ORR

OFFICE OF **RAIL AND ROAD**

Conclusions on our initial consultation on the 2018 periodic review

Summary of comments and our response

17 November 2016

Contents

1. Introduction

Purpose of the document

1.1 This document discusses the main points raised by stakeholders in response to our initial consultation on 2018 periodic review (PR18). It supplements our [letter](#) concluding on our initial consultation. This letter also sets out next steps in PR18 as we move on to develop the detailed framework following these conclusions (see paragraph 46 of the [letter](#)).

Background

1.2 In May 2016, we published our initial consultation on PR18. PR18 will determine:

■ Network Rail Infrastructure Limited's (Network Rail's) outputs and funding in control period 6 (CP6, which we expect to run from 1 April 2019 to 31 March 2024). This will feed through into the service passengers and freight customers receive and, together with taxpayers, ultimately pay for;

■ the charges that Network Rail's passenger, freight and charter train operator customers will pay for access to its track and stations in CP6; and

■ the wider 'regulatory framework', including the financial framework for Network Rail and the incentives to encourage it and train operators to perform well.

1.3 We received 59 responses to the consultation (respondents are listed in the appendix). These are available on our [website](#). We would like to thank all those that responded.

Structure of this document

1.4 The numbering of each of the following chapters corresponds to the chapter numbers of the initial consultation. It sets out a brief overview of what we said in our initial consultation before summarising and discussing the main points raised in responses.

2. Context for the review

Overview of chapter 2 of our initial consultation

In chapter 2 of our May 2016 document, we said that PR18 needed to respond to the context in which we were carrying out the review. We described six particular areas which we thought were key to the context:

- growing demand from passengers and freight customers;

- the challenges facing Network Rail with trying to recover and improve performance and efficiency;

- the reclassification of Network Rail and constraints on public spending;

- devolution within Network Rail and politically within Great Britain;

- changes in industry structures and incentives; and

- technological change and High Speed 2.

We asked stakeholders to comment on whether they agreed with our description of the context or whether they considered there were additional significant points that might affect the review.

Summary of stakeholder views

2.1   Overall, there was broad agreement from consultees with our description of the context for PR18 and our views on the issues and opportunities for the rail industry in CP6. There were some detailed comments on aspects of what we said, and some suggestions for areas that we may have missed. We have highlighted some of these below.

Growing demand from passengers and freight customers

2.2   Some stakeholders noted that demand was not uniform across the network and that this was something that would need to be taken into account. In particular, the geographic impact of the shift from coal and steel traffic towards intermodal and construction, which would put more pressure on the rail lines over which these goods were moved. Drax Power said that certainty was the key thing sought by freight customers, rather than operational flexibility (though it noted flexibility was likely to be important to construction and network maintenance traffic).

Performance and efficiency

2.3 A number of stakeholders highlighted concerns with Network Rail's management of enhancements, particularly given delays in CP5. TravelWatch SouthWest and West of England LEP suggested that Network Rail needed to find ways to make itself more attractive to investors through improved delivery times and better value for money.

2.4 London TravelWatch said that the industry needed to focus more emphasis on basic railway operating disciplines to support better performance (such as train dispatch from stations and more regular inspections and maintenance of key assets such as signalling).

2.5 Some consultees raised concerns with Network Rail's plans for asset sales and the longer term implications that these would have for access charges. They considered Network Rail should do more to engage with potentially affected parties on this issue.

Reclassification and public spending

2.6 Where stakeholders commented on reclassification it was mainly to note the implications of Network Rail not being able to raise debt itself to fund shortfalls and concerns around the asset sales it planned in CP5. Some stakeholders said that passengers and freight customers should not have to pay increased charges which resulted from reduced income to Network Rail due to the sale of income generating assets. Network Rail itself noted that asset sales were not a sustainable long term solution to the issue of cost shocks. It also flagged the importance of addressing its financial sustainability in order to attract third party investment.

Political and operational devolution

2.7 The Campaign for Better Transport said that there was a lack of a long term vision for rail from the UK Government and that this may hinder PR18. It noted that the Shaw and Bowe reports recommended that such a vision should be set out.

2.8 Transport for the North/Rail North and Urban Transport Group flagged that station devolution had not been covered in our consultation. They said that the regulatory framework for CP6 would need to be able to accommodate any changes to ownership models.

Industry structures and incentives

2.9 Network Rail, RDG and some train operators flagged the significance of franchise reform and the importance of taking advantage of opportunities to better align franchised train operators' obligations with those of Network Rail.

2.10 Linked to this, the Rail Freight Group (RFG) said it was vital for early clarification on whether franchises would be exposed to any changes in track access charges at the

periodic review, given that this would drive the level of benefits of more radical changes in access charges.

Technological change and High Speed 2 (HS2)

2.11 DfT asked that we give greater prominence to HS2 in future review documents, noting the impact that it would have in CP6, when most of phase 1 of that programme is due to be built. Similar points were made by some other respondents, some of whom emphasised the impact that greater demand on supply chain resources would have on Network Rail's costs and delivery.

Other main points raised

2.12 A few stakeholders noted that the result of the referendum on the UK's membership of the European Union now formed part of the context for PR18 and that ORR and stakeholders would need to consider its implications for the railway.

2.13 Some freight stakeholders drew attention to the economic value of rail freight to the UK economy, stating the importance of taking non-railway benefits into account when considering changes to the regulatory framework. Similarly, they emphasised the importance of stability to the regime affecting freight operators.

2.14 RSSB said that the industry's Rail Technical Strategy was a significant reference point for PR18, as was the industry's 'Rail Sustainable Development Principles'. Linked to this latter point, several stakeholders raised the importance of sustainability of the railway as part of context.

Our response

2.15 We welcome the broad agreement with the context we set out, and will reflect on the additional points raised in our work.

3. Focusing the review where it can have most impact for passengers and freight customers

Overview of chapter 3 of our initial consultation

Chapter 3 of our consultation set out our proposed priorities for the review, linking to six high-level outcomes relating to what Network Rail delivers. We set out our high priority areas of focus based on where we thought we were best able to make a difference to passengers and freight customers along with those areas where there are significant risks which need to be managed effectively to sustain current successes. In terms of our relative priorities:

■ we said that our proposed high-priority areas of focus in the review were on supporting a more efficient and better used network that was expanded effectively;

■ we said that we proposed to continue to focus on safety; and

■ we said we proposed to make incremental improvements to the regulatory framework to support a network that was more reliable and available.

We then set out our proposed approach to delivering these priority areas, through: a focus on regulating at a route-level; improving the regulation of system operation; refining the framework for outputs and how outputs were monitored; increasing transparency around costs and improving incentives; and supporting new ways to treat enhancements.

We sought views on our proposed relative priorities for the review, as well as any other areas that should be prioritised.

Summary of stakeholder views

3.1 The priorities that we set out in the consultation were supported by most stakeholders. There were however suggestions from some respondents for additional priorities or outcomes that we should target. The overriding theme arising from the responses though was on how vital it was for us to prioritise and in particular that more radical reform of access charges should be deprioritised. These points are discussed in more detail below.

Comments on high-level outcomes

3.2 Network Rail strongly considered that an outcome of PR18 should be the improvement of the company's financial sustainability. It suggested potential balance sheet restructuring, cash funding of some enhancements and a regulatory regime that better supports third party enhancements, as ways to support this.

3.3 WSP Parsons Brinckerhoff (WSPPB) questioned whether Network Rail was prioritising minimising whole life costs of assets, at the cost of comfort and the on-board safety of passengers and train staff. This was on the basis that its approach was to tilt railway tracks less in order to reduce track degradation. WSPPB said this would mean that those on-board would feel the curves more intensely. It argued that PR18 should be reprioritised to include a focus on on-board safety and comfort, in terms of Network Rail's ability to influence them through its asset management strategies.

3.4 London TravelWatch proposed that we should incorporate an additional objective for a network that is responsive to the needs of passengers, changing demand and wider stakeholders. It considered this important because it said Network Rail currently operated in a way that was insulated from these needs.

3.5 Transport Focus said that there was a good degree of read across between the high-level outcomes in Figure 3.1 of our consultation and the priorities of passengers. However, it said that there was scope to build upon the 'how this would be done'. It proposed that engagement by Network Rail with passengers should be a specific outcome, noting that train operators were not a complete proxy for passengers' views. Similar suggestions were made by some other respondents.

