

**THE OFFICE OF RAIL AND ROAD
153rd BOARD MEETING
10:30-15:30 MONDAY 1ST OCTOBER 2018
ONE KEMBLE STREET, LONDON WC2B 4AN**

Non-executive members: Stephen Glaister (Chair), Tracey Barlow, Anne Heal, Justin McCracken, Michael Luger, Graham Mather, Bob Holland

Executive members: Joanna Whittington (Chief Executive), John Larkinson (Director Railway Markets and Economics), Graham Richards (Director Railway Planning and Performance); Ian Prosser (Director Railway Safety).

In attendance: Juliet Lazarus (Director Legal Services and Competition), Tess Sanford (Board Secretary), Chris Hemsley (Deputy Director RME), Carl Hetherington (Deputy Director RME), David Dingwall (PR18 programme executive) Lisa O'Brien (Head of media relations, campaigns and digital communications).

Observer: Declan Collier (Chair designate)

Other ORR staff in attendance are shown in the text.

Item 1 WELCOME AND APOLOGIES FOR ABSENCE

1. The chair welcomed everyone to the meeting.
2. Russell Grossman and Dan Brown had sent apologies.

Item 2 DECLARATIONS OF INTEREST

3. No new external interests were declared. During the meeting, Joanna Whittington declined to comment on biomass freight charges given her forthcoming move to BEIS.

Item 3 APPROVAL OF PREVIOUS MINUTES AND MATTERS ARISING

4. The minutes of the previous meeting would be circulated with the main October board papers.

Item 4 PR18 – FINAL DETERMINATION

Chris Hemsley and Siobhán Carty joined the meeting for this item

5. The chair congratulated the team for the clarity of the PR18 decision pack. Subject specialists would be on hand throughout the discussions to clarify any points of detail. After the discussion, the team would circulate draft executive summaries for the two main documents for comment before they were finalised for publication on 31 October.
6. Chris Hemsley set out the planned approach to the decisions.
7. Juliet Lazarus reminded the board of their three obligations for the review. a) to conduct a review to make the best and most practical way of meeting the HLOS in the light of section 4 duties b) to assess whether the HLOS was affordable within the SoFA and c) not to adversely affect train operators. She stressed that there was no priority between the various s.4 duties – they needed to be balanced in each decision.
8. The board discussed the context for today's decisions including increasing congestion on the network, the changing picture of NR's contribution to delays,

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the overall safety record, and spend on asset sustainability and elsewhere on the network. ORR had worked hard to help secure adequate funding to maintain asset condition in the control period in a more constrained funding situation.

9. The board discussed: measurement of performance and whether franchise commitments could be met, the overall package of funding and commitments, how change would be managed and reported, monitoring and enforcement policy, government budgeting and spending constraints, and overall NR GB expenditure. This last issue was discussed in relation to Transport Scotland's representations on shared cost allocation and other concerns. The board considered that NR needed to be more responsive to its funders' concerns and asked that this be made clear. The board noted the increase in estimated costs coming out of the early stage planning of the Carstairs renewal and discussed the treatment of the project and of gauging work in Scotland.
10. The board discussed how reporting would work if performance trajectories were not agreed with TOCs. The board received assurance on the work that had gone into reviewing NR's business plans for CP6: NR needed to deliver those plans. It was important that the lay reader of the settlement could understand the new relationship between the regulator and regulatee with greater focus on the company facing its customers.
11. The board discussed the issues around performance which had arisen since the draft determination had been published. Although there was no case for major change in the settlement, it would be important to reference the issue and show how it could be addressed within the settlement.
12. The board confirmed the broad approach set out in the draft determination which was to:
 - Encourage NR's route based devolution and its transformation
 - Encourage joint working between NR routes and the industry to agree scorecards
 - To prioritise asset sustainability as set out in the HLOS.
13. This would result in: the adoption of a high level approach to considering changes in spend/forecast cost and not to make detailed interventions; not altering route based expenditure tables; not imposing scorecard requirements - all because the NR plans are generally much better than previously. The board remained mindful of the overall funding envelope.

Roger Davis and Steven Dennis joined the meeting for the next three items.

