

Rail Delivery Group

Response to:

Department for Transport

Rail Regulation Call for Evidence

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Introduction: The Rail Delivery Group (RDG) was established in May 2011 to lead the industry in delivering a higher performing, more cost effective and sustainable rail network for Britain's rail users and taxpayers.

The RDG brings together the chief executives of passenger and freight operator owning groups with Network Rail. RDG develops policies, strategies and plans for the coherent management of the rail industry and advances the provision of a safe, efficient, high quality rail service for users and taxpayers.

The RDG mission is to promote greater co-operation between train operators (passenger and freight) and Network Rail through leadership in the industry and by working together with Government, the supply chain and stakeholders.

It is committed equally to the long-term health of the railway as well as the need to see improvement in the shorter term.

It does this by developing strategies for the industry to put into practice and by proposing solutions for policy makers to implement.

Introduction

The Rail Delivery Group (RDG) is pleased to respond to the DfT's Call for Evidence on Rail Regulation. This submission should be read alongside the RDG's recent response to Nicola Shaw's scoping paper (attached as an appendix to this document), in recognition of the inter-dependencies that there are between the two reviews. We believe that the DfT's review of rail regulation should not be concluded until such a time as industry stakeholders have had the opportunity to consider the findings of the Shaw report and the impact that this may have on the regulatory framework.

Overarching comments

The RDG works across the industry in the evolution of the economic, organisational and contractual structures, so that industry players can deliver excellence in the railway. Our overall strategic aim and purpose is to inform government or regulatory decision makers to enable the delivery of whole-industry outcomes through a framework that focuses more clearly on the end-user. Our work in this area covers industry structures, incentives, franchising and EU legislation.

The RDG members are of the view that a strong, confident and independent economic regulator can bring significant benefits for all railway stakeholders. This includes providing clarity for funders around choices to be made and an opportunity for expectations to remain realistic. Accordingly, RDG looks to government to ensure that economic regulation continues in the sector irrespective of the conclusions that the Shaw review reaches about the structure and financing of Network Rail.

It is right, however, that the DfT should be reviewing the scope of the regulator's functions and the possible ways that Parliament can ensure that regulation is targeted in the correct areas. It is in no one's interests for there to be discomfort within the industry about the role that the Railways Act hands ORR or for there to be day-to-day disagreements at a working level about the reach of the regulator's jurisdiction. Key objectives in the DfT's review should therefore be to bring new clarity to the purpose of regulation and to establish consensus about the way that the regulator's role meshes with the responsibilities of other bodies.

This inescapably means that detailed consideration needs to be given as part of the current review to the role of the DfT, particularly as regards the relationship that the DfT has with Network Rail. As a general sense of direction, RDG members take the view that the DfT should be looking to step back from day-to-day control of the railway's infrastructure manager. As part of the transition back to a more normal set up, the DfT should feel comfortable looking to independent regulation to protect the interests of the full range of funders, customers and end users, whilst providing a sustainable business environment for operators and investors.

We expand on these comments in our answers below to the specific questions that the DfT poses in its Call for Evidence.

Q&A

1. In the light of Network Rail's reclassification, does the role of the regime remain valid? If not, how might it be changed? Having particular regard to . . .

- *The impact of the reclassification of Network Rail on the roles and accountabilities of Ministers and Government's relationship with the ORR.*

- *The regulatory requirements of various parties including Government, infrastructure managers, train operators (passenger and freight), the supply chain, passengers and freight customers, with particular reference to the promotion of private investment in the railway.*
- *The implications of the reclassification of Network Rail on the role of the ORR in relation to investment in the railways, particularly in the light of changes to the financing regime (e.g. the introduction of the borrowing limit), identifying particular impacts in relation to the ORR's role in: – Enhancements – Operations, Maintenance and Renewals – Performance*
- *The potential implications for the regime of any future changes to Network Rail's structure and/or ownership.*

The reclassification of Network Rail impacts on certain of ORR's functions, but does not fundamentally alter the rationale for independent economic regulation in the railway. Among other things, independent regulation will still be needed to:

- ensure that new operator licences are awarded on a fair and transparent basis;
- give customers confidence in the capacity allocation process and its results;
- ensure that all customers have access to the network on fair terms, including but not limited to the structure and level of charges; and
- manage the effective and even-handed enforcement of competition and consumer law.

