

PR18 working paper

Working paper 1: Implementing route-level regulation

Date of publication: 7 June 2016

Overview

Our [initial consultation](#) on PR18 sets out that the increased devolution of responsibilities by Network Rail to its route business units provides an opportunity for us to improve how we regulate the company by focusing our regulation much more on its individual routes. This in turn supports Network Rail's strategy of increased devolution, the creation of route business units, and provides for greater involvement of customers and end-users in the decisions that affect them.

Route-level regulation has the potential to deliver benefits both by improving information on Network Rail's financial and operational performance, for us and Network Rail's customers and funders), and also by improving incentives on the routes to outperform each other.

But this change will have major implications for how we conduct PR18 and how we monitor its delivery in control period 6, as well as for Network Rail itself and other key stakeholders. To get the most from this change, we will need to be clear about the relationship between the routes and Network Rail centre, and how each interacts with us, the governments, train operators and other stakeholders (including new regional bodies such as Transport for the North).

In deciding how we regulate at route-level, we will also need to decide how we might regulate Network Rail's national system operator function and other national activities. The regulation of the national system operator is the subject of a [separate working paper](#).

Working papers are intended to facilitate a more dynamic process of engagement and consultation with stakeholders, to support an iterative approach to developing policy. We welcome all responses to the paper, including less formal responses such as emails, bilateral or multilateral discussions on any aspects covered in the paper, as well as alternative ideas and proposals. Paragraphs 10-11 of this paper provide further information on responding.

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Responses and engagement on this paper are requested by 24 August 2016

Introduction and purpose

Context and challenges

1. Network Rail is a complex public sector monopoly that faces different incentives to those that typically exist in other markets. Network Rail's ongoing work to devolve responsibility to its routes¹ presents opportunities: first, to move decision-making closer to its customers; and, second, to use regulation to replicate some of the benefits of competitive markets, through comparison of route performance, to improve outcomes for current and future rail users and taxpayers.
2. Our proposals complement the Shaw Report², which makes a compelling case for significant and substantive route devolution to enable a greater focus on customers and use of comparative competition. The report also highlights the importance of independent regulation in this context through balancing the needs of today's customers with those of future customers and the taxpayer.
3. However, as the Shaw Report noted, the effectiveness of devolution and route-level regulation depends on routes having sufficient responsibility to take decisions on how they manage the network in their route³. Without this, the scope for routes to vary their approach will be limited, making it harder for them to respond to stakeholders and giving them weaker incentives to perform. Network Rail's progress in implementing its plans on devolution will therefore be key.
4. The approach taken for Network Rail will need to be different to that adopted in other sectors. In particular, route-level regulation will need to reflect the following:
 - Network Rail is a single legal entity (with a single network licence and separate borrowing limits for England & Wales and Scotland) and a single duty holder with one safety management system. This makes its Board, rather than its route management teams, corporately accountable for its performance, safety management and compliance with its licence. This raises the issue of how Network Rail's corporate centre (Network Rail centre) relates to its routes. This will be a key factor in the degree of ownership felt by the routes and correspondingly how effective our proposed regulatory approach will be;
 - the benefits to customers of a single, national network (delivered through cross-route coordination and central oversight, notably by the recently announced

¹ In this paper, references to "routes" are to the (currently) eight devolved business units within Network Rail, as listed in Figure 2, rather than to specific lines of route.

² Recommendation 2 on page 2 of [The Shaw Report – the future shape and financing of Network Rail](#), March 2016.

³ The Shaw Report recommended, amongst other things, that routes should have responsibility for asset management planning, optimising engineering works and performance.

virtual route for national passenger and freight operators and a national system operator function);

- that enhanced engagement with Network Rail's customers should mean that Network Rail's plans will be better focused on end-users' priorities (with our determination also taking account of this information); we need to work through with Network Rail and industry how the engagement process would work, in particular, how it would inform Network Rail's outputs and take account of the costs (from which its customers are to a large degree protected), both in the short and longer term; and
- Network Rail's relationships with Department for Transport (as a funder and sponsoring department) and Transport Scotland (as a funder) means it is subject to certain requirements⁴. These include the statutory process for governments to set out their requirements and the funds available to deliver them, but also requirements included in the [framework agreement](#) relating to the development and agreement of Network Rail's strategic business plans (SBPs). This may constrain the ability of the routes to prepare independent plans.

5. There are also technical and communication challenges associated with making effective comparisons between different routes, and doing so in ways that are fair and which attract sufficient support from stakeholders both internal and external to Network Rail. We will work through these issues with Network Rail, governments, customers and other stakeholders, and will be transparent in setting out the evidence to support our conclusions on route-level regulation during PR18.

Structure of working paper

6. Our working paper starts by:
 - outlining where we are now in terms of route devolution and regulation; and
 - giving an overview of the potential framework for our PR18 determination that we set out in chapter 5 of our [initial consultation](#) on PR18.
7. We are mindful of the need to make significant progress in determining clarity about this framework, to implement it for PR18. To support this, for the remainder of the working paper we describe in more detail the practical steps that would be needed ahead of the submission of the SBPs and beyond. The SBPs are particularly

⁴ We recognise that the Welsh Government and regional bodies such as Transport for London, Transport for the North and Midlands Connect have an important role in informing what is delivered in CP6, whether or not their role is recognised in the current statutory process for the review. As noted in our initial consultation document, our review process will need to take account of their views and we will engage with them to ensure this.

important as we typically undertake significant scrutiny of the information contained within them.

8. This working paper is published as a supporting paper to our [initial consultation](#). The initial consultation sets out how we intend to undertake our periodic review of Network Rail in respect of control period 6 (CP6), which we expect to run from April 2019 for five years. It forms one of a number of working papers prepared to support the initial consultation, with others relating to system operation, outputs and enhancements⁵.
9. A glossary of terms used in PR18, including in this working paper, can be found [here](#).

Responding to this working paper

10. Working papers are intended to facilitate a more dynamic process of engagement and consultation with stakeholders, to support an iterative approach to developing policy. We welcome all responses to the paper, including less formal responses such as emails, bilateral or multilateral discussions on any aspects covered in the paper, as well as alternative ideas and proposals. We have set a deadline for responses, but this should not prevent stakeholders from sending thoughts to us ahead of this date; indeed, we hope that our ongoing conversations with stakeholders following publication of this paper mean we will be able to make significant progress by the deadline. Earlier responses on this paper, or just on particular issues raised in it, would help us in this respect.
11. Where written responses are made to us (particularly more formal responses), we may publish these on our website. If you wish any information that you provide, including personal data, to be treated as confidential, please say so in your response (an automatically generated confidentiality disclaimer by IT systems will not necessarily be sufficient in this respect). However, please be aware that regardless of any such request, we may be obliged to disclose or release any submissions made to us under the access to information regimes, such as the Freedom of Information Act 2000 or Data Protection Act 1998. Further information about how we may treat your response is available in paragraphs 6.40-6.43 of our [initial consultation](#) on PR18.

