OFFICE OF RAIL REGULATION

Staying focused on delivery is critical for rail's future

Richard Price [1]

Marketforce's 'The Future of Rail 2014' conference,

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Introduction

Both government and shadow rail ministers spoke this morning about the importance in this industry of planning for the long-term, giving the industry the stability and clarity to invest and to stay focused on delivery. As in other sectors with long-term investment programmes, in rail that is at the heart of the regulator's job. And today I want to talk to you about the challenge to success in CP5: staying focused on delivery.[2,3]

We know that this is a remarkable time for rail. We have seen investment at unprecedented levels since the second world war.

- Passenger journeys are up by 50 per cent – the highest growth in the last decade than in any country in Europe and inflation adjusted passenger revenues up 52 per cent (chart 1)
- Freight is also growing. Notwithstanding a difficult recession, freight is 20 per cent up in the last decade (chart 2). We have a freight market with real competition, and the huge strides the freight sector has made in productivity make it an exemplar to the rest of the industry.

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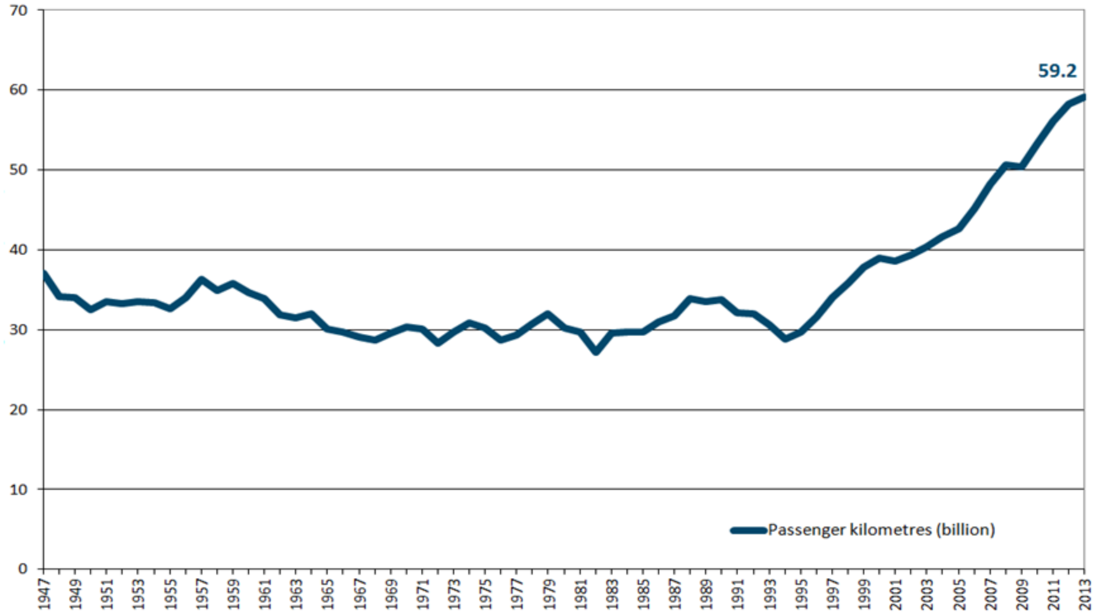
2 CP5 refers to the fifth price-control period for Britain's rail infrastructure, set by the ORR. It sets the expected outputs, finances and efficiency improvements for Network Rail between 2014 and 2019. It includes the access charges and other payments and incentives paid by or to train operators.

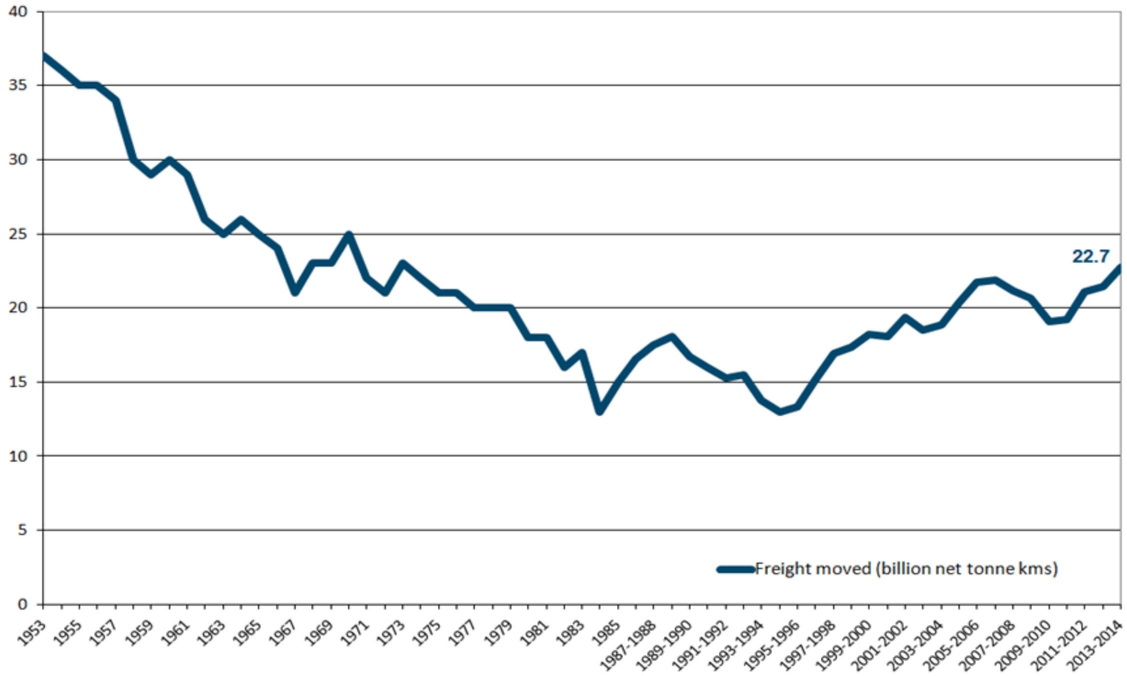
3 See the Annex for a summary of what we expect Network Rail to deliver in CP5.

