ORR PR13 consultation event
Cardiff
Hilton Cardiff, Kingsway

11 July 2011

Slides of the presentations are available on the ORR PR13 website (http://www.rail-reg.gov.uk/pr13/). As there is no slide set from Paul Plummer's presentation a summary of his comments is set out in Annex A.

MORNING SESSION – PR13 in context of industry reform

1. The session commenced with comments from:

   a. Paul McMahon, Deputy Director, Railway Markets and Economics, ORR, setting out the goals and objectives for the day and an overview of PR13;

   b. Richard Price, Chief Executive, ORR, who spoke about PR13 within the broader context of industry reform;

   c. Paul Plummer, Group Strategy Director, Network Rail who spoke about PR13 from Network Rail's perspective; and

   d. Tim James, Deputy Director, Networks and Planning, Welsh Government who spoke about what the Welsh Government would like the rail industry to deliver in CP5.

2. Presentations were followed by a general panel discussion with the audience.

3. Q1: There needs to be clarity on the outputs to be delivered in Wales, funding available and the potential return on investment. More needs to be done to improve the economy and enable Wales to catch up. To support this, the appraisal system for investments needs to be better.

Panel response

4. The panel recognised the problems that there have been with appraising investment decisions and acknowledged that work needs to be done to improve this. The questioner was invited to put forward their more detailed concerns with the

current appraisal system. The importance of boosting the economy was acknowledged and it was noted that the control period should be seen as a continuum which is part of a larger longer term narrative to put in place the building blocks for longer-term investment. In terms of clarity, the importance of having clear and more explicit outputs along with sufficient flexibility to make the most appropriate decisions over inputs was noted.

5. Q2: Longer-term and less specified franchises are now being proposed as a way of delivering more benefits. However, a relatively long-term franchise is already in place for Arriva Trains Wales. This was predicated on no growth, no increase to capacity or additional rolling stock. How do you envisage what is being proposed for longer-term franchises being different from what currently exists?

Panel response

6. At the time the existing franchise was specified, the investment environment was uncertain. Whilst the current franchise does not involve any investment, the Welsh Government has chosen separately to invest in rail which has lead to improvements being made.

7. Going forward, longer-term arrangements for franchises should encourage better and more optimal investment decisions and partnerships and enable investors more time to make a return. One of the reasons for the significant efficiency gap on the railways is due to the sub-optimal use of rolling stock assets during the off-peak. At the moment, train operators are locked into very specified arrangements for delivering franchised services. If this can be addressed, with greater flexibility being given to train operators, significant benefits should arise.

8. Q3: Could you say a bit more about how price controls might work at route level?

Panel response

9. Network Rail is currently a Great Britain-wide company and manages itself on this basis. However, we currently have separate price controls (with separate SoFAs and HLOSs) for Scotland and England & Wales. A single price control for England & Wales could be retained, or this could be broken down to route level. If a route level approach was adopted, it would be important to ensure that there is clarity on what outputs are to be delivered on each route.

10. However, a drawback of completely separate price controls is that it would restrict Network Rail's flexibility to manage risk. Whilst it would be important for Network Rail to work with suppliers, partners and take decisions at the most localised level possible, there would be some things best done at national level. This would need to be taken into consideration when deciding whether to have separate price controls and how far to take the 'separation'. Alternatively, there could be more accountability locally whilst retaining a single price control.

11. Q4: Accountability is important so that aspirations can be met. There is a responsibility on government to ensure that communities get improvements.

The south-east of Great Britain is getting significant investment – Olympics, HS2, Crossrail etc. Would it be better to look at investment on a more regional basis, focusing on areas that require infrastructure investment to support local economies? Is it the case that Network Rail focuses investment on bigger projects rather than smaller more local projects that would benefit communities?

Panel response

12. It was pointed out that the high-level outputs set at a periodic review are specified by government. The improvements being made at Birmingham New Street and Reading were examples of what the Secretary of State specified in PR08. Below this level, it is up to Network Rail to decide what investment decisions it wants to make (including for schemes at a more local level), with ORR responsible for holding them to account for delivery.

13. The perception that Wales was losing out on investment was discussed and it was pointed out that the Network Rail Discretionary Fund had been used to improve capacity between Shrewsbury and Abergavenny, and enhancements were being made elsewhere. By the end of CP4, Network Rail will have spent £400m on resignalling in South Wales. The initial industry plan would set out the case for electrification of the Valley Lines and Network Rail was in discussion with the Welsh Government over improving access to 25 stations in Wales.