Where we are now

Substantial devolution of Network Rail's functions

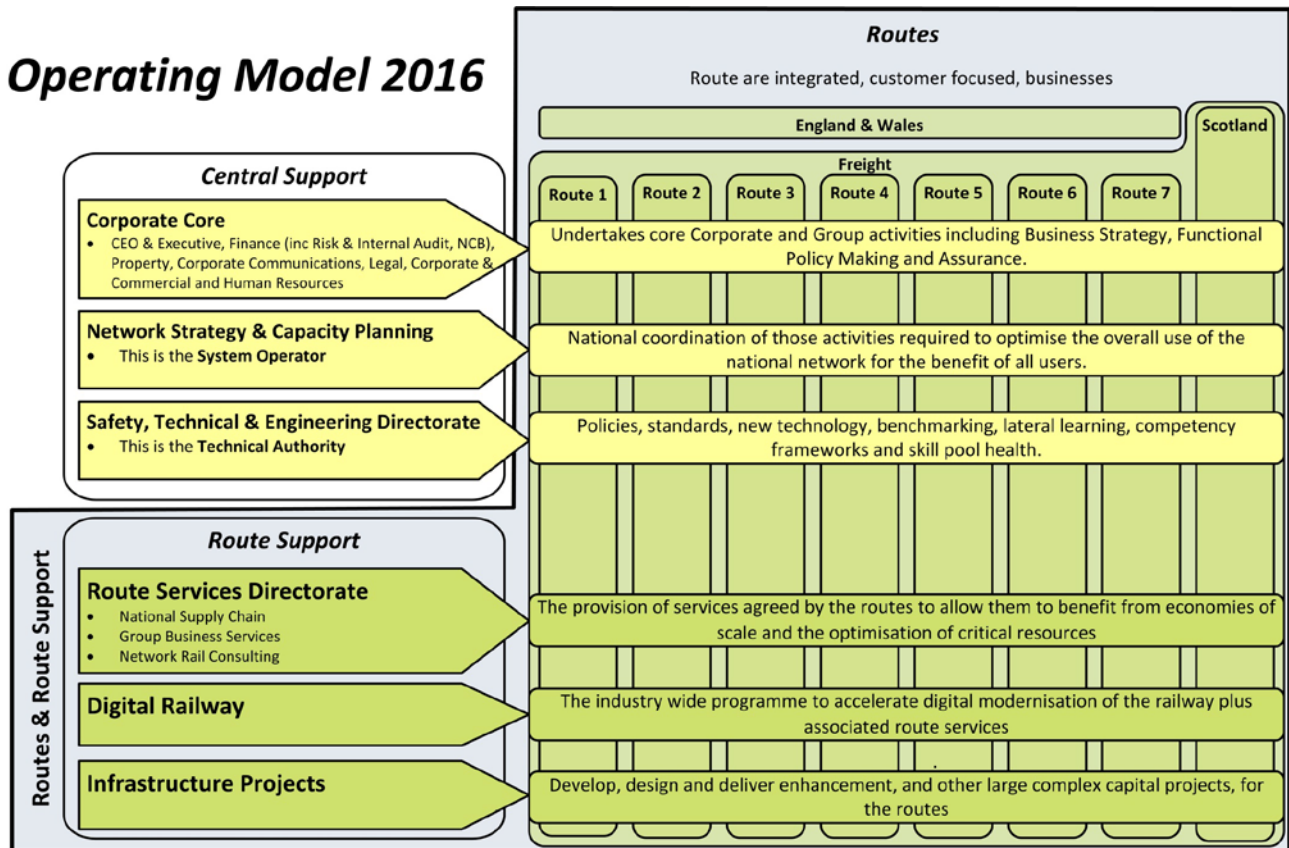
12. In November 2011, Network Rail announced that it was devolving responsibility for the day-to-day running of its infrastructure from its centre to ten 'strategic' devolved

⁵ The working papers will be available at www.orr.gov.uk/pr18. The system operation working papers were published alongside this working paper, with the remainder scheduled to be published around the end of June 2016. See Figure 1.1 of our [initial consultation](#) for links to these.

routes, each with their own management team. These ten routes were subsequently consolidated into eight routes (which are listed in Figure 2 below). As part of this, Network Rail disaggregated its financial information and has produced route-level accounts from 2012-13 onwards (though financial separation for the Scotland route started earlier, including separate determinations for Scotland from England & Wales from CP4 onwards).

- In November 2015, Network Rail announced that it was moving to a new “optimised route based operating model”, as set out in Figure 1 below. This model involves a rebalancing of operational responsibility from the centre, with greater devolved accountability for the routes and the creation of a Route Services Directorate to act as a provider of services to the routes for which economies of scale or scope might be retained through centralised delivery, or for which a degree of network-wide coordination is needed.

Figure 1: Network Rail’s operating model 2016



Source: Network Rail

- This shows how Network Rail has been and is making changes to its internal structure to move more responsibility from the centre towards its routes. As the Shaw Report says, the proposals for further devolution “represent an evolution, extension and validation of a direction of travel already set in motion by the company’s leadership”.

Adapting how we regulate Network Rail to reflect devolution

15. In this section we describe how we have evolved our regulation of Network Rail to reflect the changes it has made and describes the extent to which we regulated at route level in the last periodic review (PR13) and in the current control period (CP5).
16. In PR13 our determination included some aspects of route-level regulation:
 - Network Rail submitted its SBPs at an England & Wales and Scotland level, but with much of the England & Wales information disaggregated by route. As part of our scrutiny process, we held a review meeting with each route to discuss its plan, which allowed for some analysis and comparison but we did not undertake formal comparative analysis of route submissions.
 - In our PR13 final determination, we set out our assumptions for CP5 costs and income by route. Although this was not binding, it informed the baselines for the route-level efficiency benefit sharing mechanism (REBS). For the purposes of REBS, Network Rail adjusted these baselines to reflect its view of route costs and income. The fixed track access charge was split by route and then allocated to franchised train operators.
 - Together with Network Rail, we also established a methodology for apportioning both its regulatory asset base (RAB) and debt to individual routes on the basis of the geographical distribution of physical assets. These indicative assumptions were included in our PR13 final determination.
 - We also set some incentives at a route-level:
 - the volume incentive, which is a financial incentive to encourage Network Rail to support growth in traffic, was set at route, rather than national, level for the first time. The aim here was to encourage each route to work more closely with its customers to increase passenger and freight traffic; and
 - REBS, which is a financial incentive to encourage participating train operators to work with Network Rail to try to improve efficiency in return for a share of the gains or losses that result. REBS replaced a similar incentive that worked at England & Wales and Scotland level.
17. Network Rail has refined the way that it records costs at route level. In CP4, many costs were allocated to routes formulaically. Since PR13, Network Rail has developed a route costs allocation handbook. In CP5, costs are now categorised according to the level of route control⁶.

⁶ The route cost allocation categories are: directly attributed – route managed (e.g. maintenance); centrally managed – directly influenced (e.g. renewals); centrally managed – route identifiable (e.g. enhancements); and centrally managed – allocated by cost driver (e.g. overheads).

18. More widely, we have worked through a number of data reporting issues with Network Rail to improve consistency in reporting both within and between routes but there is more to do.
19. Our annual assessments of Network Rail's efficiency now report on route-level financial performance and compare it to our PR13 assumptions. For CP5, we have also asked Network Rail to report the volume of maintenance and renewals work delivered in each route, and we have measured Network Rail's performance against its plans, both at the centre and at route level.
20. We are working with Network Rail to gain a better understanding of its performance at a route level in order to help our PR18 assessment. We compare routes to identify issues to investigate, and thereby establish the underlying reasons for differences in performance (e.g. we may comment on whether they are due to specific local factors).
21. We have already seen some anecdotal benefits from route devolution (including benefits of comparison occurring prior to formal devolution), in terms of individual routes developing initiatives to improve aspects of their business, drawing on the experiences of other routes. There are also some examples of Network Rail's routes seeking to outperform each other, but this has not been widespread or systematic in nature.

The potential for changes in Network Rail's routes

22. Network Rail is currently considering the case for a change to the structure of its operational routes. This has already led to Network Rail announcing a new virtual route for rail freight and national passenger operators, describing it as a ninth devolved operational route. In addition, it may lead to the creation of a 'Route for the North'. This follows a recommendation in the Shaw Report.
23. More generally, route boundaries are not fixed and could conceivably change for a number of reasons before or during the next control period. Indeed, Transport for Wales is exploring options for the delivery of rail services in the Valley Lines that could involve the transfer of operational responsibility (or potentially asset ownership) from Network Rail to a third party. Reflecting this, we will need to ensure that our processes are sufficiently flexible to accommodate changes to route boundaries and the creation of new routes.
24. We will, therefore, need to consider arrangements for change control, should there be a significant change in route boundaries during PR18 and/or CP6. One important issue will be the availability of a continuous set of data that allows for meaningful comparisons between routes and as route boundaries change.

