

**ORR PR13 consultation event  
London  
Park Plaza Riverbank  
18 Albert Embankment**

**12 July 2011**

**MORNING SESSION – PR13 in context of industry reform**

1. The purpose of this event was for the Office of Rail Regulation (ORR) to explain its first consultation document on PR13 which was issued on 25 May 2011. ORR's intention was to have an open discussion on the issues and inform stakeholders' views for the formal responses to the consultation, the deadline for which was 2 September 2011.
2. The session started with opening remarks from Anna Walker, Chair, ORR:
  - a. PR13 is a crucial process over the next three years and comes at an important time for the industry in light of the rail value for money study led by Sir Roy McNulty which sets out recommendations for achieving a 30% saving in costs.
  - b. It is important to recognise that achieving the savings sought by McNulty do not come just through greater efficiency by Network Rail. Savings can be made across the industry and incentives need to be developed to support this.
  - c. Engagement from stakeholders will be critical in delivering an effective periodic review which meets the challenges we face. This is our first main consultation on PR13 and we encourage everyone to take part.
3. This was followed by a presentation by Paul McMahon, Deputy Director, Railway Markets and Economics, ORR, who provided an overview of the PR13 process. Slides of this presentation are available on ORR website at <http://www.rail-reg.gov.uk/pr13/>.
4. Next Richard Price, Chief Executive, ORR, spoke about efficiency and performance, setting out the challenges for Britain's railways in PR13 and beyond. The text of his remarks are available on ORR's website at <http://www.rail-reg.gov.uk/upload/pdf/pr-13-speech-120711.pdf>.

5. David Higgins, Chief Executive of Network Rail, then spoke about PR13 from the Network Rail perspective. He made the following key points.
- a. Network Rail is fully in favour of greater competition in the provision of infrastructure services and believes that benefits will result from this. The role of regulation should be to drive this and monitor the delivery of agreed outputs. Network Rail supports greater transparency of information to enable competition and benchmarking. Network Rail also considers that unsupported debt can play an important role in improving efficiency.
  - b. Good infrastructure is fundamental to provide the building blocks for economic growth. Significant improvements to the rail infrastructure are already being delivered and planned, including Crossrail, Thameslink and electrification.
  - c. Network Rail is improving its knowledge of its assets and by the end of the current control period (CP4) it will be able to make more efficient decisions on renewals.
  - d. Network Rail acknowledges that there are huge challenges in delivering substantial improvements to infrastructure whilst keeping affected parts of the network open and delivering better punctuality.
  - e. Network Rail recognises that it must change and behave differently if it is to meet the challenges it faces. A programme of change is underway to increase its flexibility and improve relationships with key partners and suppliers.

6. This was followed by comments from Anton Valk, representing the Rail Delivery Group (slides at <http://www.rail-reg.gov.uk/pr13/>) and Theresa Villiers, Minister for Transport (speech at <http://www.dft.gov.uk/news/speeches/villiers20110718>)

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

*Panel*

Anna Walker – Chair, ORR (panel chair)

Richard Price – Chief Executive, ORR

Paul McMahon – Deputy Director, Rail Markets and Economics, ORR

Charles Robarts – Director of Planning and Regulation, Network Rail

Anton Valk – Managing Director, Abellio, representing the Rail Delivery Group (RDG)

Rt Hon Theresa Villiers MP – Minister of State for Transport

Paul Collins – Deputy Director, Rail Sustainability – Infrastructure, Department for Transport (DfT)

**8. Q1: Assuming that a five year control period is retained for control period 5 (CP5) how will you ensure that actions taken in CP5 do not damage the industry in the longer-term particularly given the long asset lives that typically exist in rail?**

*Panel response*

9. The panel acknowledged that clarity on the government's longer-term strategy beyond the control period would be important to support longer-term planning. PR13 would be a stepping stone for the future, in terms of sustainability and value for money, and it is important that it be seen in this way.

10. Secondly, it was recognised that there was a need to understand better the impact of timing of enhancements and renewals on the network. It was also recognised that focusing solely on cost reduction could lead to worse outcomes. It was important to look for scope for achieving greater value for money by growing the railway to get more revenue, whilst at the same time increasing efficiency.