3.6 While it agreed with the six outcomes we had set out, RDG said that "supporting the sustainable development of the railway" was missing, although it did not elaborate on how PR18 should seek to achieve it. Some other stakeholders referred to the importance of environmental sustainability as well.

3.7 The Campaign for Better Transport considered that ORR should include an objective relating to accountability and wider public policy objectives, to capture Network Rail's contribution to environmental, social and economic objectives.

Our response

3.8 Given the broad support to what we proposed, we are not minded to add to the six high-level outcomes we described. We are also mindful that too many proposed outcome areas could diminish the clarity of what we want to achieve. In respect of the suggestions for an outcome for greater engagement, we set out in our consultation the key role that we see Network Rail's engagement with stakeholders playing in PR18 so that its decisions are focused on the interests of current and future end users and taxpayers. It is a key means to achieving the right outcomes and the framework we develop will reflect that.

3.9 We note that Network Rail would like PR18 to give it the profile of a financially sustainable private sector business. Network Rail's funding structure is fundamentally a matter for governments. However, we recognise the importance of financial sustainability and will consult on the full range of financial factors that could affect

Network Rail's business in our December 2016 consultation on the PR18 financial framework.

3.10 On environmental sustainability, we have a statutory duty to contribute to the achievement of sustainable development, and will continue to discharge that duty in PR18. We also recognise that DfT and Transport Scotland have each said that they have an objective in this area. Reflecting this, the main means in PR18 for supporting sustainable development is with Network Rail's plans for CP6, and for these to reflect any sustainable development objectives set out in each of the governments' high-level output specifications (HLOSs). Furthermore, Network Rail's planning assumptions for its strategic business plans (SBPs) refer to the Rail Sustainable Development Principles, and also set out sustainable development metrics which its routes and business units will need to take account of when producing their plans.

3.11 In respect of WSP Parsons Brinckerhoff's point about safety and comfort, these choices should be informed by Network Rail's engagement with customers, who have a particular interest in improving passenger comfort. More generally, moves to increase Network Rail's engagement with train operators should provide an opportunity for passengers' views to be reflected in Network Rail's decision-making. More generally, we have no grounds to believe that Network Rail's standards and processes do not manage the lateral forces imposed on track by a train running over curves.

Proposed high priority areas

3.12 Our proposal to make a high priority of the outcomes of a **more efficient network**, a **better used** network and a network that is **expanded effectively** was broadly supported overall.

- On 'more efficient', comments included the importance of driving better efficiency in absolute terms, rather than just moving costs from Network Rail to train operators, and suggestions that Network Rail should support reductions in train operator costs. There were suggestions that there needed to be a better understanding of the reasons for cost escalations and the decline in performance. RSSB said that whole life costing should be incentivised.

- However, for 'a better used network' there were some comments that this should not necessarily imply 'more trains' but should also include faster trains or improved integration of trains.

- For 'a network that is expanded effectively', the shift to more flexible ways of specifying funding enhancements outside of a periodic review led to comments from supplier organisations about the need for a reliable and stable future pipeline for the supply chain. Some freight stakeholders noted the risk that

freight enhancements may become neglected, if decision making shifted to align with franchise letting.

Our comments

3.13 We welcome the support for these outcomes, particularly a more efficient and better used network.

- In respect of the point made on efficiency, closer relationships between Network Rail and train operators (supported by devolution and our approach in PR18) should help to facilitate more joined up decision making, including how Network Rail can support reduced costs for train operators.

- On the point on cost escalations, our draft guidance to Network Rail on its SBPs will set out our expectation that the SBPs include the company's assessment of the drivers of efficiency in CP5. It will also ask Network Rail to explain how its plans for CP6 build on the strengths and address identified weaknesses in CP5.

- We agree that a better used network does not necessarily mean *more* trains (e.g. as opposed to *faster* trains).

- We note the points made in respect of enhancements by supply chain representatives on the need for a stable pipeline and freight stakeholders on the risk of freight enhancements being neglected. These will be important issues to consider, particularly for governments, in the development of more flexible approaches.

Proposed area for continued focus: a safer network

3.14 On a **continued focus on a safer railway**, the following main comments were made.

- A question was raised whether, conceptually, safety should be a priority (and there was a suggestion that it should be the overriding priority) or whether it should just be a 'given'.

- RMT welcomed our proposed focus on ensuring there is adequate spending on safety-critical maintenance and renewals (expressing concern about the lack of priority given to renewals in CP5). RMT was, however, disappointed that we did not anticipate significant stand-alone safety projects through PR18 (reflecting that the funding of these is essentially a decision for government).

- IOSH noted our proposed aim for PR18 included a "safer" railway. However, it observed that we did not explain how this would be achieved (e.g. how a balanced approach to risk and cost decisions would be achieved as envisaged by the legal requirements of reasonable practicability). It suggested that further thought be given to clarifying how safety issues will be considered as an integral

part of the framework so that it is given equal emphasis as part of investment decisions for PR18.

- Network Rail said that safety should not be looked at in isolation but considered together with business performance and financial value, with appropriate consideration of the value for money from potential investment in safety improvements.

Our response

3.15 On the comments on a continued focus on a safer railway.

- In the context of an economic review of Network Rail, health and safety is a key consideration for us. However, it is important to note that a periodic review is not the principal means for driving improved safety on the rail network. There is an existing legislative framework providing protections on health and safety. Given this, and that current safety levels on the railways in GB do not suggest an additional need to address safety issues across the piece, we remain of the view that our focus in PR18 should be on maintaining current successes and reducing risk where appropriate.

- We agree with Network Rail that health and safety should not be looked at in isolation but as an integral part of the business. Indeed, where it makes investment proposals relating to health and safety in its SBPs, it should include robust business cases to make clear the value that these would bring.

- In respect of IOSH's point, our approach in PR18 is designed to ensure decisions are taken in a joined up way, with an integrated decision making process for economic and health & safety issues. Network Rail has an ongoing requirement to ensure the continued safety of the railway and to exploit all reasonably practicable opportunities for improvement. Our consultation on our draft guidance to Network Rail on its SBPs (to be published later in November 2016) will set out what we expect from the company in relation to health and safety considerations when developing its plans for CP6.

Proposed areas for incremental improvement rather than fundamental review: A network that is available and reliable

3.16 For the outcome '**a network that is available and reliable**', we had proposed focusing on incremental changes to deliver improvements. This reflected feedback that most (but not all) stakeholders considered that the contractual possessions (Schedule 4) and performance (Schedule 8) regimes were broadly fit for purpose, and that while improvements could be made, the fundamental basis of the regimes (such as the liquidated damages aspect) did not require major structural change.

Likewise, with the outputs framework in respect of metrics for network performance and availability. While our approach was mainly supported:

■ we received comments that network reliability should be a higher priority, given disruption caused due to asset failures and that more should be done in PR18 to investigate why performance has declined and to improve incentives;

■ there were a number of suggestions for how Schedules 4 and 8 could be improved;

■ Network Rail considered that changes to Schedules 4 and 8 and the capacity charge should be key areas of focus in PR18, and link with the volume incentive and outputs to provide stronger incentives to make better use of the network, beyond our work focusing on the system operator; and

■ Network Rail considered that the outputs framework needed a more fundamental review, in order to support route-level regulation. In particular, it said that a more flexible approach to output targets would be required for CP6, underpinned by greater customer engagement and more of a 'balanced scorecard' approach.

Our response

3.17 We recognise that the move to route-level regulation – and with it the greater emphasis placed on customer engagement – will represent a significant shift in the outputs framework, and so we agree with Network Rail that this aspect of the outputs framework will not be incremental in nature. This was recognised in our consultation document. The principal driver for this is the move to route-level regulation, prompted by one of our key priority areas ('a more efficient network').

3.18 In line with our consultation proposal, we do not intend to fundamentally redesign the regulatory framework to support an available and reliable network, though we are seeking a significant improvement in how we measure passenger punctuality and reliability. Further, we remain of the view that while important improvements can be made to Schedules 4 and 8 for the benefit of end users, fundamental structural changes are not required at this time. Similarly, we consider that many of the ways in which we measure Network Rail's key outputs remain fit-for-purpose. In that sense, we describe our approach to delivering against this outcome to be 'incremental'.

3.19 On the capacity charge, we are investigating options for reform, and are carefully considering how improvements to the charge and the wider charges and incentives framework could incentivise Network Rail and train operators to make better use of the network.

