
 - wherever practicable, moving away from specifying inputs (e.g. activity levels);
- to improve incentives:
 - to deliver continuous improvement in operations and maintenance and renewal/enhancement procurement efficiency;
 - optimise cost/quality trade-offs based on evidence of what railway users value;
 - balance outputs in different time frames (e.g. performance in the short and longer term);
 - to challenge Network Rail to improve its knowledge/understanding of assets, especially its ability to predict impacts of changing patterns of usage and ways of working to optimise extent/cost of accommodating forecast/emerging demand;
 - to develop Network Rail's planning framework and asset knowledge; and
 - to promote continuous improvement in health and safety.

4. Proposed timetable

Main phases

4.1 Over the coming months the timetable for the review will need to be developed in more detail. There are three main phases:

- a preparation phase – running from now until when ORR issues its notice of an charges review expected to be early in 2007;
- a formal review phase – which begins with ORR issuing its notice of an access charges review and ends with its final conclusions in October 2008; and
- an implementation phase – which begins after ORR issues its final conclusions. This phase is not considered in this document, but will be covered in a future consultation.

4.2 The 2005 Act does not lay down any specific requirements for the preparation phase. The formal review stage is shaped by the Act, although the Act does not prescribe every aspect of it.

Preparation phase

4.3 In ORR's proposed timetable (see below) the preparation phase would run until early 2007. A critical part of this phase is an early shared understanding between DfT, Scottish Executive, Network Rail and ORR of the 'base case' (that is, assuming current trends with no major policy changes) for the railway in terms of demand forecasts, expected outputs and forecast costs. This would take into account developments in industry processes such as performance trajectories and JPIPs. It will inform development of the HLOSs by DfT and Scottish Executive on behalf of the Secretary of State and Scottish Ministers respectively and facilitate preparation and assessment of Network Rail's formal cost submission in the formal review phase.

4.4 In the preparation phase ORR will:

- publish an assessment of Network Rail's current business plan including consideration of scope for further efficiencies, the main drivers of longer term projections and possible output and cost trajectories;
- set out our requirements for Network Rail's initial cost submission, including any key output assumptions;
- publish an initial consultation document on Network Rail's financial framework for CP4, including the possible approach to setting the rate of return and amortisation allowance (as set out in Chapter 7);
- ask Network Rail, on the basis of these documents and the consultation response to produce an initial cost submission for CP4 by June 2006. This will be a separate document from Network Rail's business plan (published in March) which will focus on CP3;
- integrate our ongoing workstreams (as described in Chapter 2) with the review, with the aim of ensuring results are produced in time to inform our November 2006 assessment of Network Rail's submission; and
- develop the analytical capability for the review, specifically the infrastructure cost model and modelling of Network Rail's financial framework. ORR is also working closely with DfT and the Scottish Executive to take forward a network modelling framework to develop a suite of models for the review work.

4.5 In this phase DfT and Scottish Executive will develop the HLOSs and statements of available funds. ORR believes that these need to be available no later than June/July 2007, ensuring that Network Rail and ORR have sufficient understanding of the emerging position to enable rapid production of a formal cost submission. DfT has said it will be producing a passenger only HLOS and hence freight forecasts will also be provided by the freight industry to complement DfT's HLOS.

Formal review phase

4.6 The formal review stage will follow the process described in Chapter 2, beginning with ORR issuing its notice of an access charges review, followed

by the submission of HLOSs and statements of funds available by the Secretary of State and Scottish Ministers. ORR will cost these specifications and notify Government as required by the 2005 Act if specific circumstances arise, such as it not being possible to deliver the outputs within the available funds.

4.7 Key elements of this process will be:

- ORR issue a statement of the implications for Network Rail of the HLOS and statement of available funds, which provides planning assumptions for Network Rail;
- Network Rail publishes a cost submission in response to this; and
- ORR reviews that cost submission and produces draft conclusions and then final conclusions.

If, during the review phase ORR considers that the HLOS(s) cannot be delivered with the funds available, it will use the procedure set out in the 2005 Act to enable DfT and /or the Scottish Executive to revisit the HLOS(s) and/or funds available. In carrying out the review, ORR will, as required by the 2005 Act, have regard to any measures or contractual compensation payments which Network Rail would be required to take or pay as a result of changes in outputs.

ORR's proposed timetable

4.8 ORR believes that it is important that the timescales for the review:

- give sufficient time for whole industry efficiency and incentives issues to be fully considered;
- give Network Rail adequate time to develop its cost submissions in response to ORR's consideration of the HLOSs; and
- allow adequate time for consultation at each stage.