Our proposed approach in PR18

25. We set out below the proposed process and structure for our determination.

Overview of the process for a periodic review

26. Our timetable and overview of key milestones for PR18 can be found [here](#).
27. When considering how route-level regulation might work, it is important to understand the key statutory provisions that dictate how the periodic review must take place. Under the Railways Act 1993 (the Act), both the Secretary of State and the Scottish Ministers are required to set out what they each want the railway to deliver in the next control period in their areas of responsibility. We call this a ‘high-level output specification’ (HLOS). At the same time, they must advise us of the public funds that will or are likely to be available to support what they want to be achieved (we call this a ‘statement of funds available’ (SoFA)).
28. A further key aspect of the overall process is the production of ‘strategic business plans’ (SBPs), which set out Network Rail’s plans for the relevant control period. This typically sets the activity that it proposes to undertake (e.g. on renewals and maintenance), the outputs that it would deliver (e.g. on passenger punctuality) and the costs involved in doing so. The HLOSs and SoFAs are the key inputs for Network Rail to produce its SBPs; the SBPs need to set out how Network Rail would comply with the HLOSs and how much funding it would require to do this.
29. We then review the SBPs to determine whether they would deliver the HLOSs – including whether they would do this efficiently – and whether there are sufficient funds in the SoFAs for this. If there are not (and there is a ‘mismatch’), we must then notify the relevant government who may then revise any information in its HLOS and/or SoFA. Ultimately, we must carry out the review in a way that will make the best and most practicable contribution to achieving the HLOSs. This involves us determining the specific outputs that Network Rail will be required to deliver.

A potential framework for our determination

30. As our initial consultation document on PR18 sets out, our determination for Network Rail could comprise:
- a separate ‘settlement’ for Scotland and each of Network Rail’s eight geographical⁷ routes in England & Wales, including specific financial arrangements (i.e. forecasts of efficient cost, assumed required revenue, debt, regulatory asset base and management of financial risk) and a set of outputs.

⁷ i.e. this is separate from the virtual route for freight and national passenger operators.

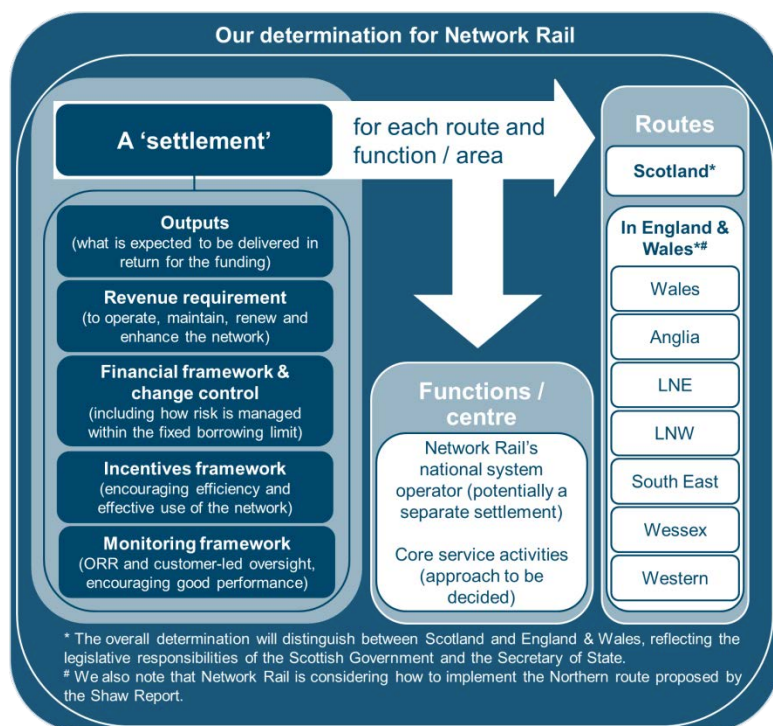
The settlement for Scotland would continue to reflect the separate legislative arrangements and the distinct role of the Scottish Government.

- a tailored approach to our regulation of Network Rail's virtual route for freight and national passenger operators and system operator functions, which might involve a full separate 'settlement' or be limited to separate outputs and increased transparency; and
- a framework for monitoring and holding Network Rail to account at the relevant level (e.g. route, system operator or overall). This would fit with how Network Rail is now structured, providing for clearer accountabilities for the management within the company. It would also align with a more customer-led approach by Network Rail's business units and allow us to monitor and publicly report on the performance of each route / function against its settlement.

31. Although comprised of separate settlements, we would still establish a single determination for Network Rail as a whole (in one publication, as in prior reviews), reflecting that it is ultimately a single regulated company. This is summarised in Figure 2⁸.
32. We discuss below how route-level regulation affects each of the different elements of our determination below. The issues relating to the regulation of system operation functions are discussed in separate working papers (see [working paper 2](#) and [working paper 3](#)).

⁸ This figure is as set out in our initial consultation which preceded Network Rail's announcement of a virtual operational route for freight and passenger traffic. We will consider this explicitly in our approach.

Figure 2: Potential framework for our determination



Outputs

33. We are publishing a separate [working paper](#) on outputs.
34. We set outputs that comply with the UK Government's and, separately, the Scottish Government's HLOSs. We are also able to set outputs that are supplementary to those required by the HLOSs.
35. Regulatory outputs typically include outputs on operational performance, network availability and asset stewardship. In previous reviews they have also included outputs related to delivery of enhancements either directly or indirectly – for example through the use of capacity metrics.
36. In previous reviews outputs were set at a national or train operator level. Consistent with the HLOSs, we anticipate doing the same for PR18, setting outputs at a level that is most appropriate.
37. In addition, however, to make route-level regulation effective, we propose to **determine relevant outputs at route-level**, including for the virtual freight and national passenger operator route, potentially building on the progress Network Rail has already made with route scorecards.

Revenue requirement

38. At previous reviews, we calculated the revenue requirements using the standard [building block approach](#), for which the calculation of required income includes a forecast of Network Rail's costs, including financing costs⁹.
39. Within the overall PR18 determination, we propose to use a similar building block approach but that **each route would have its own settlement, with funding determined at a route-level**. Some of the amounts contained within the settlement may be closely related to the costs and revenues at a route level. Others may reflect charges for services received from other parts of Network Rail. Whereas, some may reflect an apportionment of corporate overheads and/or centrally-incurred costs. We will need to work through how each is treated in terms of holding the route management teams to account.
40. This will provide a baseline against which to measure financial performance, and allow any transfers of resources made by the Network Rail centre to be tracked and made transparent. This is an important aspect of route-level monitoring, so that the performance of route management teams is properly understood and appropriately reflects the resources available to them. For example, if funding is transferred out of a route its job may have been made much more difficult, and our assessment of route-level business performance would need to reflect this.
41. To help calculate CP6 funding settlements for each route in England & Wales, inform our decisions on how financial risk can be managed and improve transparency, we would apportion Network Rail's total England & Wales debt and RAB to each route. In PR13, we calculated indicative revenue requirements for each route in England & Wales. To do this, we made indicative assumptions about the share of Network Rail's debt and RAB that should be allocated to each route. We will consult on the allocation methodology for CP6 in our December 2016 financial issues paper.
42. There will also be an overall revenue requirement for each of Scotland and England & Wales. The former aligns with one of Network Rail's routes. Whereas the latter would cover seven routes.

Financial framework

43. As a single company, we note that currently **Network Rail may move funds from one route to another**, and between any parts of the business including system

⁹ In PR18, we expect that we will continue to use a 'single till' approach. This means that the income (which we call 'other single till income') that we expect Network Rail to earn on activities such as commercial property is deducted from the gross revenue requirement, leaving a 'net revenue requirement' to be recovered through track access charges and network grant.

operation (apart from between England & Wales in total and Scotland, reflecting the provisions of the Act). Indeed, such movement of funds may be desirable as a way of managing risk.

