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Dear stakeholders,

## **Our conclusions on the overall framework for regulating Network Rail**

1. Today we are concluding on how we will regulate Network Rail in CP6. This includes increasing our focus on regulating each of Network Rail's routes; encouraging closer working between Network Rail and operators; making greater use of comparison between routes to incentivise delivery; and strengthening our regulation of Network Rail's System Operator (SO) function.
2. Network Rail's structure continues to develop, and our monitoring and reporting on Network Rail is already becoming more route-based. In PR18, the routes, the SO and other functions have each prepared a strategic plan for CP6, and we have started our detailed scrutiny of these plans. We are finding that this ability to make comparisons across routes is delivering benefits, and we have seen new structures put in place to support more effective stakeholder engagement.
3. Our approach should encourage Network Rail to become more efficient and responsive to the needs of its customers, strengthen its accountability, and contribute to better outcomes for passengers, freight customers and taxpayers.

### *Our July 2017 consultation on the overall framework*

4. In July 2017, we published our [consultation](#) on the overall framework for regulating Network Rail. This set out our high-level approach to regulating Network Rail both through PR18 and in CP6. The main document was supported by two subsidiary documents on: route requirements and scorecards; and possible measures of the SO's performance. Over the summer we also published the design framework for regulating Network Rail, which summarised the policy positions outlined in the main consultation document, and indicated the status of those policies.

### *Consultation responses*

5. The consultation closed on 21 September 2017 and we received 37 responses from a broad range of stakeholders, including passenger representatives, freight customers, the supply chain, regional transport bodies, Network Rail, train operators and governments.
6. Stakeholders were broadly supportive of our approach to regulate at the level of the routes and the SO, to emphasise improving stakeholder engagement, for scorecards to have a central role in our regulation, to make structured use of reputational and procedural incentives, and to use comparison between routes in our regulation.



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7. Stakeholders raised various points. A number had concerns regarding Network Rail's internal governance, including between routes and other functions, and between geographic routes and the FNPO; and commented on our regulation of functions other than the routes and SO. There were a number of specific suggestions with respect to scorecards, and also with regards to the role of route supervisory boards. There was support for customers agreeing targets with Network Rail, balanced against a wish to see ORR setting targets as part of PR18. In general, stakeholders supported a move away from use of fines for breach of licence towards use of other incentives. And there were different views concerning the extent to which changes to the settlement should be controlled during CP6.

8. We would like to thank all those who took the time to respond to the consultation and to engage with us on its content.

9. We have published the responses to the main consultation on the overall framework [here](#). Separately, in autumn last year we published stakeholders' responses to the consultation on possible measures of the SO's performance (available [here](#)), and produced a summary of responses (available [here](#)). Responses to the route scorecard document are available [here](#).

#### *Our conclusions publications*

10. Having carefully considered the points made to us and relevant evidence, this letter sets out our conclusions on the overall framework. It also sets out our next steps. In addition to this letter, we are publishing:

- (a) an updated version of the [design framework for regulating Network Rail](#), which sets out our concluded policy positions;
- (b) a supporting document, overall framework [summary of comments and our response](#).

11. Further detail on the routes' and the SO's outputs and scorecards will be published as part of our draft determination in June 2018. This will build on our views set out in the subsidiary documents, as well as taking account of stakeholders' views in response to this.

#### *Our conclusions*

12. We are pleased that in large part stakeholders were supportive of many aspects of our proposals. We have reflected on points raised by stakeholders and are proposing to strengthen our proposals in a number of ways. Today we are confirming our conclusion that **we are changing how we regulate Network Rail to put an increasing focus on regulating each of Network Rail's routes and the SO**. In addition, we are:

- (a) **Supporting contestability and improved accountability of Network Rail's services to its geographic routes, the FNPO and the SO** Other than the routes and SO, we distinguish between two broad categories of Network Rail functions: (1)



‘route services’, which are those that provide services to the routes and / or the SO, and (2) ‘central services’, which are other functions, including functions that set company policies and provide assurance to Network Rail’s board regarding its legal obligations. With respect to the former, we want to see routes and the SO acting as informed customers of such services, with much greater ability to choose whether to use these services, to provide them locally, or to procure them direct. Where there is no real choice but to use Network Rail’s services, we are asking Network Rail to develop governance arrangements that support accountability to the routes. These governance arrangements will also need to cover the relationship between the geographic routes and the FNPO.