4.9 In our corporate strategy document published in April 2005⁴ we set out our indicative timetable for the review, assuming publication of the HLOSs in

⁴ *Corporate Strategy* available at www.rail-reg.gov.uk/upload/pdf/233.pdf.

2006. We have amended this, following discussion with DfT and Scottish Executive to reflect a June/July 2007 HLOS publication. The main consequence is that ORR would reach draft conclusions in June/July 2008, and final conclusions in October 2008 (rather than July 2008 as envisaged in the corporate strategy).

4.10 The following outline timetable is therefore proposed:

Preparation phase

End 2005	ORR publish initial analysis of possible Network Rail outputs, efficiency and OMR expenditure for CP4
	ORR publish consultation document on Network Rail's financial framework for CP4
January 2006	ORR issue guidance to Network Rail on content of its CP4 initial submission
March 2006	Consultation closes on ORR material published at end 2005
March 2006	Network Rail business plan, focussed on CP3, but reflecting improvements to planning capability e.g. on route plans
June 2006	Network Rail initial CP4 submission
July/August 2006	Provisional conclusions from industry group on possessions policy
July/August 2006	ORR publish draft conclusions on long term signalling review
November 2006	ORR consults on its assessment of Network Rail initial submission and developments in possessions/ signalling reviews.
Feb 2007	Consultation closes on ORR's assessment of Network Rail initial submission
March 2007	Network Rail Business Plan published

Formal review phase

Quarter 1 2007/08	ORR issues notice of Access Charges Review ⁵ ORR issues initial 'information requirement' to Network Rail, for compiling submission on outputs, cost and financing plans
June/July 2007	Secretary of State and Scottish Ministers issue HLOSs and statements of funds available ORR publishes its statement of implications of HLOSs and funds available for Network Rail, for consultation, and to give Network Rail initial assumptions for its cost submission ORR revises, as necessary, Network Rail information requirements following consultation
October 2007	Network Rail detailed submission to ORR for CP4 in the form required by ORR in its 'information requirement' ORR commences review of submission, and consults on the submission
February 2008	ORR produces initial assessment of Network Rail's submission and implications for access charges and industry outputs ORR consults on its assessment
April 2008	Revisions to Network Rail submission as necessary in response to initial assessment ORR makes statement about funding for 2009-10 (on the early start principle – see below)
June/July 2008	Draft conclusions on review
October 2008	Final conclusions on review

⁵ Schedule 4A is expected to be commenced by DfT during 2006. Under these provisions the HLOS must be provided to ORR at a date specified by ORR in the Access Charges Review Notice, with this date being not less than three months after publication of the Notice.

- 4.11 This timetable will require close and open working between the parties. It will only be possible, for example, for ORR to issue its planning assumptions for Network Rail soon after publication of the HLOSs if there has been transparency in the preparation phase.
- 4.12 The long process makes it even more important than usual in a review to allow businesses to plan with some confidence. Hence we consider that it may be useful to make an early statement on Network Rail funding for 2009/10 (i.e. the first year of the control period) in April 2008, but will be consulting further on this proposal and how it might be implemented.

5. Setting whole industry outputs

- 5.1 It is the responsibility of the Secretary of State and Scottish Ministers to produce output specifications to be costed, hence we are not consulting on these. This chapter focuses on issues concerning the link between these specifications and the PR2008 process.
- 5.2 Schedule 4 of the Act states that, once ORR has initiated a charges review, the Secretary of State and Scottish Ministers must provide ORR with 'information about what [he/they] want to be achieved by railway activities in Great Britain as a whole during the review period' – i.e. rail outputs.
- 5.3 The 2005 Act does not prescribe what must be in an output specification but the White Paper envisaged that these would be set at a 'high level'. The Act defines outputs as including 'objectives and standards' which in turn are defined as 'may include' outputs such as capacity, safety and service frequency and also policy assumptions such as the 'level and types of fares'. This specification is a matter for the Secretary of State and Scottish Ministers, but it is important for ORR that:
- the specifications can be costed, in order to establish whether they can be delivered within the funds available;
 - the specifications are in a form which can be turned by ORR into an appropriate output specification for Network Rail;
 - in the event that ORR considers the public financial resources will be inadequate to secure the achievement of everything that the Secretary of State and/or Scottish Ministers want to be achieved, ORR is able to determine how much of what is wanted should be achieved; and
 - if at any time it appears to ORR that it is likely that implementation of the review will adversely affect certain interests specified in the Act, that it is able to notify the Secretary of State and/or Scottish Ministers as required by the Act, including its assessment of the cost of the actions to be taken by facility owners in respect of obligations under access agreements.

