

AN INDEPENDENT STUDY INTO THE OFFICE OF RAIL REGULATION'S
CONSULTATION WITH STAKEHOLDERS DURING PR13

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1 Executive Summary

1.1 ORR set itself a demanding agenda in determining Network Rail's price control for PR13. It consulted those involved through a thorough process that respondents judge to be a clear improvement on earlier price controls. Consultation made a clear difference to the outcome on many significant points.

1.2 ORR's consultation documents are judged to be well written and signposted; ORR's workshops are much appreciated; and the willingness of ORR executives to engage with and support stakeholders receives near unanimous praise.

1.3 Those responsible for funding and planning the rail sector value the good informal working relationship that ORR has established with them.

1.4 The exercise was, however, too onerous and was not a cost effective use of time. Stakeholders believe that a clear agenda focussed on key priorities would have achieved more. Whatever agenda ORR sets for PR18, a successful conclusion will depend on identifying key priorities and consulting fully with stakeholders on how best those key priorities could be met. ORR should explain what its proposals are designed to achieve and why that is important.

1.5 The first consultation document did not set out the full programme of work involved to underpin ORR's aims. As a result, consultation on some proposals was rushed and their cumulative impact on some respondents was not fully considered until a very late stage. For PR18, ORR should ensure that consultation on its key priorities is supported by reasonably well-developed proposals with supporting data, including modelling, and impact assessments. This should be accompanied by a clear timetable.

1.6 Consultation and engagement worked best through ORR's workshops on specific proposals. Information and expertise was shared in this collaborative process. It produced sound results in a more cost effective way than bilateral engagement.

1.7 For the future, ORR should consider how to build on the success of its workshops. This might be through the Rail Delivery Group but this way forward would depend on ensuring that stakeholders outside the industry had sufficient involvement with RDG. The aim would be to reinforce a culture of collaboration and effective engagement across the sector. A change on these lines would also echo ways of working adopted by some other regulators.

1.8 More detailed suggestions for improving the efficiency and effectiveness of ORR's consultation and engagement for the next price control review are:

- Consultation documents should take the form of a simple summary, with technical details and supporting data annexed;
- Consultation documents should be immediately available on ORR's website, with e-mail alerts sent to those known to have a particular interest;
- ORR's workshops should be webcast;
- More effort should be made to avoid jargon and to explain the effect of proposals and conclusions;
- Where ORR has rejected evidence or arguments put against its proposals, it should try harder to explain why.

2. Introduction

2.1 The Office of Rail Regulation (ORR) asked me to undertake an independent review to examine how, as part of its process for setting Network Rail's price control in PR13, it consulted with external stakeholders. The aim is to help those planning the next price control to identify ways in which the process could be improved. My terms of reference were to:

- examine the way in which ORR engaged with stakeholders as part of the process to carry out the periodic review;
- seek views from ORR's stakeholders on the review process and specifically,
- whether ORR addressed the key issues in the review, consulted appropriately on its proposals, gave stakeholders the opportunity to discuss issues, listened to feedback from stakeholders and explained clearly its decisions;
- if there are any areas in which the effectiveness and efficiency of the process could be improved;
- produce a report on the findings, including recommendations that ORR should consider in planning and carrying out the next periodic review.

2.2 I have direct experience of contributing to thinking on price controls, and of managing the process of setting them, through my previous roles as Deputy Director for Electricity Regulation (1989-93) and as a Non-Executive Director at Ofwat (2006-2014). I also have direct experience of engaging with a wide variety of stakeholders in those roles and as Secretary to the Competition Commission (1996-2000) and Executive Director at the Office of Fair Trading (2000-2005). Before I agreed to undertake this review, I discussed with both the ORR and Network Rail whether my continuing role as one of the Membership Selection Panel for Network Rail's Members was compatible with independence. All agreed that it was. I also mentioned my membership of the MSP to all those whom I interviewed.

2.3 It would have been a lengthy and disproportionate task to examine all of the 40 documents that ORR issued during PR13, or to discuss issues with all the 70 organisations who responded. I therefore decided, with ORR's agreement, to limit my research and discussions to a reasonable spread of key stakeholders. These covered:

- (a) Network Rail itself;
- (b) other rail industry stakeholders (the Rail Delivery Group into which the Association of Train Operating Companies is now subsumed, three passenger train owning groups and two freight companies);
- (c) those setting outputs and funding or planning rail services (Department for Transport, Transport Scotland, Welsh Government, Passenger Transport Executive Group);
- (d) the former Chief Executive of the Rail Safety and Standards Board;
- (e) those representing passengers and wider interests (Passenger Focus, Rail Freight Group, Railway Industry Association);
- (f) the Transport Select Committee to whom ORR is accountable.

