



15 December 2005

## **Responses to the Periodic Review 2008 first consultation document**

Dear Colleague

1. We published our 'Periodic Review 2008 first consultation document' in August 2005. We have today published our initial assessment of Network Rail's revenue requirement for the next control period<sup>1</sup>, one of the first milestones in the Periodic Review 2008 (PR2008) process.
2. While the August 2005 consultation document did not pose specific consultation questions, we did ask for responses on any aspects of the document and said we would particularly welcome views on whether the document provided stakeholders with enough information to begin to plan their involvement in the review.
3. We received 11 responses and these responses have been placed on our website.
4. This letter summarises the responses and, in turn, gives our views. Although the responses covered a wide range of general and specific points, they can be drawn together under four main headings:
  - scope of the review;
  - requests for clarification;
  - participation in the review; and
  - timetable for the review.

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<sup>1</sup> *Periodic Review 2008: Initial Assessment of Network Rail's CP4 Revenue Requirement and Consultation on the Financial Framework, December 2005*

5. Many detailed comments were made, and these will be addressed during the course of the review.

## **Scope**

### *Issues raised by consultees*

6. We stated our intention to carry out a review of freight access charges as part of PR2008. EWS disagreed, instead proposing that the structure and level of freight access charges should be left unchanged. EWS noted that the rail freight industry faced a number of uncertainties and would benefit from the stability that an early decision not to review charges would bring.

7. GNER, expressing concerns about infrastructure failures on the East Coast Main Line (ECML), proposed that certain infrastructure assets on the ECML should be designated 'key assets' and funding for the improvement of these assets should be separately identified in PR2008.

8. FirstGroup sought assurance on how Network Rail's potential efficiency gains would be treated in PR2008.

### *ORR's response*

9. While we understand the uncertainty faced by the rail freight industry and we are fully aware of the potential benefits of future growth in rail freight, we do not agree that this provides a reason for excluding freight costs and charges from PR2008. Freight charges were last reviewed in 2001, since when there have been significant changes in the cost base of the railway. We would need to balance all of our duties in deciding whether there should be a change in charges as a result of changes in cost drivers and costs.

10. On the issue of ECML, Network Rail will be producing its initial cost submission for CP4 in June 2006, and this will need to reflect the company's views on any major renewal and enhancement schemes which it believes will be necessary. We will be consulting on this cost submission.

11. We confirm that we will set Network Rail's access charges on the basis of challenging, but achievable, efficiency assumptions. Our initial assessment of Network Rail's revenue requirement for the next control period provides early estimates of what these efficiency targets might be.

## **Requests for clarification**

### *Issues raised by consultees*

12. Go-Ahead said that ORR should set out the criteria it will use in the event that the HLOS cannot be delivered with the funds available, particularly in view of the possible consequences for passenger franchises. National Express asked what would happen if existing franchise agreements were incompatible with the HLOS. It also asked about the status of suggestions

made around the time of the White Paper<sup>2</sup> of a possible ORR franchise arbiter role.

13. Network Rail noted that the consultation document made several references to the Railways Act 2005 (the Act), the White Paper and the requirements for devolution and disaggregation. It pointed out that the Act is not specific on these requirements. While Network Rail supports the separate specification of outputs in Scotland, it is concerned that this is not done in a way which undermines its ability to manage its overall business. More generally, it was concerned that wider disaggregation requirements should not be pushed too far and too quickly, leading to increased bureaucracy and reduced efficiency.

14. The South East Regional Assembly wanted ORR to ensure the rail network is planned in a way which complements other planning processes and documents, such as Regional Spatial Strategies.

#### *ORR's response*

15. The relationship between the HLOSs and franchise agreements is a fundamental issue and we will need to understand Government's intentions on this point. We will continue to discuss with DfT and the Scottish Executive how this process can be made more effective – a possibility might be an arbiter role for ORR, but currently DfT does not consider this necessary.

16. We will give further thought to setting out the criteria we might use in the event of the funds available not being sufficient to deliver the HLOSs, based on our statutory duties.

17. Our position on the devolved arrangements for Scotland will be published shortly. We understand Network Rail's wider concerns about the possible costs of disaggregation, but while we agree that the White Paper and the Act do not precisely specify requirements in this area, the broad intent of Government policy is clear. It is important that the regulatory framework is fit for purpose to support the devolution proposals.

18. The issue of consistency with wider planning documents is primarily one for Government to consider when forming its output specifications. However, we will ensure – through our commitment to consultation - that the regional planning bodies will have full opportunity to be involved in the parts of the process for which we are responsible.

## **Participation**

### *Issues raised by consultees*

19. A number of respondents welcomed our commitment to conduct the review in 'a rigorous and open manner with full opportunity for stakeholder input'.

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<sup>2</sup> *The Future of Rail*, July 2004

20. However, ATOC were concerned that the review might be seen as the preserve of the industry's funders, regulator and Network Rail. ATOC stressed the knowledge and experience of the train operators and also the impact the review may have on them.

21. National Express pointed out specific areas where train operating company (TOC) cost data might provide a useful comparator to Network Rail costs and where the TOCs' role as customers of Network Rail gave them particular insight into the appropriate corporate and managerial incentive structure which Network Rail should work to.

22. TfL said they would welcome early engagement with ORR to ensure that the longer term objectives for rail are fully considered within the review programme.

### *ORR's response*

23. We agree with the points made by ATOC and National Express and we intend to ensure the TOCs and franchise owners have the fullest possible opportunity to contribute to the review. We intend to begin a debate on the incentive framework for Network Rail in early 2006. We will also engage closely with TfL – the consultation document stressed the importance of us having a clear understanding of how the requirements of funders, other than the DfT and Scottish Executive, were to be taken into account in the review.