How we will deliver our aims, objectives and priorities

3.20 Generally, respondents supported our proposed aim for the review ("a safer, more efficient and better used railway, delivering value for passengers, freight customers and taxpayers in control period 6 and beyond").

3.21 Figure 3.2 of the document set out five areas we proposed to focus on to deliver our priorities (as summarised at the beginning of this chapter) and how these linked to the six outcome areas.

3.22 RDG, in particular, supported the five priority areas for focus but considered that only route-level regulation, system operation and enhancements should be areas for significant change, with incremental change only for 'Increasing transparency around costs and improving incentives', as well as outputs and monitoring. Indeed, many of the detailed consultee comments on prioritisation related to costs and incentives.

   ■   There was a strong theme from the responses that major changes to access charges should only be made where there is a substantial need or where there would be significant benefits.

   ■   Freight stakeholders said that the benefits of major changes to charges were unlikely to be significant if DfT did not expose its franchised operators to changes in charges at periodic reviews (and the impact of any changes would fall on freight and open access passenger operators). They also stressed the importance of simplicity in freight charges and either their reduction or capping at the end of CP5 levels, and early certainty on freight charges.

   ■   A number of stakeholders said that we should follow the recommendations of the RDG review of charges and that we should not explore the geographic disaggregation of the variable usage charge. However, DfT itself was keen for us to explore more radical changes to charges and Transport Scotland endorsed considering fundamental changes where these were likely to lead to significantly better outcomes for rail customers.

3.23 The substantial amount of work that would be required to implement route-level and system operation regulation was discussed by many stakeholders. There were concerns that if the focus of PR18 was too broad, this would divert ORR and industry attention away from developing the framework for route-level regulation and system operation. Given the complex issues that need to be considered for these, it was feared a diluted focus could risk less effective outcomes.

Overall conclusions

3.24 We are confirming our aim and objectives for the review. However, to achieve these, we recognise the need to prioritise carefully. We also acknowledge the concerns about the risk of having too broad an agenda for PR18. On this basis:

■ we agree with those that said route-level regulation and system operation demanded the greatest focus, as well as areas of the wider framework that are inherently linked with these, such as aspects of the outputs framework.

■ we will take a more incremental approach to costs and incentives in PR18, but will separately seek to indicate areas we see value in exploring (during CP6) for the longer-term. We will be consulting on options for charges and incentives in December 2016. This is discussed further in paragraphs 4.38-4.42;

■ in line with our consultation proposal, for outputs we will take account of the work that the National Task Force has led in relation to improving the measures of passenger performance, while ensuring these are consistent with our approach to route-level regulation. We will continue to work with stakeholders, including the National Task Force on this; and

■ we will continue to work with governments and stakeholders on developing new ways to treat enhancements.

3.25 We consider this focused approach is the best way for us to deliver a more efficient and better used railway, which delivers value for passengers, freight customers and taxpayers.

4. Our proposed approach to the review

Overview of chapter 4 of our initial consultation

Chapter 4 of our consultation sought views on our proposed approach to delivering the aims and objectives for the review, including through:

- focusing on regulating at route-level;

- improving system operation;

- improving the framework for outputs and how they are monitored;

- increasing cost transparency and improving incentives; and

- supporting new ways to deliver enhancements.

It also discussed the roll out of the European Rail Traffic Management System (ERTMS) and related technology i.e. the "Digital Railway".

Focusing on regulating at route-level

4.1 Most stakeholders supported our proposed approach to route-level regulation, particularly the opportunities arising from greater customer engagement in informing priorities and holding Network Rail to account. RMT, however, was opposed to devolution, saying it would fragment Network Rail and make industrial relations more difficult.

4.2 There were a number of comments about the challenges of implementing route-level regulation, in terms of the resources required to develop an effective framework (affecting ORR, Network Rail and train operators in particular). The importance of being realistic in what can be achieved in PR18 was further stressed. Arriva suggested that the focus should be on establishing the processes through which routes will engage with and deliver to customers. Similar points were made by some others on the need to focus on end-user priorities.

4.3 Many responses stressed the importance of the framework not being unduly complex or bureaucratic. For example, Arriva suggested that it would be important to understand the extent to which costs can be genuinely measured at route-level, to avoid adding large administrative effort for little practical benefit.

4.4 Freight stakeholders sought clarity on the role of the 'virtual freight route', including its relationship with other parts of Network Rail and how it would be regulated. (The virtual freight route has now been renamed by Network Rail – see paragraph 4.9 below.)

4.5 A number of comments were made on the risks arising from a shift to route-level regulation that would need to be considered and mitigated.

■ The Civil Engineering Contractors Association (CECA) and Carillion Rail were concerned that devolution could lead to eight different commercial models for suppliers to contract with routes. If this happened, they considered it was likely to hinder efficiency, and the effects would need to be mitigated. The Rail Industry Association (RIA) said that a key concern from suppliers (arising from its Supplier Perception Survey) was the lack of consistency across Network Rail in approach to suppliers; it said the move towards route-level regulation would need to be carefully managed to stop this worsening.

■ GB Railfreight (GBRf) raised the importance of ensuring that each route's programme of engineering works are coherent across the network, so that cross-route impacts are considered and planned in an efficient way.

■ Siemens queried how route-level regulation would cater for the effective roll-out of network-wide investment programmes, given greater route autonomy.

■ DB Cargo considered that it would be insufficient just to rely solely on the system operator or virtual freight route to ensure that routes treat cross-route traffic appropriately. It, along with other stakeholders, queried how routes would be incentivised to support this. Concerns were raised that, currently, routes do not want more trains to run because of the performance impact.

Our response

4.6 Clearly, there is a lot of work to do to work through the detail of how route-level regulation will work. Although some key changes will occur as part of PR18, there will inevitably be some evolution during CP6 with further changes at the next periodic review.

4.7 We agree that devolution should drive a focus on end user priorities and that our framework for route-level regulation should support this; a key element to this will be the engagement by Network Rail's routes with their customers. As discussed in chapter 6, this is one such area that will evolve over time.

4.8 We note the risks and issues flagged up by stakeholders and will take them into account as we develop the detailed design for route-level regulation ahead of our July 2017 publication on the proposed framework.

4.9 On the virtual freight route (now named by Network Rail as the 'Freight and national passenger operator route' or 'FNPO'), Network Rail is continuing to develop the scope of its role and relationship with other routes. In late November 2016, we will consult on our draft SBP guidance (the link will be activated when the consultation

goes live); this will set out the information we are seeking from Network Rail in its SBPs, including in respect of the FNPO. We will further develop our regulatory approach to the FNPO in 2017, working with stakeholders on this.

Improving system operation

4.10 Most stakeholders supported our proposal for a more tailored approach to the regulation of Network Rail's national system operator function (the NSO), with many seeing it as an opportunity to improve the effectiveness of the system operator role. For example, Freightliner said it could optimise capacity (thus getting more value for money from the network) and address the impacts of the timetable on performance. A number of specific comments were also made.

■ There were suggestions that the NSO should cover all networks in GB (regardless of ownership) and that it should consider broader elements of the 'railway system' such as rolling stock and depots.

■ Current issues with system operation were raised by a range of stakeholders, including the need for better train planning and improved information on network capability information to help build better timetables.

■ The regulatory approach to the NSO should not be overly-complex and/or prescriptive; there were some suggestions for more qualitative (rather than quantitative) measures and a role for monitoring of improvement programmes and maturity of key processes.

■ There were suggestions for how the NSO's operational performance should be measured and how it should be incentivised. Transport Scotland said that the framework would need to strike a balance between a system wide perspective and local priorities, while protecting cross-route train operators. A number of freight stakeholders said that average scheduled velocity of freight trains should become a key performance metric for the system operator, to support greater freight efficiency and to support better use of the network.

Our response

4.11 In providing for a more tailored approach to the regulation of the NSO function, we are developing the design of the regulatory settlement for the NSO; this is discussed in more detail in our [consultation on the design of the NSO settlement](#), which is published alongside this document.

4.12 We note the suggestion that the NSO should have a wide remit across other networks and/or other infrastructure. While Network Rail may have agreements with some other networks to carry out certain system operation functions (e.g. timetabling), it is not within the scope of PR18 to require the NSO to have a wide

remit. This is more for government (as well as Network Rail and other network owners) to consider. Furthermore, how Network Rail organises its system operator functions is a matter for Network Rail.