I also had helpful background discussions with the ORR itself.

2.4 I decided to concentrate on ORR's three over-arching consultation documents and the implementation arrangements, in particular:

- the First Consultation Document of May 2011 which outlined the broad principles under which ORR proposed to conduct the review and its methodology;
- the Draft Determination issued in June 2013;
- the Final Determination issued in October 2013;
- the process for implementing final decisions through access charges.

2.5 However, where those interviewed raised points of real concern to them over any of the other documents issued, I widened my review to include them. Each of the organisations to which I spoke gave me their own frank assessment of how ORR engaged with them throughout PR13. At the end of each meeting, I produced a note covering the gist of our discussion and agreed this with each organisation. The report itself draws on these notes but represents my own independent views. Sometimes there are differences of view between stakeholders and ORR. It is not the purpose of this review to reach a judgement on these points but to highlight general concerns and to identify ways in which a more efficient and effective process could be conducted in future. I should like to record my thanks to all of those who agreed to participate for the thought and time they put into my discussions with them and for the open and reflective way in which they contributed.

2.6 A team led by John Nelson (including representatives of the National Audit Office) carried out a review of ORR's previous price control for Network Rail (PR08). This review was wider than mine, in that it covered ORR's internal processes for conducting the review. Chapter 4 of the Nelson Report, however, covered consultation with external stakeholders. To ensure the independence of my own review, I did not read this until my own study was complete. Some of the Nelson Report's findings, particularly the gains to be had from more joint workshops, are echoed in my review.

3. Background and context

3.1 When the UK privatised the airports, telecommunications, water, gas, electricity and rail utilities some twenty to thirty years ago, independent economic regulators were set up under statute. Each statute varied but in broad terms the regulators' core task was to promote competition, ensure that prices charged by companies providing monopoly services did not exploit that monopoly position, and that the services

provided by them to consumers met minimum quality standards. Statutory duties to protect consumers, promote competition and ensure that efficient regulated companies were adequately financed underpinned regulators' role. Regulators were appointed by Ministers but operated independently from government. The principal reason for independence from government was to reassure private investors that they would receive an adequate return on capital and not be subject to the risk of political interference.

3.2 Over time this 'pure' definition of economic regulation has changed. The remit of regulators has widened to include social and environmental policy aims for which Ministers have prime responsibility. Boards have replaced single regulators. Provision has been made for Ministers to give policy guidance on how regulators should interpret their various statutory duties. Ministerial guidance has extended to the way in which regulators work, for example keeping regulation to the minimum and avoiding burdens on regulated companies. Some regulatory bodies have been merged. Some sectors have become competitive to the point where regulatory control has become unnecessary – most obviously in telecommunications and most recently in the removal of Stansted airport from price control.

3.3 Even though the main reason for setting up independent economic regulators was to reduce the cost of capital raised from the private sector, the same model has been extended to companies in the public sector. The Post Office was put under the charge of Postcomm (now merged with Ofcom) prior to privatisation. The ORR continued to regulate Network Rail as a private sector company after Railtrack's demise. Responsibility for franchising rail companies, however, moved from Opra (the independent body set up when the rail industry was privatised) to direct government control under the Department for Transport. ORR's responsibilities remain broadly unchanged following the reclassification of Network Rail as a public sector company.

3.4 The way in which each regulator works has varied, reflecting the specific situation of the sector concerned, the philosophy of those leading the regulatory body and emerging public and media concerns over particular issues. But there are still many points in common between regulators in how they approach the task of setting price controls and standards for monopoly providers. It is usual for a review of the regulated industry to take place every 5 years and for wide consultation to inform that process. In all sectors with economic regulators, efficiency gains, though in some cases at a diminishing rate, have been secured. In some cases and at some points, prices charged have been reduced. Huge investment programmes have been financed. Services have expanded to meet the needs of a rising population. Services have also significantly improved, though not always to the extent that customers would wish. Other economic regulators can provide a helpful comparison for the ORR in how price control reviews are conducted.

3.5 Over time, the traditional 'top down' way of imposing price controls has resulted in regulated companies focussing more on their relationship with the regulator than with their customers. This removes an important stimulus to companies to behave as if they were in a competitive market. It risks diminishing services to customers. It risks making long term investments that are divorced from the reality of what customers want. It also places a much greater burden on regulators to act as proxy for customers. ORR itself recognises this dilemma. Both the draft determination and the final determination stated: *We want Network Rail to become more commercially responsive to the needs of its customers.*

3.6 Two regulators, the CAA and Ofwat, have changed the way they determine price controls to try and improve customer focus. The Civil Aviation Authority has moved away from the role of determining outputs and the efficient prices necessary to secure them. In regulating the prices of those airports deemed to have market power (now only Heathrow and Gatwick), it relies instead on the negotiation between each of those airports and its commercial customers, i.e. the airlines using those airports. The airlines, operating in competitive markets, can put pressure on the regulated airports to keep prices at an efficient level and to invest in those services for which passengers are prepared to pay. The CAA's task in conducting price control reviews and consulting on them is made much simpler as a result. Although

there is an invitation to consult to which anyone may contribute, the task of analysing proposals emerging from the industry and determining prices for the control period is largely confined to discussions with the airports and airlines.

