

**ORR PR13 consultation event  
Edinburgh  
Dynamic Earth, Holyrood Road**

**5 July 2011**

Slides of the presentations are available on the ORR PR13 website (<http://www.rail-reg.gov.uk/pr13/>). As there is no slide set from Paul Plummer's presentation a summary of his comments is set out in Annex A.

**MORNING SESSION – PR13 in context of industry reform**

1. The session started with comments from:
  - a. Paul McMahon, Deputy Director, Railway Markets and Economics, ORR, setting out the goals and objectives for the day and an overview of PR13;
  - b. Richard Price, Chief Executive, ORR, who spoke about PR13 within the broader context of industry reform; and
  - c. Paul Plummer, Group Strategy Director, Network Rail, who spoke about PR13 from Network Rail's perspective.
2. Presentations were followed by a general panel discussion where the speakers were joined by John Provan, Head of Regulatory Policy: Rail, Transport Scotland, to answer questions from the Scottish Government's perspective.
3. **Q1: The consultation document says a lot about increasing freight and passenger capacity. Do we think there is still more existing capacity out there, given that we have already delivered increased capacity?**

*Panel response*

4. Use of the railway has increased dramatically and we are being asked to deliver cost reductions at the same time as increasing capacity. We have to make the micro trade-offs in a way that optimises service to users. There is a huge focus on performance, which is sometimes at the expense of outputs, possibly because of current incentives. When it comes to making the best use of capacity, we will have to make changes to deliver more services. We can do more to increase capacity.

5. There are a whole series of potential micro changes to do with capacity and use of capacity across industry. Roy McNulty (in the rail value for money study) talked about the capacity for train operators to be flexible and tailor timetables to what passengers want rather than pre-determined provision as at present. It is worth looking at projects/investments that would improve performance and also, over their lifetimes, significantly reduce operating expenditures. It is important that we understand whole industry costs. This will enable us to better to align Network Rail incentives with those of users, suppliers etc.

**6. Q2: There were a series of issues raised about passenger demand forecasts and the feasibility of accommodating anticipated growth.**

*Discussion*

7. It was noted that Scotland and Edinburgh have very narrow peak periods and it would be a benefit to expand the peak, as happens in London, to better use existing capacity. An audience member queried whether the figures for growth had been reconsidered in light of changes in the economic situation. Another observed that Edinburgh numbers are particularly affected by Airdrie-Bathgate, the potential to open Borders to increase capacity, and Edinburgh-Glasgow improvements.

8. We would expect growth predictions to be based on underlying economic prosperity though in fact the expected drop in demand due to the credit crunch hasn't happened. It would be worth looking to see how sensitive the numbers are to growth.

9. It was stated that the railways seem fixated on passenger numbers but the prime consideration should be passenger km, it is possible to increase this significantly without huge investment in the few areas that are restricted in the peak hours.

10. There was no one best approach, in some areas, we need more miles and less passenger numbers – it is the market value that is important.

**11. Q3: With regard to a balanced package from UK-wide operators, how do you intend to provide a price control with a regulatory regime that makes it possible for a clear tariff? Also, how do we reconcile the differing priorities of various groups?**

*Panel response*

12. This relates to questions around franchising which the Scottish Government is looking at. The Scottish Government needs to have a dialogue with Westminster about the integration of cross-border and intercity services.

13. On the infrastructure side it is important to ensure a predictable, well-incentivised structure of access charges and ORR is currently consulting on this.

14. Also, as decentralisation/devolution progresses within Network Rail it is important to ORR that there is a network operator role so that transition between route boundaries works efficiently for operators working across them.

15. Network Rail said that it is important to have the networks devolved within Network Rail effectively developing devolved partnerships. This ensures decisions are made in the right way without always referring to the regulator. Regulation does have an important role but should not be the first port of call for network issues. So we need strong partnerships.

**16. Q4: Regarding devolution and partnership working, what are the incentives to encourage TOCs to become partners? What length of franchises encourages partnerships? Is this an opportunity to bring stations into TOC franchises in the longer term?**

*Panel response*

17. There is an incentive for Network Rail and TOCs to collaborate; a large chunk of cost reductions can only be achieved through joint working. We need to understand better the ways in which we can share the task of reducing inefficiency between Network Rail and partners, and we need to understand the barriers to doing it.

18. Stations – A consultation on contractual station issues has just concluded. We can do things better for stations in Scotland. If we have the right mindset and aligned incentives, it doesn't matter who has primary responsibility as we should be able to work out between us who is best to do the work. However, Network Rail is not seeking to retain stations, and is open to TOCs doing more, especially with interchange issues.

