

Periodic review 2008: draft determinations

Industry seminar

RSA

9 July 2008



OFFICE OF RAIL REGULATION

Welcome and introduction

Bill Emery
chief executive



OFFICE OF RAIL REGULATION

Purpose of the seminar

- ❑ **Domestic arrangements**
- ❑ **Important opportunity** for you to discuss, and question us, on our proposals for the next control period
- ❑ We hope the seminar will help you **develop your views** on the draft determinations before you submit your **formal response** to our consultation – by **4 September 2008**

- ❑ We have structured the day around “**parallel sessions**” – to provide more **focus on the key issues** and **opportunities for discussion**

- ❑ Slight change to the draft agenda
 - No separate session on deliverability – it is replaced by a session on accountability and monitoring
 - The ‘outputs’ session will cover the enhancement programme

Agenda

10:30 – 10:35 **Welcome and introduction** (Bill Emery)

10:35 – 11:00 **Overview of the draft determinations** (Paul McMahon)

First parallel sessions

11:00 – 12:15 **A: Outputs (including enhancements)** (chair: Michael Lee), *Tavern room*

B: Asset management and efficiency (chair: John Thomas), *Great room*

12:15 – 12:45 **Feedback from first parallel sessions** (chair: John Thomas)

12:45 – 13:45 Lunch

Second parallel sessions

13:45 – 15:00 **C: Accountability, monitoring and delivery** (chair: Michael Lee), *Great room*

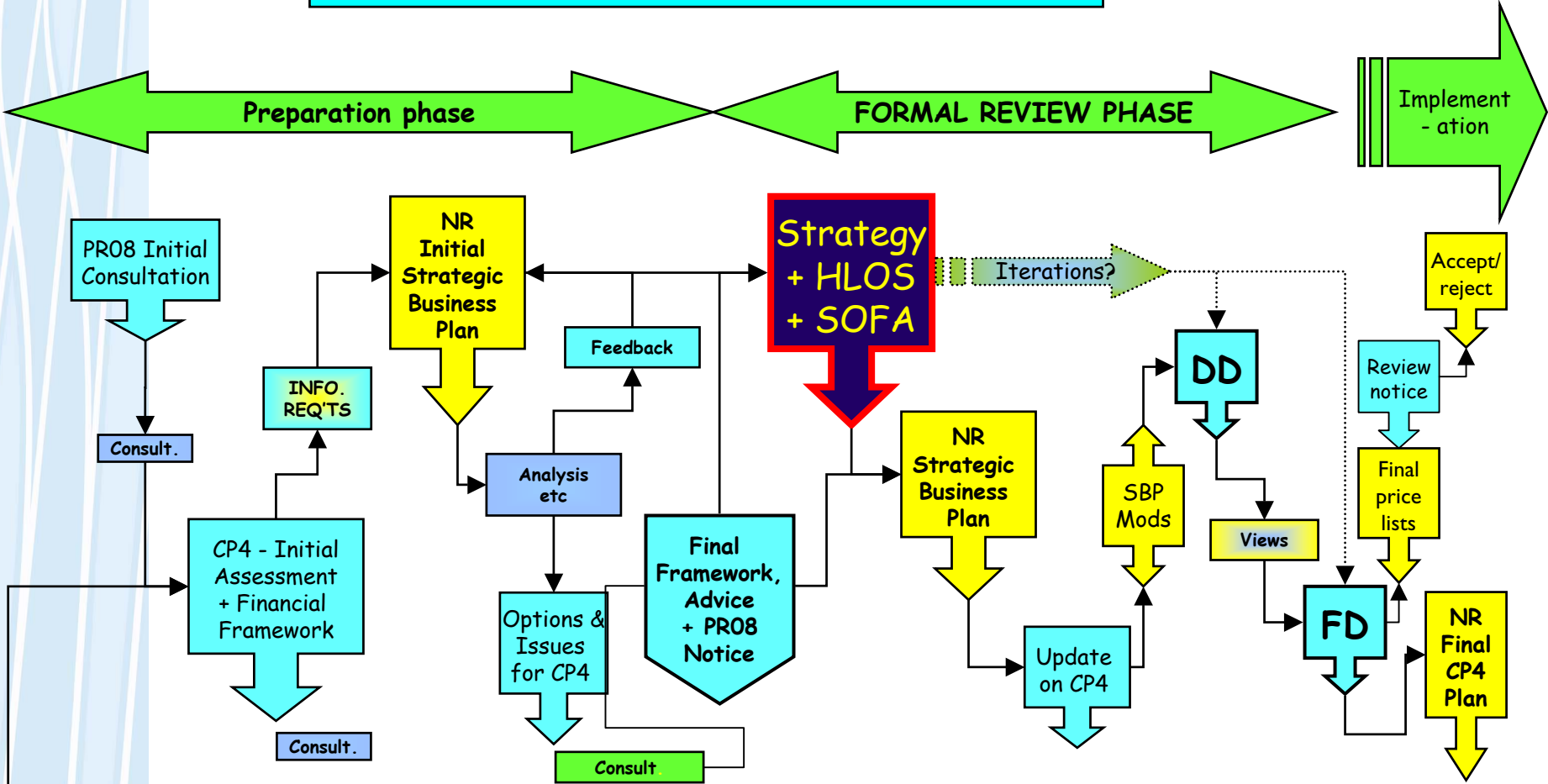
D: Incentives and access charges (chair: John Thomas), *Tavern room*