5.4 Some of the factors which may affect ORR's role are set out below.

Scope of proposed changes

5.5 It is for DfT and Scottish Executive to decide the extent to which an output specification envisages changes to the current contracted or planned outputs. Clearly however, a change which implies adjustment to access agreements and franchises would affect ORR's costing role since ORR would need to understand the mitigation measures available and compensation payable. It might also require a longer implementation phase for the review.

Which outputs to include

5.6 Possible outputs for a specification are listed in schedule 4A to the Act as noted in paragraph 5.3 above. For England and Wales, DfT has said that it is likely to specify capacity, performance and safety outputs as the core elements of the HLOS.

5.7 A key issue for ORR is its role in determining 'the best and most practicable contribution' to what Government wants to achieve, in the case where there is more than one way of meeting an output specification. The ORR will require clarity on the assumptions underlying the HLOSs in order to be able to carry out its assessment which will need to establish the contribution from Network Rail to meeting the HLOSs.

5.8 The role of funders other than DfT and Scottish Executive is not explicitly covered by the Act and ORR will consult further on how their views should be taken into account in ORR's setting of Network Rail outputs in the light of the HLOS. As far as ORR is concerned this is particularly important in the translation from HLOS to Network Rail outputs. ORR will want to consider how other stakeholder views are taken into account at this stage.

Level of detail

5.9 In planning and operational terms the railway works at differing levels of disaggregation, including the evolving franchise map and Network Rail's routes and areas. RPAs and RUSs have their own geographical definitions which do not necessarily align with Network Rail routes or particular franchises.

- 5.10 Government has a number of options in terms of how it specifies outputs and could also specify different outputs at different levels of geographical detail. It may also be the case that DfT and the Scottish Executive have some very location-specific requirements e.g. in relation to certain projects.
- 5.11 This may again affect ORR's role in determining 'the best and most practicable contribution' to what Government wants to achieve: the less detailed the specification the greater the flexibility to secure the most efficient delivery.

Other funders

- 5.12 The 2005 Act requires ORR, as part of the review process, to determine whether the public financial resources that are, or are likely to become available through the Secretary of State or Scottish Ministers will be adequate to secure the achievement of what they want to be achieved. Establishing the **total** level of funding available will therefore raise a number of issues, of which the most important for the working of the overall process is establishing the funds available from, and reasonable requirements of, other funders (such as Welsh Assembly Government (WAG), Transport for London (TfL) the Passenger Transport Executives (PTEs) in England, and the rail freight industry).
- 5.13 Such funders may seek to obtain (and pay for) incremental outputs from Network Rail over and above those required to deliver the HLOS. The review will establish baseline outputs for Network Rail. ORR will be discussing with funders, the industry and Network Rail how existing reasonable requirements of other funders are taken into account, and how the baseline for future plans should be clarified.
- 5.14 For rail freight, the DfT has asked the freight industry to provide a freight demand forecast to complement its passenger HLOS, and ORR will work with the DfT, the Scottish Executive, Network Rail and the freight industry to determine the best methodology for developing the assumptions to be made in respect of freight outputs and the reasonable requirements of freight operators. Network Rail's Freight Utilisation Strategy will play a key part in this process.

6. Network Rail's outputs and expenditure

Introduction

- 6.1 ORR's methodology for calculating access charges at the ACR2003 was based upon a standard building block approach in which Network Rail's revenue requirement was built up piece by piece, by assessing each individual component of cost, revenue and financing in turn.
- 6.2 Under this building block approach, projected expenditure on operations and maintenance (O&M) is remunerated pound-for-pound on a pay-as-you-go basis. Projected expenditure on renewals and enhancements is added to the regulatory asset base (RAB). The RAB is amortised under rules set out by ORR and an annual allowance for amortisation is included in the calculation of access charges. A further allowance is made for the return that Network Rail should earn. Therefore, Network Rail's overall revenue requirement is the sum of O&M expenditure, amortisation and the return.
- 6.3 Network Rail's income, from open access operators, stations and depots, and from property and other commercial activities is then deducted from this requirement. The remaining revenue requirement is then paid for through access charges (and network grants).
- 6.4 This chapter considers the determination of Network Rail's output and expenditure, while Chapter 7 considers the financial framework.
- 6.5 ORR's assessment of Network Rail's outputs and expenditure will be based on Network Rail's own submissions. Network Rail must make a soundly based, clearly argued and fully quantified case for what it intends to deliver and at what cost, within the framework of the HLOS. ORR will then need to examine Network Rail's proposals in detail.
- 6.6 The last review demonstrated shortcomings in Network Rail's ability to forecast accurately the activities that are needed and how activity and expenditure link with actual outputs such as performance and asset condition. Since 2003, ORR has been working with Network Rail to improve its business planning and asset management processes and in developing systems which

should result in a robust decision-making process on which to base the review.