4.13 We have taken account of stakeholders' views (and will continue to do so) on the way system operation (and the NSO's role) is undertaken, as well as suggestions for how it could be improved. This will be particularly important in helping to inform what measures the NSO could report on for CP6, and where efforts should be focused in developing those particular measures. This is discussed in our corresponding document on the design of the NSO settlement.

4.14 We are also taking account of stakeholders' views on the design of the NSO settlement, as well as the particular measure of the NSO's operational performance. We are keen to develop a practicable approach that provides sufficient transparency to industry on the NSO's operational performance, while ensuring it has the incentives to both manage the network more effectively and to develop its tools and capability to facilitate the benefits of a coherent network. This is also discussed in our consultation document on the design of the NSO settlement.

Improving the framework for outputs and how they are monitored

4.15 Stakeholders were generally in favour of our approach to the outputs framework and monitoring, including greater transparency. However, there were a number of comments relating to this.

4.16 Many stakeholders including RDG and Network Rail considered that the outputs framework needed to be flexible, to provide for outputs to be adjusted during CP6 to reflect changing circumstances and customer requirements. There were suggestions that there should be trajectories for performance outputs.

4.17 Similarly, many consultees said that the outputs framework needed to ensure that routes and the system operator focused on the needs of customers rather than ORR. In this context, there was broad support for the use of scorecards within the framework, albeit with several comments.

- Many train operators raised concerns with the CP5 scorecard process and noted the need for improvement, particularly the quality of Network Rail's engagement/collaboration with train operators.

- Stagecoach and West Coast Trains said that scorecards would need some enforcement capability behind them, to address where things were not working well. ORR would need to take a stronger leadership role to ensure accountability is reinforced and to hold Network Rail accountable for its actions (albeit not through fines).

- CECA suggested that scorecards should have a supplier feedback metric to highlight which routes are getting best results in the view of the suppliers that work for them. Similarly, RIA suggested a collaborative behaviour measure be included in the CP6 framework, given the importance of collaboration to improving efficiency.

- Network Rail proposed a balanced scorecard approach, where outputs could be assessed collectively, rather than individually. Freightliner considered this was important too, as it said that currently there was an undue focus on performance at the cost of getting more out of the network.

4.18 See chapter 6 for comments on engagement in informing outputs and our response.

4.19 Network Rail said that the way indicators have been used in CP5 has led to the wrong behaviours within both Network Rail and ORR, with them being treated as regulatory targets, leading to a sense that ORR is the customer. It considered it should not be required to publish forecasts of indicators in CP6. It suggested that the indicators could be shared through the ORR Data Portal rather than being included in the annual return, which would reduce the regulatory burden while making the data more accessible for monitoring by ORR and others.

4.20 On output measures, comments included:

- support (including from RDG and FirstGroup) for Network Rail's outputs being based on measures that it can control;

- support for improved measures of passenger train performance that take account of the passenger experience. However, Urban Transport Group (UTG) and Transport for the North/Rail North (TfN/RN) said it was important that measures that take account of the number of passengers on each service should not be too simplistic but should take account of the economic and social value of the service. There was also a suggestion that performance measures should take account of connections, to reduce passenger inconvenience from missed connections where there are delays; and

- support for the retention of the freight delivery metric (FDM), though DB Cargo noted that consideration would be needed on how it would work in a route/system operator/virtual route context. GBRf also said that there should be greater transparency of factors affecting FDM such as asset condition, to support a focus on improving FDM further. Along with the suggestion of a freight velocity output, there was a suggestion of having an output for Network Rail to increase train length, to support greater efficiency.

4.21 On transparency, UTG said that better, more disaggregated, performance and cost information was needed to support regional bodies in the process of informing

outputs and holding Network Rail to account. It said that these bodies were better placed to focus at this level of detail compared to ORR and DfT. Similar points were made by TfN/RN, Transport for London (TfL) and the Association of Public Transport Users (APTU) that sub-route data should be made available. TfL proposed that a 'virtual route' for London should be established with corresponding data.

Our response

4.22 Developing the framework for outputs, including the role of scorecards (and their related action plans) and deciding the degree of flexibility to change outputs during CP6 is a complex area that we will need to develop carefully with Network Rail and others. This will need to build on the comments made by consultees to our initial consultation and working paper 4 on outputs (WP4), for which we will issue a conclusions note in December 2016/January 2017. Taking account of the lessons learnt from using scorecards in CP5 will be a key part of the policy development process; we have been working with the RDG/NTF outputs working group to examine this developing policy area.

4.23 We note Network Rail's comments on indicators in CP5. WP4 included a proposal to remove these for CP6 and we acknowledge Network Rail's suggestion about including the same data through our Data Portal. We will consider the issue of publication of this data separately, in the context of Network Rail's transparency agenda.

4.24 We note the comments on output measures. We agree that Network Rail's outputs should be based on measures it can control and, in the context of a focus on route-level and NSO regulation, on measures which the respective parts of Network Rail can control. On the metrics for passenger performance, we remain committed to the use of measures that take better account of passenger experience. The industry's work on this is ongoing. A number of potential measures have been identified and are subject to feasibility assessment. There are currently no connections measures proposed by the industry.

4.25 In respect of transparency, where we receive more disaggregated data (for example, in connection with our performance monitoring work), we will look to make it publically available as we currently do with the sub-operator level PPM, CaSL[1] and 'right time' data published on our Data Portal.

4.26 We note TfL's suggestion about a London virtual route. Decisions on this would be for Network Rail.

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[1] PPM is the 'public performance measure' and CaSL is the 'cancellations and significant lateness' measure.

Increasing cost transparency and improving incentives

4.27 The response to our proposals on charges and incentives was mixed.

4.28 There was broad support for our proposals to develop a better understanding in the industry of what drives infrastructure costs. However, a number of stakeholders said that a better understanding of cost drivers did not need to be translated into charges; indeed, they did not support this.

4.29 The potential for the variable usage charge to be disaggregated in CP6 was strongly opposed by the majority of stakeholders. Network Rail said route-based charges would create perverse incentives. RFG queried what incentive effect this would provide for freight operators with a limited choice of route and services dependent on customer demand.

4.30 RDG, along with a number of other stakeholders, reiterated that PR18 should build on RDG's review of charges, with resources focused other areas that require more attention.

4.31 In contrast, DfT supported the investigation of the merits of geographically based charges, given the potential for more effective efficiency incentives on franchised train operators. However, it recognised that these could pose certain challenges and said that changes to charges and incentives should only be made where they would lead to significantly better outcomes. Transport Scotland supported considering such changes as well, albeit with the same caveat.

4.32 Freight stakeholders made strong representations on freight charges:

- ORR was asked to reduce or cap freight charges at CP5 levels and provide early clarity on the structure of freight charges, including whether national charges would be retained in CP6;

- a simpler freight charging structure was requested, with suggestions that some existing charges should be scrapped to support this (Freightliner suggested that there should just be a variable usage charge and a freight specific charge); and

- ORR was encouraged to reflect the benefits of rail freight in freight charges and to revisit coal-specific charges on the grounds these were no longer justified. GBRf suggested that train paths with a poor train velocity should have discounted charges, to reflect that a FOC's operating costs are higher for services that have to run more slowly.

4.33 Other main points on charges:

- Transport Scotland flagged the importance of revisiting discussions around the allocation of the fixed track access charge (FTAC) to individual train operators,

and said this was particularly important given emerging investment opportunities for key cross border routes in Scotland;

■ VTG Rail UK asked that the structure of charges for CP6 encourage the development of, and investment in, new wagon technology. It said technologies for wagons to reduce track damage (and costs) existed but there was currently no financial incentive for wagon manufacturers to fit these;

■ UTG said that lines where there is little capital investment but higher maintenance should attract less fixed charge, and referred to the 2014 PTEG report "A heavy load to bear";

■ there was support for our proposal to simplify or abolish charges that do not deliver sufficient benefits; and

■ finally, ORR was asked to make decisions on charges in a holistic and transparent way, with a full assessment of impacts.

Other incentives

4.34 On other incentives, while there was broad support for retaining the fundamental structure of the Schedules 4 and 8 regimes, there were a range of views on what improvements should be made to them.

■ FirstGroup said that Schedule 8 should be reformed to factor in delay repay contributions from Network Rail. However, Freightliner expressed concern that this could make the freight Schedule 8 "even more unaffordable" for FOCs.

■ There were proposals that the sustained poor performance (SPP) regime in Schedule 8 and the sustained planned disruption (SPD) regime in Schedule 4 should be improved to reduce transactional costs. Some train operators said that arrangements relating to late notice cancellations and major operational disruption needed to be improved.