44. This links to what protections and arrangements should exist for routes in the event of cost shocks during CP6. We need to consider the extent to which our PR18 determinations for England & Wales and Scotland include financial buffers to enable Network Rail's routes to respond to changing circumstances during CP6, and the extent to which these buffers are held at route-level or centrally.
45. Route managers need to understand how they will be held to account and on what basis they should be preparing their business plans (e.g. what risks will they need to manage and which will be managed centrally). This will be important, as if routes are unsure about these arrangements it may lead them to build the uncertainty into their cost estimates when producing their route strategic business plans (RSBP). In general terms, we would want to encourage routes to make the case for funding in a way that reflects their best understanding of the costs faced by the route (as opposed to a worst-case level).
46. We will consult in late 2016 on how the routes can deal with financial risk in our financial framework consultation, including the role of Network Rail centre in relation to the routes and the implications of an over spend for any devolved regional funders in England & Wales.

Charging and incentives

47. Network Rail's charges will be levied for access to its network using a framework that is consistent across all routes. However, there may be a route-level dimension to individual charges (just as we determined the fixed track access charge for CP5 by route). This income from charges would continue to be recognised at the route level, within the regulatory accounts of each route.
48. A key issue in PR18 is how the regulatory regime can provide the right incentives for Network Rail to accommodate traffic growth. Our work in this area is likely to consider the role of: charges; the volume incentive; and the system operator.
49. **We will need to consider the degree to which route-level regulation has implications for the structure of charges**, as route-level regulation might affect the case for disaggregating charges to reflect any significant variation in costs in different locations. For example, in order to provide effective incentives on route teams to collaborate with customers to reduce costs, and/or to identify opportunities for new services, we may need to ensure that there is a sufficiently strong link between costs within a route and the resulting income from charges at that route level.

50. **We will review existing incentive regimes to ensure that they work effectively for a devolved Network Rail.** These include existing incentive regimes such as REBS, the volume incentive and Schedules 4 and 8.
51. We will consult in December 2016 on charges and contractual incentives (i.e. Schedules 4, 7 and 8 of the track access contracts).

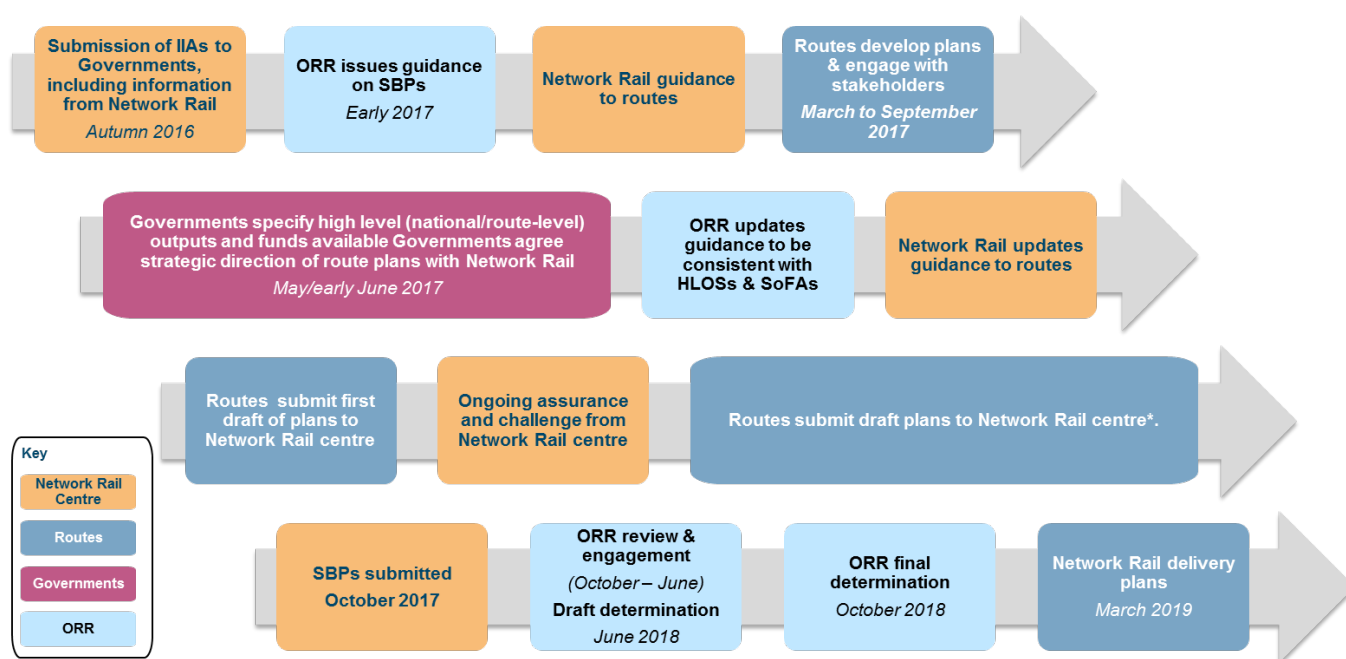
Health and safety

52. While we plan to conduct the periodic review largely at a route-level, we do recognise that:
- Network Rail has a single company-wide safety certificate and safety management system (and, related to this, company-wide asset policies);
 - the regulatory framework for health and safety is not subject to change through a periodic review; and
 - we would not want to compromise Network Rail's or its routes' ability to meet health and safety obligations.
53. Consideration of route-level regulation requires a full understanding of its implications for health and safety risks at the company and route-level.

Making route-level regulation work: the periodic review process and interfaces

54. The remainder of this paper focuses on: the key stages of the periodic review process and the interfaces between different stakeholders (including ourselves); how these might work to maximise the benefits of route-level regulation; and any particular issues that we have identified that need to be worked through. It reflects existing legislation and our current understanding of what would need to be done to carry out the periodic review (including the ordering of some of the key milestones).
55. **While we have set out this material in some detail, it should not be read as us necessarily having firm views on all of these points. It is intended to provide a strawman proposal to support discussion and further policy development.** We welcome views on it and any alternative ideas.
56. Figure 3 gives an overview of the key steps and interfaces between the different parties involved in the periodic review process, based on the text that follows. Indicative dates have also been included to add context.

Figure 3: The high-level (strawman) process for PR18 route-level regulation



*The role of governments in “agreeing” SBPs before submission to ORR will need further consideration.

Network Rail preparation for the IIA (Autumn 2016)

Description

57. RDG will submit initial industry advice (IIA) to the UK and, separately, Scottish Governments in autumn 2016. As part of its contribution to the IIA, Network Rail’s routes are preparing plans, including forecasts for expenditure and outputs for CP6 and beyond. These will then be refined and form part of the SBP submissions in October 2017.
58. The IIA is not part of the formal process for PR18 but it is highly relevant, given that the work Network Rail is doing to prepare for the IIA overlaps to a large degree with its work for the SBP.

Process

59. Since PR13, Network Rail has been moving towards continuous business planning, where its business plans are updated on a rolling basis. Thus both its contribution to the IIA and its SBP submissions will be derived from its business plan at those particular points, rather than being prepared specifically for those submissions.
60. In addition, Network Rail has moved to “route based planning”, where routes take substantial responsibility for developing their business plans.
61. For the IIA, Network Rail’s contribution is expected to take the form of advice, including expenditure projections, rather than a specific plan of activities. Network Rail is preparing projections for a number of options, based on different assumptions

regarding, for example, budget, outputs and the timing of the Digital Railway. Its routes are developing the “core scenario”, while other options are being developed centrally with input from the routes.

Potential issues for discussion

62. Although we are not proposing to scrutinise the IIA formally, the content of the IIA and Network Rail’s analysis that underpins it will inform our guidance for the SBP.

ORR guidance to Network Rail (February 2017)

Description

63. We expect to provide guidance to Network Rail on the information we will require for the SBP submissions. This is needed so that the information we receive enables us to undertake appropriate scrutiny, supports progress towards the final determination, and facilitates effective ongoing monitoring.
64. We would develop the guidance in consultation with Network Rail (and other interested parties such as Department for Transport (DfT) and Transport Scotland) in 2016, and would published it in early 2017. Following publication of the HLOSs and SoFAs, which we currently anticipate requesting for May/early June 2017, we would make any necessary adjustment to the guidance to reflect these.