- 6.7 This chapter describes ORR's initial views on these requirements, and sets out the areas where it believes Network Rail's current knowledge still needs further development. Later in the process, we will issue more detailed requirements. Underpinning this work will be further development of Network Rail's decision support tools and a new infrastructure cost model, which will allow the company, ORR and funders to help answer 'what if' questions on infrastructure use, capacity and capability options. Network Rail needs to demonstrate that it understands what drives costs in its business and hence possible output/cost trade offs.
- 6.8 There are four areas where Network Rail will need to make significant improvements in its analysis for the review:
- asset management strategy;
 - robust, geographically disaggregated activity and output forecasts;
 - disaggregation by type of work; and
 - scope and quality of unit cost data, including better benchmarking.
- 6.9 Network Rail has recently submitted very constructive proposals to ORR for the preparation and presentation of its business plan and CP4 submissions. These would provide a greater level of detail than previous plans and submissions, especially in respect of route-based activity and expenditure proposals. We have welcomed this and will be working with Network Rail to agree clear milestones for progressing this work.

Asset management strategy

- 6.10 Since 2003, Network Rail has been improving its asset management regime: it has brought track maintenance in-house; it has been increasing the volume of asset renewals delivered; and it has been taking steps to improve the quality and availability of information about its network assets.
- 6.11 Inevitably, much of the company's focus has been on establishing its new organisation and addressing the relatively short-term. The challenge for Network Rail now is to build on these achievements and establish an asset

management regime that clearly identifies what activities are needed to sustain the required network outputs.

6.12 The asset management strategy must be able to:

- predict future maintenance and renewal activities with much greater accuracy;
- define those activities in more detail in respect of the type and mix of work;
- define them in more detail in respect of why and where they are required;
- define the criteria for, and allow properly informed choices about the timing of maintenance and renewal interventions, requiring accurate knowledge of activity costs, asset behaviour and risks; and
- do all these things while looking much further ahead than has hitherto been possible.

6.13 We would expect Network Rail to base its approach on the guidance contained in PAS 55, issued by British Standards Institution in May 2004⁶. Specifically it will need to show:

- that it has quantified performance and condition targets;
- how these targets relate to existing performance and condition;
- what options it has considered in finalising its plans to manage the performance and condition of its assets by undertaking the right activities at the right time; and
- how it has prioritised the multiple demands of a complex network of disparate assets to achieve maximum effect with best value for money.

6.14 Network Rail will need to set out clearly its criteria, principles and assumptions, including the network disaggregation framework, by route

⁶ PAS 55 is the Publicly Available Specifications for the Optimised Management of Physical Infrastructure Assets.

classification, which will be used to structure subsequent activity, expenditure and output forecasts. Then, using this framework it will need to derive:

- the engineering policies as they apply to each route classification, e.g. different intervention strategies and varying the balance between renewal and maintenance;
- the technology and material choices and specifications;
- demand and growth assumptions; and
- statement of any assumed constraints on use.

Geographical disaggregation of activity forecasts

6.15 Network Rail will need to identify achievable outputs, activity levels and expenditure requirements for different sections of the network. While Network Rail already prepares its business plans using a configuration of 26 geographically divided strategic 'routes', these do not necessarily represent sufficiently the variations in use, route characteristics and asset management policies and practices that often exist within each such route. Further sub-division will therefore be necessary and Network Rail is currently analysing possible further disaggregation to strategic route 'sections' which could reflect:

- different route classifications, e.g. primary routes;
- different route characteristics, e.g. electrified/non electrified;
- different funding responsibilities;
- different traffic volumes/usage patterns; and
- separate identification of the DfT community rail projects.

6.16 By producing its outputs and expenditure submission at a greater level of geographical detail, Network Rail will be better able to demonstrate:

- that its plans reflect value for money by optimising activity and expenditure where it is most needed and most effective; and
- that it is harnessing the improving quality of its asset information in better decision making.

