Whole sector working strategic workshop
5 December 2013
Summary of discussion

On 5 December 2013, the Office of Rail Regulation (ORR) chaired a workshop with a cross section of people from within the rail industry, other regulators and academics. The event was chaired by Anna Walker – ORR Chair. The workshop followed on from the Long Term Regulatory Statement (LTRS) which was published in the summer of 2013. This posed questions about where the rail sector needs and wants to be in the medium to long term. This workshop focused on one of the themes in that document which was how the industry could achieve beneficial whole sector working.

Looking ahead to the next control period, it is vital that we work together as an industry now. The review of charges is a crucial part of this work and as the regulator we want to explore with industry whether or not it is possible for government and the regulator to design better incentives into the system for the industry to work together. We want to explore how Network Rail can develop its important role as the system operator of the network. We want the industry to be in a position where it requires less regulation and we want to build on existing and look for new approaches to achieving better outcomes for passengers, customers, investors, suppliers and taxpayers.

This is a note to summarise the key points that were raised during the workshop discussion. They are grouped in to overview points, possible enablers to whole sector working which were identified in the course of discussion and specific points raised in relation to charges and costs and capacity.

Overview

- We've talked a lot in the past about the interaction between governments, the regulator and the industry. The government and the regulator have to be responsible for defining "the what" and greater clarity is needed on their respective roles. The industry, working collaboratively, is best placed to deliver "the how". In that context the industry has a **broad definition** which not only includes Network Rail and operators but also its supply chain, ROSCOs and their funders.
- Rail is a complex sector and there are very complex issues that we need to work through as an industry to improve things and cope with the long term demands that will be placed on us. Improvements to whole industry working will only be realised if the industry recognises and takes **ownership** of the steps which are required to facilitate the desired collaboration.
- It is important to recognise the different priorities which rail supports – socio, economic, environmental and clarify the role of government and the regulator in deciding between these. Regulators are under increasing pressures to make these **trade-offs** itself while they would probably be better off focusing on their core objective of facilitating cost efficiency.
- The industry is best placed to find a way through the complexity of issues but in order to do this there is a crucial need for better clarity of **objectives** from the government/ regulator. For example, sometimes the industry is balancing the expectation of passengers with providing affordable options to businesses to drive freight onto the railways, rather than using the road network.
- There is some desire for **less regulation** and for more cross sector working to take its place where possible. This will involve a different way of working with the regulator.

Possible enablers

- More could be done to address the issue of **short termism** in the sector. For example train operators are not encouraged or incentivised to consider or plan for the network in the medium to long term (10-20 years). Many of them do produce a forward-looking strategic plan, but there could be a more overt requirement in franchise bids to do this.
- It is important to encourage and facilitate meaningful **stakeholder engagement**. Other sectors have experienced that increased competition leads to improvements in the quantity and quality of engagement as companies compete to be the best.
- In energy, directly funding **innovation** - for example the low carbon investment fund, has created flexibility as it does not require re-opening of the price control, while driving improvement in cross-industry working and in the delivery of efficiencies. The funds are there if required but that money is not spent without clear needs and benefits – and the approach is cost neutral since the efficiencies generated outweigh the costs.
- In the regulation of airports, there is an established process of **constructive engagement** between the airports and the airlines. Effectively they lead the discussions in those areas where they are best able to agree a negotiated position. This leaves the regulator to focus on the more contentious issues which cannot be solved through airport/ airline negotiation. It also minimises potential distortion through regulation.
- It is important to recognise that the mechanisms to facilitate collaboration are not always about achieving better **economic outcomes** – they can just be about making the sector/area better for everyone thereby focusing on social and environmental objectives.
- The industry has achieved lots in moving towards better collaboration, but there are three things that are also important to understand:

    - **consumer outcomes** – this is something which the Financial Services Authority is working on at the moment – what do consumers want and what role does competition play in this? This will establish the groundwork for designing incentives i.e. competition is not an end in itself but rather a tool for stimulating better outcomes.
    - **clarity of roles and responsibilities** - whole industry working is important, but need clarity at what stage government or a regulator should intervene.
    - **private investment** – in light of McNulty, we need to assess at what stage this comes into play for the industry and in what way. It is key to driving the right behaviours across the sector.