Potential process

65. As far as it is practicable, we would base our guidance on Network Rail’s own processes and guidance to its routes (and existing regulatory guidelines). But the extent to which we can do this (as opposed to specifying our own requirements), would depend in part on Network Rail’s processes and the extent to which they support the shift towards route-level regulation.
66. Routes will have already started work to prepare for producing route strategic plans as part of their submission for the IIA. Therefore this guidance, and the routes’ preparations, would build on this substantial earlier work and represent one more stage in an iterative process.
67. We would then update our guidance following the governments’ publication of their SoFA and HLOS, to ensure our guidance is consistent with these statements.

Potential issues for discussion

68. Our guidance would set out what we require from routes (with separate arrangements for the virtual route), and our expectations regarding the role of Network Rail centre. Some aspects of what this guidance will cover appear relatively clear at this stage, based on the potential approach set out in our [initial consultation](#).

For example, a requirement that each Network Rail route should submit a separate RSBP as part of the overall SBP submissions.

69. In respect of parts of Network Rail other than the routes, it is less clear how many business plans would be required and what their scope might be. This needs to be worked through, particularly the arrangements for the national system operator, for which we currently expect to require a separate business plan.
70. If the HLOSs and SoFAs are not prescriptive at route-level (discussed further in paragraphs 90-99 below), there will be a degree of uncertainty about how the management of financial risk and borrowing limits would work at a route level and potentially how each route would contribute to any national-level requirements.
71. This might involve us setting principles for how such national requirements should be disaggregated (potentially informed by the governments' guidance to us), which Network Rail centre would then use to prepare an allocation that is well-evidenced. It may be appropriate for us to include or revise such principles shortly after the HLOSs, in an update to our guidance.
72. Alternatively, governments may have chosen to specify high-level outputs at a route level, in which case guidance from ORR would instead focus on areas where we see value in additional outputs being set.
73. We expect that at a high-level our guidance will set out that:
 - Each route should produce and take responsibility for its own RSBP, in particular the strategic asset management plans, devolved system operation activities and output projections for CP6 and beyond.
 - To do this, Network Rail centre would set out guidance on the likely availability and cost of centrally procured services, resources and equipment.
 - There would be a separate plan for the national system operator.
 - There would also be consolidated plans for England & Wales and Scotland.
 - These RSBPs should be prepared consistent with consistent with our regulatory accounting guidelines or other guidance for the SBPs.
 - The strategic asset management plans within each RSBP should be prepared on a basis that is consistent with minimising whole life costs (as specified in Network Rail's asset policies), to the benefit of future passengers and taxpayers. If this principle cannot be followed because there is insufficient funding available, the size and consequences of this funding gap should be made explicit in the plans, for example in terms of the longer term deterioration in performance or cost increases that result.
74. Our guidance would also set out our expectations in respect of:

- Stakeholder/customer engagement that routes (and the system operator) should carry out to inform their plans and how we would use this information. We would seek to set this in a way that allowed each route the flexibility to take an approach tailored to its customers' and users' needs.
 - The role of the centre in assuring the plans and in ensuring that they are consistent with the company's resources, and how transparent this process might need to be.
75. The Shaw Report recommended that a Northern route and a 'virtual' freight route be established. Network Rail has since [announced](#) that it is establishing a 'virtual' ninth route for freight and national passenger operators. It is also considering recommendations with respect to a Northern route. We will need to work through with Network Rail and stakeholders how we reflect these changes in our approach to PR18.

Network Rail centre's guidance to routes

Description

76. Our guidance would not be targeted directly at individual routes. Rather, Network Rail centre would play an important role in translating our requirements into guidance for the routes, just as it does as part of its ongoing business planning process. This guidance will be important in ensuring that the RSBPs are prepared on a comparable basis and that there is an effective process in place for Network Rail's centre to review, coordinate and challenge the separate plans.

Potential process and issues for discussion

77. Network Rail issued guidance to its routes as part of the current business planning process, to inform the preparation of its part of RDG's initial industry advice (IIA), scheduled for autumn 2016. Looking ahead, we would envisage that Network Rail's centre would update this guidance, taking account of the guidance received from ORR, and reflecting developments on how best to involve customers and funders in the business planning process.
78. Given its ultimate accountability for the routes, the guidance from Network Rail's centre will be one of the key ways in which it can ensure its overall plans will be consistent with: the HLOSs and SoFAs; any comments from DfT (in consultation with Transport Scotland) on the approach and strategic choices as per the framework agreement; and our own guidance to the company.
79. We anticipate that Network Rail's own guidance would include:
- guidance on the process, including on: the role of Network Rail's centre; quality assurance; the timetable; and how stakeholder engagement should be carried out;

- assumptions regarding the CP5 exit baseline;
- asset policies and other operational policies;
- regulatory accounting policies;
- information to help make trade-offs between routes, for example sensitivity testing;
- output and volume ranges, providing clarity on the level of flexibility routes can have in agreeing local outputs within the overall framework of HLOSs and available funds;
- the framework for managing delivery risk; and
- advice on change control: setting out how any Network Rail expenditure agreed outside PR18, notably on enhancements, is reflected in the base route plans at a later stage.

80. There will also be a set of common assumptions that the centre can specify, for example regarding the cost of shared asset management equipment or some cost models for which insufficient route-specific data are available.

Our advice to ministers

Description

81. In previous periodic reviews, we have provided advice to governments in advance of their HLOSs and SoFAs to assist with the production of these. This is not a statutory requirement (albeit that ORR must issue a notice to begin the statutory review process requesting the HLOSs and SoFAs from the two governments).

Potential process

82. It is not clear whether there would be sufficient benefits from providing advice in the manner that we did in previous reviews (where we gave an early view on the funding that Network Rail might require for CP5 in advance of our full analysis of Network Rail's SBPs, ahead of the preparation of the HLOSs and SoFAs).

83. An alternative, more flexible, approach could be to provide more frequent advice to governments throughout the process, and for this to be provided through engagement with DfT and Transport Scotland, as required. This would allow advice to be provided when it is of most value and when sufficient information exists to support it.

Potential issues for discussion

84. Given our proposed route-level approach, we think one particular area where it may be helpful to give advice to governments would be to explain how governments can frame their HLOSs in a way that can best support route-level regulation. We will

discuss with both governments any particular requirements that they have for this advice, as well as reflecting the engagement we have following this working paper.

Statements of funds available (SoFAs) (May/early June 2017)

Background

85. As discussed above, the Secretary of State and Scottish Ministers will each need to submit a SoFA to us. In PR13, the SoFAs set out the public funds available for railway activities (the Secretary of State's SoFA also included an illustration of the potential level of the network grant that might be provided directly to Network Rail). The SoFAs did not include a borrowing limit. In any case, this was prior to reclassification.
86. To regulate Network Rail's borrowing in CP5, ORR set a limit on Network Rail's debt in its PR13 final determination, as a proportion of its RAB. Following reclassification, this limit remains but its practical effects have been largely superseded by the borrowing limits that were set by DfT (in consultation with Transport Scotland) in 2014.

Potential process and issues for discussion

87. For Network Rail to prepare its SBPs, it will require an understanding of the funding available to it. Following reclassification, with DfT (in consultation with Transport Scotland) now directly controlling the maximum level of borrowing available to the company, this also implies that Network Rail will need to adopt an assumption about future borrowing limits for CP6.
88. The CP5 borrowing limits (for both England & Wales and Scotland) cover all of Network Rail's activities, i.e. income, support costs, operations costs, the costs of maintenance and renewals, and enhancements. It also covers the renewal of existing private sector debt. However, looking ahead, it is possible that the funding and financing of some or all new enhancements for England & Wales could be separated from the remainder of the business and be covered by different borrowing arrangements.
89. In order for the routes to prepare their SBPs effectively, Network Rail needs to know how the borrowing limits would work in CP6. As part of this, it needs to know how over-spend (whether due to less efficient working or financial or operational shocks) might affect the resources available to fund and finance the appropriate levels of spend (e.g. on maintenance and renewals), and how any decisions to proceed with new enhancement projects might affect these resources.