Disaggregation by type of work

- 6.17 The corollary of the requirement to produce plans that reflect route management priorities is that there must be much greater detail about the type and volume of work to be undertaken, extending well beyond the limited number of generic types of activity description that have previously formed business plan submissions. For example, robust business planning needs to go beyond national renewal volumes for rail sleeper and ballast and demonstrate more detailed track renewal activities broken down into individual components of work and work mixes.
- 6.18 Similarly, for track maintenance (which represents the largest category of maintenance spend), there are 21 principal track maintenance activities that comprise 80% of spend. Some of these are largely time-based activities such as patrolling and other vehicle based inspections. Others such as rail weld repair or maintenance of track geometry are condition based. The volumes of these activities will vary significantly according to the stewardship class, the output requirements, the planned volume of asset renewals and the baseline condition of each section of the network.

Unit costs

- 6.19 Network Rail is making progress in defining a framework for measuring unit costs consistently. Some activities have better information than others, but it remains a concern that the knowledge of the costs of core infrastructure maintenance tasks is still relatively limited.
- 6.20 ORR expects that the volume of unit cost data will improve progressively, but it is important that Network Rail maximises its effort in this area so that its 2006 business plan is based upon the best possible assessment of efficient activity costs. This in turn will allow better benchmarking across the organisation.

7. Network Rail's financial and incentive framework

Overview

- 7.1 In developing the appropriate financial and incentive framework for the next control period our work will include reviewing the:
- overall approach to incentive based regulation;
 - approach to determining amortisation of the RAB and the rate of return on the RAB: and
 - role of managerial and corporate incentives.
- 7.2 The importance of the financial framework for Network Rail is highlighted by the fact that around 50% of Network Rail's revenue in the current control period relates to its allowed rate of return and amortisation allowance.
- 7.3 A key issue is that of timing. ORR considers that it would be helpful to funders to get some degree of certainty at an early stage on these important financial components in Network Rail's revenue requirement. We therefore propose making an early assessment of these issues by publishing a consultation document at the end of 2005.

Overall approach to incentive based regulation

- 7.4 Since privatisation and the establishment of independent economic regulation, regulators in the UK have used incentive-based or price cap regulation. Under this model, prices or revenues are capped to inflation (RPI) plus or minus an efficiency factor (x) determined by the regulator.
- 7.5 If companies manage to deliver specified outputs at a lower cost than the regulator assumed, they keep the benefits of this saving for a fixed period of time. This provides the companies with an incentive to become more efficient in the way they run their businesses.
- 7.6 Other economic regulators, in the USA for example, use a different approach. This is sometimes referred to as 'rate-of-return' regulation where the period

between regulatory reviews is not fixed in advanced and is determined according to whether costs remain close to the level assumed when prices were last reset.

- 7.7 Although in practice the distinction between price cap and rate of return regulation is not clear cut, under rate of return regulation the risks to the company of a cost increase are much smaller but the incentives to reduce costs are weaker. For price cap regulation the incentives to reduce costs are stronger but the company generally bears the risk associated with cost increases.
- 7.8 The review provides a good opportunity to look again at how the incentive approach has worked in practice in the railway industry and to assess whether any changes are warranted. This will include reviewing the form of the price control and the process for dealing with cost or revenue shocks between periodic reviews.
- 7.9 In considering this, ORR will need to take into account:
- Network Rail's own analysis, its financial structure and its ability to bear risks;
 - Network Rail's 'not for dividend' status;
 - the extent to which Network Rail has been able to reduce costs in the current control period; and
 - ORR's view of the scope for further efficiency savings in the future.

The RAB and amortisation

- 7.10 In broad terms, the RAB is ORR's calculation of the value of Network Rail's assets. The value of the RAB has a significant impact on the overall level of Network Rail's revenue requirement since it forms the basis for calculating two of the components of allowed revenue: the level of return and the allowance for amortisation.
- 7.11 In the final conclusions of the ACR 2003, ORR set out in detail each of the components which formed part of the opening RAB, i.e. for April 2004 and the amounts to be added (through renewals and enhancements) and deducted (through amortisation) during each year of the control period.

- 7.12 A key principle which determined the amortisation rate at the last review was that, in broad terms, the total allowance for amortisation in any year should be broadly equivalent to the proportion of renewals and enhancements expenditure that is required to maintain the overall capability, age, condition and serviceability of the network in steady state.
- 7.13 ORR concluded that the methodology for amortising the RAB should allow for approximately half of Network Rail's renewals and enhancements programme to be financed through the allowance for amortisation during the five years of the current control period. The remaining expenditure, which is improving the capability of the network, would then be funded through borrowing.
- 7.14 ORR will review the rules and approach to amortisation of the RAB, including the principle discussed above and the approach to depreciating both future and past investment.

