

Our conclusions on Working Paper 1: Implementing route-level regulation

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Introduction

This document discusses the main points raised by stakeholders in response to Working Paper 1: Implementing route-level regulation ('our working paper')¹ which we published in June 2016. We received 17 responses to the working paper. These responses have been published on our website². We would like to thank all those that responded.

In this document we outline key themes that emerged in the responses and discuss how these issues are being taken forward. All the comments raised in the responses will help inform our policy development.

In our working paper, we set out our intention to focus our regulation of Network Rail much more on individual routes, alongside more targeted regulation of the national system operator functions. This route-based regulation 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.

Our working paper sets out:

- where we are now in terms of route devolution and regulation;
- our proposed approach in the 2018 periodic review (PR18) including an overview of the process for a periodic review and the potential framework for our determination; and
- our thinking on making route-level regulation work, the periodic review process and interfaces.

Most responses we received related to the policy and process sections of the working paper, namely the potential framework for our determination and how to make route-level regulation work, and hence we focus on these areas in this document.

Overarching points

Respondents were broadly supportive of our proposals to focus our regulation of Network Rail much more on its routes. The majority of respondents explicitly agreed with the objective of bringing the decision-making process closer to Network Rail's

¹ The working paper can be found [here](#).

² The responses can be found [here](#).

customers and keeping customers' needs and priorities at the centre of the regulatory framework.

The most common concern regarding route-level regulation was related to freight services, and the risk that they might be disadvantaged in some way.

Network Rail is in the process of establishing a freight and national passenger operator (FNPO) route to protect and enhance the interests of customers. We understand Network Rail's intention is for the FNPO route to have a similar relationship with its customers (train operators) as the geographic routes. This should help ensure closer working between Network Rail and operators.

Reflecting the broad support for our proposals, in our recent conclusions letter on the initial consultation we confirmed our decision to move to route-level regulation³.

A potential framework for our determination

Overview of our working paper position

In our working paper we set out our proposed approach to route regulation for PR18 including:

- determining relevant outputs at route-level; and
- that each route should have its own settlement with funding determined at a route-level.

We also noted that that we would need to give further consideration to:

- the financial framework, noting that currently Network Rail may move money from one route to another, but that route managers need to understand how they will be held to account and on what basis they should be preparing their business plans; and
- the degree to which route-level regulation has implications for charges and incentives.

Consultation responses

This aspect of the working paper generated the most interest and feedback from stakeholders. Although respondents generally supported our proposals for route-level outputs, a number noted the challenges with setting these including:

- the need to take into account the varying characteristics of routes and priorities of stakeholders when setting route objectives;
- The considerable difference in the starting position regarding route devolution in Scotland;

³ Our initial consultation and its conclusions can be found [here](#).

- the need to ensure sufficient consistency across routes to allow comparisons; and
- that in some cases a route-based approach may not be sufficiently granular.

Respondents were also generally supportive of separate settlements for routes. However respondents expressed mixed views on the issue of moving funds between routes. Some recognised the need for flexibility to respond to changing circumstances whilst others felt the redistribution of funding should be limited if not entirely prohibited.

A number of respondents disagreed with the suggestion of disaggregating charges by route (with some expressing particular concerns about the impact for freight operators). Others thought there might be some merit in considering this further as part of a thorough review of charges.

In terms of incentives, the Department for Transport (DfT) in principle supported the route-level efficiency benefit sharing (REBS) mechanism, whilst Freightliner suggested a similar scheme could be developed for freight operators.

Our response and next steps

Alongside this note we are publishing our consultation on draft guidance for Network Rail's strategic business plan. In this guidance we:

- confirm that we expect to receive a separate strategic plan for each route, including the freight and national passenger operator (FNPO) route (as well as the national system operator – the NSO), and that each route's strategic plan will be signed off by the route managing director;
- ask for a forecast of key metrics for control period 6 (CP6, which we expect to run from 1 April 2019 to 31 March 2024) and beyond (including metrics for performance, network availability and asset sustainability) that are calculated on a consistent basis in order to facilitate inter-route comparisons, both for the purpose of assessing the strategic plans and for holding the routes to account during CP6; and
- emphasise the importance of Network Rail taking account of the priorities of end users and engaging extensively with stakeholders when developing route objectives and outputs.

More information about how the route-based settlements might be structured will be included in the consultation on the financial framework, which we are due to publish in December 2016.

In respect of charges and incentives framework, we have decided to limit the changes to those areas where there is a clear and pressing need for reform, or where there are opportunities for incremental improvement and simplification. This

means that we will not be taking forward geographical disaggregation of the variable usage charge (VUC).

