



Department for Transport

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Dear John,

We welcome the ORR's publication in June of the policy consultation on reforms to the Network Licence ("the Licence"), followed by the subsequent July consultation on the draft Licence itself. This letter represents the Government's response to both consultations.

We strongly support the ORR's intention to reform the Licence, given the important role it plays in establishing the framework in which Network Rail (NR) operates. We are particularly encouraged by the progress that the consultation documents represent towards embedding the important reforms heralded by the NR transformation agenda and wider Periodic Review 2018 (PR18) process into the Licence, particularly the clear focus in supporting culture change with NR. Between the wider issues addressed in the ORR's Draft Determination and our own work to reform the Framework Agreement that defines the relationship between NR and Government, there is a real opportunity to ensure that NR is placed on a properly sustainable and more accountable footing from the start of Control Period 6 (CP6), supported by a culture even more supportive of effective delivery. It is critical that this opportunity is fully seized.

We are also particularly pleased by the extent to which your consultations address the Government's policy priorities for CP6. In particular, we think it is vital that there is continued emphasis on:

- continuing to drive and embed meaningful route devolution within NR;
- ensuring a accountable system operator function with clear responsibilities, with the capability and culture to deliver effectively;
- driving further progress on the good start that has been made to promote closer working between NR and its customers, bringing closer together track and train; and
- ensuring that the regulatory framework supports continued transformation of NR across CP6, including steps to increase the contestability of certain functions.¹

While we believe that the documents presented for consultation represent very positive steps forward, we nevertheless wish to raise several more specific issues which we consider are important to ensure the opportunities of this reform are fully seized.

¹ Consistent with the themes of the Secretary of State's guidance to the ORR (July 2017). We ask that the ORR continues to have regard to that Guidance (most particularly paragraphs 9 and 11) as it continues and concludes its work to reform the Licence.

Driving devolution, transformation and effective System Operation

The ORR has set support for NR devolution as a key objective for the review of the Licence. We are pleased by the steps taken to embed devolution and enhance accountability through requiring NR to designate routes and being clear that the Routes have primary responsibility for the operation, maintenance, renewal, improvement and development of the railway within the route, as well as the clear identification of the role and accountability of Route Managing Directors.

We also strongly agree on the importance of allocating specific responsibilities between NR's routes and System Operator in a more granular manner, supported by effective change control. This is key to driving accountability from, and stronger reputational incentives on, NR's management teams. We are therefore highly supportive of the ORR's overall approach, including the emphasis it places on continued effective co-operation between the routes and the central functions. However, we would note that there may be a legitimate need in some circumstances to preserve a degree of future flexibility on the assignment of responsibilities, to allow for emerging trends or innovations within the transformation programme. However, to prevent blurring of accountability, the reasons for such flexibility in the assignment of roles must be clearly and strongly justified.

We therefore see real value in your drive to clarify the respective roles of the routes and System Operator. It is particularly critical that, as the ORR proposes, the Licence properly supports the development of more effective relationships between the routes and central functions. We would be keen to see the Licence helping to embed a shift in the internal dynamics within NR, such that the routes become informed and empowered customers of the System Operator and Central functions, further supporting accountability and contestability.

We believe this is particularly relevant in respect of capacity allocation and the sale of access rights. We have noted some tensions between the System Operator function and routes over the assessment of network capacity and the ability of the network to accommodate additional train paths. We are clear that the System Operator must retain responsibility and accountability for ensuring the effective operation of the railway at a network level and for ensuring that all parties wishing for access to the network are treated fairly. We would, however, be pleased if routes were to take a more active role in the capacity allocation process, recognising their detailed knowledge of their local assets.

More generally with respect to the System Operator we consider that clear accountabilities are absolutely critical to create strong incentives to continually improve the capability of the System Operator, including in the critical areas of capacity allocation, performance analysis and the critical issue of timetabling. We therefore welcome the proposed allocation of SO primary responsibilities, including the establishment of the national timetable and the provision of timetabling information to passengers. With respect to timetabling specifically, we consider it is critical that the ORR ensures that the process of Licence reform ensures that the key lessons arising out of the ORR's timetabling inquiry (including the interim report in September) can be reflected in reforms to the Licence. It may also be necessary to preserve flexibility to adapt to the final report due by December. Doing so is absolutely vital to ensure all steps are being taken to prevent a repeat of the recent significant timetabling challenges, helping to prevent future unacceptable timetable related disruption to rail users.

We recognise the potential benefits in introducing a regulatory requirement for the SO to handle customers' information sensitively (2.11), not least because it could help to allay concerns of people providing information. However there are risks this creates an overly

bureaucratic and prescriptive set of processes within NR. It may be more useful for the licence to set a higher level requirement, for instance requiring a clear data handling protocol to be put in place that ensures people providing data to the SO agree to the uses NR may make it and makes appropriate provisions to protect commercially sensitive data.

Finally, we strongly agree on the importance of the Licence being clear that information requests can be provided to the Routes and the SO directly, as well as instructions to independent reporters being capable of being focused on the Routes and the SO. This is important to underline the accountability of local management teams.