19. We are collaborating – but we can do more. The periodic review is an opportunity to kick-start that, particularly with the coincidental timing of Scottish HLOS and franchise. These align the specification and output terms, but it allows Network Rail and TOCs to decide how best to deliver.

20. The Scottish Government is supportive of partnership working. This review will play a critical role. We have a new administration, a relatively new Minister, and the thinking and development of future services are at an early stage though the Minister is clear that passengers should be at heart of it.

21. Length of franchises – The London Government is clear about its view that longer franchises help with investment over the longer term.

**22. Q5: The May PR13 consultation document seems to anticipate that TOCs will be wedded into the process of implementing change. If you have to consider TOCs' businesses, how will this affect/limit your ability to make changes?**

*Panel response*

23. Although the ground has shifted since the last review, ORR has good dialogue with TOCs; it has good relationships with TOCs on the safety side and the opportunity is there to extend dialogue on the economic side.

24. They are fundamentally different businesses with different drivers but we need to understand the key impact of incentives. We need to ensure good alignment with

London and Edinburgh Governments, as they look at the competition element of franchises.

25. ORR is doing a capability review for the longer term to prepare if it is asked to take on extra responsibilities.

26. We need to be clear on changes and follow through as there's not much time. In terms of risk/benefit sharing within or out of franchises, rather than doing all through the periodic review, the review can provide enablers for bilateral deals between Network Rail devolved routes and TOCs.

27. Effectively we will have baseline expenditure and key outputs for each part of the network; this will give greater transparency and clarity, and act as an enabler for mutually beneficial deals to share rewards. Even if revenue sharing was not universal, it would facilitate bilateral deals.

**28. Q6: What can be done to achieve greater capacity for freight, particularly around incentivising Network Rail to encourage freight operators to surrender paths and allow access to terminals?**

*Panel response*

29. PR13 will be looking at this. Freight is key to providing the infrastructure that businesses need to grow. We see a number of issues raised by FOCs about transfer of paths. We need to look at this to see if there is more we can do to build incentives into system to minimise the number of issues that arise when the system doesn't work for operators.

30. This issue is not just about freight, it is about the best use of capacity on the network. Need to discuss with FOCs where there is a demand for more. We need balanced incentives coming out of this.

**31. Q7: How are issues that matter to freight, such as improved line speed, being considering in the Initial Industry Plan (IIP)?**

32. The IIP will be supported by freight-specific documents looking at market demand and reconciling the conflicting demands for capability.

**33. Q8: How is ORR ensuring that the passenger perspective is part of the PR13 review?**

34. Scotland and Westminster need to understand what consumers want. It is important to understand the passenger experience across all areas: station, journey time, customer care, all the things that make a journey better, even interface between rail and other modes. ORR has done some research in this area. Need to talk to Passenger Focus, and find ways to talk to local authorities as a way of understanding local communities.

35. We need to understand what the customer wants, TOCs are Network Rail's customers but their customers are therefore also Network Rail's customers. In terms of the IIP, Network Rail and TOCs need to bear in mind the end users. Specifically

this is reinforced by input from Passenger Focus on what they think is important in the context of the IIP.

36. Transport Scotland is consulting later in the year on passengers.

**AFTERNOON SESSION – Comments from Frances Duffy, Director of Rail at Transport Scotland; discussion about outputs, incentives, structure of charges and financial issues.**

37. Paul McMahon set out the procedure and expectations for the afternoon session. Paul also stressed that the discussion in the afternoon on technical topics should not be treated as a substitute for providing written responses on the May 2011 PR13 consultation document. These discussions are meant to clarify and inform stakeholder thinking.

38. Frances Duffy joined the meeting and provided her thoughts on PR13 from the perspective of the Scottish Government. Frances noted that although the consultation that officially launched PR13 was published on 25 May 2011, Transport Scotland has been working on the topics concerning this review for a while. Following PR08, the first post devolution review, Transport Scotland assessed what went well and what went less well. On balance PR08 went well but there are things that Transport Scotland will seek to do differently during this review.