14. Problems with the Passenger Demand Forecasting Handbook (PDFH) approach to assessing investment decisions were noted. It was commented that the Valley Lines investment made by the Welsh Government would not have proceeded using this method even though the scheme has been successful in carrying significant numbers of passengers.

15. The panel acknowledged that 'fighting funds' for smaller scale enhancements were useful in providing improvements and should be encouraged. However, it was also recognised that investments either needed to be supported by a commercial business case or through government funding and be sustainable.

16. Q5: The need for a holistic approach was discussed. However, there are various strands at work in the industry, whilst the PR13 objective is focused on Network Rail, what processes are in place to ensure that the whole system – Network Rail, government, train operators etc make effective decisions?

Panel response

17. One of the recommendations of the rail value for money study (McNulty) was that the industry and government needed more effective decision making mechanisms. The Rail Delivery Group has now been set up to provide leadership on the industry side. On the government side, the Secretary of State is planning to chair a group (the 'Secretary of State Group').

18. Q6: To what extent will future periodic reviews consider integrated transport? Is there any plan to change how outputs are monitored such as switching from using PPM to 'right time' to measure performance?

Panel response

19. ORR was open minded as to how outputs should be measured in CP5 and looked forward to receiving views on this in the consultation. In respect of integrated transport, it was noted that this was a matter for the Welsh Government to consider when it sets out what it wants from PR13. The Welsh Government's transport plan would consider integrated transport schemes and was not averse to looking at other forms of transport (such as light rail) if these can deliver better outputs.

20. Q7: There are a lot of bodies – ORR, WAG, DfT, regional bodies etc involved in the planning process and rail delivery. How do you think the industry should approach PR13 given this fragmentation?

Panel response

21. The panel noted that a periodic review is a very good process for thinking about investment decisions. CP5, whether five years or longer, should not be a block to longer-term decision making. It was also pointed out that control periods were not as inflexible as some might think. The Welsh Government saw a process of incremental improvements, with CP5 providing the building blocks for the long-term. The right incentives would also need to be set, for example, to limit car use and encourage use of the railways to make investments work more effectively. Network Rail also added that being able to think about issues earlier and from a whole system perspective would be important, for example in respect of the proposed electrification of the Valley Lines.

22. Q8: There have been discussions about incentives and partnerships. What is the appetite within government, Network Rail and ORR for partnerships? Could you also reflect on including the economic benefits of new schemes in appraisals, such as employment?

Panel response

23. The panel recognised that to drive greater efficiency by controlling costs and reducing risks, good engagement with suppliers was critical. Network Rail was now focused on adopting this approach. On safety, whilst standards must not be compromised, it was important to consider whether some standards were too prescriptive and whether the industry could think up more innovative and better ways to deliver safety standards if given more freedom to do so.

24. In respect of the appraisal process, there was support for recognising wider economic benefits in the appraisal process; the Welsh Government did look at other economic benefits when considering schemes, and was supportive of extending this to bigger schemes.

25. Q9: It is often hard to make a business case for investment in some parts of Wales because fares per mile are too low. Should fares be evened up to enable more investment?

Panel response

26. It was noted that there was a fine balance between affordable fares and investment. There were some parts of the network where there might be potential for fares to be set at market levels. Other routes however would continue to require subsidy.

27. Q10: In 2005, Wales had the option of taking on similar powers to Scotland in respect of having its own High-Level Output Specification (HLOS) and Statement of Funds Available (SoFA). However, it decided against this because there was too much uncertainty over the cost of the network. If Wales wished to reconsider this for the future, what would be different this time to enable Wales to take an informed decision?

Panel response

28. The panel referred to the fact that in 2005, Network Rail was still recovering from the aftermath of the Railtrack era and, associated with that, there was significant uncertainty over costs. However, this situation had significantly improved and we were now in a much better position in terms of awareness of costs compared to 2005. That said, it was noted that the Welsh Government now had a specific budget for the railway and, provided that there was devolution of decision making, acquiring similar powers to Scotland in this area may not be necessary.

29. Q 11: What is the basis on which fares will be priced? To get the best fare deal, you need to be an expert. There are issues about information on fares for passengers which gives rise to competition concerns.

Panel response

30. The panel recognised that there was complexity in the fares system at present. Whilst responsibility for fare structure and provision of information currently lies with ministers, the DfT would shortly be launching a fares review to consider the problems with the existing structure. It was noted that in Wales, Welsh ministers have control over fares but currently follow DfT's approach for consistency with the rest of the country.

31. It was also noted that the pricing of fares had an important role to play in the efficient use of capacity and some price discrimination between ticket types can be appropriate.

