

Consultation Document by the Office of Rail Regulation – Periodic Review 2013; Draft Determination of Network Rail’s outputs and funding for 2014-19, June 2013. Response by the Railway Industry Association, September 2013



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1. INTRODUCTION

- 1.1 This note constitutes the formal response of the Railway Industry Association (RIA) to the above consultation document, the Draft Determination (DD).
- 1.2 RIA is the representative body for the UK-based railway supply sector, with more than 180 member companies from across the entire field of railway supply. Members include manufacturers, consultancies, contractors and numerous specialist service providers. Most major supply companies are members, together with many SMEs. The supply sector is believed to employ some 80,000 - 90,000 people in total.
- 1.3 This response has been informed by (in addition to a number of informal conversations):- the open presentation given by ORR on the DD in London on 19 June; the discussion at RIA Council with Ian Prosser and Carl Hetherington on 3 July; John Larkinson’s presentation and subsequent discussion at the RIA Infrastructure Clients Interface Group meeting on 25 July; and finally by the meeting between Anna Walker (Chief Executive), Ian Prosser and John Larkinson of ORR and Jeremy Candfield (Director General) and Peter Loosley of RIA on 8 August 2013. Most of the key themes of this response were raised at this last meeting and this note constitutes a more detailed exposition of them.

2. SUBSTANTIVE RESPONSE – THE POSITIVES

- 2.1 It would be appropriate to begin this response with recognition of certain aspects of the DD which RIA welcomed.

The Context

- 2.2 The positive context within which the DD is placed is encouraging. Whilst there is still clearly much to do, it is helpful to see public appreciation from ORR of what has already been achieved by the industry in terms of increased patronage, performance and efficiency gains.

The Format

- 2.3 Of particular importance, given its length, but in contrast to its predecessors, is the fact that the DD has been made relatively accessible by the adoption of clear summaries of each Chapter as well as the overall Executive Summary.

The Emphasis on Asset Management

- 2.4 RIA has for some while been a strong advocate of the need for improved asset management across the industry. ORR's emphasis along similar lines is therefore to be welcomed.

Deliverability

- 2.5 The focus on deliverability and consideration of the associated risks are also appreciated. We have however concerns around both a potential hiatus at the start of CP5 and also the uncertainty accompanying some of the programme deferrals, both of which are explored in more detail in paragraphs 3.2-3.9 below.

Sustainability & Resilience to Climate Change/Extreme Weather

- 2.6 We share the concern of other industry parties about the resilience of the network to climate change and extreme weather and welcome ORR's recognition of the scale of the problem.

Route Efficiency Benefits Sharing (REBS)

- 2.7 The initiative for TOCs and NR to share savings in reduced costs at route level is seen as an important one (Chapter 19 paragraphs 19.3 – 19.31 refer). Improving relationships between NR/TOCs, and indeed between NR and its supply chain, are seen as key ingredients in achieving the necessary CP5 efficiencies and performance targets (see also paragraphs 3.15 – 3.16 below); and aligning incentives plays a vital role in improving relationships.

Incentivising Efficient Behaviour

- 2.8 Linked to 2.7 above, we therefore welcome the general approach taken to incentivise NR and other industry parties to outperform the determination.

Early Involvement of TOCs and Suppliers in Project Development

- 2.9 It is encouraging to see (top bullet p309 and Chapter 24 paragraph 24.33(e)) that NR will be expected to work closely with both TOCs and suppliers in defining project scope and with suppliers in the planning of enhancements projects, particularly those that have not yet been developed to GRIP 3 level.

3. SUBSTANTIVE RESPONSE – SPECIFIC SUPPLY SIDE ISSUES

- 3.1 There are also a number of specific supply side issues and concerns that we would bring to your attention.

Risk of Hiatus Between CP4 and CP5

- 3.2 This issue has been voiced repeatedly in our exchanges with you (and others) regarding PR08 and PR013, and was raised substantively in each of the events mentioned in paragraph 3 above and in particular during the 8 August meeting.
- 3.3 Our clear position is that if the industry is collectively and efficiently to deliver the CP5 requirements, it is vitally important that we avoid a repeat of the period-start hiatus in workload that occurred between CP3 and CP4. The lack of a smooth transition between Control Periods made it virtually impossible for suppliers to plan and allocate their resources efficiently with a consequent adverse impact upon delivery and cost (see also paragraphs 3.6-3.9 below).
- 3.4 There are a number of welcome references to this issue in the DD, for example:-

Executive Summary – paragraph 113

“We have also funded Network Rail to develop CP5 projects during CP4 to avoid any ‘hiatus’ in orders between control periods”

Chapter 10 - paragraph 15

“Under an early start mechanism we have allowed Network Rail to commence work on some enhancement projects now so there is no hiatus and Network Rail can plan ahead with the industry”

Chapter 24 – paragraph 33

“We have made clear that we expect Network Rail to develop its CP5 delivery plan in parallel with responding to this draft determination, and that this plan must be published before the start of CP5, following consultation. This should reduce the risk of a discontinuity in orders early in CP5, as happened in CP4”.