HLOSs and statutory guidance (May/early June 2017)

Background

90. As discussed above, the HLOSs are a key part of the statutory process for the periodic review. They set out what a government wants railway activities to achieve over the next control period. The Act is flexible in terms of the level of detail required.

Potential issues for discussion

91. We will work with the governments on how the HLOSs could be best drafted, amongst other things to maximise the benefits of route regulation, acknowledging that how governments wish to specify their HLOSs is ultimately a matter for them.
92. We also recognise that different approaches might be appropriate in Scotland and England & Wales, as the former relates to one route whereas the latter covers several. We set out some ideas for how this might work below.
93. For both governments, the HLOS could be supported by reissued statutory guidance to ORR. ORR would then have to have regard to this, alongside its other statutory duties.

HLOS in England & Wales

94. From discussions with DfT, we understand that the Secretary of State expects to specify all or most future enhancements outside of the periodic review. This means that his HLOS is likely to be much more high level than in previous reviews and not be a vehicle for setting out new enhancement projects that he wishes to procure.
95. To take advantage of the opportunities created by a move to route-level regulation, the Secretary of State could set the HLOS in terms of objectives for what he wants delivered, rather than specific outputs such as national performance targets.
96. If the Secretary of State wished to include specific output metrics and values, these might be expressed as ranges or the minimum that all routes should achieve, allowing flexibility for Network Rail to optimise the trade-offs between routes¹⁰. Such an approach could have benefits beyond enabling route-level regulation, including:
 - decisions on specific output levels would be informed by fuller analysis of Network Rail's plans, rather than being prescribed in the HLOS two years in advance of the control period;
 - trade-offs of performance, capacity and cost could take better account of what a route's customers want; and

¹⁰ Though, however, the HLOS is expressed, it must be sufficiently clear for us to be able to cost it against the funds in the SoFA, so that we can carry out our statutory responsibility to advise on overall affordability.

- there would be a reduced likelihood of a mismatch between the HLOS and the funds available, as the flexibility in the HLOS could allow outputs to be adjusted by us in our draft or final determinations according to funding and likely efficiency levels.

97. In addition, we will need to consider how these arrangements might need to adapt to the devolution of transport decision-making to national and regional authorities. For example, local funders may wish to agree certain outputs with Network Rail and to provide funding to meet the associated costs. This sort of agreement would likely need to be reflected in the outputs that were set.

HLOS in Scotland

98. The timing of the Scottish franchising process and the existence of a single Scotland route may mean that the Scottish HLOS is based on a different approach to that for England & Wales. For example, customer and stakeholder engagement in informing the Scotland route's outputs in CP6 may come through existing processes to inform the next round of franchises.

99. Nonetheless, the benefits of retaining flexibility in the HLOS might still have merit in terms of enabling final decisions on specific output levels to be taken after fuller analysis of what is deliverable and the funds available, reducing the potential for a HLOS/SoFA mismatch.

Production of the route strategic business plans (RSBPs)

Description

100. We envisage that the routes will each produce a RSBP, which will include subsidiary 'strategic route asset plans' for each relevant asset area, system operation activities that take place at route-level, and plans for delivering outputs¹¹. The RSBPs will be a key part of the evidence base for our determination.

Potential process and potential issues for discussion

101. We see the production of RSBPs as an extension of routes' ongoing process of both engagement with customers and business planning. However, the periodic review process necessitates some additional requirements on this formal submission of plans to ORR to ensure that we receive the information we need for our review (as discussed above). In addition, the RSBPs need to be reconciled nationally to ensure that they are collectively consistent with the HLOSs and SoFAs.

¹¹ Although we envisage that there will be a separate submission for the 'virtual route' for freight and national passenger operators, it will inevitably have a different focus to the other routes, for example with less information on asset management.

102. A key issue will be to have a process that promotes routes submitting plans that are achievable but include a realistic level of challenge. To support this, it is essential that plans are well evidenced and that forecasts are underpinned by clear commentary. Network Rail's centre will need to establish an effective assurance process to support this. Likewise, the process for our scrutiny will also have a role in encouraging routes to submit good quality plans.

Customer engagement

103. Building on the steps Network Rail is already taking to ensure that its routes work more closely with their customers and stakeholders, it is important that customer engagement is a core part of the process for developing RSBPs. Network Rail has begun establishing route scorecards and the Shaw Report recommended these be developed further, with action plans for delivery. These could form a key building block of individual RSBPs.

104. We see Network Rail's customers and stakeholders as primarily being involved in the following areas:

- **outputs:** in the detailed specification of output targets for each route (within the scope allowed by the HLOSs), reflecting the priorities of passengers and freight customers. There would need to be a degree of consistency across routes in the form of outputs to be set at route-level, to ensure that routes could be compared and benchmarked. But beyond this, where appropriate, routes and stakeholders could potentially agree different output metrics to reflect the nature of the services that operate on the route.
- **operational improvements and, potentially, enhancement priorities,** to the extent that enhancements are relevant to the HLOSs (including, potentially, how any earmarked funds might be used).
- **delivery:** how works are delivered taking into account the disruption that different delivery options cause rail users (reflecting the points made in the Bowe Report). This includes the possessions strategy that each route adopts.

105. We do not propose to be prescriptive in how stakeholder engagement is undertaken. We anticipate that this would be an extension of ongoing good practice stakeholder engagement (which may or may not already be in place), notably in developing a route scorecard, route forums or meetings and possible dedicated research, rather than a separate process.

106. However, we will expect all RSBPs to:

- explain the engagement process carried out and demonstrate how the route has taken proper account of their stakeholders' views;

- provide supporting information that gives reassurance that meeting such customer preferences is value for money, i.e. that the associated costs are not disproportionate to the value derived; and
 - explain how plans are consistent with the interests of end users (i.e. passengers and freight customers), including in the longer-term.
107. Those routes that do not do this are likely to be subject to more detailed scrutiny by us and potentially further work to provide assurance that their plans are appropriately customer focused and reflect end-user interests.
108. Freight and national passenger operators will not necessarily want to engage across all the routes that they operate over. We recognise the need to consider how their views can best be taken into account. This is potentially an area where Network Rail's centre can give guidance to the routes on how to reflect the interests of these operators. (The role of the recently announced virtual for freight and national operators is likely to have a key role to play here.)
109. As required by its network licence, Network Rail needs to take account of future as well as current users of its infrastructure, for example by renewing the network on a sustainable basis. Alongside being informed by current customers and stakeholders, we will expect Network Rail's centre and the routes to demonstrate that this has been taken into account; indeed Network Rail's planning processes already to a large extent do this.
110. The scope that stakeholders have to influence the business plans would depend in part on the flexibility allowed for in the HLOSs and the funding constraints. Ultimately, the RSBPs must – in totality – be affordable within the funds available and must be consistent with the requirements in the HLOSs. The guidance provided by Network Rail's centre to the routes on outputs and funding will be important in ensuring this is the case.

Role of Network Rail's centre

111. We set out earlier that there is a tension between routes having full accountability and ownership of their plans and the ultimate corporate accountability of Network Rail centre (given that Network Rail remains a single company). Too much oversight by the centre would inhibit the benefits of devolution and comparative competition, but too little risks an incoherent and unaffordable set of plans. Further, there is an opportunity here: if Network Rail's centre undertakes an effective and transparent assurance role, we may be able to reduce our scrutiny appropriately.
112. So, although each route would produce its own RSBP and be responsible and accountable for it, Network Rail's centre would still need an appropriate level of involvement in its production. Drawing on the process that Network Rail has

developed to make business planning a 'business as usual' activity, we would anticipate that Network Rail centre would have three main roles in the preparation of route-level SBPs:

- **providing guidance and technical support to the routes:** for example ensuring that the plans will be developed consistent with Network Rail's asset policies;
- **providing assurance on route submissions:** we expect that this would cover assuring the quality of the quantified volumes, outputs and funding and associated commentary from route managers; and
- **reconciling route submissions:** there would be an iterative process of assessment involving both the routes and the centre in respect of:
 - broad levels of deliverability; and
 - consistency with higher level objectives and constraints, including meeting the needs of freight and national passenger operators, compliance with the HLOSs and available funding.