15:00 – 15:30 **Feedback from second parallel sessions** (chair: Michael Lee)

15:30 – 15:45 Tea

15:45 – 16:15 **Further issues, discussion and wrap up** (chair: Bill Emery)

PR08 timetable



2005/06				2006/07				2007/08				2008/09			
Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
A	M	J	J	A	M	J	J	A	M	J	J	A	M	J	J
S	O	N	D	J	F	M	A	M	J <td>J</td> <td>A</td> <td>S</td> <td>O</td> <td>N</td> <td>D</td>	J	A	S	O	N	D
D	J	F	M	A	M	J	J	A	M	J	J	A	M	J	J



Headlines

- ❑ We have undertaken **thorough and detailed assessments** of Network Rail's plans
- ❑ We have based our determinations on **strong evidence**
- ❑ Our draft determinations are a '**balanced package**' of judgements and decisions
- ❑ The determinations have been **agreed by ORR's board**
- ❑ We will hold Network Rail to account for **delivery of the outputs...** *it is not about levels of expenditure*
- ❑ The determinations are a **challenging and achievable package** that needs to be considered and judged as a whole
- ❑ The package is **good news** for train operators, passengers, freight customers, the taxpayer and the supply chain

Overview of our draft determinations

Paul McMahon

deputy director, competition and regulatory economics



Purpose and structure

Purpose

- ❑ To give a high-level overview of our determinations
- ❑ More detail will be given in the presentations at the start of each of the individual sessions

Structure

- ❑ PR08 background and context
- ❑ Key elements of the draft determinations
- ❑ Summary

Periodic review 2008

- The review of:
 - Network Rail's **access charges and outputs**
 - The wider **regulatory** framework, including the associated industry contractual and financial **incentives**
- Applies to control period 4 (CP4), from **1 April 2009 to 31 March 2014**
- Our overarching aim is to:

Ensure an outcome that delivers a railway that is safer than ever before, is more reliable than ever before, whilst carrying significantly more passengers and freight, at a cost that represents ever better value for money for users and taxpayers

Producing our draft determinations

- ❑ Published on 5 June; we are **consulting until 4 September**
- ❑ PR08 has involved a **considerable amount of work** across the industry over the three years since August 2005
- ❑ We have undertaken **thorough and detailed assessments** of Network Rail's plan; we have **strong evidence** to back up our determinations
- ❑ After a tentative start **Network Rail has worked well with its industry partners**
- ❑ The **industry has engaged constructively** in PR08

Our draft determinations ‘package’

- A ‘**package**’ of judgements/assumptions and decisions, including:
 - Network Rail’s **output** requirements
 - How much **expenditure** we consider Network Rail needs to incur to deliver all these and meet all its obligations
 - Decisions on the **financial, risk, monitoring and incentive frameworks**
 - How much **revenue** Network Rail needs year by year
 - How this revenue should be raised – **access charges, network grant and other income**
 - A consultation on improvements to Network Rail’s **licence**
- It is a **challenging and achievable package** that needs to be considered and judged as a whole

How did we determine Network Rail's outputs, revenue requirement and access charges?