Chart 1: Passenger demand, 1947-2013
Sustained growth since the late 1990s



Source: Office of Rail Regulation.

Chart 2: Freight demand, 1953-2014
Stabilising then (mostly) rising since the mid-1990s

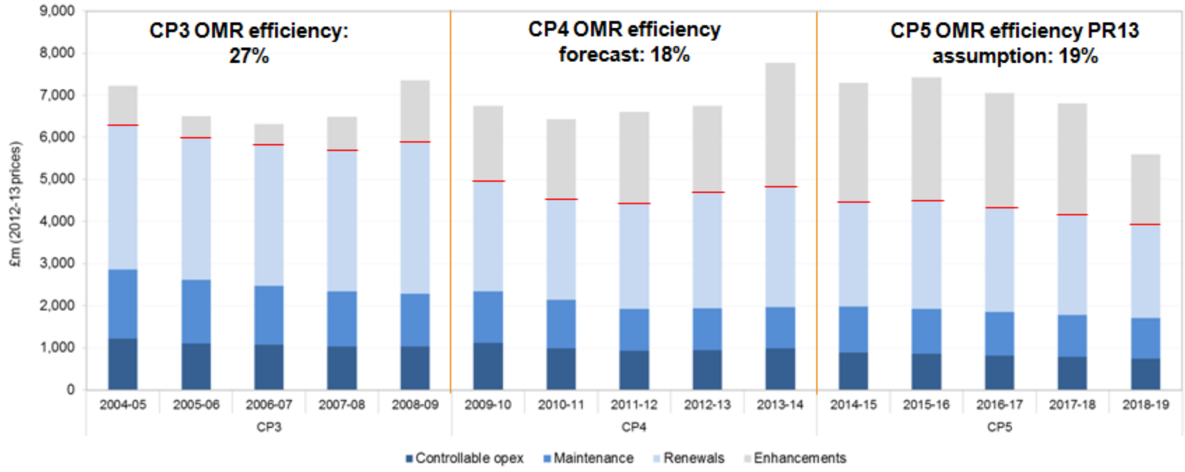


Source: Office of Rail Regulation.

- Network Rail’s like-for-like costs are also down by nearly 40 per cent in a decade, and we expect the company closing the efficiency gap with the best rail infrastructure businesses in Europe by the end of CP5 (chart 3).

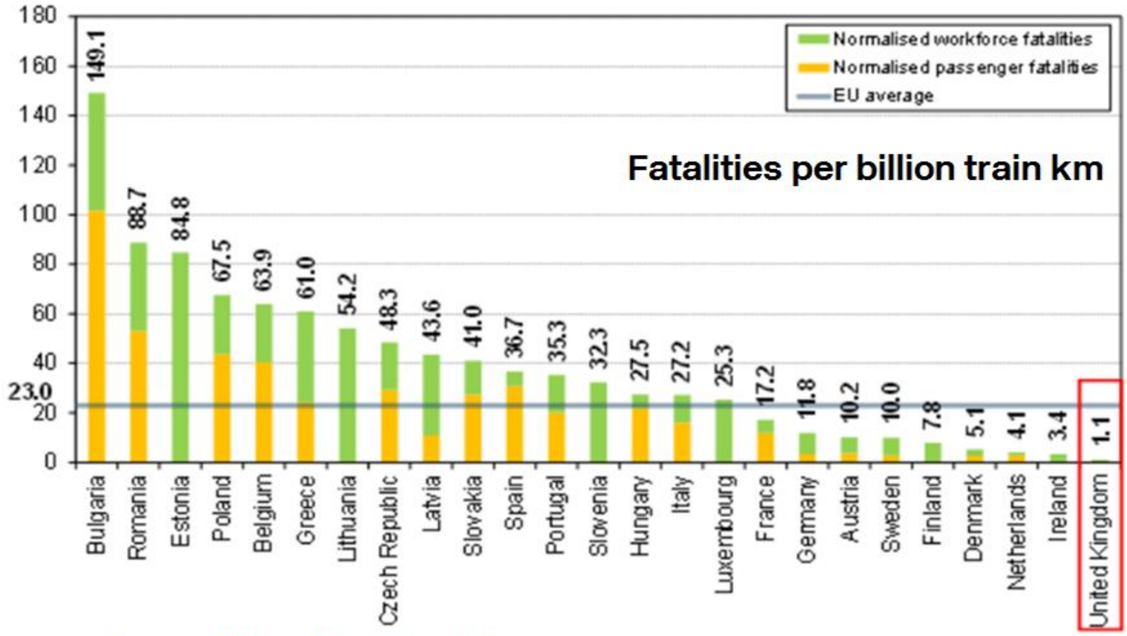
- The industry’s recent safety record is good and underlying risks are reducing – though we can’t be complacent the industry is among the safest in Europe (chart 4).