- Encouraging greater investment is partly about improving the **perception** of the rail sector. It is currently viewed as complex which can be confusing and off-putting to investors and potential funders.

Charges

- We have to consider our **objectives** in relation to a charging review. If we are moving to a structure of charges which is about encouraging efficient use of network capacity, there are some important points to address –for example, how do we deal with freight and open access in that context?
- It is crucial that the industry has **greater exposure** so that incentives such as charges can actually have an effect and drive more normal commercial behaviours.

- The process around charging is not **transparent** enough which makes it difficult to coordinate decisions on whether competition happens. If there are no prices set, it is difficult to know what to do. We need to know whether a tiered pricing system is possible. Some of this information probably exists, but it needs to be common currency to everyone to enable decision making.
- Similar issues about conflicting priorities also face other industries – for example socialised charging mechanisms – whether it is **fair** if costly locations pay more for energy, or where there are clear economic benefits, whether it is fair that businesses pay for connection to the network – or is this for the greater economic wealth of the country?
- There are real **practical issues** in moving to a model where there are different charges for different times of day – there was doubt expressed that the industry could move to this point even for the next control period.
- The process of determining market prices is complex. There are people on the network with **different values** – for example government is looking at the socio-economic benefits, while freight will be concerned about their business models.
- Decisions about capacity charging cannot be made in isolation – freight customers such as large retailers will make decisions about whether to use rail or road for their goods for as little as 0.07pence per unit. As a rail industry we need to be mindful of that **modal choice**, yet also understand the other benefits – for example the environmental benefits which rail provides.
- We need to be clear on what **purpose** we want the charging regime to fulfil. For example, do we want it to promote freight or open access competition? Do we want to encourage decision making and highlight cost to the decision maker? We need government to make choices on what it wants to buy and industry needs the flexibility to deliver the requirements in the best way.
- In freight, significant investments are made by customers. There is a need to rebuild the **relationship** and trust with freight customers post PR13 charging discussions.
- There needs to be an **open dialogue** with government on where they want to go in relation to charging – for example, changes to the capacity/scarcity charge do not make a difference to passenger franchises as the net bill to government is unchanged, but have consequences if freight and open access operators are priced off the network.

Costs and capacity

- A very strong theme in the discussion was that there needs to be more **transparency and granularity** of costs since, at the moment very little is known about what a part of the network costs or the numbers of passengers carried. This information is important in understanding how best to respond to future changes in demands, for example HS2. Once we have this information we should focus on how to properly use it e.g. its role in implementing capacity based charging. It will be important for someone to take responsibility for sharing and utilising this improved understanding.
- Network Rail needs to be more explicit about its role as a **system operator** – other sectors have separate, shallow system operators balancing capacity, but there is also scope for a system operator to play a role in planning capacity. Designing and calibrating effective **incentives** to encourage good performance is challenging.

- There is already some localisation of routes, with route directors, but tools need to be developed to enable more localised decision making. The rail industry is complex, and we need to try to simplify it as much as possible. Devolution of the running of parts of the network to those with local/ regional responsibilities is likely to be high on future agendas.
- While ORR is doing some work to understand and encourage wider transparency around costs, this information is needed at different levels as there is currently not the **granularity of information** to make fine-tuned decisions.
- Capacity is not a single figure and can be **influenced** by a number of factors, for example franchise specifications and rolling stock. We need to dig deeper into capacity and maximise the use of it to ensure that incentives are leading to the right enhancements.
- The **access regime** must drive the right outcomes on a mixed network of both passengers and freight and needs to properly interact with and complement the charging regime. It needs to be reviewed.
- More needs to be done to improve the **granularity of costs**. There has been some work through the use of route level efficiency benefit sharing (REBS) and alliances, but more information is needed to be able to make better business decisions.
- We need to recognise that some areas will always be **heavily subsidised** as the benefits that they provide are socio-economic rather than commercial. For example, urban transport networks. Any policy needs to take this into account.