■ Network Rail said that Schedule 8 should have better incentives on passenger operators to reduce the reactionary delay that they cause; and

■ Network Rail, along with RDG and others, said the capacity charge should be reformed.

4.35 More generally, Stagecoach said that we should put in place initiatives to ensure a better understanding in the industry of what drives good performance. TfL raised a concern that freight operators were delaying passenger services in the London area and that FOCs were insufficiently incentivised to maintain performance and minimise impacts on other train operators.

4.36 On capacity incentives, as noted in respect of chapter 3, Network Rail wanted stronger incentives for it to grow traffic on the network. UTG was concerned about perverse incentives for Network Rail to accommodate additional slower services rather than speed up strategic services between key locations. To address this, it suggested that the volume incentive or a capacity incentive should factor in changes to operating speed on the network as well as changes in train kilometres.

4.37 In respect of freight incentives, freight stakeholders drew attention to the actions taken by freight operators in recent years to support increased efficiency. They noted that there were increasingly limited opportunities for freight operators to benefit from 'doing the right thing' and referred to the increase in freight Schedule 8 benchmarks in PR13, while payment rates had been left unchanged.

   ■ It was suggested that there be a longer-term approach to setting freight benchmarks to encourage investment; and

   ■ Freightliner said consideration should be given to a 'freight efficiency benefit sharing scheme' which is upside only to provide an incentive for FOCs to help Network Rail to reduce its costs. It said train operators opted out of the CP5 route-level efficiency benefit sharing scheme (which had a downside as well as an upside) because they felt that they could not sufficiently control Network Rail's costs. It suggested an upside scheme could include limited types of assets, initially at least, to test the effectiveness of the concept.

Our response

4.38 We acknowledge that the issue of charges and incentives is a significant one for many stakeholders, particularly freight and open access passenger operators, and note the detailed comments made.

4.39 We have reflected on the evidence and arguments put forward about the relative benefits of major reform to charges in PR18. We consider that reform of charges could be an important way of supporting improved efficiency over time, particularly if governments increase the degree to which franchised passenger operators are exposed to changes in these charges. But given the progress that we now expect to be made in the shift to route-level regulation (which should make a significant contribution to improving efficiency), and the limited capacity of all parties successfully to implement further changes, we consider that charges reform should be focused on particular aspects of the charging framework (i.e. fixed charges), with other changes being a lower priority at this time. On this basis:

   ■ we will explore incremental, rather than fundamental, improvements to variable charges in PR18, including simplification of charges where there is a case for this. This means that, for PR18, we will not continue work on options for the geographic disaggregation of the variable usage charge (VUC), or take forward

work to consider the implications (if any) of the differences between the current bottom-up calculation of the VUC and econometric benchmarks;

- in line with existing commitments, we will continue to prioritise reform of fixed track access charges so that open access operators (OAOs) make an appropriate contribution to fixed costs, alongside the Department for Transport's (DfT's) work to consult on introducing a public service obligation (PSO) levy for OAOs. In line with legislation, our work on access charges will require us to update our analysis of what the market segments can bear in both the passenger and freight sectors; and

- we will continue with the work to improve the transparency of fixed costs, of which Network Rail's cost attribution study is an important part.

4.40 In December 2016, we will set out more detail about the package of reforms that could be implemented in PR18. This will include a mix of proposals for simplification and more detail on the proposals set out above. We will also give an indication of the likely timescales for carrying out analysis on the ability of passenger and freight market segments to bear mark ups, to inform whether these should be applied in CP6 and, if so, at what level.

4.41 We will also set out potential options for the capacity charge, and the route-level efficiency benefit sharing mechanism (which encourages Network Rail and train operators to work together). The document will discuss improvements to Schedules 4 and 8, which will aim to address many of the areas for improvement that were highlighted in stakeholder responses. Alongside the consultation document, we will also publish impact assessments on our proposals. These will be in draft, for stakeholder comment.

4.42 Alongside our determination in 2018, we intend to set out plans for further reform to charges. This work will take place during this and the next control period, but no decisions would be taken until the next periodic review (PR23).

Supporting new ways to deliver enhancements

4.43 The majority of stakeholders broadly supported proposals for a flexible approach for the funding of enhancements, albeit with a number of comments and concerns that they would want to be addressed. RMT and Campaign for Better Transport were either not supportive or did not see the benefits of moving away from the more conventional periodic review approach to a more flexible rolling programme.

4.44 DfT and Transport Scotland confirmed in their responses their respective intentions to move away from specifying most enhancements projects through the periodic review process. DfT noted that this would provide for committing to enhancements when funds and supply chain capability are available and they make strategic sense.

4.45 In terms of the concerns and comments on this shift to a more flexible approach:

- there was some concern from freight stakeholders that if enhancements were taken out of the periodic process and aligned more with franchising processes, this could lead to potential improvements for freight services being overlooked. A related concern was that the shift to routes could lead to insufficient attention on freight improvements if a route focused unduly on the needs of the predominant franchised operator. Indeed, RFG said that there should continue to be an appropriate framework for the specification of freight enhancements and projects that span route boundaries;

- supply chain stakeholders emphasised the importance of the new framework providing long-term certainty around the programme of investment, with no hiatus – either from changes in control period or from projects having uncertain or annualised funding. Early supplier involvement in planning projects was stressed as being essential to improving outcomes in terms of cost and delivery. RIA cited the Staffordshire Alliance as an example of good client/supplier collaboration in this respect;

- Network Rail said that the more flexible framework should be consistent with its memorandum of understanding with DfT in respect of enhancements. It also sought clarity on how governments would fund enhancements, whether within or outside of PR18. It considered that enhancements that proceed on the basis of the benefits that they would deliver to wider society (as opposed to the railway) should be grant funded, rather than paid for through borrowing and the regulatory asset base. Otherwise, the railway would end up funding the societal benefits at the cost of increased debt and servicing costs for Network Rail and its customers;

- TfN/RN said there should be transparency in whatever mechanism is adopted for the assessing and approving the cost of enhancements in CP6. It proposed post-scheme assessment of outturn costs to understand how these compare with the anticipated final cost at the 'GRIP 4' stage of single option development;

- some stakeholders, while supporting a more flexible approach, considered that smaller schemes should continue to be part of the periodic process. In particular, there was strong and broad support for governments to retain ring-fenced funds for sensible deployment of small scale improvements; and

- Freightliner suggested the new framework provide for a stronger focus on the delivery of outputs and value for money, through Network Rail being encouraged to take a more flexible approach to projects. This would allow

Network Rail more flexibility in delivering required outputs, rather than it being required to deliver specific physical aspects of the projects.

4.46 Many stakeholders commented on the arrangements for third parties to fund enhancements. These included:

- concern from several stakeholders with Network Rail's processes for planning and managing enhancements, particularly third-party funded schemes. There were comments that Network Rail was sluggish in responding to funders, and that delivery is typically slower and more expensive than originally agreed with the company. It was suggested that it needed to improve to attract investment;

- there were suggestions that ORR should improve regulatory structures to support third party investment, including supporting greater value for money for those considering investing. West Coast Trains said that Network Rail had been more successful at attracting funding late on in control period 3 and control period 4 but not in CP5. It said that existing arrangements meant development and delivery needed to be squeezed into a single control period and that this deterred third party investors; it would be better for the arrangements to align more with franchises and rolling stock and depot strategies; and

- the Welsh Government noted issues it had experienced when funding or part-funding projects. It also said it wanted to be able to fund enhancements without being considered a 'third party'.

Our response

4.47 We acknowledge the many comments made in this area and will consider these as the new enhancements framework is being developed. Further to Network Rail's views about how the costs of enhancements that deliver societal benefits are recovered, our December 2016 financial framework consultation will discuss this further. This links with how to improve incentives to investment in cross-border enhancement schemes.

4.48 While we note widespread support from stakeholders, including train operators, industry groups and devolved bodies, for the continuation of ring-fenced funds in CP6, it remains for governments to decide whether to include these in their HLOSs.

4.49 We welcome the calls for increased third-party funding of enhancements during the next control period, to provide both additional sources of investment and promote more sustainable development of the network.

4.50 We will continue to develop proposals for the regulatory treatment of enhancements outside of the periodic review, working closely with Network Rail, governments and other stakeholders on this following their responses to our initial consultation and

[working paper 5](#) on enhancements (WP5). We will publish a summary of responses to WP5 along with our comments on these and next steps, in December 2016/ January 2017. The next steps will include how we plan to support third party investment.