3.7 Ofwat has regulated the prices and services charged by water and waste water companies operating as regional or local monopolies for over 25 years. The way in which Ofwat conducted price controls was very similar to that adopted by ORR until the most recent price control, due for implementation in April 2015. The old way involved increasingly complex and lengthy consultations, a programme of engagement with those directly affected (including environmental regulators, consumer groups, academics, those with a particular voice on social policy matters as well as the regulated companies themselves) and lengthy explanations of the decisions made at the stage of draft and final determinations. Detailed outputs for each company were specified, to which they were held to account.

3.8 An independent review of Ofwat itself was commissioned in 2010. This concluded, inter alia, that the price control review process, and Ofwat's detailed style of regulation, was disproportionate to the benefits secured. It drew attention to the risks of companies focussing too much on the regulator, rather than customers. As a result, Ofwat re-thought its role. Each company was required to draw up its own business plan and to take responsibility for consulting its own stakeholders before submitting that plan to Ofwat. Environmental regulators settled necessary projects with each company, largely without Ofwat involvement. Each company was required to put in place a consumer forum under independent chairmanship. Options for service improvement, tariff changes and investments were fully discussed. Each independent chairman of the consumer fora submitted a separate report to Ofwat commenting on the company's business plan. Ofwat then appraised the plans and fast-tracked those where there were no issues of concern, reverting to more thorough investigation and discussion on the others.

3.9 The ORR is in a different position to other regulators because it is government itself (the Department for Transport, Transport Scotland and to a more limited degree the Welsh Government) that sets high level outputs and determines the public funding available for them. ORR cannot therefore replicate the arrangements for consultation on price controls adopted by the CAA and Ofwat, where regulated companies can make their own choices on outputs after consultation with customers. However, ORR could make its own changes to the process for consultation, with the aim of putting more emphasis on Network Rail's relationships with its customers and building on some of the ideas behind the approaches taken by the CAA and Ofwat. I discuss the case for this in section 7.

3.10 When PR13 started, Sir Roy McNulty's study on the rail industry's value for money had just been published. This highlighted the growth in demand that is projected and recognised that costs needed to be further reduced by a significant amount. Greater collaboration between Network Rail and train operators was seen as essential to achieving greater efficiency. In response, the industry set up the Rail Delivery Group. This is a forum within which Network Rail and train operators work together to improve efficiency and services to customers. Stakeholders view it as the centre within which long term planning for the rail sector is coordinated, though Network Rail has the licence obligation for this. ORR is involved and oversees its governance. The RDG also includes as associates other major stakeholders and other bodies (eg the Department for Transport, Transport Scotland, the Welsh Government) attend meetings where necessary. It has thus changed the landscape from that within which ORR worked on earlier price control reviews.

4. ORR's Objectives for PR13, process for consultation and key issues

4.1 At a high level, ORR set clear objectives for PR13 and a timetable for the major milestones that was, commendably, met. The first consultation document issued on 25 May 2011 – some seven months later than ORR had hoped because it was held back until the McNulty report issued. In her Foreword, the Chair expressed her hope that:

Through this periodic review we can drive through the step change required in delivery and efficiency for the benefit of taxpayers and the passengers and freight customers who rely on Britain's rail network.

4.2 The proposed objective was set out in the document itself as:
to protect the interests of customers and taxpayers by ensuring our determination enables Network Rail and its industry partners to deliver or exceed all the specified outcome and output requirements, safely and sustainably, at the most efficient levels possible comparable with the best railways in the world by the end of the control period.

As for how to achieve this aim, the first consultation document highlighted that the determination would be output and outcome based; that ORR would use market mechanisms and promote competition where possible; and that the aim was to give Network Rail stronger incentives to improve outcomes and efficiency.

4.3 ORR opened up debate on whether, following Network Rail's own decision to devolve more responsibility, efficiency gains and risks should be shared by Network Rail and train operators at route level; whether the price control itself should be set at route level; whether Network Rail should have a stronger incentive to make best use of capacity; whether to introduce new incentives for innovation and for carbon reduction; and whether track access charges should be more cost-reflective. It was this last issue that proved the most controversial.

