



Submission by the Chartered Institute of Logistics and Transport

to the

Department for Transport call for Evidence:

Rail Regulation

The Chartered Institute of Logistics and Transport (“the Institute”) is a professional institution embracing all transport modes whose members are engaged in the provision of transport services for both passengers and freight, the management of logistics and the supply chain, transport planning, government and administration. Our principal concern is that transport policies and procedures should be effective and efficient, based on objective analysis of the issues and practical experience, and that good practice should be widely disseminated and adopted. The Institute has a number of specialist forums, a nationwide structure of locally based groups and a Public Policies Committee which considers the broad canvass of transport policy. This submission has been prepared by the Institute’s Strategic Rail Policy Group.

Q1 *In the light of Network Rail's reclassification, does the role of the regime remain valid? If not, how might it be changed?*

- 1.1 EU directives require that the efficiency of the infrastructure be ensured either by a multi annual contract between the infrastructure manager and the state, or a review by the regulator. The change in status of Network Rail may lead to a view that this role could be undertaken by the Department for Transport.
- 1.2 In the Institute’s view, that would be a mistake. The Institute considers that an ORR answerable to Parliament is a more appropriate regulator as far as private sector operators – franchise owning groups, open access passenger, freight and investors – than DfT would be. This is notwithstanding that should DfT take on the role it would need to separate its regulatory function from its other activities and like ORR would be subject to the possibility of judicial review (this being an EU requirement in relation to those areas where a regulator is needed). There is a real advantage in making regulation the responsibility of an independent body, which can take a rigorous approach to measurement of efficiency, rather than leaving it to negotiation as happened in the BR era. In recent years this approach has seen a significant reduction in Network Rail’s unit costs. For instance, in control period 4, Network Rail achieved efficiency savings of 15.5%. This was substantial, although below the 23.5% target¹.

¹ ORR, 2014, *Network Rail's efficiency and financial performance from 2009-2014 control period 4, CP4*.

- 1.3 Under the current regime there is a clear process for setting out the HLOS and then having an independent assessment of the efficient cost – this brings pressure for cost reduction in the form of efficiency improvements, whilst also ensuring that enough money is available to meet the HLOS. There must be question marks over whether a multi-annual agreement can really guarantee that. There is evidence that “efficiency” cost pressure is less under other regimes.² Other European regulators are seeking to enhance their efficiency determination powers, so we would be moving against that general trend with no clear benefits from doing so.
- 1.4 With private operators, a key function of an independent regulator is to ensure that the network is maintained and developed to a high standard. That does not change – we still have private operators who need that reassurance about appropriate levels of investment on the infrastructure if they are going to put their money into train operations. However, Network Rail’s reclassification means that the Government will have an interest in any costs not recovered from access charges, since they will count as government expenditure. So it may increase pressure on Network Rail and the regulator to reduce such expenditure, especially on enhancements, which are more discretionary than renewals and O&M.
- 1.5 If DfT did take on the regulatory role, additional safeguards would be needed to ensure that Government does not become over involved in decision making. It will be more important to ensure that inadequately prepared schemes are not included in the HLOS, which was one of the causes of the recent cost escalation of enhancement schemes.
- 1.6 Reclassification might also make it more difficult to revert to the original intention of the HLOS, which was to specify outcomes in terms of improvements in journey quality and in safety, rather than to list the schemes to be delivered over the Control Period. The Institute would support such a reversion. The move away from the original principles has not been successful and ORR’s regulation of enhancement (not actually required under EU law) has earned criticism. The key concern is that there are inadequate skills and knowledge in ORR (or in DfT) to deal with the costing and monitoring of major schemes. Whoever is in charge of approving enhancement will need much better project management capability, including engineering, contractual and funding sophistication. It can be done well – Crossrail provides a model.
- 1.7 The impact of any future changes to Network Rail's structure and/or ownership will depend on what those changes are. Privatisation of Network Rail would require a regulatory regime that is similar to the current one which was largely designed for private ownership. In contrast, any breakup of Network Rail would provide an opportunity to make more use of benchmarking, as used in the regulation of water and electricity distribution companies.
- 1.8 The details of Network Rail’s licence may also need to be reviewed in the light of it becoming part of the public sector. But the licensing role (and the safety role) should remain with the economic regulatory body to ensure alignment and consistency.
- 1.9 The freight sector, which is financially more exposed than the franchised passenger sector, sees an independent economic - and safety - Regulator as a key feature of rail industry governance, whether NR is privately or publicly owned. Freight operators and their

² Valerio, Benedetto, Andrew, S.J., Smith, Chris A. Nash, 2015, *Rail regulation in Europe: an industry-based survey*. Institute for Transport Studies, University of Leeds.

customers also need assurance and continuity in the structure and level of access charges, which are real money in their Profit & Loss accounts.