The 'Digital Railway'

4.51 RDG and Network Rail stressed the importance of early clarity on the funding arrangements, deliverability and affordability of the 'Digital Railway' programme. This was necessary to provide certainty and allow the first stages of the programme to be rolled out in CP6. Network Rail also said that there were research and development activities that were not directly part of the programme but which were critical to its success.

4.52 Other points made on the 'Digital Railway' included:

- comments on the affordability of ERTMS;

- the need for it to be delivered in a way that does not harm freight traffic (given that it operates across the network);

- a suggestion that European Train Control System (ETCS) roll-out be linked to franchise award, to ensure it links up with rolling stock changes and plans to maximise the operational benefits; and

- the importance of suppliers being involved as early as possible in the programme.

Our response

4.53 As noted in our consultation document, the Digital Railway has the potential to deliver many benefits, but some Digital Railway solutions, especially ETCS, have significant cost implications. The extent to which the Digital Railway can be included in the PR18 determination will depend on how developed the programme is as well as the decisions of governments on what they want to fund.

4.54 We will also expect Network Rail to provide business cases for any research and development related to Digital Railway and for this to be included separately in its business plans.

5. Developing the high-level framework for the review

Overview of chapter 5 of our initial consultation

Chapter 5 of our consultation set out a potential way to implement our high-level approach, with the aim of getting stakeholders' thoughts on how the high-level framework for CP6 should be constructed. It discussed the concept of separate 'settlements' for key parts of Network Rail's business, such as the devolved routes. We said these settlements could include specific funding, outputs and incentives (depending on the part of the company involved), providing for the relevant management team responsible to deliver/outperform against this. We noted that some parts of the company (such as the NSO) might have a full or tailored settlement.

The working papers that we subsequently published (particularly on route-level regulation and system operation) provided more detail on how the settlements might work. Stakeholders' responses and our views on these will be made available shortly.

Introduction

5.1   Given the potential for stakeholder comments on chapters 4 and 5 of the consultation to overlap (noting one is broadly about the principles and the other is about high-level implementation), where it made sense to do so we have covered comments in chapter 4. We have not covered all section headings of chapter 5 of the consultation here where comments were relatively minor or are better picked up in response to the working papers.

Summary of stakeholder views and our response

Settlements

5.2   While there was there was broad support for the concept of separate settlements within the determination for Network Rail, there were different views on how far these should go.

- Network Rail broadly agreed with the potential approach we set out but said that revenue requirements should be set for the devolved routes only, with the costs of the system operator and central functions being allocated to the routes' settlements (e.g. for the purposes of calculating access charges). It said the outputs for the routes and system operator should be based on scorecards agreed with customers.

- RDG, in particular, stressed the need for flexibility within the framework so that Network Rail could move resources and activities between routes and functions, to maximise efficiency.

- Freight stakeholders, in particular, wanted to understand how the virtual freight route would be regulated, as compared to the geographical routes. The Chartered Institute of Logistics and Transport said that the virtual freight route (and the system operator) should not be heavily regulated; the bulk of ORR's focus should be on the geographical routes. Freightliner noted the need to be wary of potential perverse incentives, and said that at present there was a lack of clarity within Network Rail about how money flows between the freight team and the geographical routes. It said that the freight team currently receives income from the freight capacity charge, rather than the relevant route(s). This meant there was a disincentive for routes to accommodate more freight traffic. It considered that income should flow to routes where costs were borne.

- More generally, there were comments that the amount of work implied by the potential framework seemed very ambitious.

Our response

5.3   We are taking forward the concept of separate settlements within the determination. However, there is a lot of detail to work through on this and we will continue to engage with stakeholders ahead of setting out our 'minded to' view on the framework for routes and the system operator in July 2017.

5.4   We acknowledge the importance of ensuring the freight and national passenger operator route (FNPO) is regulated appropriately. Network Rail is continuing to develop the scope of its role and relationship with other routes. Our draft SBP guidance[2] which will be published for consultation later in November 2016 will set out the information we are seeking from Network Rail in respect of the FNPO.

Revenue requirement and duration of control period

5.5   On the issue of the length of the control period and how we should treat Network Rail's income, there was a consensus in favour of our proposal to retain a five year control period and the 'single-till' approach. However:

- RMT considered the control period should be substantially longer, to support long term planning and innovation;

- Freightliner suggested that freight charges and incentives should be set for ten years, to provide certainty to the freight sector and support investment; and

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[2] The link to this document will be activated when the consultation goes live.

- there was concern from some stakeholders that sales of Network Rail's assets would reduce other single till income, increasing track access charges (a point we noted in our consultation). TfL was concerned about the impact on mileage-related charges, which it said could discourage growth in traffic.

5.6 On efficiency, Network Rail said that it was important that our efficiency assumptions for CP6 were realistic, reflect the pace of change that is possible, and take account of the funding and financing arrangements which would have a bearing on efficiency. Where other stakeholders commented, they generally agreed with this.

5.7 Our proposal to make more use of comparisons and benchmarking between routes was also broadly supported, albeit that the comparisons needed to be appropriate and fair. Alongside route benchmarking, Abellio said that there remained merit in ORR continuing to look at (but not relying on) comparisons with overseas rail networks and other customer-focused industries within and beyond the UK.

Our response

5.8 Having considered the responses, we remain of the view that a five year control period and the single-till approach should be retained. We do not propose to set charges and incentives for freight operators on a longer basis, as this would span control periods and risk significant divergence between cost and these charges.

5.9 We note the comments on efficiency. In response to Abellio's point, while route-level comparisons will have a greater role than in PR13, we agree that we should not rule out using comparisons with other countries and industries. We intend to maintain our work on these where we think they will have value and can be used appropriately – for example, as a cross-check against our other analysis (which is how we used these comparisons in PR13).

Financial framework, managing uncertainty and monitoring financial performance

5.10 Our consultation did not set out any specific proposals in respect of the financial framework but discussed some of the key issues that need to be considered, including how the borrowing limits for Network Rail would affect PR18.

5.11 In its response, Network Rail stressed the importance of having certainty on the mechanisms through which funds would be provided to it (including borrowing/debt limits), both to inform the development of its strategic business plans and for us in developing our financial framework policy. It said that this information should be included in the Secretary of State's statement of funds available (SoFA). RDG also supported the borrowing limit being included in the SoFA.

5.12 Network Rail also reiterated its point (discussed in the enhancements section in chapter 4 of this document) that enhancements with wider societal benefits should be cash-funded in CP6.

5.13 On the issue of Network Rail reallocating funding between routes where this is appropriate to manage risk, Network Rail agreed with us that there would need to be a clear reporting process of over- and under-spending at route-level. TfN/RN commented that any such reallocation of funding should not affect obligations to deliver agreed route-level outputs.

5.14 Network Rail also agreed that settlements for CP6 should include a specific financial buffer to recognise potential changes in circumstances. But it also considered that the framework should allow for trade-offs between outputs and expenditure, which would be reported in route scorecards. Network Rail said it strongly supported the creation of a central risk reserve to manage network-level uncertainty and contingent risks, and said that this would need to be included in Network Rail's central plan.

5.15 On monitoring at route and system operator level, Network Rail said it would be important for the reporting burden that we put in place to be proportionate. TfN/RN commented that while it supported route-level reporting and monitoring, it thought this would only be of limited use to it and its partners, as train operator measures would be important as well.

Our response

5.16 In December 2016, we will consult on financial framework issues, including the management of uncertainty. Our work on the monitoring framework is linked to development of the outputs framework, for which next steps will be set out in a conclusions note to the outputs working paper in December 2016 and the framework developed further in 2017.

Incentives framework

5.17 Most of the main points raised about the incentives framework have been covered under chapter 4. One detailed point that some stakeholders made was in relation to Schedule 8 and our comment in the consultation that this may need to be route-based if routes are to be held to account on the basis of route-specific targets.

- Freightliner did not consider that this was needed and that it could lead to arguments between routes about delay attribution, reducing focus on working together to address delays.

- Network Rail had a similar concern, considering that such an arrangement would be complex and said it would be more valuable to customers for it to deliver a good, consistent level of performance across the entirety of a service. It wished to understand the rationale for our suggestion.

