

RDG Submission to Shaw Review

December 2015

1. Introduction

- 1.1 The Rail Delivery Group (RDG) brings together Network Rail (NR) and the passenger and freight train operating companies (TOCs and FOCs) to lead and enable improvements in the railway which are ultimately for the benefit of passengers and freight users, as well as the taxpayer and the wider economy.
- 1.2 Nobody in the rail industry is in any doubt about the need for constant improvements in the service to passengers and freight users as well as improvements in value for money to the taxpayer. Rail plays a critical role in the economy and the nation needs a successful railway industry. At the same time, however, it must be remembered that our railway is the safest major railway in Europe and it is increasingly recognised internationally as one of the most efficient, fastest growing, intensively used and punctual with among the best passenger satisfaction. It is important that these improvements are understood and to provide confidence in the industry so that it can address the significant challenges ahead and build on progress over the last two decades.
- 1.3 This paper therefore represents RDG's overarching submission to the Shaw review on the future shape and financing of NR. Responses to the specific questions asked by the review team will follow. The views expressed are the result of analysis, discussion and challenge between members of RDG and there remains a range of views about some issues.
- 1.4 While RDG believes that changes are required in order to build on progress, the industry needs to be clear as soon as possible about the nature of these changes to avoid an extended period of uncertainty which could compromise delivery to customers, stakeholders and industry partners. The required changes are largely about behaviours and organisation change is only an enabler to help catalyse these changes. The changes need to be designed to 'add simplicity' to contractual structures, then managed in a controlled way to avoid unintended consequences, distraction or risk to existing progress and investment. A key test for changes is to ensure they assist in managing the challenges already facing the industry. In many cases the issues highlighted by Collette Bowe, Peter Hendy and Nicola Shaw relate to the overall system and the importance of aligned incentives which means that any recommended changes are likely to require support from all industry players.

2. Immediate changes - devolution to Routes and reform of the NR centre

- 2.1 NR has set out the changes which it is now making to give greater accountability to its Routes while still retaining the benefits of a national network and genuine scale economies where

appropriate. To enable this change in accountability, NR has proposed significant changes to the centre by distinguishing between the roles of System Operator, Technical Authority and Route Services. Investment Projects and Digital Railway are also repositioned to make it clear that they are providing a service to the Routes.

- 2.2 The intent of NR's proposed changes is that as much resource and control as possible is transferred to the Routes so that they have greater control over the means of delivering the outputs which are expected of them. The Routes would become more clearly accountable, bottom-line focused businesses with the authority and resources to deliver their commitments with minimum constraints. The success or failure of the Routes would be measured by their delivery of the outputs they have agreed with their customers (passenger and freight train operators), clients and stakeholders. NR would continue to be sighted on and guided by the needs of end-user customers, (passengers and freight users) but the industry owners of the relationship with the end-user is with the operators.
- 2.3 There is strong support among all RDG members for the changes proposed by NR and the flexibility which this allows for further evolution. There is a broader range of views about the pace and extent of any further change beyond the initial changes with some members much more concerned about the potential unintended consequences referred to above.
- 2.4 Freight operators have emphasised the importance of Network Rail carrying out the System Operator and Technical Authority roles partly as a safety net to counteract the risks of devolution of a national network, to prevent unintended dislocation of national services and retain national network optimisation and network benefits. All members recognise these concerns and agree that the industry must play a leading role in coordinating long term planning to inform governments and devolved bodies about their decisions on the required outputs from the railway and to be confident that the resulting plans are deliverable and affordable. The current ORR review on the functions of System Operation should seek to clarify roles in this area in conjunction with the Shaw Review.
- 2.5 Initial thinking by TOC owning groups concluded that there were problems stemming from NR being too far from customers, its incentives being misaligned with customers' needs and opportunities, and its capabilities being insufficient to meet today's challenges. The main priority of most TOC owning groups is therefore to make sure that the changes proposed by NR make enough of a difference to behaviours on the ground and that these changes are made rapidly and sustained. Regardless of whether NR continues to own all the Routes, most members consider that the right behaviours would emerge if Routes are increasingly allowed the flexibility that would be required under separate ownership subject only to the need to comply with minimum standards (Technical Authority) and network requirements (System

Operator). Even if there was no further change, this would also enable an effective track record for these businesses to be established which would help to attract or retain talent and improve the effectiveness of regulation by comparison.

