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Response to the PR18 Initial Consultation Document

Thank you for the opportunity to respond to the Periodic Review 2018 (PR18) Initial Consultation. PR18 provides a key opportunity to continue to improve how our railways serve passengers and freight shippers, and it is important the ORR ambitiously takes the chance to improve outcomes for rail users. This response sets out some particular areas of opportunity and initial thinking on our future engagement.

Introduction

Britain's railways are a key part of our national transport infrastructure. With new trains, improved infrastructure and more services, passenger numbers have grown strongly, doubling in the 20 years since privatisation, and freight has grown by over a third.

However, with this success, there have come challenges - train service reliability is still not good enough, and the increasing demand for rail services means some parts of the network are increasingly crowded. Looking ahead, the network needs to maximise benefits from the Government's programme of major investment, including in Crossrail, the Thameslink Programme, new trains and HS2. The rail industry also needs to redouble its efforts to put users at the heart of its work.

A well conducted process will provide the regulatory framework required to improve the railway for its users - passengers and freight shippers - and to enable it to support our economy. It will help maximise the benefits from the Government's investments, not least in helping to ensure HS2 is fully integrated with the existing network. It will also help ensure users benefit from continual improvements to their services over the coming period, not least in terms of performance, reliability and resilience, where the railway has more to do. Furthermore, it will be critical to improving efficiency, creating the right incentives on all parties to facilitate greater value for money.

PR18 is also an important contributor to supporting the Government's approach to rail reform. The recent Shaw Report into the future shape and financing of Network Rail (NR) made a number of recommendations to create a NR that is more effective, efficient and responsive to the needs of its users. While NR is already addressing many of the issues raised by Shaw, PR18 can further support and enhance this process, providing further opportunities to make NR more efficient and responsive to users. This includes new arrangements for specifying and delivering major enhancements; a substantial process of devolution within NR to put decision makers closer to customers and a whole-industry focus on delivering the outcomes that matter for users. At the same time, the railway's safety record must be preserved and greater emphasis placed on innovation, modernising technology and providing more choices for passengers.

Achieving all this will require ambition and concerted effort from the ORR, from NR, from train operators, the supply chain and Government. We therefore look forward to engaging fully in the PR18 process.

Objectives for PR18, the High Level Output specification and the Statement of Funds Available

Objectives

We strongly support the ORR's overall objective for PR18, and particularly the focus on user interests. The Government is at an early stage of the process which will lead to the publication of the High Level Output Specification (HLOS) and Statement of Funds Available (SoFA) during 2017.

Our objectives for PR18 naturally may develop as we continue our engagement with you and the full range of interested stakeholders. Our initial view, which I think we substantially share with the ORR, is the objectives are:

- to ensure the needs of **users of the railway are placed at the heart of the railway**. This includes through the implementation of the key recommendations of the Shaw Report, including a substantial devolution of power and responsibility to NR's routes (including maximum appropriate financial accountability), supported by independent regulation. In particular, we support the principles underlying a move towards a route-based regulatory regime which we consider could substantially increase the ability of ORR to hold NR to account, e.g. allowing route-level benchmarking to inform distinct outputs and efficiency targets, identifying best practice across the network and using it to hold routes to account for performance.
- to **preserve and enhance the improvements that have been made in the safety of the railway**, for passengers and the workforce, ensuring that we continue to have one of the safest railways in the world;
- to ensure the railway's **performance**, including in areas where it is not currently delivering what users want, meets the reasonable expectations of its users;
- to ensure a funding environment that provides sufficient **certainty** to allow investors to plan their decision making, with a particular focus on giving the supply chain confidence to invest in people, innovation, facilities and equipment, while

also providing **strong, sustainable efficiency incentives** for NR and the wider industry;

- to provide funders with **sufficient flexibility in respect of the enhancements programme** so they can ensure their investments remain aligned to their priorities. This means the regulatory process should support a robust, credible infrastructure planning process which delivers what users need, aligned with the franchising timetable. As the Bowe review recommended, this means some substantial improvements - a more flexible process, where the Government only commits to enhancements at the point when funds and supply chain capability are available to deliver them and they make strategic sense; and,
- to improve the **environmental sustainability** of the railway so it makes a full contribution to the Government's environmental agenda, is resilient to climate change and extreme weather conditions, and maintains its position as a sustainable form of transport by responding to the rapid environmental improvements being made by other modes.

How this may impact on the HLOS and SoFA?

This means the next HLOS and SoFA will look significantly different to those which were published in 2012. PR18 is likely to see from DfT a much higher-level HLOS, and accompanying SoFA, focussed on:

- the “steady state” costs of the railway (operations, maintenance and renewals);
- meeting the Government's commitments to the projects in the Enhancements Delivery Plan;
- delivering major projects (such as Crossrail); and
- projects that are deemed critical to prevent serious deterioration disruption to passenger or freight services.

This will enable greater flexibility to take forward and fund additional new enhancements on a rolling basis, as and when they reach sufficient design maturity, enable better alignment with franchising and facilitate a broader range of funding models. The current intention is to distinguish separately proposals that are considered by Ministers to be worth developing, from those that have been developed to a stage worth designing in detail, and from those that are worth delivering. There will then a further test as to whether those worth delivering are also capable of being delivered and are timetabled to have regard to other factors such as the state of the supply chain and the impact of disruption on the network. We look forward to working with the ORR in the coming months to further refine this process, including how it will impact on the determination.