The central question for the DfT at the current time is what continuing value there is in extending the scope of economic regulation beyond this 'de minimis' package to include ongoing oversight of Network Rail's performance, funding and operations, maintenance and renewals expenditure. This question comes about because reclassification has brought Network Rail much closer to central government, with the DfT taking on new roles under Network Rail's Articles of Association and the DfT-Network Rail framework agreement and choosing to be more hands-on with enhancements. With regards to enhancements, a more direct customer-supplier contractual approach between DfT and Network Rail could allow more precise specification of enhancements, or greater flexibility to increase funding where necessary. There would continue to be a role for ORR, however, where enhancements are funded by operators or third parties. Public expenditure rules also appear to have limited the freedom of manoeuvre that ORR has at periodic reviews.

The RDG members take the view that, even with public ownership, there is value in having an independent (by which we mean separate from the DfT and the Secretary of State) and expert body to oversee the plans of a monopoly company, to hold the company to account for its performance and to encourage a focus on the needs of its customers. The experience from a range of regulated sectors is that the incentives and disciplines that independent scrutiny creates lead to better service, improvements in efficiency and better delivery. It was noticeable that the government placed significant emphasis on the benefits of independent monitoring in the impact assessment that it produced prior to the creation of the Highways Monitor function within ORR,¹ and we would suggest that exactly the same logic applies in the case of rail.

Network Rail's customers and funders also obtain significant benefit from the clarity and transparency that five-year periodic reviews bring about Network Rail's funding and output obligations. Independent review helps to optimise the outputs that can be secured for any given level of funding, while also ensuring that the aspirations that funders have are realistic and

¹ DfT (2014), Transparency for roads: creating the watchdog and monitor

https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/367431/transparency-for-roads.pdf

DfT (2013), Roads reform: impact assessment, sections 4.2 and 5.3.

https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/253366/roads-reform-ia.pdf

deliverable. Each periodic review determination helps train operators plan their businesses and gives customers a baseline against which Network Rail's performance can be transparently monitored. Five-year funding settlements also take the railway out of the normal government budgeting processes and the uncertainty that shorter term funding arrangements can entail. These are important attributes and should not be lost.

Finally, strong independent economic regulation gives a tried-and-tested underpinning for private-sector investment, as may be seen by the low costs of capital and track record of efficiency improvement and service delivery that one observes in other regulated sectors. Any departure from the regulated model would carry risks and would require detailed prior evaluation.

It is difficult to be more definite about the need for change in the regulatory regime prior to a decision on Network Rail's future form. Where parts of Network Rail are to stay in the public sector for the foreseeable future, there may be an argument for making changes to ORR's statutory functions, for example to align the regulator's role to the oversight that it gives to Highways England. For those parts that may move back to the private sector, it is less clear that there is a case for making changes to the more standard regulatory model.

2. Are the ORR's present statutory duties appropriate? If not, how might they be improved through refocusing, simplification or prioritisation? Having particular regard to . . .

- *Whether Network Rail's reclassification to the public sector requires any revisiting or prioritisation of the ORR's duties and how any such prioritisation might be structured so as to promote investment and secure value for money from the investments made by Government and industry.*

The number of objectives and duties in section 4 of the Railways Act has grown over the last two decades, to the point where the sheer number of factors that ORR is to have regard when exercising its functions has become quite unwieldy. This contrasts to the set up in other regulated sectors – e.g. the CAA's duties under the Civil Aviation Act 2012 – which tend to set out a regulator's duties more succinctly.

There is merit, therefore, in an exercise which tidies up ORR's statutory duties, provided that key duties in relation to the protection of customers, support the development of the industry and financing remain at the heart of ORR's objectives. However, it is also important to be clear that this task is separate and additional to the job of reaching a consensus on the scope of the functions of the economic regulator. Any review should be independent and consult the whole of industry, as a potential change in these duties could affect the commercial viability of existing businesses.

3. What is the most effective role for the regulatory regime in competition and securing effective protection of rail users and passengers? With particular regard to . . .

- *The effectiveness of the current regulatory regime, in balance with the franchising system, in securing effective protection for passenger interests.*
- *The appropriateness of the current division of responsibilities between bodies responsible for the protection of passenger interests, particularly the role of Transport Focus and its interaction with other entities concerned with the interest of passengers.*

EU law requires that an independent regulatory body should be vested with certain responsibilities in relation to licensing, capacity allocation, access agreements and infrastructure charges. Rail companies must also adhere to general UK competition and consumer law, as set out in the

Competition Act and the Enterprise Act. These arrangements all contribute greatly towards the promotion of competition and the protection of rail users and passengers, which could lead to a reduced need for additional regulation.

