

**Rail Strategy & Funding
Rail**

Buchanan House, 58 Port Dundas Road, Glasgow G4
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Samantha McLelland Hodgson/Gary Taylor
Office of Rail Regulation
1 Kemble Street
London
WC2B 4AN

6 February 2015

Dear Samantha/Gary,

**REVIEW OF ORR'S ECONOMIC ENFORCEMENT POLICY & PENALTIES
STATEMENT**

Thank you for the opportunity to respond to this consultation.

I have provided some general points below with answers to specific questions attached in the Annex:

- At a general level there is limited evidence in the document or elsewhere to suggest that the current enforcement policy and penalties statement is having a positive effect on behaviours. In particular, that Network Rail has and continues to fail to meet outputs.
- Transport Scotland's own experiences suggest that where enforcement action has been taken, the passengers that suffered from the failures or missed targets usually see little tangible benefit. This may be down to a lack of public exposure, but in the case of fines which affect Scotland, that the funding is returned to the UK Exchequer and effectively lost from the Scottish rail system. This is effectively a "double-whammy" for rail users in Scotland.
- The use of fines in any circumstance is questionable and has to be thoroughly examined as part of this review process. Post the reclassification of Network Rail, it is counter-intuitive that one public entity would levy a fine against another. Particularly given that ultimately the cost would be met from public funding. In addition, given the separate arrangements in place for funding rail infrastructure and services in Scotland, a situation cannot occur where enforcement action threatens the delivery of the investment programme for Scotland's railways.
- In the case of publicly funded passenger services, it would not be in the best interests of rail users or the tax-payer for the financial sustainability of a

franchise operator, or the quality of the services they provide, to be put at risk through ORR enforcement action. In such cases, efforts to resolve the issue should in the first instances focus on the terms of the franchise agreement.

- We are aware that the ORR's enforcement powers are in some respects limited, but fines should really only be seen as an absolute last resort and come with a substantial and compelling body of evidence that the overall impact on behaviours will be to the direct benefit of rail users and funders.
- The ORR should also give some thought as part of this process to linking enforcement action to direct accountability at senior level within the body in question. In terms of Network Rail, there could be a link to the management incentive plan. In terms of all licence operators, the ORR should examine more effective use of reputational measures and/or the use of public statements.

I hope this response is useful.

Yours sincerely

A handwritten signature in black ink, appearing to read 'John Provan', written in a cursive style.

John Provan
Head of Regulatory Policy

ANNEX

REVIEW OF ORR'S ECONOMIC ENFORCEMENT POLICY & PENALTIES STATEMENT

Responses to the specific consultation questions

Q1 – Do you agree with ORR's view that it should continue to have one economic licence enforcement policy and penalties statement which covers all licence holders?

We fully support the principle of simplicity so in that context it would be sensible where possible to have one point of reference for enforcement and penalties which is easy to understand.

Key to this approach is that the policy should be sufficiently flexible to accommodate differing circumstances. For example:

- Geographic differences and adaptability to local circumstances. In particular, that the Scottish and UK Administrations may have different priorities for those rail functions for which they have statutory responsibility.
- There should be full recognition of the role and extent of public funding for rail operations. Given the revised borrowing arrangements for Network Rail, and in particular the separate Scottish borrowing limit, the investment programme for Scotland's railways cannot be put at risk by enforcement action taken by the ORR.
- Similar to the above, the vast majority of funding for the ScotRail and Caledonian Sleeper Services is provided by the Scottish Government and we would not want to see a diminution in the quality of passenger services, or an increase in the requirement for public support, as a consequence of ORR actions. In this context, the ORR's first consideration should be whether the franchise requirements are sufficient to deal with whatever behaviours or actions has led to the potential enforcement action.
- The behavioural effects of enforcement action on a commercial company with shareholder requirements to satisfy will inevitably be different to a body which is either fully or substantially funded from the public purse and therefore subject to Ministerial or Parliamentary scrutiny.

Q2 – Do you agree ORR should be more transparent in highlighting issues and its activities for intervention; for example publishing more of our intervention correspondence and associated documents? Including more information on which we make our judgement?

As a principle, we fully support transparency in rail information. In the context of economic enforcement this approach can help strengthen accountability and provide stronger reputational incentives. More broadly it should also enable passengers and freight users to make better informed choices, enable funders to make the right

investment choices and to compare, contrast and learn from good practice across the network.

However, simply providing more information is not enough and in fact saturation can often obscure the key issues. What is important is that the ORR is able to provide the right information at the right time and this must come alongside full and proper analysis and insight.

What has been lacking in the past is an effective analysis of how the enforcement policy and penalties statement has affected Network Rail and operator behaviours at both a central/corporate and route level. Both in terms of what happens when action has been taken and also as a diversionary measure i.e. how behaviours are affected by the fact that both the policy and statement exist.

This, and the fact that Network Rail continues to fail to meet outputs, inevitably leads to the conclusion that the current policy and statement, or how it is applied, has had limited effectiveness.

Q3 – What kinds of activities would better incentivise the industry and licence holder to raise issues and resolve these before formal enforcement was needed?

The optimum outcomes for rail users should be the primary driver behind the licence conditions. Therefore, it follows that if the regulatory framework encourages the industry to 'do the right thing', a natural consequence should be behaviours which seek to raise and resolve issues in a manner which is timely and effective.

As industry regulator, ORR is in the optimum position to ensure that this mind-set pervades such activity across the industry. Allied to this, the ORR must ensure that the industry is truly working in partnership to both mitigate and resolve licence issues.