Sustainability

14. NR had responded positively to the challenge on sustainability. It had improved its modelling of forecast sustainability and updated its proposals in light of this. Reflecting this, their new commitments were better value for money and not considered over- ambitious. The board accepted the recommendation and asked that there should be a clear time limit set on the development of the new measure of network sustainability.
15. The board agreed the recommendations in the paper and:
 - To approve an additional £608m (£538 E&W) for renewals (compared to NR's SBPs).
 - To work with Network Rail to develop a better funding allocation methodology to routes that addresses their specific requirements, to be used for future allocations of funding within CP6.

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- To work with Network Rail on the development of an alternative, improved measure of network sustainability.
- To use change control to make adjustments to CSI scores in light of confirmed enhancements and reactive work interventions

Headwinds and efficiencies

16. The board heard that although consultants had provided estimates of a bigger potential efficiency challenge, the available data meant that this should be viewed as an indication of the potential range of possible outcomes on efficiency. Importantly, the NR route MDs were prepared to accept the challenge included in NR's updated proposal. Accepting this proposal has the benefit that they would be committed to delivering it.
17. The board agreed to approve NR's response to our efficiency challenge of £491m and a reallocation of £180m from headwinds to base costs. It was also noted that compared to the assumptions in NR's Draft Determination response we are moving £50m of efficiency savings from year 1 to later in the control period and decided that a £7.8m efficiency proposed by NR for Scotland was not an efficiency. NR agrees with these changes and they have no effect on the overall funding in the determination.

R&D funding

18. The original submission from NR had been substantially rewritten to give evidence of a programme of work designed to deliver benefits to the business. NR also provided evidence that its SBP had under-stated CP5 R&D spend; we reviewed the updated information and found it to be reasonable. Significant improvements to governance were proposed for CP6. The board were surprised to see the lack of previous accountability around R&D spend and stressed the importance of clearer budgets and transparent reporting in future. The importance and urgency of matched funding was also noted. Given the choices already made on sustainability and efficiencies, there was sufficient flexibility in the funding to accommodate this increase.
19. The board agreed to the recommendations in the paper and:
- to approve funding of £245m;
 - to require the proposed governance arrangements to be formalised and implemented before the programme commences;
 - to require the programme to be reviewed and approved by the advisory board prior to commencement;
 - to note the intended level of matched funding and to require Network Rail to secure commitments for this urgently.

Other single till income (OSTI)

20. The board noted that NR's counter proposal did not include new evidence on these figures apart from identifying an error in the consultant's analysis, which we have adjusted for. The board noted recent press reports of NR's commercial estate and asked this be cited in the commentary.
21. In ORR's calculation of Network Rail's revenue requirement, we will assume that Network Rail can deliver £55m of additional income in GB in CP6: £52m in England & Wales and £3m in Scotland.

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Lyn Armstrong, Nicola Machado and Sneha Patel joined the meeting for the next three items

Setting trajectories for CRM-P

22. NR was required to consult its customers and to seek agreement on performance trajectories measured in CRM-P. The board discussed representations from Grand Central and LNER, and NR's response to the consultation and the impact on CRM-P of accepting the operators' proposed adjustments. The board also discussed the practical challenges for TOCs and NR of joint planning.
23. The board accepted the recommendation to revise the trajectories for LNE/EM but otherwise to accept NR's proposed CRM-P trajectories.

Freight route level performance trajectories

24. The FOCs had been working with NR to agree a trajectory specified as a national performance measure but it still needed to be broken down for devolved routes using a new methodology. There were still concerns about FNPO governance and authority.
25. The board agreed to require NR to use the updated methodology to set the route level (FDM-R) trajectories. It should seek to agree these with routes – however a route must provide compelling evidence if it wants to move away from this methodology.
26. ORR will calculate the floor for this measure with reference to the revised methodology. FNPO governance issues will also be addressed in the Final Determination.

CRMP – regulatory minimum floor

27. The floor needed to be set to encourage working together between routes and customers. It had been below the forecast trajectory by a margin of 20% of average historical performance over CP4 and CP5. But a more consistent base would be 20% below forecast performance.
28. The board agreed to set the CRM-P floor at 20% below the forecast route-level CRM-P trajectory.