4.4 To explain and promote consultation, ORR held four workshops in each of Edinburgh, Cardiff, London and Manchester. It is clear from discussions with stakeholders that this initiative was very well received. All involved felt their attendance at the workshops was worthwhile, though there are some suggestions for improvement and for reducing the cost of participating.

4.5 The high level timetable for PR13 was clearly set out in the first consultation document. ORR asked for responses by 2 September 2011. The development phase was to cover exploration of Network Rail's costs, consideration of responses, advice to the two governments on their High Level Output Specifications and Statements of public Funding available. These last documents would be issued by July 2012. The formal review phase would run from February 2012 to October 2013. ORR issued their draft determination for consultation in June 2013 and the Final Determination issued, as planned, in October that year. The implementation phase, where access contracts and Network Rail's licence are amended to reflect the final determination, ran from October 2013 to 1 April 2014.

4.6 What was missing at this stage was a clear overview of the programme of work that ORR would put in place to underpin changes, particularly in the structure of access charges. A number of stakeholders commented on this. Between the first consultation document in May 2011 and the draft determination in June 2013, ORR published 14 separate consultations on specific proposals. Some, but not all, were flagged in the first consultation document. When detailed proposals emerged from ORR for consultation (the last major policy consultation document was published in April 2013), respondents felt rushed. Several stakeholders, particularly freight operators on whom the changes had most impact, have also said that it did not seem to them that ORR had looked at the cumulative effect of their proposals. Some stakeholders commented that work on the structure of charges was not affected by the McNulty report and that ORR could have commenced consultation on this issue ahead of that on PR13.

4.7 The programme of work in the development and formal phases was intense. Every aspect of the outcomes intended for PR13 was explored. A major focus was on the punctuality targets set for Network Rail under schedule 8 (performance regime) and the financial incentives for minimising planned disruption under schedule 4 (restrictions of use regime). Network Rail's costs and the scope for additional efficiency gains were obviously central to the review. Other key issues were:

- the role of competition and the regime for open access operators;

- how best to align incentives;
- the scope for Network Rail and train operators sharing efficiency benefits and risks
- possible changes in the variable usage charge;
- a freight specific charge;
- the volume incentive to encourage Network Rail to make better use of the network
- a freight specific charge for biomass;
- incentives on Network Rail and the train operators to improve energy efficiency by reducing transmission losses and minimising electricity for traction;
- Network Rail's financing and the financial framework for the price control.

4.8 ORR consulted on all proposed changes. This involved publishing further consultation documents and considering the numerous written responses to them. The major part of the consultation, and that most valued by those affected, was through discussion at meetings or over the telephone. All those whom I interviewed spoke very highly of the effort ORR put in to this part of the process. ORR executives, at every level, consistently made themselves available to explain the proposed changes and why they were thought to be important. It must have required considerable time and effort – but it was worth it.

4.9 On some issues, for example the proposal to disaggregate the price control to route level and to set variable track access charges to reflect geographical considerations, ORR changed its mind and decided that this should not be implemented during the next control period. Instead it committed to work with RDG and the industry early in that control period to review the case for more fundamental changes to the structure of charges for implementation over a longer time period. The ORR also modified proposals to set more cost reflective track access charges for freight operators by confining changes to that part of the freight market for which road could not compete. These decisions were announced in the ORR's decision document of January 2013. The proposed modification to freight charges did not allay the concerns of the freight operators.

4.10 There were some other issues where ORR announced changes, or likely conclusions, during the development phase. Most of ORR's proposals were however, not announced until the draft determination issued in June 2013. That then left a further period for discussion and consultation until the final determination issued in October 2013. The final months of consultation led to further significant changes, for example on the trajectory within which Network Rail's efficiency improvements should be secured and on only a partial increase in freight charges. RDG has established a work stream looking at options for the future structure of Network Rail's charges, which will help inform ORR's review.

4.11 The final determination of some 950 pages was published on time on 31 October 2014. There was further engagement in relation to implementation following this. Network Rail had the right to challenge ORR's final determination by refusing to accept it and by ORR then referring the matter to the Competition Commission (now the Competition and Markets Authority). Discussions were held between the two Boards and ORR provided clarity on how it would assess Network Rail's licence compliance on delivering performance outputs. This left the way clear for PR13 to commence, as planned, on 1 April 2014.

5. ORR's expectations from the consultation

5.1 There are various reasons why regulators are required to consult fully before setting price controls. There are other reasons why, even if consultation was not a requirement, it makes good sense to do so. The regulated companies, their customers and their suppliers have much more information and are closer to the market than a regulator can ever be. Consulting them can draw out useful data and comparisons that help to determine realistic outcome and efficiency targets. Where incentives are concerned, it is actual behaviour and the influences on it that count most, not just theoretical models. Network Rail and train operators are better placed than ORR to know what is practicable. Those directly affected by possible changes know their business models and their customers' behaviour and can thus estimate realistically what the impact of proposed changes will be on them.

