

Cynulliad Cenedlaethol Cymru	National Assembly for Wales
Y Pwyllgor Menter a Busnes	Enterprise and Business Committee
Ymchwiliad i'r Blaenoriaethau ar gyfer dyfodol Seilwaith y Rheilffyrdd yng Nghymru	Inquiry into the Priorities for the future of Welsh Rail Infrastructure
WRI 34	WRI 34
Swyddfa Rheilffyrdd a Ffyrdd	Office of Rail and Road



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20th January 2016

William Graham AM
Chair of Enterprise and Business Committee
National Assembly for Wales
Cardiff Bay
Cardiff
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Dear Mr. Graham,

1. Thank you for the request for a written submission of our views on the issues you raised in advance of the meeting of the Enterprise and Business Committee on 11 February 2016.
2. I have provided below our response to these issues and I am looking forward to appearing before the committee.

Background

3. The Office of Rail and Road (ORR) is the independent regulator of the railways for Great Britain. We regulate the rail industry's health and safety performance, we hold Network Rail to account and we ensure fair access to the network for train operators. More broadly we protect consumer interests through our responsibilities for enforcing consumer law and train operator licences (which include conditions such as one to provide passengers with good information during disruption). We also monitor the performance of the strategic road network in England.¹

Responses to specific questions:

The periodic review process and preparations for CP6, particularly how Welsh interests are reflected in this

4. We wrote (Annex 1) to the Welsh Government in December 2014, setting out our views on how we could assist the Welsh Government in the development of our Periodic Review 2018 (PR18). PR18 is the next review of Network Rail's outputs and funding for control period 6,

¹ Full details of our role can be found here: http://orr.gov.uk/_data/assets/pdf_file/0009/18909/what-we-do-infographic.pdf



covering the period from 2019. We have met with officials since then to help ensure the interests of Welsh passengers, freight customers and taxpayers are taken into account.

5. To date we have particularly engaged with stakeholders on:

- ‘System operation’²; which covers, for example, how the network is planned and services are timetabled. We are seeking to improve Network Rail’s capability to make better use of the current network (e.g. by improving timetabling capability) and considering what changes might improve long-term planning.
- Structure of charges³, which covers the charges train operators pay to use the network. This work is looking for ways to improve the detailed understanding of costs and at whether charges could better reflect infrastructure costs. This would improve the information available to funders and the incentives faced by those using the network to, in turn, improve efficiency.
- The performance and engineering possessions regimes⁴, which covers the payments made between operators and Network Rail when trains are delayed and the financial regime around engineering works. Here we are seeking views on the effectiveness of the current regimes and what the priority areas for improvement should be.

6. This preparatory work has allowed us to explore a number of important issues ahead of the formal start of PR18. We will shortly be publishing a document to start the formal PR18 process, drawing on this material and other discussions with stakeholders – this is currently planned for April 2016. This will set out options for how the review process could work, our proposed objectives and priorities for the review, and how we will engage with all stakeholders, across all aspects of the review.

7. We would welcome responses from the Welsh Government, Assembly Members and other stakeholders in Wales to this consultation, and we will be holding specific meetings with stakeholders in Wales to get views.

8. As part of the work on the structure of charges, Network Rail is carrying out a major piece of work to improve the understanding what causes costs to be incurred at a detailed geographical level. This is taking the form of a pilot study in Wales, exploring how the total cost of the Wales route can be allocated to the users of the infrastructure. The analysis is looking at issues including: the level of geographic disaggregation of costs; the relationship between costs and traffic on the network; and how costs might be allocated to different users of the network, e.g. between freight and passenger operators. The performance of Network Rail, both in Wales and nationally

² More information is available at: <http://orr.gov.uk/consultations/closed-consultations/pr18-consultations/system-operation-consultation>

³ More information is available at: <http://orr.gov.uk/consultations/open-consultations/network-charges-a-consultation-on-how-charges-can-improve-efficiency>

⁴ More information is available at: <http://orr.gov.uk/consultations/open-consultations/stakeholder-engagement-on-schedules-4-and-8>



9. In our letter we proposed to increase the information publicly available about the Wales route in our Network Rail Monitor, which we have now done⁵. This is also available in Welsh. The work builds on our increased focus on Network Rail's routes, a process that we started in Wales and which now forms an integral part of our scrutiny of Network Rail across Great Britain.

10. We will shortly be reviewing the latest performance with Network Rail as part of our process of regulatory engagement on issues in Wales. We will brief Welsh Government officials on our views and discuss this with them.