**11. Q2: In a largely non-competitive industry, transparency of costs and other information is very important. However, in rail, the language used is often impenetrable for non-experts. How can this be made clearer for the public to understand? Secondly, how do passenger aspirations fit into PR13?**

*Panel response*

12. It was acknowledged that the customer perspective was very important. Whilst in CP4 there had been no specific output target for passenger satisfaction, this was being considered for CP5. Passenger aspirations were being incorporated into the invitations-to-tender for new franchises.

13. It was agreed that plain English should be used as much as possible and that government and the rail industry needed to work together to promote transparency so that costs could be reduced.

**14. Q3: ORR is an independent economic and safety regulator. How will ORR ensure independence from what the rail value for money study proposed so that it does not just deliver what the McNulty rail value for money study (RVfM) recommended?**

*Panel response*

15. The RVfM study was an important piece of work and was co-sponsored by ORR with DfT. However, ORR stated that PR13 would not be constrained by the study. PR13 would draw on a number of sources, as well as the study. The periodic review process is a statutory one and requires ORR to take into account the requirements of funders (including DfT) as well as the views of other stakeholders. In coming to its conclusions ORR would take an independent view consistent with its statutory duties.

**16. Q4: The transition from CP3 to CP4 saw a hiatus in work by Network Rail which impacted suppliers. According to the programme schedule, the Network**

**Rail Delivery Plan is to be finished in March 2014 and will take effect on 1 April 2014. How can we ensure that there will be no hiatus this time?**

*Panel response*

17. The review process should allow for forward planning and it is envisaged that there will be scope for some 'early starts' with decisions made before final determinations. There are significant renewals to be completed which are not dependent on what ORR decides in its final determinations. Network Rail should also be better placed to implement major projects through the supply chain as its planning will be more advanced than previously.

**18. Q5: How can we be sure that Network Rail will be able to attribute costs down to individual route level when it has been unable to do this previously? Also, Network Rail is remote from the passenger experience as it has no direct relationship with passengers. What can be done to make Network Rail more accountable to passengers?**

*Panel response*

19. Network Rail will be publishing route based information soon which will be monitored and challenged by ORR, though it is recognised that allocating a proportion of head office costs to each Network Rail route will take more time but will be achieved.

20. In terms of the passenger interface, train operators have a much closer relationship with passengers. With the decentralisation of Network Rail, each Network Rail route will be working much more closely with train operators and so will be better placed to understand passenger concerns.

21. Even so, at present, where Network Rail causes disruption, it can pay out significant amounts of money through the schedule 4 (possessions) and schedule 8 (performance) incentive regimes. Network Rail is therefore conscious of the impact of disruption.

22. In respect of disruption from possessions, Network Rail said that there was an important debate to be had about how engineering work could be carried out more efficiently. If Network Rail could take full blockades for longer periods rather than numerous short-term possessions, this could achieve significant cost savings and lead to lower fares. The views of customers need to be sought to understand if there is support for this approach.

**23. Q6: Given the need for sustainability and effective long-term planning, is it now time for a longer control period or for rolling reviews? Also, given the long-term nature of big rail projects which span parliamentary terms, isn't it important that we secure cross-party agreement to prevent uncertainty over whether projects will be continued if there is a change in government?**

*Panel response*

24. Stakeholder views on the length of the control period were welcomed in responses to the consultation. It was acknowledged that it was important for

government to provide clarity over what it wants from rail over the longer-term. Even if the control period remains at five years, it would be possible for ORR to indicate what approaches were expected to stay the same in the longer-term and what might be subject to change in subsequent control periods.

25. It was acknowledged that cross-party support for big rail projects was important – indeed, the government was seeking to build a consensus for HS2.

**26. Q7: It is important that we have transparency over what is being paid for on the railways. However, the railways have been opaque since 1996. It is very difficult to secure information from DfT on franchise premia and subsidy. Going forward, please can all money that goes to Network Rail be paid through track access charges so that this is transparent? Also, the RVfM study suggested that the existing contractual regime was a hindrance to value for money. However, if we are going to have greater competition, contracts will be necessary. What are the panel's views on this?**

*Panel response*

27. Market-led mechanisms such as competition generally produce better outcomes than relying solely on regulatory intervention. Passenger surveys indicate that higher levels of satisfaction are achieved where there is competition between rail operators. So, competition should be encouraged where it can deliver benefits and value for money for funders and taxpayers.