113. In PR13, routes produced plans but with significant central involvement, for example to ensure that the plans added up to an affordable amount. While understandable, this did have a consequence that it cut across the ownership of the routes for those plans and this was not transparent in the SBP submissions that were given to us.

114. To support greater route ownership and comparative competition in PR18, it is:

- desirable that, if plans in totality are unaffordable, it is the routes that adjust their plans to reduce the costs (i.e. by reducing the level of outputs appropriately, subject to meeting the minimum required by the HLOSs), that this adjustment is transparent and is signed off at route level; and
- important that there is transparency (in submissions to us) in respect of any changes to RSBPs required by the centre, and the reasons for these.

115. In terms of how to provide this transparency, we think there are two options:

- for us to see the versions of each route's RSBP both before and after any centrally driven adjustment to the activities, costs and funding; and / or
- for Network Rail to provide a transparent commentary of the changes that have been made, and any iterations, since the original version of the plan.

116. In any case, we think it is important that the final version of the RSBP be 'signed off' by the route managing director to confirm that he or she takes ownership of it (potentially with any qualifications they wish to make) to support accountability.

Governments' roles in relation to the RSBPs

Description

117. As a result of its reclassification, Network Rail's relationship with DfT has changed. The formal terms of this relationship are set out in the framework agreement between Network Rail and the Secretary of State. This agreement requires Network Rail to: (1) discuss the approach it is adopting to its SBPs and any strategic choices being made; and (2) gain DfT's agreement before it publishes the SBPs.
118. In addition, in line with the memorandum of understanding¹² between DfT and Transport Scotland, DfT is to inform, consult and take full account of the views of the Scottish Ministers prior to agreeing Network Rail's SBP for Scotland.

Potential process and issues for discussion

119. The requirements of the framework agreement mean that Network Rail would need to agree with DfT its approach to the SBP. The framework agreement did not envisage route-level SBPs. However, to the extent that the RSBPs form part of the overall Network Rail SBP (which also includes the business plans for the national system operator and other central functions), the requirement of the framework agreement would still apply – albeit indirectly – to the RSBPs. In addition, DfT would consult Transport Scotland on matters relevant to it.
120. The timing of the two stages is key, as is the depth of any DfT review ahead of 'agreeing' the SBP submissions. It will be important that ORR and DfT's reviews complement each other.
121. This raises issues for route-level regulation. There will need to be an appropriate process for securing DfT's agreement (taking account of Transport Scotland's views) that supports route-level regulation, customer engagement, and our role in scrutinising the RSBPs and determining what must be delivered. We propose to work with DfT, Transport Scotland and Network Rail to understand how this process will work in practice so that there is clarity on this.
122. One approach could be that, around the time of the HLOSs and SoFAs, DfT (and Transport Scotland) could discuss and agree with Network Rail the strategic choices for the RSBPs and Network Rail's approach (which could include the extent to which the routes are engaging with customers and stakeholders). With less detailed HLOSs, this could provide some assurance to DfT about the process being undertaken. Then, the process for 'agreeing' the SBP submissions could be a check

¹² *Memorandum of understanding between the Scottish Ministers and the Department for Transport*, September 2014, available at <http://www.transport.gov.scot/report/memorandum-understanding-mou-between-scottish-ministers-and-department-transport-6139#sthash.zDSeZuKO.dpuf>

that Network Rail followed the agreed approach and that the plans are within the available funding and borrowing envelope.

ORR scrutiny of the RSBPs

Description

123. Network Rail's RSBP submissions will form a key source of evidence for our PR18 determination. From these submissions, and those relating to the national system operator, we will establish Network Rail's revenue requirements, and hence charges, as well as the outputs it needs to deliver.
124. In order to do this, we would scrutinise the RSBP submissions to establish whether the cost forecasts and output levels are appropriate (and consistent with the HLOS requirements). If necessary, we would propose changes to these in our draft determination. There are a number of reasons why this might be appropriate. For example, we may disagree with some of the assumptions, or better information may have become available.

Potential process and issues for discussion

125. In support of our scrutiny of RSBPs, we would focus our analysis at route-level, and plan to use two additional techniques to support this: benchmarking and the grading of business plans. These are discussed in the next two sections.
126. Our route-level scrutiny would require that we meet individual route teams and carry out detailed analysis of the information provided, so that we can challenge the plans and seek clarification and substantiation where necessary. This will take a significant amount of time, but is a key part of giving Network Rail the opportunity to justify its plans. In PR13, we held a significant number of SBP meetings with Network Rail (but only one with each route). In PR18, we would expect the majority of these meetings to be at route-level.
127. As part of our review, we will want to understand both:
- the level of buy-in from each route's stakeholders on the submitted RSBPs, following the engagement that they had with the routes. If plans did not reflect the balance between the needs of the route customers and costs, this would be likely to lead us to scrutinise the plan in relatively more detail; and
 - the views of DfT and Transport Scotland on whether the plans (the proposed outputs and costs) are consistent with the objectives and principles in the respective HLOSs (notwithstanding any agreement to the submissions that they may have given under the framework agreement).
128. Our scrutiny of the RSBP submissions can only commence after they are formally submitted. However, there is potential for preparatory work to take place ahead of

this point, which may reduce the time taken for the subsequent scrutiny, provided the information for this preparatory work is available and of an appropriate quality.

Benchmarking and comparison

129. We used benchmarking techniques in PR13, by which we mean techniques that compared some aspects of Network Rail's performance with other businesses. These techniques included econometric efficiency analysis, top-down comparisons of some cost elements with those of other businesses (for example support costs), and comparisons of detailed infrastructure management processes. However, the assumptions we derived from this work were applied on a national basis rather than specifically to Network Rail's routes.
130. In PR18, we would continue to use benchmarking techniques, and we would seek to place some weight on benchmarking comparisons between Network Rail's routes. For example, we would use route-level data to help explore reasons for differences between routes, such as structural differences, and investigate outliers.
131. As part of our scrutiny of the SBP, comparison between routes can help to prompt useful conversations between route management, customers, other stakeholders and ORR, supporting more effective scrutiny and challenge. We are currently working with Network Rail on econometric efficiency analysis at company and route-level, to help develop the evidence base to support our and Network Rail's own efficiency analysis.

Grading of business plans

132. The formal grading of business plans has been a major recent innovation in regulation. Ofgem and Ofwat developed this approach to encourage networks to submit better quality plans in return for a lower level of scrutiny and potential financial and reputational rewards, as well as a procedural benefit from having early certainty from having 'fast-tracked' determinations.
133. In these other sectors, this has involved the regulator carrying out an initial review and then grading the plans, with the best networks potentially then being 'fast-tracked' to an early determination. Regulators and independent commentators have observed examples of positive changes in behaviour by regulated companies, with better quality and more realistic plans being submitted¹³. The non-financial elements (i.e. the reputational effects and procedural benefits) were themselves strong factors in encouraging networks to develop high quality plans.

¹³ [A review of recent UK price review innovations: a report prepared for the CAA](#), September 2015, First Economics. Also, [UK Economic Regulation: A Stock Take](#), June 2014, First Economics.

134. Network Rail's status as a single legal entity and public sector body means that it would not be sensible to apply some aspects of Ofgem and Ofwat's approach. In particular, fast-tracking determinations for high performing routes would not be appropriate, not least because we are not proposing wholly separate price controls for each individual routes, e.g. Network Rail's centre may decide that the best way of delivering the overall settlement would be to change some aspects of the plan that has been fast-tracked hence some of the benefits of the early certainty, provided by our determination to that business, would be lost.
135. However, we see merit in recognising where a route management team has produced a well-evidenced, robust plan which is informed by effective stakeholder engagement. There could be two elements to this assessment of route business plans:
- recognising routes that produce high-quality business plans by giving them proportionately lower levels of detailed scrutiny by ORR, reflecting that we can take more assurance from well justified plans. Routes submitting weaker plans would attract correspondingly higher levels of detailed scrutiny; and
 - publicly recognising those routes that have submitted 'high quality' business plans, adding to the reputation of those management teams.
136. This would be an evolution from PR13, where Network Rail's independent reporters scored aspects of Network Rail's asset plans but with little publicity. It would, however, require Network Rail's centre to allow each route sufficient flexibility to prepare its own plans, and to ensure that route managers retained accountability for their content and quality. We need to work through the details of how this would work, particularly in the context of the scrutiny that Network Rail's centre might make of the route-level plans.