Additionally, there are also likely to be changes to how DfT specifies outputs as part of the PR18 process. At this stage, we are attracted by a model of specification which emphasises broad outcomes for users (e.g. increased capacity or faster journey times) rather than inputs (e.g. specific projects). We are also considering whether it might be

appropriate to specify performance trajectories rather than specific targets, particularly in light of the progress on route-based devolution within NR. We also want to see a move towards performance metrics which better reflect the needs and perceptions of passengers, consistent with the preferred approach that is emerging from the work of the National Task Force.

As you will appreciate, we are also considering other issues that will impact on PR18. These include the overall availability of funding for Control Period 6, against the backdrop of a continued need for restraint in public spending. It will also be important to fully reflect the changes to the manner in which Government provides funding to the industry following the reclassification of NR to the public sector.

The ORR's proposed PR18 process

We have reviewed the proposed process for conducting the PR18 process outlined in the Initial Consultation. We particularly welcome the open process the ORR is taking, including the publication of working papers and stakeholder workshops to inform its thinking. We also welcome the ORR's ambitious agenda of taking full advantage of a more devolved NR to significantly enhance the regulatory framework. We will be actively engaging throughout these processes to support this important and ambitious agenda.

We fully recognise the time required to complete a robust carefully considered review, and also consider that it remains important that the process preserves sufficient flexibility in the timetables, including around the HLOS and SOFA, to ensure that the review can be conducted in an effective manner. This is likely to involve more flexible and iterative approaches than may have been the case in the past.

Areas for further focus

There are a number of additional strategic or policy areas which would benefit from a particular focus as PR18 develops.

- First, it would be helpful if issues relating to **HS2** could be given greater prominence within future review material. Most of the construction programme for phase 1 of HS2 will take place during CP6, and this is likely to have significant implications across the duration of CP6. Furthermore, significant development and planning work for the integration of future HS2 services with the rest of the rail network will take place during CP6 and beyond.
- Second, and as suggested above, a greater emphasis on potential options for private investment in **rail infrastructure**, in line with the recommendation in the Shaw Report, so that the regulatory framework supports third party investment to add real value alongside continuing Government investment.
- Third, a greater focus on **encouraging innovation** across the rail sector. This is a vital counter-point to work on NR's efficiency. If users are to see significant advances in reducing the costs of the railway and encouraging NR's route managers to take a more flexible approach to tackling problems, then innovation has a key role to play. Every possible step needs to be taken to ensure the regulatory framework supports this.

- Fourth, **the importance of closely working with stakeholders who can provide a robust view of user preferences and behaviour**. In particular, the passenger perspective including that provided by Transport Focus, with whom you already work closely, will be important in the PR18 process.
- Fifth, the PR18 process and outcome should **support investment in skills**. The rail industry is facing a significant and growing skills gap as older workers retire and new technology – such as digital signalling – is introduced. This poses a risk to the cost-effective delivery of rail enhancement schemes and the continued operation of the network. Rail will increasingly be competing for scarce resources with other industry sectors so needs effective mechanisms for attracting, retaining and developing staff.
- Sixth, DfT is already discussing with ORR particular issues with regard to **station licensing and access charging**, on which we welcome ORR's continued engagement as part of the PR18 process.
- Finally, while fully recognising the particular circumstances of rail, it is important to build on the lessons learned in other utility sectors, to ensure **effective route based regulation and an effective system operator**. We welcome ORR's work on the system operator and route-based regulation and we look forward to working with you to further develop the approach in this area, including through the exploration of the potential for route-based charging.

Additionally, it is crucial to focus on steps that can reasonably be taken to improve the capacity and performance of the existing network, rather than unduly focus on steps which require its expansion. This is particularly important to minimise disruption to passengers, whilst maximising value for money.

Charges, incentives and open access

The work on charges and financial incentives is key. We recognise this is being taken forward in a parallel process to the initial PR18 consultation document¹. A regime which provides strong incentives for NR and operators to work together to reduce costs and drive improvements for passengers will be critical. This is why we particularly look forward to working with the ORR and industry on potential means to significantly enhance this collaboration, creating stronger, sustainable commercial incentives for efficiency. However, changes should only be made where they lead to a significant better outcome for users. We would be concerned at changes which increased complexity, and potentially costs, without clear evidence these would lead to improvements for users and taxpayers.

Furthermore, for incentives to work effectively, there will need to be clarity and transparency about where costs are incurred and what different sources of funding are paying for. This should support better decision-making across Government and the rail industry. We would encourage the ORR to fully consider the opportunities create by route

¹ The DfT's initial letter to the ORR on charges and incentives can be found at: http://orr.gov.uk/_data/assets/pdf_file/0008/19853/DfTs-letter-on-improving-incentives-for-better-outcomes.pdf

based regulation - while we recognise that route based charges pose certain challenges, we support full consideration being given to the issue during the PR18 process.

As you know, we are also exploring how a levy could be introduced so that open access operators make a fair contribution to unprofitable, but socially and economically important services - as franchises do. We want to ensure any such levy enables more services for passengers while protecting taxpayers, avoids creating perverse incentives, and can be effectively administered. We currently plan to consult on the levy later in 2016, aiming to coordinate the timing of our work with your consultation on changes to charging. We intend the levy to be payable in relation to all open access applications granted from Budget 2016.

Conclusion

We welcome the ORR's ambitious agenda for PR18, which places users at the heart of the approach and supports a more devolved, accountable NR. We recognise, however, that there is a lot to be done to reach a determination that produces real benefits for passengers and other users. We look forward to working with you to achieve this.

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