Deren Olgun joined the meeting for the next two items

Performance Innovation Fund

29. The fund was intended to support operational experimentation and the original sum of £10m could be increased to £40m given other decisions already taken. The board asked about comparable figures on the spend on performance interventions in CP5 [Action]. The board discussed that operators and NR sometimes cite the schedule 8 regime as a barrier to certain ideas to improve performance (although there had been no appetite for its revision at the point the review was being scoped). This fund would be a way of supporting innovative responses to performance issues and gathering evidence for alternative approaches. The governance for the fund had not yet been agreed and would need to clearly distinguish between the R&D programme and this work.
30. The board discussed the overall recent poor performance in the industry and the role of PR18 and noted the continuing importance of improving performance.

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Given the funding identified from elsewhere in the overall settlement, the board increased the Performance Innovation Fund to £40m over CP6.

31. In the FD it should be clearly stated that ORR will establish a performance innovation fund, and set out some broad principles for how it should be used (to solve coordination/free rider problems, as well as issues relating to uncertain or distant payoffs).

Schedule 8 reopener

32. After discussion of the representations made around Schedule 8 reopeners, and the potential risks of the options set out, the board agreed to indicate that ORR would consider applications for recalibration of Schedule 8 in CP6 only on a case by case basis – in effect the status quo but signalling this more clearly.

Sheona Mackenzie (phone) and Siobhán Carty joined the meeting for this item

Managing Change

33. The board discussed the proposed mechanism which was designed to protect the system operator and routes from imposed changes from the centre or elsewhere (which could be triggered by a reduction in the funds available to the company) and so to preserve their accountability and line responsibility. Change could still happen if needed but would be transparent – and better transparency was an important part of the regulatory framework for CP6. Our financial monitoring at route level should reveal if changes were taking place and route teams did not appear to be offering appropriate challenge.
34. The board agreed that the policy should continue to be developed with NR and, should be finalised by Chris Hemsley or PR18 programme board, only reporting back to the Board if major new issues arise.

Lunch

Deren Olgun, Natasha Frawley and Nick Hall joined the meeting for the next 5 issues.

Capping of freight variable charges

35. Freight variable charge caps are due to be lifted at the end of CP5 unless the board chose to change this. The draft determination proposed a cap and phase-in on freight variable charges and a shift to CPI as a better measure of inflation. The principle of moving toward cost reflective charging was important.
36. Although there were a number of significant responses to our draft proposals, there was little by way of new evidence. A number of operators made an alternative proposal ('CPI+1%'), but this lacked an underlying justification. The board discussed freight growth in Scotland, the relative impact of charges on growth in different commodities, wider economic risks, and MDS Transmodal estimated elasticities. The board agreed to retain the DD position on the average profile of total variable charges. ORR will seek to review any update of the MDST evidence (if received) and consider whether it affects the overall balance of evidence to a significant degree. The board delegated the decision on this to the PR18 Programme Board.
37. There was a discussion of the commodity-level analysis that had been undertaken. In light of the impacts at a commodity level, ORR confirmed its overall policy on capping and phasing-in of charges.

Infrastructure cost charges for ESI biomass

Joanna Whittington noted that she would take no part in the discussion of ICCs for ESI biomass, and had not been involved in the final recommendation

38. The board discussed the nature of the biomass market and the expectation set in PR13 that it would be subject to fixed cost recovery in PR18, as well as the scale of likely revenue increase and profile options.
39. The board agreed a phase-in period for ESI biomass be put in place and a profile consistent with that of the FSC in CP5 (ie Year 1 = 0%, Year 2 = 0%, Year 3 = 20%, Year 4 = 60%, Year 5=100%)

Treatment of Open Access Operators

40. In November and December 2015 ORR had indicated that it was considering how to make open access operators contribute more to the costs of the railway. One operator in particular (First) who had been granted open access rights after that date but whose application had been received before it, was seeking to be excluded from any change in open access charges (by being defined as an 'existing' operator). The board discussed the importance of specifying the definition of inter-urban services (see below).
41. The board agreed that both the First services and other proposed by GNWR should be classified as "new" and therefore in scope for the ICC. The board noted that First Group and GNWR are allowed to apply for additional access rights taking into account the ICCs, and that more information will be set out about this at the end of 2018.