### **Timetable**

24. The consultation document set out three main phases to the timetable:

- a preparation phase – running from August 2005 until when ORR issues its notice of an access charges review, expected to be early in 2007;
- a formal review phase – which begins with ORR issuing its notice of an access charges review and ends with its final conclusions in October 2008; and
- an implementation phase – which begins after ORR issues its final conclusions. This phase was not considered in the August consultation document, but will be covered in a future consultation.

25. We proposed the following timetable:

#### **Preparation phase**

End 2005	ORR publish initial analysis of possible Network Rail outputs, efficiency and OMR expenditure for CP4
	ORR publish consultation document on Network Rail's financial framework for CP4

January 2006	ORR issue guidance to Network Rail on content of its CP4 initial submission
March 2006	Consultation closes on ORR material published at end 2005
March 2006	Network Rail business plan, focussed on CP3, but reflecting improvements to planning capability e.g. on route plans
June 2006	Network Rail initial CP4 submission
July/August 2006	Provisional conclusions from industry group on possessions policy
July/August 2006	ORR publish draft conclusions on long term signalling review
November 2006	ORR consults on its assessment of Network Rail initial submission and developments in possessions/ signalling reviews.
Feb 2007	Consultation closes on ORR's assessment of Network Rail initial submission
March 2007	Network Rail Business Plan published

### **Formal review phase**

Quarter 1 2007/08	ORR issues notice of Access Charges Review <sup>3</sup>  ORR issues initial 'information requirement' to Network Rail, for compiling submission on outputs, cost and financing plans
June/July 2007	Secretary of State and Scottish Ministers issue HLOSs and statements of funds available  ORR publishes its statement of implications of HLOSs and funds available for Network Rail, for consultation, and to give Network Rail initial assumptions for its cost submission  ORR revises, as necessary, Network Rail information requirements following consultation
October 2007	Network Rail detailed submission to ORR for CP4 in the form required by ORR in its 'information requirement'  ORR commences review of submission, and consults on the submission

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<sup>3</sup> Schedule 4A is expected to be commenced by DfT during 2006. Under these provisions the HLOS must be provided to ORR at a date specified by ORR in the Access Charges Review Notice, with this date being not less than three months after publication of the Notice.

February 2008	ORR produces initial assessment of Network Rail's submission and implications for access charges and industry outputs
	ORR consults on its assessment
April 2008	Revisions to Network Rail submission as necessary in response to initial assessment
	ORR makes statement about funding for 2009-10 (on the early start principle – see below)
June/July 2008	Draft conclusions on review
October 2008	Final conclusions on review

### *Issues raised by consultees*

26. Network Rail noted that the proposed timetable implied that ORR would be allowed much more time to review its cost submissions than it would be allowed to respond to ORR's information requirements and initial assessment. The timetable allows ORR four months to review Network Rail's October 2007 submission but then only allows Network Rail two months to respond to ORR's initial assessment in a revised submission.

27. EWS felt the timetable should reflect the need for ORR to reach an early understanding with the rail freight operators about demand forecasts and the base case. On the issue of the freight forecasts, Go-Ahead expressed concern about the implications of the freight forecasts for passenger operators in the light of possible impacts on capacity.

28. The Railway Industry Association welcomed the suggestion that ORR make an early statement (in April 2008) on Network Rail funding for the first year of the control period, to provide greater visibility to the supply chain of likely expenditure.

### *ORR's response*

29. We set out three principles which the timetable for the review should reflect, namely that the timetable should:

- give sufficient time for whole industry efficiency and incentives issues to be fully considered;
- give Network Rail adequate time to develop its cost submissions in response to ORR's consideration of the HLOSs; and
- allow adequate time for consultation at each stage.

30. We have reviewed these principles and the timetable in the light of the consultation responses and developments since August.

31. Our view is that the principles remain valid and hence – given the requirement to give Network Rail adequate time - we would be concerned if the time allowed for Network Rail to do its work was unreasonable relative to the time we have allocated to our own work. But we do not believe this is the case: the October 2007 submission is Network Rail's main cost submission in the review and it is essential that we consult on it (the third principle). The timetable allows for this consultation to take place and we do not think it can be shortened. The April 2008 date for Network Rail's revisions can only be deferred if the conclusions for the review are also deferred, which we do not intend to do.

32. The timetable in the August document was an outline timetable which we are converting into a more detailed plan. We agree with EWS's point on the freight forecasts and indeed we have already met with EWS and the Rail Freight Group to discuss the rail freight forecasts which are being fed into the review. We also agree with Go-Ahead that the interaction of passenger and freight forecasts is a key area for analysis and we intend to ensure that the full implications of the total forecast passenger and freight demand are understood.

33. The main developments since August have been in the timetable for the long term signalling review, and our further thoughts on what additional consultation documents might help shape the preparation stage of the review.

34. We intend to publish our final conclusions on the medium term signalling review shortly and this will set out a revised timetable for the long term signalling review.

35. We believe it would be helpful to consult at a fairly early stage on the wider incentive framework for Network Rail. On Network Rail's financial framework, we have set out key issues for consideration in our initial assessment published today, and we want to progress this further by also including a specific new milestone for July/August 2006. Hence the two additions to the timetable are:

May/June 2006	ORR publishes a consultation document on Network Rail's incentive framework for CP4.
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July/August 2006	ORR publishes emerging views on Network Rail financial framework (following the December 2005 consultation)
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36. With these changes, we confirm the timetable as set out in our August consultation.