Our response

5.18 Schedule 8 benchmarks are currently based on train operator performance (PPM) trajectories, which are determined by the national level regulated output. The shift to route-level regulation may require a change to that approach if there is no longer a national level regulated output for punctuality.

5.19 We are not necessarily proposing that Schedule 8 benchmarks be differentiated by route. But the shift to route-level regulation may, for the reasons set out above, require a change to the way that benchmarks are set. For this reason, we will need to consider the implications of any changes to performance outputs and how to ensure that the Schedule 8 regime's incentives operate as effectively as possible.

5.20 We will be discussing this with industry in 2017 as part of broader engagement on the approach to re-calibration of Schedule 8.

6. Process and engagement

Overview of chapter 6 of our initial consultation

Chapter 6 of our consultation gave an overview of the key phases of the review, set out our proposed approach to engagement and discussed the role of other key parties during PR18. As well as seeking views on this, we also sought views on the role that the industry wanted in implementing the review and on the process for Network Rail to object to our determination.

Summary of stakeholder views and our response

Process, main phases of PR18 and the timetable

6.1 On the proposed process and timetable for the review:

■ some stakeholders considered that the proposed timetable appeared challenging. Network Rail in particular said that the publication of strategic business plans in October 2017 would have significant implications. It noted the need for sufficient time for routes to produce robust plans and engage effectively with customers;

■ West Coast Trains and FirstGroup both said that the interaction between PR18 and DfT's franchising schedule needed to be considered. The franchising schedule would be particularly busy at the same time that PR18 would be in the process of being concluded and implemented (summer 2018 to March 2019). This would limit TOC resource and could constrain Network Rail's ability to engage in both processes;

■ DB Cargo commented that the PR18 process did not align with the governments' policy timetable and that ORR should adopt a more flexible approach if this was necessary to address this. It also flagged the risk of regulatory policy being developed ahead of Network Rail's decisions on the design of its functions such as the system operator;

■ RIA asked whether Network Rail's delivery plan could be published slightly earlier than March 2019;

■ Go Ahead Group and RDG sought more clarity on the work programme for PR18, including decision dates through to the draft determination in summer 2018 to help plan industry engagement. RDG also said that issues should not be left open late on into the review process.

- The Campaign for the Protection of Rural England (CPRE) suggested that there be greater alignment with the road investment strategy (RIS) for Highways England, so that more of a cross-modal approach could be taken.

Our response

6.2 We note comments that the draft timetable appeared challenging. We have now prioritised aspects of PR18, including by reducing the scope of our work on charges reform. We are discussing with Network Rail the timing of its SBPs, with the aim of providing more time for it to produce them while ensuring that we have enough time to carry out an orderly review of the plans.

6.3 We have reissued the [PR18 timetable](), which contains more detail than in May 2016, providing greater clarity with how and when decisions will be taken. We also agree that it is desirable to close down decisions early where possible, not least to provide more time for implementation. While there always remains the potential for complex issues to arise unexpectedly at a late stage, we do not intend to leave issues open longer than is necessary.

6.4 Unfortunately, because of the constraints in the process, it is difficult to move forward the date of Network Rail's delivery plan (because it needs to take account of our October 2018 final determination). However, as in PR13, we understand that Network Rail will begin developing its draft delivery plan following our draft determination in June 2018, with a consultation in December 2018, so stakeholders, including suppliers, can engage and have earlier sight of plans before March 2019. Similarly, while we are mindful of the interactions with the franchising process, there is no scope to change the PR18 timetable to avoid this.

6.5 We are working closely with governments to ensure that PR18 aligns with their timetables. On the issue of regulatory policy being developed ahead of Network Rail's decisions on design, we do need to make progress developing the framework or we will run out of time in PR18. But we note the need to take a flexible approach particularly to the regulation of the system operator, while ensuring it is properly incentivised.

6.6 In respect of aligning PR18 with highways investment, the process for the next RIS is set on a different timescale to PR18. However, as DfT is shifting to a more flexible approach to specifying enhancements outside of the PR18 process, this should better enable DfT to make aligned decisions on road and rail enhancements should it wish to do so.

Our approach to engagement

6.7 Stakeholders broadly welcomed our approach to engagement, including the use of RDG PR18 working groups to inform the development of policy alongside more

formal consultation and other engagement such as bilateral meetings and workshops. A number of stakeholders noted our comment in our consultation that the groups should be open to non-RDG members. Some suggested that non-rail stakeholders be invited, including combined authorities and passenger representative bodies. TfN/RN commented that it wanted to be kept informed of opportunities to participate in these groups.

6.8 Other comments on our proposed approach to engagement included:

- a comment from RMT that PR18 needs to provide for unions to be more engaged in the process and given the same status as other industry bodies;

- Transport Scotland said that we should publish a brief conclusions note highlighting the main issues raised in response to each working paper and outline how our emerging thinking has changed as a result of feedback;

- some stakeholders said that there needed to be a clear line of sight between feedback from stakeholders to consultations and our decisions;

- while stakeholders generally expressed keenness to engage in PR18, many noted the burden that this entailed; and

- the Freight Transport Association (FTA) suggested a session between ORR and freight customers, such as a specific meeting of ORR's freight customer panel, to discuss freight issues in PR18.

Our response

6.9 We have attended the RDG working groups since May 2016 and have found them to be useful ways to discuss detailed policy issues to inform the development of the regulatory framework, and are grateful for the time commitment of the attendees. The attendees have typically included passenger train operators/owning groups, freight operators, RFG, DfT, Transport Scotland, Welsh Government, RDG and ourselves.

6.10 We note the significant interest in attending the working groups. While these are RDG's working groups, we are mindful that there is a balance between ensuring – on the one hand – that each group is representative and – on the other – that the groups are not too big as to become ineffective. We should also be clear that these groups do not determine what Network Rail will be delivering within each route in CP6, but typically discuss specific elements of the regulatory framework such as options for access charges and how the system operator should be regulated, which help inform our approach ahead of more formal consultation. We also normally publish the notes

of the key points from these meetings, providing transparency for those that do not attend[3].

6.11 Network Rail is setting up separate stakeholder sessions (at route-level) to discuss its priorities and plans for CP6 (see below). These are likely to be better suited for some stakeholders to engage. Where stakeholders such as TfN/RN are interested in joining RDG's PR18 working groups, they should approach RDG.

6.12 We welcome RMT's intention to be engaged throughout the process and note that it has signed up to our mailing list and so will receive details of our consultations, along with other industry stakeholders. We look forward to engaging with it, including through our bi-annual meetings.

6.13 On FTA's suggestion of a session with freight customers on PR18, we propose to use the next meeting of the ORR freight customer panel for this.

6.14 We note the request to be clear on how we have responded to comments received. This document is intended to provide that clarity in respect of the initial consultation. We will also publish summaries of the working papers and a brief conclusions note, as requested by Transport Scotland, and be mindful of the need to provide proportionate feedback on how we have taken comments into account throughout the review.

Involvement of stakeholders in the development of Network Rail's SBPs and taking account of the interests of consumers

6.15 There was strong support among respondents for much greater stakeholder engagement in informing what Network Rail should deliver, so that it reflects what Network Rail's customers (i.e. train and freight operators), passengers, freight customers, and funders want.

6.16 There was also support for greater stakeholder engagement throughout CP6 in *how* Network Rail delivers what it committed to.

6.17 RDG suggested that the emphasis of our regulatory approach should be on encouraging effective engagement between Network Rail routes and train operators, especially in the preparation of the SBPs. Similarly, RSSB said that Network Rail needs to demonstrate that it has engaged and actively sought and acted on the requirements of its direct customer, train operators.

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[3] More information on RDG's PR18 working groups is available on our website, along with the notes of the meetings. Please see http://orr.gov.uk/what-and-how-we-regulate/regulation-of-network-rail/how-we-regulate-network-rail/periodic-review-2018/workshops/rdg-pr18-working-groups.

6.18 While the opportunities from greater customer engagement were noted, risks were identified as well. In particular:

- The risk that route plans could be unduly influenced by a lead train operator in a route was flagged by several stakeholders;

- RIA said it would be important to manage the risk of franchised operators taking a short-term approach driven by their franchise length. This could mean less interest in asset condition; and

- Network Rail noted that as franchised operators were not currently exposed to changes in charges at a periodic review (which reflect changes to costs), this would affect how they engage and seek to influence outputs.

6.19 While endorsing greater customer engagement, freight stakeholders noted that if they were to have to engage across eight routes, this would have a significant resource burden for freight operators and freight customers. Some suggested a key role for the virtual freight route in this process to represent their interests.