28. Later this month ORR would be consulting on options for the future of on-rail competition and how this can promote benefits for passengers and taxpayers. Likewise, Network Rail would soon be setting out areas where there would be opportunities for other firms to compete with it.

29. In respect of transparency, it was recognised that rail was very opaque compared to other sectors. The panel was strongly in favour of delivering much greater transparency. ORR and DfT would work together to make it clearer what public subsidy was buying in each case. Work was already underway within DfT to collate all the information on franchise costs and when completed this will be put in the public domain, subject to any necessary redactions.

**30. Q8: Is there a process in place for ensuring that investment from franchises (in particular the longer franchises that are envisaged) aligns with the PR13 process? Does DfT plan to delay any franchise competitions because of PR13?**

*Panel response*

31. The importance of alignment between processes was acknowledged. DfT was considering the franchise timetable and it was possible that the timings of some franchise competitions may be revised. There would be further information on this in due course.

**32. Q9: The importance of distributing goods quickly across Great Britain must not be overlooked in the context of increasing competition from abroad**

**where transport links are continuing to improve (such as with the new freight link between Germany and China). Our goal must be UK competitiveness rather than constructing a more complicated rail system through this review.**

*Panel response*

33. This point was acknowledged.

**34. Q10: Urban rail networks are very important for the competitiveness of local economies. However, they also absorb a lot of public subsidy. How can PR13 help make these networks more sustainable?**

*Panel response*

35. The importance of listening to local communities to understand better their needs was recognised. Greater transparency over costs would be a factor in supporting sustainability. Along with the decentralisation being pursued by Network Rail, it was felt that more localism could be a useful component in delivering better rail services. The government was exploring what more could be done at a local level to help the integration of regions – for example in connection with the refranchising for Northern.

## **AFTERNOON WORKSHOPS**

36. In the afternoon there were four workshops on the following topics (delegates attended two):

- a. how to structure the outputs Network Rail should deliver
- b. financial issues, including disaggregated price control
- c. setting incentives, including joint incentives on Network Rail and train operators
- d. the structure of charges that train operators pay

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

37. One participant considered the rail network to be one big system and therefore questioned to what reasonable extent you can or should measure behaviours of anything other than the system as a whole? ORR noted that the network comprises the workings of many individual organisations working together. Disaggregation of performance measures helps to make clear who is responsible for what.

38. The participant was wary that this approach of disaggregating responsibilities could lead in effect to ORR becoming responsible for delivery itself. A discussion then followed as to the role of the government's High Level Output Specifications (HLOS) and how industry jointly puts proposals together.

39. Another participant commented that before embarking on trying to define desired outcomes or outputs you must first be clear about the purpose of the

network. For example, is it to make rail freight more efficient, to reduce commuter crowding or something else? You need a sense of prioritisation, whereas the participant considered that the current setup tries to achieve too many separate things. ORR noted that you could restrict freight's right to roam and hence free up some space/reduce costs in return for giving freight earlier certainty on access charges.

40. Different metrics were considered potentially useful for different areas of the network. As an example, it was suggested that delay minutes might be more important on the East Coast Mainline than on a London commuter line where knowing that a train is coming along soon is more important. Other participants disagreed that commuters are less sensitive to delay minutes than intercity passengers.

41. Passenger Focus's list of rail travellers' five key issues were discussed (punctuality, value for money, customer information, journey time and getting a seat). The group felt that metrics which provide customers with better information about these at a much greater level of geographic detail would be useful.

42. Participants agreed that the Public Performance Measure (PPM) is a generally understood and useful measure. However, it can also hide or provide misleading information, particularly where train journey times are padded; one consequence of which can be for intermediate passengers to experience delays which are not captured through the PPM.

43. The extent to which measures and targets should be readily achievable or stretching was discussed. Some participants expressed concern that the current atmosphere is one where those that fail are sacrificed which leads to a culture of fear, risk aversion and even gaming of the system. Whilst stretching targets can be useful, the industry needs to be able to operate in an atmosphere with less fear of failure.