- 2.6 In considering how the changes proposed by NR are implemented and how they evolve over time, most members are therefore keen that there should be a presumption in favour of greater local accountability with central roles having to justify their existence with a strong focus on customers, clients and stakeholders. For example, Routes would initially be expected to make collective decisions about whether they want to buy Route Services from the NR centre but over time there may be areas where greater flexibility should be allowed for Routes to make individual decisions in more areas. This could also create opportunities, for example, from more of a direct relationship between Routes and their suppliers over time. Similarly, Routes would be expected to comply with standards but these standards should be reduced to the minimum necessary so that Routes have increasing flexibility over how deliver their required outputs and their bottom-line financial performance.
- 2.7 The repositioning proposed by NR of Investment Projects as a supplier to the Routes is welcomed by RDG. This change presents an opportunity for Routes and operators to adopt alternative delivery mechanisms for projects and where appropriate to introduce private capital into improvement programmes. NR has supported these alternative options and the RDG can play a role in enabling this where appropriate. It will be particularly important to learn lessons from recent attempts both where this has been successful and also where difficulties which have been encountered. This change therefore has the potential not only to provide financing for investment but for improved contestability to act as a driver of efficiency.
- 2.8 There is though a concern that changes could have unintended consequences in the light of the enormous changes already facing the industry and that this could undermine network benefits, investment or progress with business performance. There is also a desire and need to ensure that the industry remains focused not just on cost reduction but also on growing revenue and delivering wider economic benefits for the nation. Sustained conditions to enable investment are critical to a successful industry which meets the needs of users and enables economic growth. All members are therefore keen to work with NR through RDG as well as locally to help implement the proposed changes in an effective way.

3. Potential further evolution

- 3.1 The changes outlined above therefore provide the opportunity for the structure to evolve in a way which drives greater accountability and resulting variability between Routes while retaining the benefits of a national network and exploiting scale economies where the value

of these continues to be demonstrated by evidence. There are also further areas where the model could evolve as appropriate. As noted above, however, there is a broad range of views within RDG about the appropriate pace and extent of any further change beyond the initial changes outlined by NR.

- 3.2 Beyond the opportunity for alternative project delivery mechanisms, there are options for early sale of an English Route (perhaps through a long term infrastructure concession). Such a sale would introduce an alternative source of finance and greater local focus on customers, clients and stakeholders as well as creating a truly independent comparator which could help to create more effective incentives for improvement in the remaining Routes. If this option is implemented, it will be important to learn the lessons from the past to ensure that this does not undermine the focus on the business's customers and long term (as opposed to short-term) value for money. Sale of a smaller Route with more limited investment requirements would be more straightforward but would bring reduced benefits. Following any initial sale, it would be possible to sell further Routes but a decision on this could be made in the light of progress and results.
- 3.3 Once the NR system operator and technical authority capabilities have been clearly established with greater transparency about their distinct roles there would be an option to make these independent of the rest of NR. There is no need for this to be the first step or for a decision about such a change to be made immediately. Consolidation of these roles with other cross industry bodies could allow some consolidation of industry governance but they should not become too detached from the rest of the industry which they are intended to support.

4. Changes in regulation and government

- 4.1 The government, in thinking through the roles of the department, franchising, the regulator and the infrastructure manager, must design objectives, goals and targets, and roles and responsibilities to align the incentives on all parties to focus on their customers.
- 4.2 The ORR should focus on incentives to deliver outputs to customers rather than inputs. Where possible it should also focus on creating the conditions for the market or industry parties to meet the requirements of end users rather than acting as a direct proxy for these requirements. It also has an important role to play in protecting the benefits of a national network.
- 4.3 The effectiveness of regulation can be enhanced by greater transparency about NR's central roles and comparative performance information relating to the Routes. This can help enable government to adopt a clearer arm's length role which can, in turn, help to enable industry

performance. However, ORR should not become a proxy customer or shareholder for the Routes and should not undermine accountability to customers or the NR holding company.

- 4.4 Where appropriate, ORR should act as a facilitator to the introduction of third party financing as in similar infrastructure sectors. The effectiveness of regulation is widely recognised as being fundamental to achieving a low cost of capital for such investments as well as being important in creating aligned incentives for improved efficiency across the whole system.
- 4.5 These changes in regulation require significant attention such that the ORR's role, competence, mind-set and behaviours are fit for purpose. A strong and confident regulator is critical so that industry parties can be effectively held to account. But this is also needed so that everyone concerned can be assured that the expectations placed on the industry are clear and realistic. Clarity of purpose is needed for the appointment of the ORR Chair.
- 4.6 Consideration of regulation and the role of the ORR also needs to include the way in which NR is managed as part of the public sector so that routes are able to act in a commercial way with their customers. Creating more customer focused Route businesses will not be possible unless NR has the flexibility to empower these businesses. At the very least, there is therefore a need to revisit the terms of the NR-DfT Framework Agreement and the way in which the principles of Managing Public Money are applied to NR in the public sector. Network Rail should be directly accountable for delivering outputs and for meeting the needs of customers, clients and other stakeholders rather than being managed in detail by DfT.

5. Conclusion

- 5.1 The railway industry of today is an amazing success story which was not anticipated two decades ago but it is equally clear that continuous improvement is essential. It is important to recognise this success as well as the challenges and opportunities presented by growth and devolution of government.
- 5.2 Responding to these changes requires changes in NR as well as in the rest of the industry, government and ORR to enable NR Routes to become businesses which are clearly accountable to their customers, clients and stakeholders while retaining the benefits of a national network with operators that cross Route boundaries.
- 5.3 RDG is therefore keen to work with the Shaw Review team and with governments to help develop the proposals for change which can be clearly supported by the industry to facilitate smooth transition and continued evolution as appropriate.