6.20 Stakeholders representing passengers and freight customers stressed the importance of end users being represented in the process. There were suggestions on how this could work in practice and many stakeholders wanted to be involved.

- Transport Focus said that passengers should be directly engaged at route-level so that local needs and aspirations of passengers were understood. The priorities arising from this engagement should then inform decisions on what should be delivered. The route should then engage passengers directly in terms of delivery.

- Transport Focus further said that to support greater accountability to passengers, routes should produce a statement on what will be delivered for passengers (including the targets) and by when. This should then be followed by transparency on performance, such as through a passenger-friendly version of scorecard information.

- Transport for the North said that it would be important that Network Rail engages effectively with stakeholders in preparing its plans and that stakeholders are given sufficient time to scrutinise these.

6.21 The importance of ensuring that what Network Rail delivers reflects end-user priorities was also recognised by train companies and funders.

6.22 Network Rail highlighted the value of customer engagement in making plans more robust and aligned to end users' needs, but considered that the process for seeking customer input into the planning process would be an iterative one, and would be developed further beyond PR18.

6.23 On ORR's role, TfN/RN said that we should assess the effectiveness of Network Rail's engagement and the extent to which it has buy-in. Similarly, Transport Focus suggested the quality of Network Rail's engagement should be measured and compared. It also proposed there should be incentives to encourage communication and engagement with passengers, for example, in respect of delivery of engineering work. GBRf said that ORR should have a role in overseeing the engagement process.

Our response

6.24 There should be clear line of sight between what end users want and what Network Rail delivers. To support this, there need to be opportunities for Network Rail's route and the NSO plans to be informed and challenged by its stakeholders, including train operator customers, freight customers, funders and end-user representative bodies. There is also a large body of research available to Network Rail on end user priorities. This includes the Passenger Demand Forecasting Handbook, which reflects many years of research into passenger preferences.

6.25 Network Rail's engagement with stakeholders should help it to focus on delivering for its customers and end users, and remove the perception that ORR is its customer. For CP6, the following will play a key role in supporting this:

- **route-level and NSO scorecards**: these will provide a means for a route (and the NSO) to report on performance measures that its stakeholders consider are important. This reflects the scope for scorecard measures to differ across routes;

- complementing the above, **closer and more direct engagement between a route (and the NSO) and its stakeholders**. This includes both national stakeholders (e.g. Transport Focus) and each route's local stakeholders. The latter are likely to be more directly affected by the route's plans and will have local knowledge that could support greater cost savings around how the plan should be delivered. To this end, Network Rail is setting up stakeholder sessions for each of the routes and their stakeholders in February 2017, to help initiate some early and formal discussion about stakeholders' priorities for what the plans will deliver, and how; and

- in turn, **a role for greater flexibility between routes in *how* they engage with stakeholders**, reflecting the different range of stakeholders each route (and the NSO) serves, and their different preferences for how their input is secured.

6.26 Our draft guidance to Network Rail on its SBP will set out further detail on how we expect the interests of stakeholders, including end users, to be reflected in Network Rail's plans. We also intend to work more closely with Network Rail and industry to consider this further, including around the issues discussed above. This may include

an assessment of how effectively Network Rail has engaged with stakeholders, and for this to inform our overall assessment of the quality of the route and NSO business plans.

6.27 We recognise that it would be burdensome for freight and cross-country passenger operators (and their customers) to engage across all routes. The role of the FNPO is currently being developed by Network Rail, including its role in liaising with other routes, so we are not in a position to comment further, but we agree that it has a key role to play.

Network Rail's engagement with suppliers

6.28 While Network Rail's engagement with its customers is discussed above, several comments were received from supply chain organisations in respect of Network Rail's engagement with suppliers. These emphasised the importance of Network Rail involving stakeholders as early as possible in the development of capital projects and greater collaboration, to support better outcomes including greater efficiency. There were also comments about supply chain involvement in PR18 more generally.

6.29 Some of these points have been discussed elsewhere in this document, such as the suggestion of a supplier feedback metric on scorecards or a collaborative behaviour measure. Additionally, WSPPB said that the way that Network Rail procures and executes its contracts is too transactional, which does not promote collaboration with the supply chain.

Our response

6.30 We note the points raised regarding Network Rail's relationship with suppliers. We will review how Network Rail considers the supply chain's interest in and capacity to deliver CP6 work, as part of our assessment of Network Rail's delivery planning capability. We note that Network Rail's Transformation Plan sets out its intention to engage with the supply chain early.

6.31 We recognise that supplier satisfaction is important for Network Rail to consider and some responses suggested this should be added to Network Rail's route scorecards. When Network Rail and its stakeholders discuss scorecards for CP6, they may want to consider these suggestions.

6.32 We welcome specific suppliers (along with bodies like RIA and CECA) signing up to our mailing lists, responding to our consultations and engaging in the PR18 process.

Implementation

6.33 Network Rail stressed the importance of there being sufficient time towards the end of the PR18 process for implementation. This was to ensure amendments to access contracts and the Network Licence could be developed in an orderly way, ensure all

relevant parties have the opportunity to contribute and understand the provisions, and to minimise the risk of drafting errors.

6.34 In our consultation, we sought views on the appetite of train operators to take a greater role in the implementation process compared to previous reviews. While there was little response to this, Network Rail said that if train operators were to be more involved in this process, policy decisions would need to be finalised earlier.

6.35 Network Rail also supported our proposal to explore how individual route settlements could be challenged by Network Rail without reopening the whole determination. However, it queried how this could work if ultimately Network Rail did object and ORR referred the matter to the Competition & Markets Authority for determination.

Our response

6.36 There needs to be sufficient time for orderly implementation of PR18. While the shift to regulate more at route and system operator level presents challenges, we intend to take opportunities to begin drafting work earlier where this is possible, including on changes to access contracts, as policy decisions are made.

6.37 We note that train operators expressed little appetite for a greater role in the drafting process for implementation. On this basis, in consultation with Network Rail, we will decide later in PR18 what the engagement process for implementation should be, taking account of the time available. As a minimum, we would expect to consult train operators on the drafting of changes to their access contracts. We will also discuss with Network Rail whether it should have discrete areas of drafting to develop, with our oversight (and consultation).

6.38 On the issue of the process for Network Rail to object to our determination, we note Network Rail's comments and intend to consider this area in more detail next year. To manage expectations, we cannot change the process for the Competition & Markets Authority (CMA) to determine a reference we make to it if Network Rail objects. Rather, we plan to consider alternative processes that would need to work alongside/ahead of the processes provided for in legislation.

Appendix: Respondents to initial consultation

Respondents to our initial consultation		
Abellio Group	Essex County Council	Rail Freight Group (RFG)
Andrew Cordiner	Europorte	RMT (National Union of Rail, Maritime and Transport workers)
Arriva UK Trains Ltd	FirstGroup	Railway Safety and Standards Board (RSSB)
Association of Public Transport Users (APTU)	Freight on Rail	Sustainable Development Steering Group (RSSB)
British Steel	Freight Transport Association	SESTran (South East of Scotland Transport Partnership)
Campaign for Better Transport	Freightliner Group	Siemens Rail Automation
Campaign to Protect Rural England (CPRE)	GB Railfreight	Stagecoach Group
Carillion Rail	Go Ahead Group	Strathclyde Partnership for Transport
Chartered Institute of Logistics and Transport (CILT)	Historic England	Transport Focus
Chris Fox	IOSH Railway Group Committee	Transport for London (TfL)
Civil Engineering Contractors Association (CECA)	John Cartledge	Transport for the North and Rail North (TfN/RN)
CoalImP (Association of UK coal importers and producers)	John Penrose MP	Transport Scotland
Croydon Council	Local Government Association Public Transport Consortium	TravelWatch SouthWest
Cumbria Local Enterprise Partnership	London TravelWatch	Urban Transport Group (UTG)
DB Cargo (UK) Limited	Merseyrail	VTG Rail UK Ltd
DB Regio Tyne and Wear Ltd	Merseytravel	West Coast Trains (WCT)
Department for Transport (DfT)	Network Rail	Welsh Government
Drax Power Limited	North East Rail Management Unit	West of England Local Enterprise Partnership
East Coast Main Line Authorities	Rail Delivery Group (RDG)	WSP Parsons Brinckerhoff Ltd (WSPPB)
East Sussex Rail Alliance	Rail Industry Association (RIA)	