The role of ORR, including details of any future plans to change the regulatory regime for rail

11. In summer 2015, The Secretary of State for Transport commissioned Dame Collette Bowe to review the 'Planning of Network Rail's Enhancements Programme 2014-2019'^[1]. Concurrently, the Chancellor of the Exchequer and Secretary of State for Transport jointly commissioned Nicola Shaw to review the 'Future Shape and Financing of Network Rail'^[2].

12. The Secretary of State for Transport's response to the Bowe review, on 25th November 2015, announced that the role and responsibilities of the ORR will be fundamentally reviewed and the Department has since issued a call for evidence on the regulatory regime for the railways^[3]. With the changes to Network Rail's ownership and finances since it has been reclassified as a public sector company, we agree that a review is appropriate. We are engaging actively with the Department on this work, alongside the Shaw review, which will shape the future of our railways. Both projects are due to complete by March 2016.

13. We have already provided a written submission to the Shaw review which emphasised our role in economic regulation in terms of:

- We ensure current users and funders of the network are not disadvantaged by the monopoly power of Network Rail.
- We ensure access to the network is on a fair basis.
- We protect the interests of future users and funders in an industry of long-lived assets.

⁵ This is available at page 39 http://orr.gov.uk/_data/assets/pdf_file/0008/19925/network-rail-monitor-2015-16-q1-2.pdf. Welsh Language version from page 43.

^[1] https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/479560/bowe-review.pdf

^[2] https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/476944/the-future-shape-and-financing-of-network-rail-the-scope.pdf

^[3] <https://www.gov.uk/government/publications/bowe-review-into-the-planning-of-network-rails-enhancements-programme-2014-to-2019-government-response> and https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/484028/rail-regulation-call-for-evidence.pdf



Any lessons learnt from the experience of Scotland in terms of devolved responsibility for funding Network Rail, including the Scottish HLOS process

14. ORR is neutral on matters of devolution, as it is a matter for the governments. However, we do recognise the opportunity that the greater involvement of local interests and local funders can play in improving outcomes. We support the greater devolution of responsibility to Network Rail's routes that the company has progressed, and we believe this will improve services to passengers and freight customers and our ability to hold Network Rail to account. In this way, political devolution and an increasing focus on Network Rail's routes could support each other.

15. There are different ways of achieving greater devolution to Wales. In the case of Scotland, the role of the Scottish Ministers is written into legislation. We have not been party to discussions about possible devolution models in Wales.

16. That said, some lessons from devolution in Scotland are relevant.

17. First, is the importance of good data, good understanding of that data and good analysis of it to inform decisions. The position now in terms of Network Rail data is that Network Rail has worked hard to improve the range of data available in Wales. Its formal regulatory accounts provide detailed data on its income and expenditure in Wales. For example, Network Rail's expenditure on renewals is broken down by asset type e.g. track and signalling. So the starting position is much better than it would have been some years ago.

18. A second lesson is that, depending on the scale of the change involved, processes can take some time to implement because of the need to engage with all parties as early as possible on options, and to agree technical issues.

The potential implications for Wales if responsibility for funding the Network Rail Wales Route were to be devolved

19. There are a number of different options available for devolving further responsibility for funding the Network Rail Wales route to the Welsh Government. Some of these can be achieved within the current legal framework while some options may require legislative change. These are political decisions. The implications depend on the model chosen.

20. The timing of any decision would affect the extent to which it could be incorporated into PR18. But the scope of PR18 would in turn affect the extent to which greater devolved funding was an issue. If, for example, there was a shift to decide on more enhancements outside the periodic review process (as already happens with projects funded under the ORR investment framework), this would offer a different way of implementing devolved decision making.

21. More generally, specific issues could include:

- (i) treatment of risk and uncertainty – i.e. what happens if Network Rail were to overspend in Wales;



- (ii) allocation to Wales of a share of Network Rail's assets (and debt⁶) and the obligation to fund the debt;
- (iii) disaggregation of outputs. Outputs include the 'targets' the funders set for Network Rail to achieve, such as on train punctuality; and
- (iv) relationship to the overall borrowing limit set for Network Rail as part of its reclassification. Currently there is an GB wide limit and a separate limit for Scotland.

22. The ORR, as an independent regulator, can play an important role here, ensuring that there is objective analysis of the issues.

23. I look forward to answering any questions the committee may have on 11 February.

Yours Sincerely,

A handwritten signature in black ink, appearing to read 'John Larkinson', written in a cursive style.