5.2 With so wide a range of statutory duties, ORR also has to assess the wider impact of possible changes on economic growth, the environment and on social objectives. The governments concerned (the Department for Transport, Transport for Scotland and the Welsh Government) play a critical role here. They also need to ensure that ORR's conclusions and the regulatory framework it sets for Network Rail form a coherent whole for the rail sector within Great Britain. Where ORR is balancing various of its duties, it is good for all citizens to see the views expressed by the governments articulated in public.

5.3 There is no doubt that ORR is fully committed to effective consultation. The Foreword to the first consultation document emphasised that:

“ The review requires the active involvement of the whole industry, suppliers, customers, funders and wider stakeholders in making informed choices about what the railway can deliver for the money available.”

The issue of what constitutes effective consultation is at the heart of this study.

5.4 Effective consultation by a responsible regulator does not mean agreeing with all respondents and dropping any controversial proposals that are opposed. Sometimes the right course is for a regulator to lead change, even though the consequences may be painful for some (or indeed all) in the short term. On the other hand where proposals seem misconceived, to have perverse consequences that may not have been foreseen, or to cost more to implement than the benefits obtainable, effective consultation enables a regulator to drop or amend proposals.

5.5 Effective consultation should also not place so large a burden on those affected that normal business is severely disrupted. Nor should it risk the possibility that adverse consequences are not highlighted by those affected because of the time and effort involved in responding.

5.6 From ORR's point of view, the results of its consultation and engagement with stakeholders was mixed. On the positive side, the level of response at every stage was good – as much as could reasonably be expected. Network Rail articulated more fully than in earlier price controls its case for requiring expenditure and the data on which their case was based. The discussions between Network Rail and ORR resulted in more challenging outputs and efficiency targets than Network Rail had proposed. Wider engagement with respondents was also helpful to ORR in deciding where to strike the balance between the desirable and the achievable. Views expressed by wider stakeholders also influenced ORR's decision to set Network Rail specific outputs relating to asset management scheme.

5.7 ORR valued highly the contribution made by many respondents at working level on the detail of the regime for incentivising punctuality (schedule 8) and minimising disruption (schedule 4). Much effort was put in to calibrating new incentives and the result is judged to be better than ORR could have achieved on its own. ORR also found it valuable to discuss issues and proposals at industry led working groups on charges.

5.8 On the less positive side, ORR was taken aback at the level of opposition to some proposals, especially that for more cost-reflective charges for track access. Most respondents to the first consultation document accepted the case in principle for cost-reflective charges. Some freight operators clearly signalled the adverse impact that this could have on their business from the outset. Their points were repeated and amplified throughout the consultation. Some concerns (eg on the freight specific charge and the variable usage charge) were resolved at the draft determination stage. But concerns remained on the capacity charge and it is not clear that these were fully appreciated by ORR until a very late stage, after the draft determination had issued. Following a high level meeting of all concerned, further consultation through a joint working party produced an outcome that was considered reasonable.

5.9 ORR changed its proposals significantly as a result of the consultation. For example, ORR consulted on and initially decided to disaggregate variable usage charges geographically and to introduce a scarcity charge. Subsequently ORR dropped this proposal from PR13 following concerns from stakeholders on the impracticalities of implementing these in the next control period. Similarly, ORR put in considerable work on a route-based efficiency sharing scheme but it also recognised that many operators might prefer to enter into alliances or other commercial arrangements. This preference was clearly signalled in my discussion with one train operator. These changes were not necessarily what ORR expected but they are a result of effective consultation.

5.10 Where ORR's proposals were discussed with those most directly involved through workshops, proposals were developed and refined in a way that everyone could understand and appreciate. This way of engaging with stakeholders does not remove the need for consultation documents: they are a necessary prelude, where ORR can articulate what a particular proposal is designed to achieve, why it is important, the data and assumptions underlying the proposal and ORR's view of their impact. Subsequent workshops can then explore the case for change in more depth and how such changes would best be made. A good example of this working in practice is ORR's work with the industry on improving energy efficiency by introducing an incentive to reduce transmission losses and encourage better use of electricity for traction by train companies.