- 3.5 However, as discussed at our meeting on 8 August, whilst this recognition of the issue is a helpful step forward, the lack of published underpinning information regarding quantification, value and timing make it difficult for suppliers to understand fully the significance of what has been/is being done and therefore to gain assurance from it, meaning that much of the potential benefit could be lost. John Larkinson explained at the meeting that there were some further details available regarding value and timing but that these had been omitted from the DD. It was agreed that ORR would let RIA have a note of the additional details which RIA could then bring to suppliers' attention. We believe that there would also be merit in including this additional detail in the Final Determination (FD) in October to provide suppliers with added confidence where justified.

Civils Renewals Review & Enhancement Programme Deferrals

- 3.6 There is a related issue, which has the potential to increase the risk of hiatus. With respect to civils renewals, paragraphs 8.407- 8.410 of the DD explain that NR will be expected to submit a plan by 31 March 2015 for the work it proposes for years 3-5.

The reasoning given for this approach is that ORR believes that the SBP did not sufficiently substantiate the view that a significant backlog of work had developed and that this further plan is required to enable ORR to take a decision on the volumes and efficient costs for which NR will ultimately be funded.

- 3.7 Similarly, in terms of the enhancements programme, paragraphs 9.49 et seq of the DD explain that ORR has decided to treat all projects where it has set an efficient cost (a £6.7bn portfolio) via a two-stage process because these schemes are at such an early stage of development. Effectively this means that only a provisional determination will be made in the FD with NR being remitted to provide a further investment submission in March 2015 (by which time most of the projects will have reached GRIP 3 stage).
- 3.8 We do understand the concerns behind both of these proposals. However it must be recognised that they have introduced a further level of uncertainty into these programmes, with key suppliers already discounting their investment forecasts as a direct result. This will have inevitable adverse consequences for the timing and extent of their training and recruitment programmes, and thus upon their overall performance and efficiency in CP5.
- 3.9 It is critical both for restoring confidence and for sensible management of workflow that NR should be asked to submit their proposals for individual projects or sub-programmes as they are ready to do so, and that ORR should consider and respond rapidly to each submission. In other words, the industry needs a programme of approvals, not a 'big bang' approach in which projects are stored up before decisions are issued. This is important for all schemes, but self-evidently is of greatest significance to the industry for the largest ones.

Efficiencies/Actual Unit Cost Reductions/Whole Life Costing

- 3.10 We believe there is an issue around whether the baseline starting point for the CP5 planned efficiencies will be where NR had been targeted to be at the end of CP4 or where they actually end up, as the two were not necessarily going to be the same. This could make an already demanding target even more difficult and lead to increased pressure on supplier margins which have already been significantly reduced. Indeed, in certain areas supplier margins have been under extreme pressure for some while such that they cannot be sustainable for much longer. When we discussed this on 8 August you asked whether longer possessions might help improve efficiency and our response was yes they would and particularly where high-output equipment was being used. And greater use of mid-week possessions should also improve efficiency. In this context we drew attention to the workstreams of the Asset, Programme and Supply Chain Management Working Group of RDG in which we are involved as is ORR.
- 3.11 Allied to that, we are encouraged to see the endorsement of a whole life costing (WLC). RIA is working with NR at moving towards such an approach and finding means of embedding that within the ITT process. However, the potential upward pressure upon unit costs that, initially, such a WLC approach may have before the longer-term benefits can be realised needs to be understood and appreciated in the context of CP5 deliverability. If no allowance is made for this in the settlement it seems likely that further pressure will be placed on supply-side returns which, as mentioned in 3.10 above, are in some cases already at unsustainably low levels to the long-term detriment of the railway as well as of the supply sector.

- 3.12 In our view the DD's expectations for track renewal unit cost reductions appear particularly challenging, given the factors listed above, but also that the targets for CP3 and CP4 were also over-ambitious. Much work is being carried out in this area, with RIA's involvement, but we have no confidence that the target figures can be achieved within the CP5 timescales.