32. It was also mentioned that where on-rail competition has been introduced, there have been benefits to passengers including through clearer pricing. ORR added that it would shortly be consulting on the future of on-rail competition.

33. Q12: The DfT is sometimes confused as to whether it is the strategic transport body for the UK or the funder and specifier of services for England. There are railways in England that have a knock-on effect on Wales (e.g. diversionary routes) and this needs to be fully considered when the DfT takes decisions.

Panel response

34. It was recognised that maintaining flexibility of the network for when disruption occurs (whether planned or otherwise) was important. It was also important that passengers are able to access good quality real time information on disruption, but decisions on diversions and how to deal with disruption was perhaps best dealt with centrally on a network wide basis because of the interactions across Great Britain.

35. Q13: It is important to make sure the most is being made of existing capacity before developing enhancement schemes. Incentive schemes to encourage planners to make a more efficient use of capacity should be considered and taken forward.

Panel response and closing remarks:

36. The panel recognised the importance of making effective use of existing capacity and referred back to an earlier presentation which said that the best use of the network comes through the optimisation of the timetable, infrastructure and rolling stock.

37. The panel also acknowledged that in the context of a reformed industry with devolution and infrastructure management concessions, it would be important to resolve what the role of a 'whole system operator' should be so that trans-boundary issues such as disruption and capacity utilisation can be dealt with effectively.

38. The panel noted the importance of a constant focus on the need for value for money for passengers and taxpayers to ensure that whole life savings can be achieved.

AFTERNOON SESSION – Discussion about outputs, incentives, structure of charges and financial issues.

39. Paul McMahon set out the procedure and expectations for the afternoon session. Paul also stressed that the discussion in the afternoon on technical topics should not be treated as a substitute for providing written responses to the May 2011 consultation document. These discussions are meant to clarify and inform stakeholder thinking.

How to structure the outputs Network Rail should deliver – presentation and discussion led by Chris Littlewood, Industry Planning Manager, ORR

Discussion

40. It was remarked that it would be difficult to get away from a "setting the outcomes" approach, however, the outcomes need to be set up according to what the whole industry is expected to achieve, whether it is for punctuality or for safety. There also needs to be incentivisation of behaviours to encourage collaborative working and innovation.

41. It was suggested that we have a measure that charts the economic impact on the economy of investment in the railways, i.e. the gross value added given the current economic climate.

42. We need to consider how to measure areas such as assets on the network which could have an impact on the outputs and the outcomes in 20 to 30 years time.

43. It was observed that provision of flexibility in the processes is good however it might come at the cost of clarity. It is essential that the following are made clear and rolled out to the whole industry:

a. How outputs, outcomes, indicators and inputs fit together.

b. Who is responsible for delivering them.

c. The process the industry needs to follow to change the outputs and the outcomes.

44. Network Rail commented that there is a monitoring process currently in place through the PR08 process of the “change control mechanism”, which allows a degree of flexibility in the overall direction of travel.

45. ORR was also asked if it had done any thinking regarding the measures for sustainable development, environment and other social indicators. ORR said that they were expecting the initial industry plan in September to make proposals on environmental indicators.

46. An attendee also remarked that it would be best if outputs are not deliverable only at the end of the control period, and it is better to set whole system measures rather than company specific ones.

Financial issues, including disaggregated price control – presentation and discussion led by Carl Hetherington, Head of Regulatory Finance, ORR

Discussion

47. In discussing the appropriate length of the control period, it was suggested that ORR could indicate for CP5 the level of maturity it expects the rail industry could achieve in 5 years time and if the industry has indeed managed to achieve it the length of the next control period could be varied accordingly.

48. There was a question about the value for money of unsupported debt. Network Rail’s debt at present is guaranteed by the government and therefore it would be effectively paying more interest on it to the banks in the absence of that guarantee even though in reality the company is too big to be allowed to fail or go bankrupt. So what is the benefit of this? ORR said that the costs of higher interest payments would be balanced by efficiency benefits that would be achieved as the result of better governance of the company. Like in PR08, the concept of unsupported debt will go through a value for money test before it is implemented in CP5.

49. It was suggested that due to the conflict of timescales for delivery of large scale investments and whether Network Rail has the capability for delivering these investments, ORR could set a longer control period for some of these large scale enhancements and a shorter one for the others.

50. On the question of inflation, it was suggested that RPI and CPI are not relevant measures for the rail industry and it would perhaps be better to use a measure that wraps up what is relevant for the industry, as done in the supply sector.