6. Stakeholder Expectations

6.1 Stakeholders held a wide variety of views on how ORR had conducted PR13 and engaged with them. As one might expect, those whose responses contained points that were adopted by ORR in the final determination are more inclined to be pleased with the process than those who perceive themselves to have had less influence. The former judge that the time and effort they spent on responding was worthwhile. This favourable view remained even when ORR had not met all their aspirations. Conversely most of those who opposed specific proposals are much more critical of the process for consultation, even where the outcome was eventually satisfactory to them. The time and effort put in to securing this seems disproportionate to them.

6.2 Everyone agreed that the process ORR adopted for consulting with them on PR13 was better than that adopted in previous price controls. But at the same time, many stakeholders felt that the effort involved was disproportionate to the results achieved. Many drew attention to the increasing length and complexity of the documentation. The issue here is, in my view, the extent of the PR13 agenda set by ORR. Every aspect of Network Rail's business, incentives, performance measures and charging regimes was explored in depth. With so wide an agenda, particularly examining the structure of charges in parallel with their level, it was difficult for everyone, ORR included, to cope. Several stakeholders have commented that an agenda which was focussed on fewer priorities for improving outputs and efficiency, would result in better outcomes as well as being a more cost-effective use of time and resources.

6.3 One criticism that is widely shared amongst stakeholders was that, as noted in section 4.6, the programme of work designed to inform consultation on specific proposals was not set out in the first consultation document. So when documents on specific proposals issued later during the development period, those directly affected were justifiably alarmed at the impact on them. They also felt rushed. One recommendation for improvement for the next review is that ORR should set out as fully as possible in the first consultation document a timetable for the programme of work to underpin proposals. Those particularly affected would then have clear advance warning of what would happen and when and could plan better the use of their time to respond. The programme would need tight project management. The temptation to add to the agenda would need to be resisted.

6.4 Although the consultation documents are judged to be too long and sometimes repetitive, most stakeholders thought they were clearly written and well signposted. Many have suggested that it would be helpful if they took the form of a short summary with detail in annexes. This was in fact the form of the first consultation document but it was not always followed through in subsequent documents. As for the specific questions put in consultation documents, these were not always seen as helpful. They can have the effect of seeming like an exam paper set by ORR. Stakeholders know all too clearly what matters to them. Several commented that they ignored the questions and simply concentrated on making their own points in their responses. I note that ORR's decision to include specific questions followed a recommendation from the Nelson review into the conduct of PR08. However, in the light of feedback from stakeholders on PR13, this should be reconsidered for PR18.

6.5 Only Network Rail itself responded to all ORR's consultation documents. Network Rail's own views on their engagement with ORR during PR13 have been discussed between the two organisations. In their discussion with me, Network Rail accepted that ORR's challenges had led them to investigate costs more fully. They wished that ORR had given fuller reasons when they had rejected specific arguments or points. They also pointed out that ORR's final view on the timing for achieving some outputs was reached at a very late stage and only after engagement at Board level. This may imply that ORR did not fully appreciate the validity of points that Network Rail was making. But it may also imply that ORR was, as a responsible regulator, pushing a regulated company to the frontier of efficiency.

6.6 Other respondents opted in or out of responding to consultation documents, depending on the significance to them of particular proposals. Others shared the burden of responding. For example train

operators responded on some points of common concern through ATOC or the Rail Delivery Group. Several respondents mentioned that ORR needed to be more aware of the burden of responding to consultations, both from ORR itself and from Network Rail (eg on the strategic business plan).

6.7 At the outset of PR13, ORR held four workshops in Cardiff, Edinburgh, London and Manchester. Stakeholders welcomed this opportunity to hear senior ORR executives present the issues in person. Such face-to-face engagement helped them appreciate the rationale for examining the case for change. It was also helpful to hear what other stakeholders said and to begin the debate on the issues. For some, it was expensive to attend. One useful suggestion from the Passenger Transport Executive Group is that ORR should webcast future workshops.

6.8 One area of near unanimous praise for ORR is their accessibility to stakeholders throughout PR13. It is very important for ORR to support those for whom rail regulation is but a small part of their work and who could be daunted by the complexity of the issues. This is an invaluable part of consultation and engagement. It is good that it was well resourced and that ORR led from the top on this aspect of PR13.

6.9 Funders and planners appreciated the close informal working relationships that they enjoyed with ORR throughout PR13. The Welsh Government is less satisfied with its formal position. The ORR can compensate for this to some degree by ensuring that informal arrangements for consultation, and appropriate involvement for the Welsh Government in the Rail Delivery Group, are in place for PR18. Transport Scotland also noted that there was scope to think differently about what was important in different parts of Great Britain and that alternative solutions could apply without losing the overall coherence of the regulatory framework.