Rate of return

- 7.15 At the 2003 review, ORR considered that Network Rail's financial structure as a company limited by guarantee (CLG) and wholly financed by debt, meant that different approach to determining the allowed return than that used previously was necessary.
- 7.16 ORR's calculation had two basic steps:
- to ensure that Network Rail was able to meet its interest payments. This was essentially a mechanical calculation; and
 - to establish how much additional surplus was required as a cushion against shocks. This involved more judgement.
- 7.17 Other approaches were used to provide further evidence, such as comparisons with other similar companies and an analysis of Network Rail's ability to bear risk.
- 7.18 Network Rail launched its Debt Issuance Programme (DIP) in November 2004. The DIP is supported by Government through a financial indemnity (FI), which means that Network Rail is able to borrow at a relatively low cost of capital.

- 7.19 The existence of the FI means that Network Rail is able to borrow (up to a regulatory limit⁷) to fund fluctuations to its costs and revenues. In the review, ORR will analyse:
- how ORR should fulfil its duty in respect of not making it unduly difficult for the company to finance its activities;
 - the appropriate approach to setting the company's rate of return;
 - the extent to which it is prudent to maintain a reasonable cushion in the debt to RAB ratio;
 - how the buffer would be affected by shocks to costs and revenues;
 - other factors in the regulatory framework, such as the scope for ORR to re-open the price control following a cost or revenue shock; and
 - the views of relevant stakeholders including lenders and rating agencies.

Incentives

- 7.20 A key objective of any periodic review is to ensure that the regulated company's management faces strong incentives to deliver the efficiency savings that will enable it to meet the regulator's expenditure allowances and, indeed, outperform against the targets.
- 7.21 Such incentives come in many different forms. For the management of Network Rail, the impact on individual reputations of success and failure provides in itself a very real incentive to perform well.
- 7.22 Unlike many regulated companies, Network Rail as a CLG does not have equity at risk. In a CLG, the incentive structure is quite different and it is reasonable to ask whether financial incentives will necessarily be as effective, particularly incentives significantly to outperform regulatory targets. This question takes on even more significance with the existence of the FI, which protects lenders from the risk that Network Rail will default on its debt.

⁷ Condition 29 of the company's network licence imposes limits on the level of the company's borrowings as a percentage of the Regulatory Asset Base (RAB). The first trigger is set at 85%. If borrowing exceeds this level, Network Rail is required to submit a remedial plan to ORR setting out how it will reduce its borrowings to below 85%.

7.23 A CLG structure raises major challenges for regulation, but we consider that financial incentives continue to have a role to play in influencing behaviour. Currently the main mechanisms are management incentives and corporate incentives. In the case of management incentives, Condition 28 of Network Rail's licence requires the company to formulate a management incentive plan which must have regard to regulatory targets. The current corporate incentives cover:

- an out-performance incentive which allows Network Rail to retain underspend due to efficiency savings (beyond those established by ACR2003) if it meets its regulatory outputs. We are currently consulting on the treatment of underspend and efficiency;
- a performance regime, contained in Schedule 8 of franchised passenger train operators' track access agreements with Network Rail;
- a possessions regime, contained in Schedule 4 of franchised passenger train operators' track access agreements with Network Rail;
- a volume incentive, which provides Network Rail with additional income at the next access charges review if it accommodates predicted growth in traffic during the next five years; and
- an asset stewardship incentive, which provides Network Rail with additional income if it improves the underlying condition and serviceability of its asset base.

7.24 We are currently reviewing the performance regime and the possessions regime and the results will be incorporated in the overall review assessment. As part of the review, ORR will clearly need to consider other aspects of the incentive framework and the role of different components within it. Further details of our approach will be set out in a consultation document, which we intend to publish by the end of the year.

Annex A – ORR duties under Railways Act 1993, as amended

[Showing all amendments made by Railways Act 2005 whether or not currently in force]

4 General duties of the Secretary of State and the Office of Rail Regulation

- (1) The Office of Rail Regulation shall have a duty to exercise the functions assigned or transferred to it under or by virtue of this Part or the Railways Act 2005 that are not safety functions in the manner which it considers best calculated —
- (zb) to promote improvements in railway service performance;
 - (a) otherwise to protect the interests of users of railway services;
 - (b) to promote the use of the railway network in Great Britain for the carriage of passengers and goods, and the development of that railway network, to the greatest extent that it considers economically practicable;
 - (ba) to contribute to the development of an integrated system of transport of passengers and goods;
 - (bb) to contribute to the achievement of sustainable development;
 - (c) to promote efficiency and economy on the part of persons providing railway services;
 - (d) to promote competition in the provision of railway services for the benefit of users of railway services;
 - (e) to promote measures designed to facilitate the making by passengers of journeys which involve use of the services of more than one passenger service operator;
 - (f) to impose on the operators of railway services the minimum restrictions which are consistent with the performance of its functions under this Part or the Railways Act 2005 that are not safety functions;
 - (g) to enable persons providing railway services to plan the future of their businesses with a reasonable degree of assurance.