ORR has during the last five years sought more and more to use its licensing powers to attach or enforce conditions to train operators' licences in what has felt like an attempt to extend economic regulation into the TOC community. Many RDG members consider that these interventions can make the current environment unclear, given the measures that franchising authorities place in franchise agreements to protect the interests of passengers, and given the perceptions that there have been of heightened regulatory risk during recent franchise competitions.

In general, operator members also feel that ORR should focus its efforts on its main job of overseeing and regulating Network Rail and question the role and value of maintaining a system of concurrent regulation between the CMA and the ORR as sector regulator.

As part of the DfT's review of rail regulation, consideration might usefully be given to ways of enshrining the principle that franchising authorities have primacy in matters relating to franchised operators' dealings with passengers, avoiding double regulation. Operator licences could, for example, shrink to become simple authorisations to operate a service, thus making it clear that additional obligations in respect of service levels are to be specified in franchise agreements, subject to the provisions of normal competition and consumer law.

In protecting the interests of users and potential users of rail services, the ORR should actively engage with both the RDG and Transport Focus. We would advocate a regulatory regime which protects customers' interests by allowing industry to prioritise, monitor and adapt to customers' changing needs and requirements.

4. How might the arrangements for securing the effective governance, accountability and efficiency for the ORR as part of the regulatory regime be improved? With particular regard to . . .

- *The effectiveness of the current governance arrangements for the ORR*
- *The nature and extent of the ORR's engagement with stakeholders when conducting its regulatory functions and its approach with respect to transparency*
- *The implications for the regulatory regime of further devolution, both within England, and between the nations of the United Kingdom.*
- *Any broader changes to the regulatory landscape which could reduce or otherwise change, the range of bodies, with regulatory or related functions, operating in this sector.*

Strong and confident regulation requires that the regulator's competence, mindset and behaviours are all fit for purpose. This must start from the regulator's board, as the formal decision-making body within the organisation. The RDG members consider it extremely important that the DfT makes every effort possible to attract knowledgeable and experienced regulatory and rail professionals to the regulator's board. It will be especially helpful if the DfT is able to ensure that there is a core of individuals within the board who have first-hand experience in carrying out regulatory and efficiency reviews, preferably as applied in a rail or transport setting.

Regulators are ultimately accountable to Parliament for their performance in discharging their functions, and we would not expect the DfT to bring forward proposals which interfere with the rail regulator's independence.

We note that there are other initiatives within government at present to bring more coordination between economic regulation in different sectors, as well as bodies like the UK Regulators Network (UKRN). The spread of regulatory best practice should be encouraged, e.g. as regards the intensity of regulation that is applied to an individual company, focus on outcomes versus inputs, timely impact assessments, techniques used in efficiency assessments, etc. The five principles of better regulation are relevant here – proportionality, accountability, consistency, transparency and targeting.

In terms of engagement, some RDG members take the view that ORR could work more collaboratively with the industry and contribute specific solutions to problems. This should include providing evidence-based reasoning why certain regulatory decisions have been made.

There may also be merit in considering whether ORR could at some stage be merged with one of the other economic regulators; members have differing views on this matter. A more broadly focused regulator could help attract talent and make regulation more predictable, sustainable and efficient.

5. The implications of comments in relation to the above for the broader functions of the ORR, particularly in relation to safety and roads regulation (to the extent not already detailed above)

The comments that we make in this submission do not obviously impact on the arrangements for safety and roads regulation. It ought to be feasible for the DfT to make changes to ORR's functions as economic regulator of the rail industry without having to alter ORR's functions in other areas.

The bringing together of economic and safety regulation within ORR ten years ago is widely seen as a positive, and there is no appetite within the industry for a reversal of this integration. Indeed, a strong safety regulator is crucial and there is a view that more still can be done within ORR to coordinate the two types of regulatory interventions. However it may be beneficial to review this area to ensure these functions are working together in an effective manner.

6. Is there anything else about the future role and responsibilities of the ORR, or the regulatory functions of the railways, not covered in the questions above that you consider should be taken into account?

In RDG's response to Nicola Shaw's scoping paper we called for much greater focus from Network Rail on the needs of its customers. While it is important to get the regulatory framework right and align goals, regulation must not become a substitute or proxy for effective supplier-customer relationships. Instead, regulation should increasingly create the conditions in which Network Rail and other industry partners are driven to understand and meet customer requirements directly.

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