6.10 However, although ORR personnel were accessible, there is criticism from some that there did not always seem to be real engagement by them on the issues. Freight operators in particular make this point. It may be that there were divided views within ORR on those specific proposals and that there was an understandable reluctance by staff to expose this division to others. In any consultative process, it should be legitimate to signal that a matter is still under careful consideration and that minds are not closed. Similarly those pressing a contrary view should accept that decisions are not reached **during** a discussion but afterwards when all views can be considered. The exercise of consultation differs in this respect from commercial negotiation.

6.11 Most stakeholders commented that engagement worked best where they could work with ORR staff in workshops designed to find the best way forward on specific proposals. This way of working shares expertise and knowledge from all involved. It also builds trust and understanding. It is also a more cost effective use of time than a series of bilateral meetings between ORR and those involved. I believe PR18 would work more smoothly than PR13 if ORR were to build more of its consultation and engagement around workshops. This view is shared by others.

6.12 Did stakeholders' views make a real difference? There is clear evidence that the answer to this is yes. For example, Network Rail produced more detailed evidence on costs of maintaining the network that justifiably reduced ORR's estimates of efficiency targets. ORR's proposals for geographical route-based track access charges were dropped once respondents drew attention to the practical difficulties they involved. Much more emphasis was placed on passengers' views as a result of evidence from Passenger Focus. ORR adopted many of the points made by the Rail Industry Association and by the Rail Safety and Standards Board in reinforcing collaboration across the industry.

6.13 ORR is accountable to Parliament for its decisions and in this context, I sought the views of the Transport Select Committee on their dealings with ORR on PR13. The Chief Executive of ORR had kept the Committee in touch with developments through correspondence. ORR had also held a special briefing for the Committee. This approach was appreciated. The only points of possible concern raised by

the Clerk on behalf of the Committee were the need for ORR to recognise that the Committee's concerns range much more widely than Network Rail's price control and to tailor communications more to the Committee's agenda.

7. Conclusions and Recommendations

7.1 The ORR set itself a daunting task in PR13. As the Chairman said in her Foreword to the first consultation document, ORR sought to drive through the step change required in delivery and efficiency following the McNulty study, for the benefit of taxpayers, passengers and freight customers who rely on Britain's rail network.

7.2 ORR recognised that the key to achieving this was to develop better incentives on the rail industry to do things differently and better. Every aspect of Network Rail's business was examined around a demanding set of criteria summarised below:

- Specifying outputs and outcomes that were challenging but achievable in a safe and sustainable way;
- Stronger incentives for Network Rail and the train companies to work together by sharing efficiency gains and risk;
- Better use of capacity;
- Cost-reflective access charges;
- Using market mechanisms where possible and promoting competition.

7.3 Every aspect of this agenda was put out to consultation. ORR issued 40 separate documents. Over 70 organisations responded, in many cases to a number of different documents. ORR held workshops across the country to explain proposals, to encourage debate and to facilitate informed responses. Most important of all, ORR staff engaged continuously through informal meetings and dialogue with all those directly concerned. The milestones for various stages set in the timetable were achieved, including the Final Determination that was 958 pages long. All this represents a huge achievement by those involved.

7.4 The consensus from those interviewed for this study has many positive aspects:

- The process followed for PR13 was an improvement on earlier price controls;
- Consultation documents, though complex, were well sign-posted;
- A discernible effort had been made to simplify language (though more needs to be done);
- ORR executives were almost always accessible thus helping the critical process of informal engagement;
- Where ORR chose to work collaboratively with the industry (eg through working groups held between the Draft Determination and the Final Determination), useful results were achieved.

7.5 Where specific proposals adversely affected business interests in ways that had not always been foreseen, those involved are much more critical of the consultation process. This is particularly true of the freight operators on whom the cumulative impact of the move to more cost reflective charges was very significant. The consensus from those companies, and from some others on specific proposals, is that:

- ORR did not have an adequate overview of how the various building blocks of PR13 fitted together and thus failed to assess the cumulative impact of individual proposals: in consequence, consultation and engagement was insufficient and sometimes too late;
- It was difficult to assess whether, and to what extent, points made in responses had been fully understood and appreciated;
- Some proposals seemed divorced from commercial reality and were too complex to be practicable or to achieve their stated objective of improving efficiency.

7.6 One key message stands out from everyone – the need to simplify and prioritise the whole process of engagement in the next review. The effort involved from the industry and others directly affected, was a major distraction from the real tasks of improving efficiency and services. It was not in their view cost-effective.