1. 10 This sector also looks for regulation to reflect key policy objectives. These might be the growth of rail freight and the provision of sufficient capacity on key routes, which might be obtained by better use of existing capacity or by investment in enhancements. It would welcome a strengthening of the ORR's capability to bear down on Network Rail's costs and thereby drive efficiency, leading to a more competitive market position.
1. 11 To support this, ORR stakeholder involvement needs to be strengthened to ensure that it does not become too inward-looking, in a government or rail industry sense.
1. 12 The Institute proposes three key tests for any revision to the regulatory framework:

Proportionality. Does the complexity of the regulatory regime actually drive the behaviours that we would want the transport industry to exhibit, and is the divide between regulation and franchising an area that causes long-term inconsistencies? Is the boundary between government and independent regulation clear and well-defined and does it work for the wider good?

Devolution. Does the regulatory framework support local self-determination, subsidiarity and defined outcomes, while protecting the interests of national and international operators and their customers?

Capability. Is the regulatory body able to deliver its mandate efficiently and effectively? Can it assess whether outputs are being delivered and intervene to protect the interests of passengers, freight customers and taxpayers?

Any changes would need to demonstrate improvements in these areas.

Q2 Are the ORR's present statutory duties appropriate? If not, how might they be improved through refocussing, simplification or prioritisation?

- 2.1 Industry stakeholders expect consistent decision making from its regulator. With the current mix of 22 non-prioritised statutory duties (objectives) which often point in different directions, there is a real tension in balancing them, rendering decision-making complex, subjective and potentially opening ORR to legal challenge. This is too many for any organisation to be expected to balance. ORR has managed this well by ruling some out depending on the particular decision it has been faced with.
- 2.2 Some duties are clearly more important than others; for example, it is a key requirement to have regards to funds available to various government bodies. Others are simply means of achieving other higher level objectives; for example, competition could be subsumed under efficiency. Having so many objectives may also be unhelpful in determining appropriate behaviour.
- 2.3 Many of the duties derive from EU legislation so cannot be changed and do not need to be changed because of the reclassification of NR.

Ways to simplify the duties would be:

- an ORR consultation leading to more transparency as to how they are balanced
 - and/ or possibly more specific Secretary of State Guidance - the 2012 Guidance does not attempt to prioritise the duties but to focus the content of specific duties .
 - amendment to UK legislation where the duties do not derive from EU legislation.
- 2.4 Simplification and prioritisation of ORR's duties would also facilitate its role in relation to regulating Network Rail in the key areas of capacity allocation and timetable planning. These are likely to become even more challenging as:
- devolved bodies take control of suburban routes, and
 - demand for train paths is expected to grow faster than capacity.
- Train path shortages are likely to occur, despite the investments being made in infrastructure and digital technology.
- 2.5 The Institute's perception is that at present efficient timetabling and use of capacity are constrained by the rights granted incrementally in track access agreements. This provides too little flexibility to respond efficiently to future needs and is an area needing attention.
- 2.6 Another such area is information gathering; in carrying out its duties on capacity allocation, ORR is currently too dependent on Network Rail for the provision of information. ORR should make more use of independent timetabling studies.

Q3 *What is the most effective role for the regulatory regime in competition and securing effective protection of rail users and passengers?*

- 3.1 Ever since the initial privatisation of the industry, the duty of the ORR to promote competition has been in strong tension with its other duties. These focus on a centrally driven systems view of network efficiency, driven by cooperation and coordination. Government has argued against competition where it might have a serious negative impact on franchise value (whether via reduced bids for the franchises or increased subsidy from government to let them). However, the moderation of competition policy which protected initial investments was carefully designed to fall away over time, allowing the controlled introduction of on-rail competition.
- 3.2 The physical constraints of a railway network operation do not allow road style full competitive access. The broad approach therefore has been to consider competition for the franchises as a reasonable proxy for competition within franchise areas.
- 3.3 However, a commonly held view is that taxpayers' interests have been too much preferred to those of rail users in franchise allocation decisions, with little opportunity for users to play a part in the process. Limited open access has been allowed and seems in some cases to have produced benefits to users where there has been demand for new direct train services such as to and from Hull and where price and service offers have spurred responses from the relevant franchisees.
- 3.4 A relaxation of the 'not primarily abstractive' criterion might allow stronger competition and promote the introduction of customer-focused service improvements.
- 3.5 Transport Focus does excellent work to promote passenger interests, identifying and publicising key issues, but it has very limited powers beyond lobbying to address them. With the possible devolution of Network Rail and a stronger role for regional transport bodies, consideration could be given to Transport Focus being granted additional powers to make

customer protection recommendations at both national and regional level, with duties on ORR, Network Rail and local transport bodies to take these into account in planning and decision making.