Draft and final determinations (June and October 2018)

Background

137. Our final determination contains our overall conclusions on the periodic review. It sets out what outputs Network Rail must deliver and the funding it will be allowed to recover. The determination is then incorporated into formal 'review notices' setting out the changes we would make to the network licence and access contracts to implement the periodic review. Network Rail then has to decide whether or not to object to changes contained in the review notices and indirectly therefore the determination (discussed further below).
138. We give Network Rail and stakeholders the opportunity to comment on our proposed ('draft') determination ahead of our final decisions.

Potential process

139. Following our analysis of the RSBPs, we will set out our draft determination for consultation. This would contain our decisions at route-level, including our assumptions on expenditure and outputs, as a result of our scrutiny of the plans and taking account of the views of stakeholders and governments. We would then take into account any representations from governments, and responses from other stakeholders and Network Rail, before issuing our final determination.
140. The final determination would need to be issued by the end of October 2018 to ensure enough time to prepare review notices in line with the statutory timescales. Accordingly, the draft determination would need to be published sufficiently in advance of this date to allow appropriate consultation, so we are proposing to publish it in June 2018.

Potential issues for discussion

141. The draft determination is an opportunity for Network Rail's customers, funders, end users, other stakeholders and Network Rail itself to comment on our determination.
142. There are likely to be benefits from receiving representations on the draft determination from each of the route teams, reflecting their ownership of their plans and the fact that they would have to deliver the settlement we give them. In addition, there may be particular roles for Network Rail's centre, such as in providing representations on whether the company's overall funding is sufficient, on deliverability (including how this relates to national supply chains) and on functions undertaken centrally.
143. As noted earlier, the determination will also include final decisions on the arrangements for routes and Network Rail's centre to manage financial risk and uncertainty within the control period. These will be important to Network Rail's decision on whether to accept the determination.

Network Rail's decision to accept or object to the determination

Description

144. In line with the Act, Network Rail will have the right to object to our review notices. If it objects, we may issue a new review notice or make a reference to the Competition & Markets Authority to investigate and report on particular questions specified in the reference.

Potential process and issues for discussion

145. The deadline for Network Rail to object is likely to be in early February 2019.

146. The shift to route-level regulation implies that there should be sufficient buy-in from route teams so that they are accountable for performance against the route-level settlements. However, the legislative provisions only provide for a single, formal acceptance or objection from Network Rail as a single entity.

147. One approach to this might involve:

- establishing clarity about the roles of the routes, system operator and Network Rail centre in respect of any decision to object to the review notice;
- establishing clarity about the form of any decision that we expect to receive from Network Rail; and
- ensuring ownership and accountability for delivery at route-level, with appropriate involvement of the route managing directors in the decision on whether to accept the determination (this also applies to the system operator). This is, to a large extent, a decision for Network Rail.
 - This could work in a similar way to the principle of collective responsibility in the cabinet, with Network Rail and its route managing directors debating this behind closed doors but with the final decision binding on all routes. Should Network Rail decide to accept the determination even though one of its routes was not content with its settlement, it would be for Network Rail to manage this to ensure that all routes take ownership for delivery in CP6.
 - Alternatively, there could be a more explicit process by which each route confirmed to us whether it accepted our decision (and highlighted material concerns), alongside a formal overall decision by Network Rail. Though, if Network Rail accepted the overall determination despite a route explicitly not accepting it, it would still be legally binding on all routes. This might then create a perception of doubt about that route's ownership for delivery in CP6, which could cause issues later on. To reduce the likelihood of this, we would want Network Rail to explain why it felt it could accept the determination in these circumstances.

148. There are several issues that need to be thought through here, some of which are likely to depend on other decisions about how financial risk and uncertainty would be managed at a route-level and the process that leads up to the Network Rail decision.

Network Rail's (route-level) delivery plans (March 2019)

Background

149. Provided that Network Rail accepts our determination, it would be responsible for delivering the outputs in the determination. A key element to this would be the production of its delivery plans for CP6.

150. In PR13, Network Rail began preparing draft delivery plans after the draft determination, and updated this following the final determination. It then consulted on its draft delivery plan in December 2013, finalising this in March 2014 after accepting the determination.

Potential process and issues for discussion

151. We anticipate that delivery plans would be prepared on a route basis, by the route teams; with routes engaging their customers and stakeholders in this process.

Regulatory arrangements for CP6 Monitoring

Description

152. During CP6, we would hold Network Rail to account at a route-level for the sustainable delivery of its outputs in accordance with its licence, monitor the efficiency of its expenditure and monitor whether its borrowings are in line with the available funding.

153. At this stage, we expect to report publicly on a six-monthly basis, consistent with our current Network Rail monitor publication.

Potential issues for discussion

154. We propose that our monitoring would be undertaken at route level, with publications continuing our current focus on route-level reporting. We may also make greater use of public performance tables, allowing greater comparison between routes.

155. We anticipate monitoring a wide range of outputs at route-level, including asset management, performance, network availability, and any measures that reflect system operation undertaken at route-level (such as signalling). These would complement a series of company-wide measures for freight.

156. We also think it is important that there is a framework for monitoring the effectiveness of routes' engagement with their customers and stakeholders. This could build on the current initiatives for route-level scorecards and existing surveys and monitoring carried out by Network Rail, but might also cover monitoring any commitments given in routes' plans in respect of ongoing customer engagement.

157. Currently, in our annual efficiency and finance assessment of Network Rail, we take account of the amount of work undertaken and the level of outputs delivered in our assessment of the efficiency of costs incurred. We would take a similar approach to assessing each route's financial performance and efficiency in CP6.

158. We propose that either we or Network Rail publish route scorecards that include information on regulatory outputs. We would produce commentary on this information to shed light on reasons for differences. This would help customers and

other stakeholders to hold each route to account, as well as enhance the reputation of route management teams who are performing well and / or make a positive impact on outputs.

159. However, we will also need to take account of the impact of any changes to routes' available funding on the delivery of regulated outputs and expenditure, as well as the extent to which requirements that Network Rail is expected to deliver might be adjusted.
160. This increased focus on route-level monitoring would provide the potential to increase the link between routes' operational and financial performance and the remuneration of route managers, subject to constraints on public sector pay.

Enforcement

Description

161. One of our key roles is to take action against Network Rail if it is not doing everything reasonably practicable to meet the obligations set out in its licence. This includes meeting the obligations in the final determination¹⁴.

Potential process

162. This is an ongoing activity, informed by our economic enforcement policy.

Potential issues for discussion

163. As a single company with a single licence, any enforcement action we take will technically be against the company as a whole (though, in our decision on enforcement we will respect devolved arrangements, including funding and payment of any penalties).
164. As many of the regulated outputs will relate to routes, we would investigate whether a licence breach had occurred at the level of individual routes. In such cases, in any enforcement that we decided to pursue, we would make it clear whether we consider the licence breach to be specific to the route or routes concerned or be a wider Network Rail failure.
165. To the extent that we felt it ultimately necessary to levy a financial penalty on Network Rail in CP6, and where this was attributable to the conduct of a particular route, we envisage that any such fine would be recognised in the regulatory accounts of that route. This would provide transparency about the overall performance of that route.

¹⁴ If Network Rail objected to our final determination and we then made a reference to the CMA, the CMA's subsequent decisions would then replace our final determination, the obligations of which Network Rail would be required to meet in the same way.



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