7.7 The best way to achieve a simpler process of engagement is to set a simpler agenda. There are some issues where this may be achievable in PR18. Further work on reviewing the structure of charges is already under way in the Rail Delivery Group. The change in Network Rail's financial status may also simplify that part of the review that deals with the cost of financing. Evidence should be available on what has been achieved in efficiency through Network Rail's programme of devolution and alliancing. New franchising arrangements should pave the way for efficiency and risk sharing, which in turn may underpin revised and more cost-reflective charges for track access. Better data will be in place on the state of Network Rail's assets and its management of them. Taken together, and depending on progress, much of the PR13 agenda should have been achieved. But effective regulation changes over time in line with society's expectations. New concerns may emerge. PR18 may require another demanding agenda. But whatever goals may need to be set, it will be critical to their successful achievement for ORR to prioritise its aims, explain clearly what it wants to do and why and to engage effectively and efficiently with stakeholders.

7.8 It would be worth ORR exploring whether a more collaborative approach to consultation and engagement on PR18 could achieve more than the traditional model so far taken. The ORR cannot replicate the models chosen by the CAA and Ofwat for their price control reviews. In the case of the CAA, airlines using Heathrow and Gatwick include powerful companies closely attuned to customer requirements who have a sharp incentive to keep prices down. In the case of the water companies, there are choices for delivering service improvements and outcomes that can flow from discussions with stakeholders, rather than being set by government. Another crucial difference is that investment in both the airports and water sectors is financed by the private sector. With Government funding the major part of the rail industry and setting the required outputs, ORR's task in setting Network Rail's price control is very different. Nevertheless, the creation of the Rail Delivery Group puts in place architecture that offers an opportunity for ORR to consult more openly and informally with the industry and other stakeholders, including government, to identify changes in incentives that would further improve efficiency.

7.9 A change on these lines would require a careful appraisal of the risks involved. ORR must remain the decision maker in those areas where it has statutory responsibility: delegation of ORR's responsibilities to RDG is not an option. ORR would need to put in place firm internal governance arrangements. This would involve clear guidance to RDG at the outset; a regular review of progress on consultation regularly by the Chief Executive with the Board consulted as necessary; and proposals resulting from work within RDG being published and put out to final consultation by the ORR in the Draft Determination.

7.10 A change on these lines would also need to ensure that RDG itself enabled all stakeholders to contribute effectively to the consultation with ORR.

7.11 Regardless of whether ORR chooses to pursue this option, there are other ways to improve the process of consultation and engagement in PR18. The most effective, but perhaps the hardest to achieve, is to set a tightly focussed agenda on key priorities. This requires reasonably well-developed proposals with supporting data and impact assessments on which to consult. These proposals should be available in time for the First Consultation Document, with clear timelines for consultation on each before they either find their way, or not, into the Draft Determination. Consultation should not be the start of a process of exploration. As with good project management, proposals to widen the agenda should be resisted.

7.12 Other proposals for improving consultation are:

- Consultation documents should be in the form of a simple summary, with technical details and supporting data annexed;
- ORR's website should be improved so that all consultation documents are immediately accessible on line with e-mail alerts to those known to have a particular interest in the subject;
- ORR workshops should be webcast to enable more stakeholders to participate without the cost of attending in person;

- Further attempts should be made to avoid jargon and to explain the effect of proposals and conclusions;
- Where ORR has rejected evidence or arguments put against its proposals, it should try harder to explain why.

7.13 As for the process involved in implementing ORR's decisions in the Final Determination, this involves revising each individual access contract between Network Rail and the passenger and freight companies, as well as Network Rail's network licence. The current contractual protections for franchised operators also require the governments and operators to revise their franchise agreements. The aim here is to put the franchise companies back in the same financial position as if the access charges had remained the same. These processes are both complex and onerous. However, those external stakeholders directly affected do not seem particularly concerned by this. Nor was there any criticism of the engagement between ORR and those involved. If ORR is able to adopt a simpler agenda for PR18, and if in future DFT and Transport Scotland expose franchised train operators to the risk of cost reflective track access charges, this implementation stage will become more of a mechanical exercise. One might also argue that ORR itself should not need to give final approval to each contract: it would be more efficient if ORR were to give broad guidelines and then to leave the parties to the contracts free to implement them, with a right of appeal to ORR where necessary. However, simplification on these lines would involve a change in legislation. Another useful insight into possible improvements came from Network Rail who recognise that more flexible billing systems on their part would facilitate work in modelling different charges.

Annex

List of stakeholders interviewed

TRACK OPERATOR	Network Rail
TRAIN OPERATORS	Arriva Firstgroup Go-Ahead DB Schenker Freightliner and Rail Freight Operators' Association
RAIL INDUSTRY GROUPS	Rail Delivery Group
FUNDERS AND PLANNERS	Department for Transport Transport Scotland Welsh Government Passenger Transport Executive Group
OTHER STAKEHOLDERS	Passenger Focus Rail Freight Group Rail Industry Association Rail Safety and Standards Board
PARLIAMENT	Transport Select Committee