39. Frances identified some key areas for PR13, which Transport Scotland is more likely to focus on. These were:

- a. Upcoming franchise renewal, where the emphasis should not just be on infrastructure and asset management but also on the services to be provided.
- b. Economic growth of Scotland and how transport could support that.
- c. Establishing a transport industry which is transparent and allows the Government and the fare payer to see the value they are receiving for their money.
- d. Existing processes need simplification.
- e. Financial framework: given the current economic climate and constraints on finances, it is essential to assess if the industry is providing value for money.
- f. Disaggregation: Scotland is at the forefront of this and the question is how far they should push the route in Scotland to be a business in its own right and to manage its own efficiency.
- g. Alignment of incentives: Transport Scotland needs to think about how to establish the right relationship with train operating companies and with Network Rail in order to maximise use of capacity and incentivise innovation to achieve value for money.
- h. How Transport Scotland can identify inputs and outputs.

40. Frances's comments were followed by a discussion of challenges around delivery requirements and the funds available in CP5. ORR said that it is looking to the industry to provide input into IIP, which is the first step in the PR13 process on specifying the case for future investments especially on capital projects.

41. There was also discussion about where efficiencies are going to come from in Scotland. Frances said she was looking for industry to answer the efficiency challenge and that she would be extremely disappointed if the IIP simply said the costs were irreducible. ORR expects industry to be innovative and challenging in driving the costs down.

42. Frances encouraged broad involvement in the PR13 process.

***How to structure the outputs Network Rail should deliver – presentation and discussion led by Chris Littlewood, Industry Planning Manager, ORR***

*Discussion*

43. A summary of points raised in discussion:

- a. Why is the first output not “transporting passengers and goods”? The industry has been rather successful even in recession. This should be a huge measure of success.
- b. Should the outputs vary for those routes where the consumer has choice (for example east coast and west coast services) and where there is no choice for the consumer?
- c. There must be scope for having different measures for Scotland if this is most effective.
- d. There needs to be clarity on why a measure is required and what it will result in it.
- e. Should customer satisfaction be considered an indicator or a measure given that customer satisfaction is highly correlated to the events that have occurred near the time of being asked their views?
- f. In the devolved world of CP5, measures become more important as it will be possible to use comparisons to drive efficiency as done in other industries. There is therefore a need to have consistent measures between routes for cost benchmarking.
- g. In the next franchise re-let in Scotland, it is essential that outputs for Network Rail are aligned with those of the new franchise. It is important that the measures finalised for PR13 can be contractually replicated otherwise there will be a danger of misalignment.

***Setting incentives, including joint incentives on Network Rail and train operators – presentation and discussion led by Emily Bulman, Head of Transport Economics, ORR***

## *Discussion*

44. The following points were made about the Efficiency Benefit Sharing (EBS) Mechanism:
  - a. Why would outperformance only be shared between Network Rail and operators? There is interest in sharing underperformance also. The sharing arrangements in both cases do not need to be symmetric.
  - b. There was concern expressed about the effect the EBS mechanism might have on the value of the franchise if the operators are exposed to Network Rail's revenue requirement in future. The franchisee should be able to exert influence and not feel exposed to risks which are not in their control. It was accepted however that there is no risk free mechanism as bidders will be taking risks on various other aspects of the business in any case.
  
45. The following points were made about exposing operators to Network Rail's costs:
  - a. There was a question on how much of Network Rail's costs can be influenced by the train operating companies. There are different kinds of influences, for example challenging Network Rail on day to day activities or on scoping of the projects.
  - b. There was a question on whether Network Rail's incentives will weaken if it must share money it has saved with operators.
  - c. There is scope for designing these incentives to reflect circumstances in England & Wales and Scotland.
  - d. There was a question on why ORR is not exploring the mechanism that is working to get freight companies more involved in Network Rail's costs (i.e. exposing freight to variable costs of Network Rail) instead of introducing another incentives mechanism.
  - e. There was also concern expressed on implementing this mechanism in CP5 given that the franchise renewal will be after PR13 is concluded. The mechanism might only apply from CP6 onwards. ORR will continue to work with Transport Scotland on this issue.
  
46. The following points were made about aligning incentives – sharing costs and revenues.
  - a. There was a suggestion on having a mechanism for instances where a TOC has suggestions for improving the network but no funds. It was suggested there be a mechanism to allow Network Rail to fund such investments.
  - b. The network change mechanism was discussed. Attendees felt that it has not worked for Network Rail as it did not receive any benefits for

improving the network. Network Rail should have pushed TOCs harder on reimbursement.

47. The following points were raised on schedules 4 and 8.
- a. Both Network Rail and train companies should be incentivised to drive out costs.
  - b. It was remarked that in Scotland, TOCs are very much interested in Network Rail's performance and not indifferent as was suggested by the presentation. This is because if there is a delay caused by Network Rail it can cause further delays and therefore drag all the parties down. If Network Rail is doing well in some cases it can mask underperformance of the train operator. So performance of one can not be isolated from the other.