44. A participant expressed surprise that in its renewal of the rail network, Network Rail spends billions of pounds without any improvement in specification. The participant stated that he could not think of any other product where your money today does not buy a better specified product than years ago (e.g. cars, washing machines). Why can Network Rail not improve network specification when it is renewing it?

45. The group generally considered output measures to be more useful than outcome measures. In particular, outcomes are considered too vague, and are affected by too many independent factors. In contrast, outputs are more quantifiable, more closely linked to inputs and individual responsibilities.

46. The group did not consider that a specific safety output indicator and target is required for CP5. Safety performance is already considered to be well handled through other means, also, it is important not to discourage modal shift to rail from other (more dangerous) forms of transport. Too much focus on safety performance may also take funding away from other important areas.

47. A participant warned that any metrics and targets introduced through PR13 must be consistent with requirements set out in the upcoming tranche of franchise agreements.

48. In wrapping up, the group agreed that geographical disaggregation is essential to delivering outputs. However, disaggregation by operating route is not necessarily the best approach.

49. In developing output measures, it is essential to understand the linkage between outputs and inputs, also can the industry develop and deliver a plan to achieve these outputs with confidence, and then can we actually put pound (£) signs against this plan?

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

50. ATOC has been engaged in useful discussions with ORR and DfT about the possible introduction of whole industry financial reporting. The starting position is one that taxpayers should be able to understand where their money goes. But there are important issues about the publication of possibly commercially sensitive information that need to be overcome. It is best to develop a workable solution and then to evolve reporting as issues become clearer over time.

51. A question was raised as to how easy it will be to get train operators to provide information for whole industry reporting. ORR noted that it aims to support the industry to develop a template. ORR will need to find a balance between being too prescriptive, i.e. not letting industry try to find the right answer, but also not having sufficient clarity which could result in confusion and inconsistent reporting by different train operators.

52. The group had a lengthy discussion about duration of the control period. There was general agreement that five years feels about right. One participant was particularly concerned that a shorter control period may destabilise supply chain planning, which would impact on investment in skills and equipment.

53. Another participant noted that longer control periods could provide greater confidence in track access charges, possibly helping to encourage more freight distributors to make a modal shift to rail freight. ORR acknowledged these points but also stressed the importance of Network Rail having high quality asset management policies to ensure that there is stability in network costs over time, i.e. the duration of control periods is only one component in providing cost stability.

54. On the subject of risk and uncertainty, and in particular, whether Network Rail should be compensated for its specific inflation risk, a participant observed that due to the paucity of suitable data, members of the highways industry had developed their own 'highways inflation index', which the rail industry might also want to consider.

55. One participant thought that the price control process was disruptive, and whilst this may necessarily be the case, it is important to finalise ORR's views on as many issues as possible (e.g. duration) as quickly as possible so that industry can



move on to contributing to other aspects of the process. ORR noted its intention to finalise some financial issues in its 'advice to ministers' letter in February 2012.

56. A participant expressed concern about the ability for alternative investors to rail schemes to undertake and fund investments due to Network Rail's asset protection processes, excessive checking of costs and processes that work around outdated contracting models. ORR explained how investment can be made through a price control, or separately through the investment framework.

57. Similar concerns have previously been raised, with ORR's investigation finding that many of the concerns related to Network Rail's behaviours. Following this, Network Rail committed to providing a customer package. ORR has been undertaking follow-up interviews to identify whether things have improved and the findings will be published this summer.

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

*Impact on freight*

58. Changes in the structure of charges with a greater emphasis on variable charging are likely to have a significant effect on some operators. Freight operators in particular would be vulnerable to any changes in the structure of access charges because their margins are very low (one contributor suggested the figure of 1.7%).

*Capacity charge*

59. The review of the capacity charge was welcomed by several contributors. One contributor suggested that the impact of the capacity charge was a far greater factor in preventing service improvements from occurring than the variable charge. Another contributor questioned why the capacity charge had remained constant, when traffic on the network had declined during the last recession. A common theme was that there is a lack of clarity of what we want the capacity charge to achieve.