Level of ICCs for new interurban open access operators

42. This was a new charge designed to charge more to new open access operators on more profitable parts of the network. The level of charge was expected to have an influence on the number of new applications. Consultants modelled that 'inter-urban' train services could bear between £4.70 and £5.00 per train mile (using a cautious approach to input assumptions) so the recommendation of £4 per train mile was conservative. It would only apply to the segments of journeys between some urban areas (with the definition of which urban areas still to be determined). The board discussed the likely criteria for 'urban areas', the possible impact on operators, the risk of deterring new entrants, the continuing need for a PSO levy to be introduced by government. The board asked to review the list of inter urban centres at their November board [Action].
43. The board agreed that the charge remain at £4/train mile (noting that staff would consider whether the updated variable charges had a material impact on the appropriate ICC).

Affordability

44. The board noted the possible additional costs in Scotland to improve gauging and other uncosted HLOS requirements, work would continue on these after the final determination. The board noted the continuing uncertainty around income from Crossrail but this was not material to this decision, as we had not chosen to rely on this income to support NR's core delivery against the final determination. The board noted that their decisions had not materially altered the calls on funds in England and Wales or Scotland. Noting the differences between the two

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settlements and the two SoFAs, the Board confirmed that the outputs included in the determination (as requested by the HLOSs) could be funded by the money in the SoFAs.

45. The board noted the headline conclusions on health and safety from the review of NR's plans.
46. The board noted that it did not think implementation of the review would adversely affect the interests of persons providing railway services.
47. The board agreed that it had met its 'best and most practicable duty' in its final determination.
48. The board noted the outcome of the equality impact assessment and agreed that there was nothing in the decisions that carried adverse impacts for any of the protected characteristics.

Communications

49. Coverage of the final determination would build on DD launch and ensure it captured the following: more focus on performance and (slightly) less on asset sustainability, some reference to value for money/efficiency, the route based, ground up nature of the plans, anticipated passenger impact and benefits, service improvements and long term sustainability.

Item 5 NETWORK RAIL LICENCE REVIEW PROJECT

Claire Simpson, Chris Warburton and Rob Cook joined the meeting

50. The team briefed the board on stakeholder responses to the consultation with a clear focus on three areas. A detailed paper on the full proposal would be brought to the November board [forward programme]
51. The board discussed the degree of flexibility which was desirable for a licence and agreed that, given the new managing change process, there should be no commitment for a licence review before the next period review.
52. The board noted NR's concern about the freedom of route managing directors to procure as a separate unit: this was an important freedom if RMDs were to be accountable for cost savings and should be protected – we would need to understand the NR concerns better.
53. The board noted the representations from NR on a very narrow definition of stakeholders for resource purposes. This was not supported – activity could be proportionate but passengers and lineside neighbours needed to be listened to. The quality of stakeholder engagement by routes was an important indicator of route performance.
54. The board agreed that the licence should clarify expectations that NR would protect freight users and operators – there was more work to do on drafting here.
55. The board discussed again whether involvement in management incentives was appropriate given the new political oversight of pay and reward in NR. ORR would continue to comment on performance of the organisation at regular points in the year.
56. The board noted the next steps and timetable of the project.

Liz McLeod joined the meeting for this item

ITEM 6 MONITORING AND ENFORCEMENT POLICY IN CP6

57. The board noted the new context offered by the final determination and the licence review project.

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58. Liz McLeod described the various levels of intervention proposed, highlighting those which were new or further developed over the existing toolkit.
59. The board discussed how hearings might work and where the interventions might drive changes in behaviour.
60. The board asked for further clarity around the regulatory escalator: Graham Richards explained that all the tools were being reviewed to ensure that they were effective in identifying problems and influencing behaviour before things got too bad. [future update on forward programme]
61. The board recommended that any communications about this work focused on the outcomes it was expected to produce for passengers and users, rather than the process changes. Thinking about how the information could be made public – and how it would look - might clarify that thinking.

Item 17 ANY OTHER BUSINESS

62. Stephen Glaister noted that this would be Joanna Whittington's last meeting. He reflected on the three years since her appointment and praised her excellent leadership for the steady progress the organisation had made to its current high standing with government and the industry. He thanked her on behalf of the board and wished her well for the future.