Bringing together track and train

We were pleased to see the emphasis placed, in the July consultation in particular, on sharpening the focus within the Licence on NR carrying out meaningful engagement with its customers, supporting cultural change in NR, which is a key aspect of achieving transformation and closer working between track and train. We consider this essential to ensure a more joined up railway that works better for its customers. We would strongly urge you to continue to use the Licence as a tool to drive progress in this area, particularly through supporting further culture change in NR to enhance its responsiveness to its customers.

We have been encouraged to note a general improvement in the quality of NR's stakeholder engagement over the course of the PR18 process, as the ORR clearly indicates in the Draft Determination. However, despite the positive signs we have witnessed, we consider that considerable further improvement is still required if we are to realise the ambition set out in our Strategic Vision for Rail to improve the network for end-users through closer working between track and train.

In this light, we are highly supportive of the principles that you have set out alongside the Draft Determination for high quality stakeholder engagement, in that it must be:²

- effective,
- inclusive,
- transparent, and
- well governed.³

While we can see that these are broadly reflected in Licence condition 1.7, we consider that it would be even more effective if these principles are explicitly and directly set out in the Licence, with the accompanying definitions from the Draft Determination included. We consider that such an approach, whilst being non-prescriptive gives a clear indication of the types of behaviours that NR is expected to demonstrate in its engagement with customers. However, we consider that such a view is much too narrow – setting these principles clearly into the Licence are an important aspect of supporting the cultural change in NR which is a key aspect of transformation and in better joining up track and train in the interests of customers.

Reflecting reclassification of NR

We also support the recognition in the consultation of the importance of ensuring that the Licence reflects the reality of NR as a public body and Secretary of State as the sole

² http://orr.gov.uk/data/assets/pdf_file/0018/27801/pr18-draft-determination-stakeholder-engagement.pdf - table 2.1

³ http://orr.gov.uk/data/assets/pdf_file/0010/27757/pr18-draft-determination-overview-june-2018.pdf - para 3.16

shareholder in the company. We therefore support the removal of the Financial Indebtedness provision as with respect to new funding requirements NR is now wholly funded by the State and not through debt market issuance, meaning that financial indebtedness limits would no longer be relevant; also obviating NR's need to maintain investment grade issuer credit rating. Similarly, sole Secretary of State shareholder status and public ownership mean that Change of Control provisions are no longer relevant, all of which will simplify such aspects of the Licence.⁴

Protection for Freight Operators and Customers

The Government's Rail Freight Strategy recognises the crucial role that rail freight plays in the UK economy and we consider the continuance of a healthy rail freight market to be of vital importance. We, as we articulate in our separate response to the Draft Determination, continue to support the strong steps that the ORR are taking through PR18 to support the freight sector. However, we are concerned that the present text within the draft Licence (paragraphs 2.6-2.7) may not provide sufficient protection for the interests of freight users during a period when NR will be undergoing a process of significant and necessary transformation.

We accept that this is an area where a degree of flexibility may need to be preserved within the Licence to allow practice to evolve over the course of CP6. For instance, we recognise there may be legitimate debate as to whether it is better for the FNPO route or geographic routes to be held directly accountable for freight interests. But we would like to see the existing wording of this section strengthened to reflect the critical importance of ensuring fair treatment of freight operators and their customers, to help enable the rail freight industry to grow.

We want to see the FNPO route having the right governance in place through the Licence to ensure that freight is not disadvantaged and receives equal treatment, enabling Network Rail to make fair trade-offs. As it stands, the proposed Licence does not include a clear obligation for the SO and geographic routes to work with the FNPO route, limiting the authority the FNPO has to ensure that other parts of Network Rail's business deliver for rail freight. As such, the Licence needs to oblige all parts of Network Rail to deliver for rail freight, including an obligation to cooperate with the FNPO route (or any other part of its business that is established to act as the focal point for the freight industry).

Network Rail also has an important relationship with freight customers, such as ports and the construction industry, which is not acknowledged in the proposed Licence. Network Rail takes in to account the interests of freight customers who rely on Network Rail to support their businesses, and this needs to be reflected in the Licence.

The rail freight industry, both operators and their customers, need to have certainty to plan their businesses. This is especially important at a time when the freight industry is restructuring to focus on new markets following the decline of coal. At a time where Network Rail is also transforming, the rail freight sector needs to have confidence that all parts of Network Rail's business are obliged to deliver for rail freight, and that the industry has clear recourse through the Licence where things go wrong. This would send a clear signal to the rail freight industry that their interests are embedded across all parts of Network Rail's business.

⁴ We similarly support the other steps to simplify and clarify the Licence highlighted in the July consultation.

In Conclusion

We regard the reforms to the draft Licence as highly positive, subject to our comments above, and encourage the ORR to continue to take an ambitious approach to reforming the Licence to enhance accountability. I am pleased that constructive discussions are underway between ORR officials and our own NR Shareholder Team on certain aspects of the Licence, particularly those relating to Management Incentives, which are important to enhance accountability. It is encouraging that you have identified the need to ensure that Network Rail's scorecard, framework agreement and Licence align to support effective measurement of performance and management of reward. We look forward to continued engagement with you on this process as ORR takes full advantage of the opportunity afforded by Licence reform.

Yours Sincerely,



Dan Moore
Rail Markets Strategy