- ❑ We **reviewed and challenged Network Rail's proposals**
- ❑ We **substituted Network Rail's proposals with our own assumptions** if Network Rail's proposals were **not justified** or not what we consider an **efficient company** ought to be able to achieve
- ❑ The outputs, revenue requirement and access charges are then (more or less) **fixed** for the five year period
 - This gives Network Rail **incentives** to achieve or outperform our determinations
 - It has various **protections** (e.g. a 'risk buffer' of £1bn to cover 'cost shocks') and, ultimately, if it cannot deliver the outputs for the money available then under certain circumstances there may be an **interim review** (when its revenue requirement could be increased)
 - We **monitor** the company against the outputs and if it is failing to deliver, or appears likely to fail, we will consider **enforcement** action
- ❑ We do not micromanage Network Rail. It is for the company to decide on the **actual level and pattern of activity, technologies and working methods** necessary to deliver its outputs

In developing our determinations we have...

- ❑ **Taken account of the high level output requirements** of the governments in England & Wales and Scotland, alongside the reasonable requirements of Network Rail's customers
 - *Both governments' output specifications are affordable*
- ❑ **Improved the regulatory framework.** Key improvements include:
 - New, better defined and 'localised' output measures to improve Network Rail's accountability
 - Strengthened incentives on Network Rail to deliver and outperform, e.g. the efficiency benefit sharing mechanism

Outputs

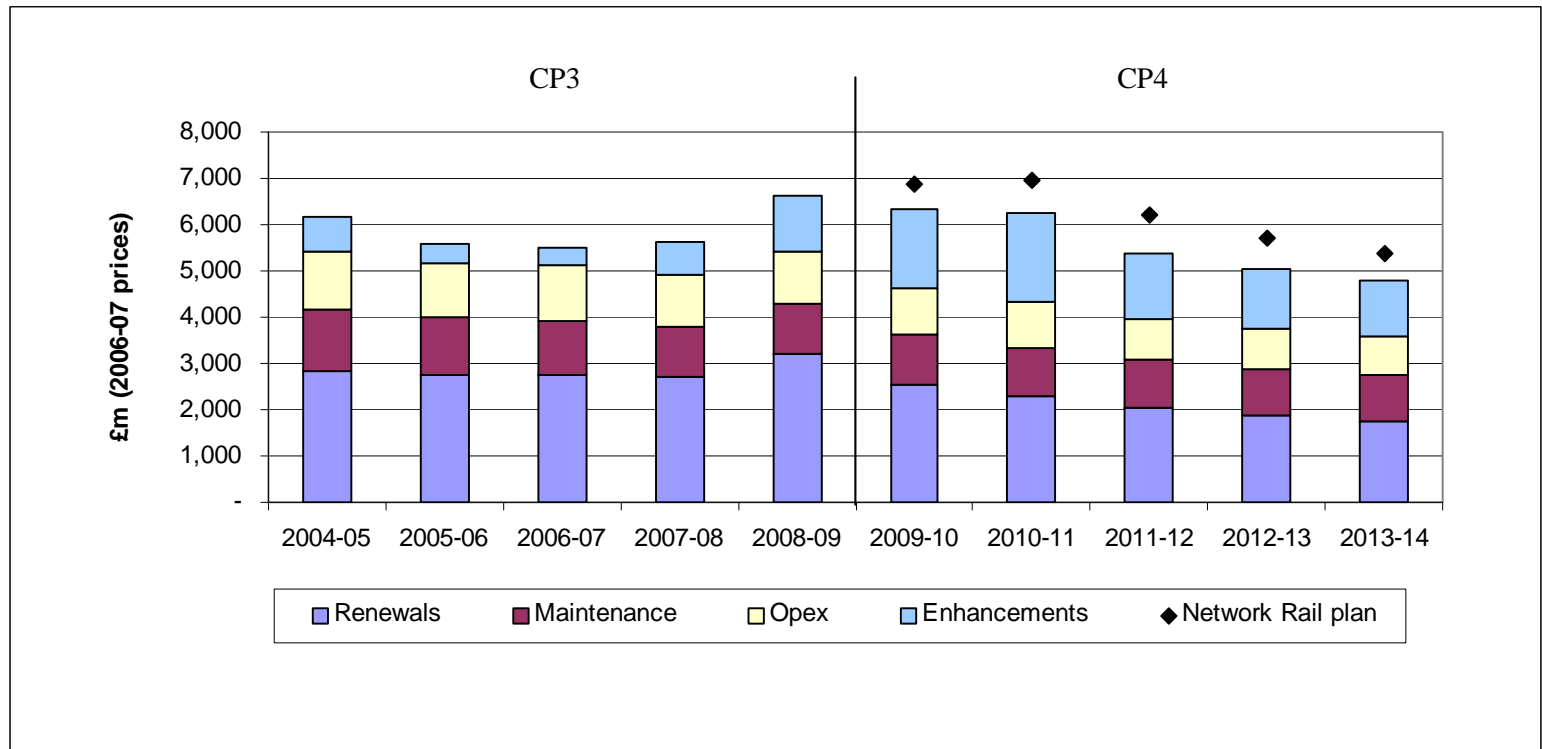
- ❑ Improvements in **reliability**... PPM, long delays, disaggregated measures; freight; network availability measure
- ❑ Improvements in **safety**...
 - Network Rail should be able to deliver its required outputs in CP4 in compliance with its statutory obligations – but it does face challenges...
 - We will adapt our inspection plans for CP4 to inspect those areas of change where we consider the risks of safe delivery are highest
- ❑ Improvements to **capacity**, and other **investments** in the network...
 - **Not all of Network Rail's proposed enhancements are necessary** to deliver the HLOSs, **or meet our criteria** to be funded through PR08 (the **investment framework** provides a basis for future funding and delivery)
- ❑ We **monitor** the company against the outputs and if it is failing to deliver, or appears likely to fail, we will consider **enforcement** action