- 3.6 The regulation of on-rail competition should also ensure (such as in the recent Freightliner case) that sharp, anti-competitive practices do not take place and that there is a level playing field between different train operators, whether franchised or open access, passenger or freight.
- 3.7 ORR should retain its concurrent (with the CMA) competition powers, e.g. to prevent the abuse of a dominant position, because it has domain knowledge and therefore a greater understanding than the CMA of the way the rail industry functions.
- 3.8 The Institute notes the separate ORR consultation on Network Charges - how track access charges can improve efficiency, which is open until 4 March 2016. There should be synergy benefits from these exercises and hopefully some consistency in their conclusions.

Q4 How might the arrangements for securing the effective governance, accountability and efficiency for the ORR as part of the regulatory regime be improved?

- 4.1 ORR has been one of the leading regulatory bodies with respect to public consultation and transparency and may be regarded as a model of good practice. ORR has a large Board and several members have rail operations experience. However, none appears to have experience in banking or finance and appointing someone with such experience should improve governance of financing issues.
- 4.2 Further regional devolution would require changes to the regulatory regime, to safeguard the central need to maintain a national network and implement consistent standards, while not constraining opportunities for local innovation in either structure or outputs.
- 4.3 A revised methodology would need to be introduced to protect long distance national passenger services and freight services from local and regional incursions.
- 4.4 Devolved regional authorities should be put in the same position as the Mayor of London and TfL. Condition 8 of the Network Licence contains an obligation for NR to treat stakeholders 'in ways appropriate to their reasonable requirements in their capacity as Stakeholders'. There is a specific requirement to cooperate with the Mayor and TfL on efficient provision of services and facilities and on infrastructure projects. This was inserted in response to the grant of greater rail powers to the Mayor and TfL, so other devolved regional authorities are likely to seek a similar specific obligation unless they consider the general Condition 8 duty is sufficient.

Q5 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).

- 5.1 Safety regulation for railways, with its interface between the ORR and HSE, currently works well and there is no strong case for change in this function. The transfer of HMRI to ORR has also appeared seamless. It could be argued that HMRI should take on all functions of HSE in

connection with railways, but then HMRI would require extra staff and have to work more closely with the HSE to ensure consistency with general workshop and factory regulations.

- 5.2 The requirements of road and rail regulation are very different, reflecting the different nature of the networks and their users. In rail the majority of operations are specified by the public sector (through franchises) with a minority being open access operations, but in all cases with a limited network which is fully regulated by the ORR.
- 5.3 In road all users are open access and while the network covered is the strategic highways network, there is a significant non-strategic second network which is not under ORR supervision (although the second network can have an influence on the strategic one).
- 5.4 Road traffic comprises fundamentally individual 'operators', whereas rail services are run by a small number of providers. A common approach to regulation would in these circumstances be inappropriate. A residual regulatory and mainly safety function for commercial road operations is exercised by the (area) Traffic Commissioners.
- 5.5 Should government ever decide to introduce access charging for the strategic road network, then the skills that ORR already possesses in relation to rail network charging would prove very valuable. Already ORR's skills are very relevant to monitoring the efficiency of Highways England.

Q6 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?

- 6.1 On track access charges, failure to charge appropriately may influence decisions about what paths to request and what rolling stock to use in ways which reduce the efficiency of the system. Also, under EU rules, Network Rail is not permitted to charge below direct cost though a degree of averaging is permitted to simplify the system.
- 6.2 In exercising its functions ORR will need to take into account the objectives of the Fourth Railway Package for greater competition on rail and the environmentally driven targets to move more freight from road to rail. This may require the statutory duties to be amended to favour access rights which promote freight paths over new passenger paths where there is an appropriate environmental case (e.g. "x" lorry movements are removed from UK roads, with an environmental benefit of "y" - or by contributing to meeting UK emissions limits and thereby potentially saving a fine of £z). But this will prove controversial.

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