Making route-level regulation work

Overview of our working paper position

The working paper set out a strawman proposal of how we might conduct PR18 and interact with Network Rail and national funders, in order to deliver route-level regulation. We indicated that we expected to provide guidance to Network Rail on the information we would require in its strategic business plan (SBP) submissions and that we anticipated that this guidance would be reflected in Network Rail's own guidance to its routes. We also set out our initial thinking on route-level plans and the role of Network Rail's centre in their production. The working paper also explained our initial thinking on our grading of route-level plans.

We suggested that it might be helpful for us to give advice to national funders in terms of framing their high-level output specifications (HLOSs) in a way that can best support route-level regulation and our initial thinking on how the HLOSs might fit within the PR18 process.

The working paper also discussed Network Rail's decision to accept or reject our final determination.

Consultation responses

In general there was less focus on this aspect of the working paper in the responses we received (with most focusing on the content of the regulatory framework). A number of respondents highlighted the need for a clear and common understanding of the roles and responsibilities of various stakeholders.

Respondents noted the importance of stakeholder involvement in the route strategic plans and in particular that sufficient time needed to be allowed for this. DfT said that the route strategic plans should explain how the interests of taxpayers, passengers and freight customers would be protected. DfT also noted the importance of ensuring the levels of maintenance and renewals necessary to maintain a safe and efficient railway.

Both DfT and Transport Scotland expressed support for the proposal that ORR provide advice on how the HLOS could be framed, including in terms of its interaction with the FNPO route.

On the issue of Network Rail accepting or objecting to the final determination, respondents had different views. RDG suggested that Network Rail should be allowed to question parts of the determination without questioning the whole of it. DfT was keen for the routes to be involved in the process, while Network Rail

expressed concern with the idea that routes might make separate representations to ORR, rather than Network Rail as a whole making representations.

Our response

We remain committed to ensuring that there is a clear line of sight between what end users want and what Network Rail delivers. Reflecting this, there need to be meaningful opportunities for Network Rail's route and system operator plans to be informed and challenged by stakeholders, including passenger and freight operators, funders (DfT, Transport Scotland and Welsh government but also local authorities and operators that fund certain enhancements) and passengers and their representatives.

Our draft guidance to Network Rail on its SBPs sets out:

- further detail on how we expect the interests of passengers and freight customers to be reflected in Network Rail's plans; and
- the need for Network Rail to achieve greater efficiency and make decisions that are cost effective.

We will continue to engage with both DfT and Transport Scotland and provide advice and support to help them in the production of their HLOS and SoFAs.

There are currently a wide range of views about how Network Rail might object to our final determination. These will need to be resolved before we issue the final determination. We will be consulting on options relating to Network Rail's right to object (within the scope of existing legislation), together with outstanding issues relating to Network Rail's overall incentives and system operation incentives and outputs, in July 2017.

Next steps

Having recently concluded on our [initial consultation](#), we are now moving on to developing the detailed framework. To support this:

- a) on 17 November 2016, we published a consultation on the development of the regulatory settlement for Network Rail's national system operator in CP6; and
- b) on 23 November 2016, we published a consultation on our draft guidance to Network Rail on its SBPs, which sets out our proposed expectations for the plans it will produce and the process it will follow for this. This will include its route-level and NSO strategic plans.

These will both conclude on 11 January 2017. This will allow us sufficient time to update our guidance to Network Rail in February 2017 ahead of its submission of the route strategic plans in autumn 2017.

In December 2016, we will issue consultations on:

- a) charges and incentives. This will set out options for improvements to the structure of charges and incentives framework; and
- b) the financial framework. This will inform the development of the regulatory arrangements for the modelling of Network Rail's revenue and financing requirements in PR18, to support financial sustainability and effective performance assessment in the context of a move to route-level regulation.

In July 2017 we intend to publish our 'minded to' decision on the overall framework for route-level regulation. This also provides an opportunity to consult on:

- outstanding issues relating to Network Rail's overall incentives (building on other consultations undertaken to date);
- 'rules'/arrangements for after the determination (including high-level monitoring, enforcement, approach for Network Rail's acceptance/rejection of the determination); and
- system operation incentives and outputs.

Our [programme timetable](#) is available on our website.

We will continue to engage with stakeholders on developing the framework for route-level regulation, including through RDG's PR18 working group on this topic, which we have found a useful way to develop ideas⁴, as well as through bilateral and other meetings.



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⁴ The notes from meetings of this working group are normally made available on our website after being finalised, and can be found [here](#).