Research & Development

- 3.13 ORR's approach to R&D is set out in Chapter 19, paragraphs 19.41 – 19.45. Whilst we can see the logic behind the matched funding approach (which is along lines similar to those used by the EU), in the context of the Shift 2 Rail Proposal we have a concern that it might not encourage the appropriate thinking and behaviours to promote R&D.
- 3.14 Additionally, we question whether placing a cap as proposed in paragraph 19.43 is the right approach in this case and might not convey the appropriate message. Our view would be that if the R&D is sufficiently worthwhile to attract matching funding, surely it should be encouraged in the long-term interests of the railway and the taxpayer, rather than being subjected to a cap.

Collaborative Behaviour

- 3.15 In our submission of October 2012 in response to the ORR consultation on NR's output framework for 2014-2019, with respect to whether there needed to be further indicators covering NR's supply chain management we said that regarding NR's move towards a more collaborative approach:-

“..... management teams change, and it was not long ago that a very different philosophy prevailed. The current approach is so important to suppliers' confidence and to driving efficiency that it should not be capable of rapid reversal at the whim of new personnel at some point in the future. We accordingly see a need for some mechanism to provide checks and balances against sudden swings of policy. We note that para 3.75 envisages that NR should monitor its own capability in a number of areas allowing ORR to monitor progress in these areas also. One area identified is that of collaborative working. It is possible that this could help meet our concerns, and we would wish to explore this further with both NR and ORR.”

- 3.16 Whilst NR continues to make welcome progress in the area of collaborative behaviours and BS11000, we do know from our own experience with the RIA Value Improvement Programme (VIP) initiative, that whilst the establishment of a collaborative approach is a lengthy and iterative process, it is possible for supply chain participants to 'revert to type' very quickly upon changes in policy or senior personnel within a client organisation – meaning that many months and possibly years of good work can be rapidly undone. We therefore believe the above statement to still be very much relevant and would restate our view that such a regular measure of collaborative working needs to be introduced. At our 8 August meeting we noted the reference at 3.154 in the DD to including an enabler measuring NR's effectiveness in programme and project management capability and reference was made to using an existing model which also included a collaboration measure. We await further details and remain willing to explore this further with both ORR and NR.

Input Prices

- 3.17 The volatility of input prices has been an issue in previous Control Periods and we have consistently argued that NR needs some protection from a market which, although fairly stable at present, can change to NR's disadvantage virtually overnight and that it was not reasonable to expose NR to such risk. The approach for CP5 is discussed in Chapter 12, paragraphs 12.19 – 12.33 of the DD and more specifically paragraph 12.27(b) which states that:-

“we have included our input price assumptions in our efficiency challenge (for CP5 this is zero for all expenditure). This means that Network Rail will gain if it delivers on that challenge and lose if it does not deliver the challenge”

- 3.18 When this was discussed at the meeting with RIA Council on 3 July, ORR argued that one of the reasons for the zero figure was that NR did have sufficient scope for substitutability. We remain to be convinced that such substitutability can sensibly offset such external pressures within a Control Period and therefore that the approach advocated in 12.27(b) above can be appropriate.

The Draft Determination as a Package

- 3.19 Annex A to the DD (p723) makes reference to the fact that ORR is consulting upon it as a package. However, few consultees will be able to master an 800+ page document so well as to evaluate whether the package as a whole is or isn't reasonable. This was accepted at our meeting on 8 August and it was clarified that the request to respond to the DD as a package was aimed primarily at Network Rail and that you were not expecting many others to do so.

Concerns Within Network Rail

- 3.20 We believe that there is concern within NR regarding the increase in controls and interventions proposed in the DD compared to those for CP4. This has relevance to the supply side because it is possible that this could lead to a demotivated client, the impact of which should not be underestimated.
- 3.21 Even with a fair wind, it is possible that NR will not achieve all the targets currently proposed. How that is handled by ORR will be of significant importance, partly because of the potential impact on NR management but also because of the risk of damage to the UK brand in the international market in which RIA members operate. And as we pointed out on 8 August, a lot of the efficiency and delivery improvements will need to be delivered on the back of collaborative working which requires the right attitude and behaviours from both client and supplier. If morale within the industry's largest single client drops, one of the possible early consequences could be a return to the old-style adversarial relationships which we have been working hard to change and which could itself jeopardise CP5 delivery (see 3.16).

4. CONCLUSION

- 4.1 We hope the above comments are helpful and we would be happy to discuss further with you any aspect of this submission.

4.2 Additionally we look forward to continuing our regular bilateral discussions with ORR as the PR013 process develops and CP5 then moves into delivery phase.

Railway Industry Association
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