In line with the points made in Question 2 above, there is limited evidence available to show that reputational levers are effective in the rail industry. This may be down to a range of factors, but likely to be prevalent in this is that any negative publicity tends to be absorbed at corporate level. Therefore there is very little, if any, direct public accountability at senior level within rail bodies. In this context, the ORR should examine its current statutory powers to see if it can make the correlation between breach and individual senior accountability much clearer. One avenue for this in relation to Network Rail may be through the Management Incentive Plan.

In relation to paragraph 84, the ORR should also consider the revised role of the Scottish Ministers in Network Rail's governance matters post reclassification and whether this should be a factor in its approach to licence enforcement issues on the Scottish network. In particular, how Network Rail in Scotland could be held to account more effectively by the Scottish Ministers and the elected representatives.

Q4 – Is the seriousness of breach table in the policy statement helpful to licence holders and wider stakeholders?

There is a significant risk that this could drive perverse behaviours. As outlined above, there should be an industry focus on doing the right thing for rail users. However, in effect a 'ready-reckoner' may encourage a decision making process too heavily influenced by assessing the cost of resolving the issue properly against the cost of enforcement.

What is of more importance is that the ORR is able to engage pro-actively with the licence holder as soon as a possible breach emerges, that it takes a lead role in helping the licence holder to determine what the optimum response should be and that where the ORR makes a decision, that the basis and reasoning for this is explained in clear and simple terms.

Q5 – Do you think the seriousness categories in the penalties statement remain appropriate?

See answer to Q4.

Q6 – Would raising ORR's percentage of turnover starting point (beyond the percentages shown in the current penalty statement) for determining penalty amounts under its seriousness levels act as a stronger deterrent to future non-compliance?

There is limited evidence available to support any proposition that fines in the rail sector have been effective in altering behaviours, regardless of quantum. For example, the ORR levied £53.1m on Network Rail for failing to meet long distance targets in CP4, and evidence is suggesting that performance has worsened in the opening months of CP5.

In addition, the points made in response to question 1 about public funding for rail, also applies in this case. It is even more acute for Scotland's railways given that any fine is paid to the UK Exchequer and is therefore lost to the Scottish rail system with little or no tangible benefits to rail users.

As outlined in the covering letter, the use of fines in any circumstance is highly questionable and has to be thoroughly examined as part of this review process. Should the ORR view that it should retain this as an option, it should only be considered as an absolute last resort and come with a substantial and compelling body of evidence that the overall impact on behaviours will be to the direct benefit of rail users and funders.

Q7 – Do you support the general revisions proposed to the penalties statement to ensure it covers all licence holders?

Yes.

Q8 – Do you have any other general comments on the penalties statement?

We too see the benefits of a predict and prevent approach. Whilst recognising the incentive aspects of a potential penalty it is vital that the ORR works with the industry

to better understand the underlying problems, particularly around areas of sustained poor performance, and develops an appropriate and effective response to these.

Q9 – Do you agree that licensees should be encouraged to make early admissions and to provide public apologies?

This is something which should happen as a matter of good practice.

Where the issue of culpability remains a live one in any given circumstance, there is a significant risk that building such a provision into the regulatory framework may shift the focus from working together to resolve issues quickly and effectively. Based on past experience, you could easily envisage a situation where the party at most risk of enforcement action spends considerable time and resource on attempting to re-apportion blame.

Q10 – Do you agree ORR should revise its enforcement processes to enable offers of reparations to be considered in each of the following circumstances on a flexible basis depending on the circumstances of the case? a) Early in the investigation process where a licence holder provides an admission, apology and offers suitable reparations; b) before considering a penalty; and, c) as a mitigating factor once it has been decided that a penalty is appropriate and the level of penalty is being set?

We are very supportive of the principle of reparations, for two main reasons:

- It would mitigate the 'leakage' effect of a fine, as discussed in the response to Q6 above.
- If done properly, it can represent a tangible benefit to rail users. Aligned to this, the ORR should encourage proactive publicising of such activity and the reasons why it has taken place.

We had pressed the ORR to include reparations in the policy for a number of years and were pleased when it was included in the version published in 2012. It is therefore with disappointment that we have seen only limited evidence of a move towards proactive consideration of reparations by the industry since then.

Given this, we would expect the ORR to actively encourage the industry to behave in this way. Properly planned and executed reparations, where the rail user can see and enjoy the tangible benefits, is a far better outcome than a fine and the ORR must be more proactive in encouraging this approach from the rail industry.

Q11 – Do you agree that ORR's enforcement policy and penalties statement should incentivise non-compliant licence holders to offer early admission and offers of reparations by stating that the absence of such offers will be considered when: a) deciding whether a financial penalty is appropriate; and, b) identifying factors informing the level of any penalty.

The ORR should encourage a culture and philosophy where the rail industry works together, in consultation with those most affected, to make good any damage caused

to rail users. The proactive consideration of reparations, driven by the ORR where necessary, is critical to achieving this.

Q12 – Do you agree ORR should revise its enforcement policy and processes to reflect a more effective use of provisional and final orders, in particular, to enable ORR to be more proactive and forward looking?

Any actions which result from provisional and final orders have to be tangible. It is not enough to simply produce a 'plan' – the outcomes, benefits to rail users and timescales have to be clear and focussed and the ORR must ensure that they are delivered in full.

Q13 – Do you have any general comments on how ORR can improve the format and style of our current published policy document to make it a more practical reference document?

It has to be simple and clear.