Improvements in efficiency

- ❑ We have strong evidence that there is **significant potential for Network Rail to improve its operating, maintenance and renewals (OM&R) efficiency by more than the 13% it proposed**
- ❑ ...But we recognise the challenges Network Rail faces and we are **profiling the further efficiency improvements over ten years**
- ❑ We have assumed an overall **21% improvement** in OM&R efficiency in CP4 – which represents two-thirds of the current efficiency gap
- ❑ We have also assumed Network Rail can make further **efficiencies to its enhancement programme**

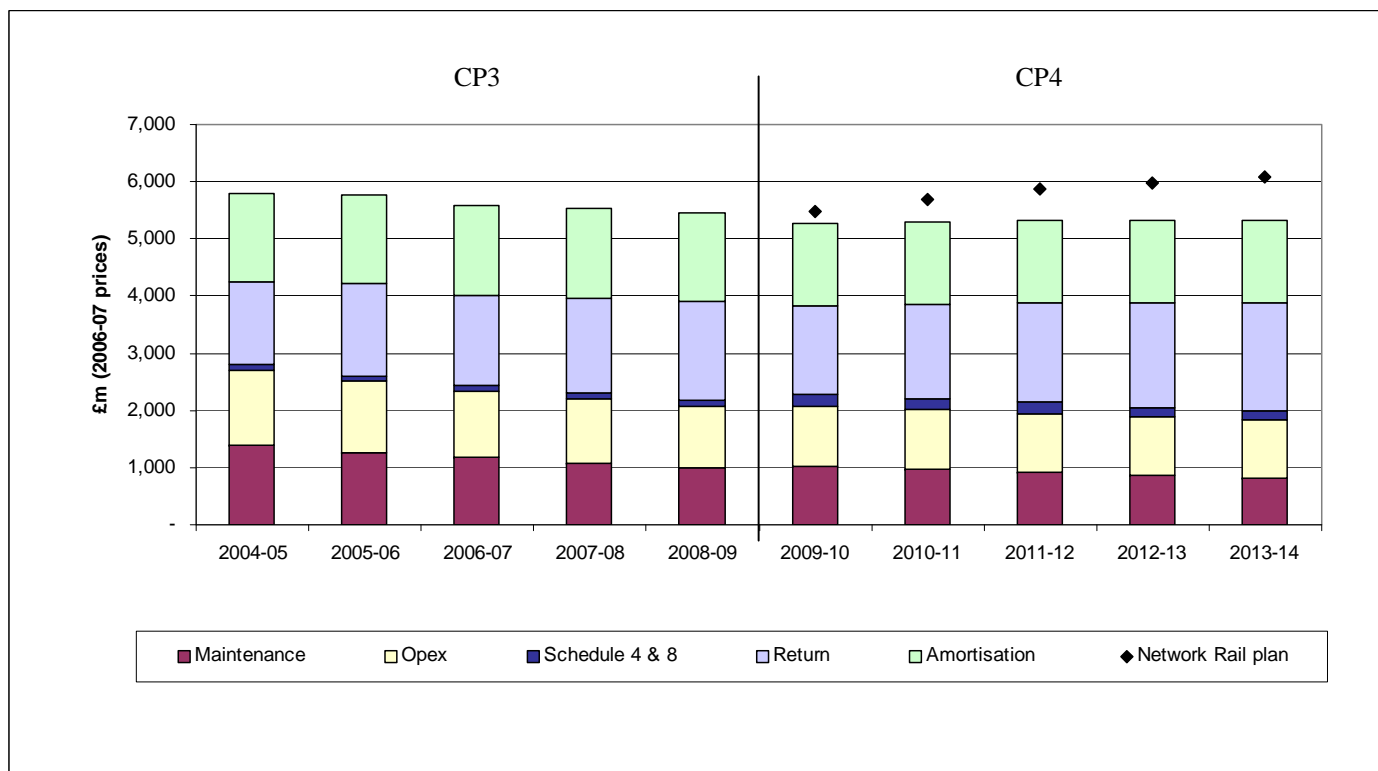
Our judgements on efficient expenditure

- ❑ We consider that Network Rail will need to spend **£27.8bn** on OMR&E in CP4
- ❑ This is £3.4bn (11%) less than Network Rail proposed, and below the £29.3bn of expenditure expected in CP3



Our judgements on the revenue requirement

- The expenditure is converted into a revenue requirement [*renewal and enhancement expenditure is capitalised: added to the regulatory asset base (RAB) – with a return on the RAB of 4.7% and amortised/depreciated*]
- We consider that Network Rail needs **£26.5bn** revenue, less than the **£29.1bn** the company sought (with CP3 being **£28.1bn**)



- The revenue requirement is funded through **access charges** (~£7.2bn), **government grant** (~£16.4bn) and **other income** (~£2.9bn)

Next steps

- ❑ We are consulting until **4 September**
- ❑ We will confirm our final determinations on **30 October**