***The structure of charges that train operators pay – presentation and discussion led by Emily Bulman, Head of Transport Economics, ORR***

*Discussion*

48. The following points were raised:
- a. All operators need to be incentivised to flex their services to make capacity available. This issue should not focus just on Network Rail and freight companies.
  - b. Is “no major changes under consideration for freight” a lost opportunity to make charges more transparent? ORR confirmed that all the existing charges will be thoroughly reviewed for CP5 including those for freight.
  - c. It was noted that good work had been done on EC4T charges.
  - d. Clarity was sought on the proposed varying variable usage charge by track. This could be about damage caused by vehicles on primary, secondary and territory routes, or variation by Network Rail route. ORR welcomes any views on varying this charge for different track of similar quality.
  - e. ORR was asked what it is doing to get Network Rail to understand its costs by routes, which are converted in to variable usage charge. As with CP4, Network Rail is responsible for calculating the variable usage charge for CP5 and therefore will drive the technical work behind it. All the costs will be assimilated in to Network Rail's infrastructure costs model.
49. ORR said that a consultation on how ORR will assess Network Rail's efficiency and expenditure for CP5 will be published shortly. ORR through this consultation will be seeking views on its approach to assessing these areas.

***Financial issues, including disaggregated price control – presentation and discussion led by Paul McMahon, Deputy Director, ORR***



## *Discussion*

50. The following point was raised:

- a. There was a question on whether there has been any evidence acquired in last 5 years on unsupported debt contributing towards reduction in costs. There was extensive work done in this area by ORR for PR08 to ensure that this passed the value for money test. ORR will revisit the value for money case for CP5 if this is approach is taken forward.

## **Close**

51. Richard Price closed the afternoon session by thanking all the attendees for taking time to attend this event and for their contributions to the discussions. He also encouraged attendees to submit written responses to the ORR May consultation document by 2 September.

**Annex A** – Introductory comments from Paul Plummer, Group Strategy Director, Network Rail

ORR's objective covers what we need to do – improving service to users, contributing to the economy, delivering value for money for taxpayers.

In Scotland there are extra angles to consider:

- Having separate controls to some degree, they will need clarity on funding and outputs. Having devolved route accountability is an opportunity to build on this position.
- The coincidental timing of HLOS and franchise specification is an opportunity for Government to join those up in a coherent way and for industry to provide a good response which considers both things.

Network Rail supports the approach of focussing on outputs and outcomes, and emphasising the relevance and importance of incentives.

Within Network Rail a big change in thinking has been to embrace competition in its broadest sense within the business. There has been a lot said about on-rail competition but it is also useful to compare geographical areas with one another.

Projects: Network Rail is looking to engage more and earlier with the supply chain to encourage competition within the process and encourage contestability within Network Rail.

Partnerships with train operators: Network Rail is using internal devolution to give more local accountability and more meaningful partnerships with local players who are empowered to make changes to deliver improvements.

However some support services will continue to be delivered centrally as that remains the most efficient approach. The mindset has changed so that these are truly 'services' and not just imposed values.

PR 13 should enable Network Rail and industry to continue to optimise the overall network; it is a network, and therefore needs to make best use of scarce capacity, trading off performance with punctuality etc. Network Rail hasn't always got the balance right in the past but getting the incentives right can make a major contribution.

Alignment between Network Rail and TOCs: this is a good opportunity to think of it as a system while the framework is designed. Decision makers need to recognise that the railway has long lived assets – it seems an obvious fact but is not always considered when making decisions. The aim is to use a whole life – whole system – whole network approach.

In some areas that means accelerating renewals to deliver savings, Network Rail is investing in systems to reduce long term costs.

Moving on it's important to say that regimes need to suit circumstances; not one size fits all. Network Rail needs to challenge itself to have flexibility to meet varying

needs. At the moment the IIP is the big priority, as there will be a Scotland -specific one for first time.

Network Rail needs to work with Transport Scotland and DfT to inform Government specifications. It will be important to respond to the McNulty challenges and challenges everywhere of achieving efficiency, and commitment to work further with industry to deliver improvements. The other issues are around choices and options for Government in terms of investment and outputs. That has been joined up, especially in Scotland.

At this stage of the periodic review Network Rail is in a better place than in previous reviews. They are more advanced in their thinking, in terms of efficiency and collaboration within industry and with Government. They are therefore able to present options and choices far more clearly to the review.