- (b) **Being clear about the way regulation will apply to Network Rail’s other functions** Where there is insufficient customer pressure on the route services, for example potentially with respect to Infrastructure Projects, and for those functions that do not have a service role, for example the corporate core and in large part the technical authority, we will regulate activities directly. We will take a proportionate approach, which we will set out in our PR18 determination, taking account of Network Rail’s strategic business plan submissions. Where needed, we are likely to impose additional requirements (beyond the current licence conditions), such as with respect to certain scorecard measures and engagement with stakeholders, to sharpen the incentives for such functions to improve.
- (c) **Putting scorecards at the centre of our regulatory approach** Scorecards are a vehicle for capturing Network Rail’s commitments to its funders, customers, and current and future end-users, and for helping ensure that Network Rail is driven much more clearly by these commitments. To make full use of Network Rail’s scorecards in our regulatory approach, we will require that they contain a balanced set of consistent measures. We will use these measures to compare routes, supporting reputational incentives and allowing us to better prioritise our monitoring. Within this, we will specify as part of our PR18 determination a small number of measures that we require to be on the route scorecards. We also require that the scorecards reflect appropriately the requirements in the governments’ high-level output specifications (HLOSs).
- (d) **Reaffirming the value of stakeholder scrutiny and support for scorecard targets and trajectory forecasts for CP6** As we will set out in our PR18 determination, route performance trajectories in routes’ strategic plans that are endorsed by their respective train operators will have a formal status in our monitoring framework, so that our monitoring will be carried out with reference to those trajectories. In addition, we will set a regulatory minimum floor, which would be likely to trigger formal investigation if breached, for passenger and freight services’ operational performance and network sustainability.
- (e) **Supporting a step-change improvement in stakeholder engagement** We are confirming today the principles and minimum requirements with which we expect Network Rail’s routes and the SO to engage with their stakeholders. We see our



ongoing comparative assessment of the quality of routes' and the SO's engagement during CP6 as an important tool for supporting that change. Given that stakeholder engagement is central to our regulatory approach, if we find progress is insufficient, we will consider more detailed regulation in this area.

- (f) **Building on our current approach to monitoring and enforcement, by using route comparisons to help us prioritise and to help incentivise Network Rail**  
We want to ensure that there is a balanced set of incentives on Network Rail that reflects its business structure and public sector status. By comparing routes/the SO, we will seek to recognise good performance, drive improvements and inform our approach to intervening and enforcing, where necessary. This approach will complement our linked but distinct role in monitoring and enforcing health and safety legislation.
- (g) **Updating the network licence and considering whether to restructure its obligations**  
In CP6 our key tool for enforcement will continue to be Network Rail's network licence. We will be working with Network Rail over coming months to consider whether to restructure its obligations for CP6 to better reflect the separation of functions between its routes, the SO and its other functions (with all obligations still being owned by Network Rail as a company). The review will also consider reforming the drafting of licence obligations more generally to ensure they are clear, up to date and fit for purpose and reflect any necessary changes in PR18.
- (h) **Managing change - achieving the right balance between the assurance provided by our PR18 settlement and the ability to respond to opportunities and events**  
Our regulatory approach gives Network Rail's routes and SO assurance with respect to their incentives, funding and what they are required to deliver during CP6, thus creating the framework in which they can plan and perform effectively. Certain changes, for the benefit of current and future end-users and the taxpayer, will inevitably be needed during CP6, however. Hence we are confirming today our commitment to a proportionate change control process that balances these considerations. We intend to publish our proposed process in a working paper. A particular issue we are considering is whether we should have greater control where a change is proposed that fundamentally undermines our PR18 settlement.

#### *Our ongoing engagement and next steps*

13. We are currently reviewing Network Rail's strategic plans, which we received in December 2017. We will receive associated assurance documents, together with any changes to the strategic plans, in February 2018. We will publish a working paper in March 2018 on change control during CP6. We will then issue our draft determination, for consultation in June 2018, before concluding with our final determination in October 2018. As part of this, we will update our overall framework for regulating Network Rail, principally to take account of our findings from assessing the strategic plans (in particular in relation to scorecards) and to take account of our working paper on managing change in CP6.



Prior to the start of CP6, we will update and consult on the network licence and our economic enforcement policy.

14. We will continue to engage with stakeholders via RDG's working groups and through bilateral and other meetings.

15. Once again, I would like to thank all of you for your continued valuable engagement in PR18 and I look forward to further discussions in the coming months.

Yours faithfully



**John Larkinson**