Setting incentives, including joint incentives on Network Rail and train operators – presentation and discussion led by Emily Bulman, Head of Transport Economics, ORR

Discussion

51. Should part of the compensation that is paid by Network Rail to TOCs be given to the passengers who are affected due to the delays? ORR clarified that TOC compensation to passengers is in the remit of the authority that grants franchises and it is not ORR's responsibility.

52. Should schedule 4 (possessions) and 8 (performance) be scrapped as there is a possibility that they might be driving perverse behaviours? ORR is very interested to hear from the industry on their experiences with these incentives regimes.

53. How is ORR planning to incentivise the rail industry to engage with the private sector to obtain funding for railway projects? ORR mentioned its investment framework, which has been established for this purpose.

54. It was mentioned that transparency of costs is important to drive aligned behaviours.

55. How can financial incentives make any difference given that Network Rail does not have any shareholders? ORR said it strongly believes that corporate financial incentives work for Network Rail even though they may be less effective than for a company with shareholders.

56. On efficiency benefit sharing mechanism ORR was asked to exercise a degree of caution in designing a risk reward mechanism just between Network Rail and the lead operator on the route, as it could marginalise the other operators on that route. ORR noted that the mechanism could be open to all the operators.

57. It was remarked that TOCs are very much interested in Network Rail's performance and not indifferent (because they receive schedule 8 payments) as was suggested by the presentation.

58. ORR mentioned that it is organising a workshop on schedule 8, which will take place on 25 July 2011. Details are to be confirmed.

59. What incentives are there on Network Rail to ensure that certain assets such as stations look the part? It was noted that a stations fund was established in PR08.

60. It was pointed out that it is essential to think about the objectives the industry as a whole is trying to achieve and then design incentives to drive behaviours required in the industry to achieve those objectives.

The structure of charges that train operators pay – presentation and discussion led by Emily Bulman, Head of Transport Economics, ORR

Discussion

61. It was noted that there is no proposal to change the methodology used to calculate station charges. How is ORR going to incorporate enhancements at stations for example including new car parks? ORR mentioned its investment framework which is designed to encourage schemes by third parties, outside the periodic reviews, including building carparks.

62. ORR's suggestion of declaring caps in certain freight charges early on in the PR13 process was welcomed. There was further explanation sought on what ORR meant by setting the caps possibly in exchange for a wider package for freight, relating to whole industry costs reductions. ORR explained that freight has go-anywhere rights, but there are some parts of the network that freight does not use. If freight operators were no longer to have access to those areas, it would potentially save maintenance and renewal costs associated with making the infrastructure suitable for freight.

63. There was a question on why variable usage charges were identified as a priority for review, given they are low, and hence have little impact on operator behaviour or associated revenue. ORR said that in spite of their relatively low associated revenue, its understanding was that they were significant to operators and did influence behaviour.

64. On capacity related charges, ORR was asked to consider that smaller TOCs with better reliability statistics and vehicles that cause less damage to tracks are not penalised with higher charges for running on the mainline network.

65. ORR also mentioned that it had plans to publish its consultation on possible changes to the open access charging regime around the end of July 2011.

Close

66. Richard Price closed the afternoon session by thanking all the attendees for taking time to attend this event and for their contributions to the discussions. He also encouraged attendees to submit written responses to the ORR May consultation document by 2 September.

Annex A – Introductory comments from Paul Plummer, Group Strategy Director, Network Rail

Key points:

- Network Rail's key principles align with ORR's proposed objective for PR13. Our ultimate purpose must be to deliver better for taxpayers, customers and the economy.

- We consider that the regulatory regime should be output based and there needs to be a focus on how regulation can be more effective at incentivising the delivery of outputs.

- There are four key things Network Rail sees as important going forward:

    1. Increased competition. Network Rail sees benefits arising from operating in real markets. We are moving to a devolved structure which should support competition and encourage a different mindset in service delivery which should improve efficiency and quality.

    2. Better and closer partnerships with operators and suppliers.

    3. Integrated economic and safety regulation, which can bring benefits for the industry as a whole, including for franchises.

    4. The introduction of risk capital.

- The government needs to be able to specify what it wants to be achieved and then leave the industry to deliver. Regulation can help with this.

- We need to be conscious of whole life optimum decisions for assets which have long asset lives. The regulatory regime needs to facilitate good investment and innovation and not lead to investment in silos.

- We must maintain focus on the overall network to ensure that economies of scale are achieved at a national level.

- Network Rail is currently working with industry partners to develop the initial industry plan (IIP). This, amongst other things, will provide our response to the rail value for money study recommendations including how we think efficiency can be improved. We believe that substantial savings can be made.

- The IIP will also set out specific investment options to inform government thinking, including in respect of electrification.