- ❑ The detailed price lists/schedules of charges will be published on **18 December** along with the **review notice**
- ❑ Network Rail has until **5 February 2009** to accept or reject our review notice
 - If Network Rail rejects then we are likely to refer to the Competition Commission
 - Determinations will be implemented on 1 April 2009 (with any subsequent changes made retrospectively)
- ❑ Network Rail's CP4 delivery plan by **27 February 2009**
- ❑ **1 April 2009**: Start of CP4 and implementation of new charges etc
- ❑ *Plus some outstanding work and consultations over the summer...*

Summary

- ❑ Our draft determinations are a **balanced package** that we have established carefully, based on strong evidence
- ❑ The package is **good news** for train operators, passengers, freight customers, the taxpayer and the supply chain
- ❑ It is a **challenging and achievable** determination for Network Rail and the industry, providing the opportunity to build on recent successes
- ❑ We would like your consultation responses by **4 September**

Parallel sessions

- ❑ Four sessions – focused on key topics
 - A: Outputs – Tavern room
 - B: Asset management and efficiency – Great room
 - C: Accountability, monitoring and delivery – Great room
 - D: Incentives and access charges – Tavern room
- ❑ Overview presentations in each session
- ❑ Questions and discussion...
- ❑ Rapporteurs...
- ❑ Feedback and further discussion in the plenary sessions – and to pick up other issues that you consider important

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