- (2) Without prejudice to the generality of subsection (1)(a) above, the Office of Rail Regulation shall have a duty, in particular, to exercise the functions assigned or transferred to it under or by virtue of this Part or the Railways Act 2005 that are not safety functions in the manner which it considers is best calculated to protect—
- (a) the interests of users and potential users of services for the carriage of passengers by railway provided by a private sector operator otherwise than under a franchise agreement, in respect of—
 - (i) the prices charged for travel by means of those services, and
 - (ii) the quality of the service provided, and
 - (b) the interests of persons providing services for the carriage of passengers or goods by railway in their use of any railway facilities which are for the time being vested in a private sector operator, in respect of—
 - (i) the prices charged for such use; and
 - (ii) the quality of the service provided.
- (3) The Office of Rail Regulation shall be under a duty in exercising the functions assigned or transferred to it under or by virtue of this Part or the Railways Act 2005 that are not safety functions—
- (a) to take into account the need to protect all persons from dangers arising from the operation of railways; and
 - (b) to have regard to the effect on the environment of activities connected with the provision of railway services.
- (3A) Subsections (1) to (3) above shall have effect in relation to the Secretary of State as in relation to [the Office of Rail Regulation], except that in their application to the Secretary of State—
- (a) ...
 - (b) the references in each of the subsections to the functions transferred or assigned to the Secretary of State under or by virtue of this Part include only the functions transferred or assigned to him under or by virtue of sections 6 to 22 and 37 to 50 below; and
 - (c) the references in each of the subsections to the functions transferred or assigned under or by virtue of the Railways Act 2005 include only the functions transferred or assigned to the Secretary of State under or by virtue of the provisions of Part 4 of that Act other than section 39.

- (3B) Subsections (1) to (3) above shall have effect in relation to the Scottish Ministers as in relation to the Office of Rail Regulation except that, in relation to those Ministers—
- (a) the references in each of the subsections to functions transferred or assigned to those Ministers under or by virtue of Part 1 of this Act include only the functions transferred or assigned under or by virtue of sections 16A to 16G of this Act; and
 - (b) the references in each of the subsections to the functions transferred or assigned under or by virtue of the Railways Act 2005 include only the functions transferred or assigned to those Ministers under or by virtue of Part 4 of that Act.
- (3C) Subsections (1) to (3) above shall have effect in relation to the National Assembly for Wales as in relation to the Office of Rail Regulation except that, in relation to that Assembly, the references in each of the subsections to functions transferred or assigned under or by virtue of Part 1 of this Act or the Railways Act 2005 include only the functions transferred to assigned to the Assembly under or by virtue of the provisions of Part 4 of that Act of 2005 other than section 39.
- (4) The Secretary of State shall also be under a duty, in exercising the functions assigned or transferred to him under or by virtue of this Part or the Railways Act 2005, to promote the award of franchise agreements to companies in which qualifying railway employees have a substantial interest, “qualifying railway employees” meaning for this purpose persons who are or have been employed in an undertaking which provides or provided the services to which the franchise agreement in question relates at a time before those services begin to be provided under that franchise agreement.
- (5) The Office of Rail Regulation shall also be under a duty in exercising the functions assigned or transferred to it under this Part or the Railways Act 2005 that are not safety functions—
- (a) to have regard to any general guidance given to it by the Secretary of State about railway services or other matters relating to railways;
 - (aa) to have regard to any general guidance given to it by the Scottish Ministers about railway services wholly or partly in Scotland or about other matters in or as regards Scotland that relate to railways;
 - (ab) in having regard to any guidance falling within paragraph (aa), to give what appears to it to be appropriate weight to the extent (if any) to which the guidance relates to matters in respect of which expenditure is to be or has been incurred by the Scottish Ministers;
 - (b) to act in a manner which it considers will not render it unduly difficult for persons who are holders of network licences to finance any activities or