*Capacity utilisation*

60. One contributor raised the issue that the current charging regime does not promote the best use of the network. He cited the example of the Settle & Carlisle route, which was designed for 80mph operation, but which currently has a 65mph speed restriction because of the high level of coal traffic on the route. He argued that the recent investment of £120m on the route had largely been passed on to the power stations rather than benefitting other network users.

*Reservation charge*

61. There was strong discussion on the subject of a reservation charge. There was some debate about what 'financially neutral' meant, and whether a financially neutral charge could actually function in practice.

62. One contributor pointed out that path holding at present is not uniform, and that the practice is largely driven by the behaviour of the power generation industry

(for whom transport costs are a relatively immaterial cost) rather than operators themselves. Power stations therefore need to be part of any solution.

63. Other contributors, while generally in favour of a reservation charge in principle, could not see how a reservation charge could be made to work in practice.

64. It was suggested that although path hoarding was seen as an occasional problem, it was difficult to assess its full impact because some passenger trains may be forced to use sub-optimal paths in order to accommodate freight.

#### *Simplicity versus incentives*

65. There was strong agreement that we need to prioritise our objectives and simplify the charging framework as far as possible. The contributors from the freight industry argued strongly that in many of the markets they serve, they are competing with road hauliers who are not subject to such a complex charging regime, and this places rail freight at a disadvantage to them.

66. This second-best argument was briefly discussed again in relation to a scarcity charge which it was felt would put rail at a competitive disadvantage to roads (in addition to being difficult to manage).

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

#### *Efficiency benefit sharing (EBS)*

67. The three main themes of the discussion regarding efficiency benefit sharing were:

- a. how to ensure transparency of costs and benefits
- b. how to ensure that EBS incentives are sufficiently strong to incentivise TOCs but do not force Network Rail to charge a risk premium
- c. ensuring that EBS agreements were non-discriminatory – particularly with regard to small operators

#### *Transparency*

68. On the first topic, there was a desire for more clarity on the definition of over and under performance, particularly where efficiency gains are a result of cumulative causation. It was felt that operators should not benefit from efficiency gains that they had not contributed to.

69. The issue of how the impact of possession overruns should be calculated was also raised. At present, this is done on the basis of engineering costs instead of lost revenue (as in schedule 8).

70. Franchises span more than one control period so assessment of what efficient is will change through out the lifetime of the EBS agreement.

71. The prospect of efficiency benefits being taken back by DfT rather than lying with TOCs might dilute the incentive properties of EBS it was argued.

72. The issue of establishing consistency in standards was also raised.

#### *Incentives*

73. Where routes have more than one user it was argued that this would potentially risk diluting the incentive properties of efficiency benefit sharing given the proposed levels of risk share – especially given the potentially complex nature of the proposed mechanism.

74. It was also felt that for efficiency benefit sharing to work, TOCs would have to have some authority over Network Rail to ensure that benefits and responsibility are truly shared. ORR replied that risk sharing could involve more upside than downside risk to TOCs and that a formulaic approach – whilst representing a good start – would need to allow for bespoke arrangements between Network Rail and TOCs. Network Rail argued that an asymmetric approach would push more risk onto Network Rail, and would mean that this might lead to Network Rail requiring a risk premium to compensate them for the lack of a portfolio effect.

#### *Non-discrimination*

75. A question t was raised about the protections that smaller operators would have in the event of an agreement being reached by a large TOC and Network Rail. An example of this might be a renewal that might benefit a large TOC on a long franchise, but might have a detrimental impact on another TOC with a shorter time horizon. This connects back to the issue of bespoke versus formulaic deals, in that bespoke deals may be more likely to favour one operator at the expense of another.

76. An example was given of where efficiency benefit sharing has worked in practice at Immingham Docks. At Immingham the involvement of freight operators has increased, and it was suggested that they were now far more active in questioning cost estimates. Payments under the scheme were done by estimated train numbers, with a wash-up at the end of each financial year to reconcile to actual costs.

### **PLENARY SESSION**

77. The workshops were followed by a plenary session in which there was feedback from each discussion. At the close of this Paul McMahon, ORR, thanked all attendees for the robust discussion during the days and encouraged written responses to the May 2011 consultation document by 2 September.