John Larkinson

⁶ Although Network Rail finances itself (i.e. borrows money) as one company we allocate its debt between England & Wales and Scotland as responsibility for funding that debt is allocated between the two governments.



Annex 1 – Letter from ORR to Welsh Government 9 December 2014

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Director, Economic Regulation

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9 December 2014

Bayo Dosunmu

Department for Economy, Science and Transport
Welsh
Government
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Dear Bayo,

1. This letter is to record the meeting we had on Thursday 20 November. The meeting was a follow up to the exchange of letters between your Minister Edwina Hart and Anna Walker, our Chair.
2. We covered three areas where we said we wanted to increase our advice and assurance to the Welsh Government.
3. The first area covers the Welsh Government's medium term goal of increased devolution for Wales, which includes a better understanding of specifying outputs and funder responsibilities in the next periodic review (PR18).
4. As an independent regulator we are neutral on political questions around devolution. We have experience of working with the Scottish Government as it took on that role. We are clear that you will need to do a substantial amount of preparation to fulfil the role – or even a more limited version of the role – and we can help in this.
5. Our experience of working with the Scottish Government is that it is important that the Welsh Government is fully included in our PR18 development process. This will include:
 - the Welsh Government playing a core part in the process for developing PR18 outputs. This process covers passenger priorities, which outputs should be set and their levels. (We will start by discussing with you our current plans. Our expectation is that we will publish our first PR18 consultation document in Q1

2016 but in the meantime we can discuss the preparatory work necessary for defining and specifying outputs);

- explaining what the options are for a wider and more specific financial role in PR18 and how this might work in practice; and
- (recognising that there are wider impacts of being a specifier of outputs and a funder) ensure that the Welsh Government is closely involved in other parts of the development of PR18, such as the development of the performance regime which affects Network Rail and the ATW franchise, and how Network Rail will be financed.

6. The second area reflects your current concerns around Network Rail.

7. Network Rail has put considerable effort into improving its relationship with the Welsh Government and we believe the company strongly recognises the Welsh Government's role, at both the official and political level. But you still have concerns particularly around transparency (what information you receive from Network Rail and us) and the Welsh Government's ability to influence the company and be fully treated as a client.

8. We recognise your concerns and the position of the Welsh Government but we noted that formally the Welsh Government's position is not currently the same as Scotland's and hence it does not have the same role. However, I said that the ORR wanted to provide you with increased assurance and that we would do this by:

- setting up a formal regular review meeting (possibly bi-annual in advance of our Network Rail Monitor publications in June and November) when we take you through our assessment of the company's progress on safety, performance, finance, projects and asset management. This will give you the opportunity to feed in your views and challenge;
- setting out the financial and operational information we collate on the Wales route and discussing with you how that information can be interpreted and used¹; and
- discussing with you how we can expand our public reporting on Wales by making changes to our six monthly Network Rail monitor (which is currently structured in terms of 'England & Wales' and 'Scotland' documents).

9. I also said that you should see us as being available to work with you on immediate questions or issues you have with Network Rail's performance. We think that improving transparency in this area is very important in helping the Welsh Government prepare for a possible future role that involves specifying outputs and being a funder in the next periodic review (PR18).

10. The third area is the Welsh Government's funding of enhancement and modernisation projects. This area is more detailed but basically the issues are around the

terms of the contracts that Network Rail will sign up to and whether efficient delivery can be secured. I said that Network Rail did have legitimate requirements in some areas – for example that the new asset that your contractors have built is compliant with railway standards and that your contactors have entered into appropriate agreements to work on the railway – safety is the priority. You said that you would write to me setting out your concerns more fully. On the basis of our discussion we plan to follow them up by:

- challenging the Network Rail contracts team in London on why they will not negotiate a bespoke contract with you, instead of imposing the template contracts;
- working with you and Network Rail on how contingencies could be structured to give you more influence over their drawdown; and
- carrying out efficient cost reviews of the Welsh Government's projects with Network Rail. This is not normally something we do on third party cash funded contracts, but we recognise your concerns and the Welsh Government's position and think that publication of these reviews would be a strong driver of efficient delivery.

11. Could you also supply us with details of the cost of the projects that you are delivering, such as Pye Corner, so we can use this information to help benchmark Network Rail's costs. We will contact you about how the data should be provided.

12. I hope you will agree these changes will, taken together, represent a significant step forward in our support to you and will mean you will get more value out of your relationship with Network Rail.

Yours
Sincerely,

A handwritten signature in black ink, appearing to read 'John Larkinson', written in a cursive style.

John
Larkinson