- proposed activities of theirs in relation to which the Office of Rail Regulation has functions under or by virtue of this Part or that Act (whether or not the activities in question are, or are to be, carried on by those persons in their capacity as holders of such licences);
- (c) to have regard to the funds available to the Secretary of State for the purposes of his functions in relation to railways and railway services;
 - (ca) to have regard to any notified strategies and policies of the national Assembly for Wales, so far as they relate to Welsh services or to any other matter in or as regards Wales that concerns railways or railway services;
 - (cb) to have regard to the ability of the National Assembly for Wales to carry out the functions conferred or imposed on it by or under any enactment;
 - (d) to have regard to the ability of the Mayor of London, London Regional Transport and Transport for London to carry out the functions conferred or imposed on them by or under any enactment.
- (5A) Before giving any guidance for the purposes of subsection (5)(a) above the Secretary of State must consult the National Assembly for Wales.
- (5B) In exercising its safety functions, other than its functions as an enforcing authority for the purposes of the Health and Safety at Work etc Act 1974, the Office of Rail Regulation shall be under a duty to have regard to any general guidance given to it by the Secretary of State.
- (5C) In performing its duties under subsections (1) to (5A) above in relation to—
- (a) any matter affecting the interests of users or potential users of railway services;
 - (b) any matter affecting the interests of persons providing railways services; or
 - (c) any matter not falling within paragraph (a) or (b) but falling within subsection (5D).

the Office of Rail Regulation must have regard, in particular, to the interests, in securing value for money, or the persons mentioned in paragraphs (a) and (b) above, of the persons who make available the resources and other funds mentioned in that subsection and of the general public.

- (5D) A matter falls within this subsection if the Office of Rail Regulation has been informed that—
- (a) public financial resources (within the meaning of paragraph 1D of Schedule 4A to this Act); or
 - (b) funds that do not comprise such resources but are provided in whole or in part by Transport for London, the National Assembly for Wales, a

Passenger Transport Executive or any other body in receipt of such resources;

are or are likely to become available to be applied for purposes connected with that matter.

- (6) In performing its duty under subsection (1)(a) above so far as relating to services for the carriage of passengers by railway or to station services, the Office of Rail Regulation shall have regard, in particular, to the interests of persons who are disabled.
- (7) Without prejudice to the generality of paragraph (e) of subsection (1) above, any arrangements for the issue and use of through tickets shall be regarded as a measure falling within that paragraph.

(7ZA) Where any general guidance given to the Office of Rail Regulation for the purposes of subsection (5)(a) or (aa) or (5B)—

- (a) it may be varied or revoked by the person giving it at any time; and
- (b) the guidance, and any variation or revocation of the guidance, must be published by that person in such manner as he considers appropriate.

(7A) Subsections (1) to (6) above do not apply in relation to anything done by the Office of Rail Regulation in the exercise of functions assigned to it by section 67(3) below (“Competition Act functions”).

(7B) The Office of Rail Regulation may nevertheless, when exercising any Competition Act function, have regard to any matter in respect of which a duty is imposed by any of subsections (1) to (6) above, if it is a matter to which the Office of Fair Trading could have regard when exercising that function.

(8) ...

(9) In this section—

“the environment” means all, or any, of the following media, namely, the air, water and land (and the medium of air includes the air within buildings and the air within other natural or man-made structures above or below ground);

“notified strategies and policies”, in relation to the national Assembly for Wales, means the strategies and policies of that Assembly that have been notified by that Assembly for the purposes of this section to the Office of Rail Regulation;

“the passenger transport market” means the market for the supply of services for the carriage of passengers, whether by railway or any other means of transport;

“railway service performance” includes, in particular, performance in securing each of the following in relation to railway services –

- (a) reliability (including punctuality);
- (b) the avoidance or mitigation of passenger overcrowding; and
- (c) that journey times are as short as possible;

“safety functions” means functions assigned or transferred to the Office of Rail Regulation—

- (a) under this Part;
- (b) under or by virtue of the Railways Act 2005; or
- (c) under or by virtue of the Health and Safety at Work etc Act 1974;

so far as they are being exercised for the railways safety purposes (within the meaning of Schedule 3 to the Railways Act 2005) or for purposes connected with those purposes.

Channel Tunnel Rail Link Act 1996, as amended

21 Duties as to exercise of regulatory functions

- 1 The Office of Rail Regulation shall have an overriding duty to exercise its regulatory functions in such a manner as not to impede the performance of any development agreement.
- 2 In exercising its regulatory functions in relation to the use by a rail link undertaker of any existing network—
 - (a) for trains used in connection with the construction of the rail link; or
 - (b) for trains used to provide international services;

the Office of Rail Regulation shall also be under a duty to have regard to the financial position of the rail link undertaker.