Chart 3: Network Rail efficiency gains are being reinvested in new capacity
Cumulative efficiency gains of £9.3 billion since 2004.



Source: Office of Rail Regulation and Network Rail regulatory accounts.

Chart 4: European safety comparisons:
Passenger and workforce fatality rates, 2008-2012



Source: Office of Rail Regulation and European Rail Agency

With commitment across parties to HS2, we have seen rail, for the first time since the war, at heart of the way people think about growth and economic geography.

However why is it that despite this record amount of investment and growth in passenger numbers, the National Rail Passenger Survey points to a lack of trust in the industry and on-going controversy about ownership structures? Why is it that we hear for example, about support for public ownership on the right of the political spectrum as on the left? What is the frustration with the current model?

The success of the railway does not therefore come without risks, and confidence in the industry's ability to deliver is essential if the current high levels of investment are to be sustained.

This morning, I will tell you how we are gearing up for the future. However before I do, I want to put this into context by setting out some of the challenges the industry faces in turning perceptions around. I will talk about tackling performance, some of the new challenges of Network Rail's new status as a public company, the importance of making the case for rail investment, and longer term challenges.

The first challenge - tackling performance

Our recent analysis of Network Rail's performance shows that current train performance is generally below target and too many passengers are facing too many delays (see chart 6). Our Network Rail Monitor, published last week, shows that there are 46,545 more late trains in England & Wales than we'd expected year to date and 18,544 more trains cancelled or severely disrupted in England & Wales than expected.

Going back to my initial question about trust, we know that punctuality is the biggest source of dissatisfaction with the railways, and Network Rail needs to tackle the problem.

Network Rail is not delivering the volumes of maintenance and renewals it believed were required to sustain performance and committed to, six months into this new five – year control period.

Network Rail needs to focus on the basics – doing the right levels of maintenance and renewals - improving its knowledge of its assets – and keeping enhancement projects on track. We recognise that this is a challenge but we will continue to hold Network Rail to account to deliver on commitments.

On such a highly congested mixed use network – a whole-industry approach is needed. Train and freight operators need to step up too. Passenger delay minutes caused by train operators are 8.5 per cent worse than this time two years ago (measured by delay minutes per 100 train kilometres).

So problems caused by TOCs as a result of crew shortages and broken down trains need to be addressed too. The Department for Transport needs to ensure franchised operators have the flexibility to help improve punctuality. And the ORR needs to make sure we are effectively holding Network Rail to account and applying the pressure and transparency needed to ensure the company is focused on resolving the problems. We all have a role to play to ensure passengers and freight customers see improvements in performance.

For this new control period, we are increasing our focus on indicators which will tell us more about Network Rail's likely performance trajectory. This enables us to get a clearer sense of whether Network Rail's work in the coming months will put matters right for passengers.

We have also introduced new regulatory targets and systematic monitoring in order to give us fresh intelligence on future performance so that Network Rail focuses on

- strengthening its asset management and delivering its plans;
- getting the basics right – delivering its maintenance and renewals volumes, and
- moving from a 'find and fix' approach to 'predict and prevent', so that problems are resolved before they affect passengers, not once the damage to the customer experience has been done.

If Network Rail can show it is delivering robustly on the parts of the punctuality challenge which are in its control, then it will have much greater credibility in working with the train operators to develop whole-industry solutions to the undoubtedly complex issues on a more crowded network.

We are also working closer with operators – ORR staff visit the passenger and freight train operators and we talk to their managing directors and operations staff to get a clear sense of the problems on the routes they operate. We are engaging with the industry from the boardroom to the ballast. I want to urge you today to continue to keep an open dialogue with us –so we can identify all the fundamental problems of delays to ensure we can then examine issues at route level to focus Network Rail to deliver.

On punctuality and other things such as ticketing, we know that gaining passenger trust is essential to addressing the industry's credibility challenge head on.

Passengers, freight customers and taxpayers need to be confident that they are getting a good deal from Britain's railways.

What we're doing

As the independent regulator, everything we do is for the benefit of rail customers.

Whether it's pushing for improvements in punctuality, safety, or value for money – the customer experience is at the forefront of our work.

In addition, we are actively working to help to improve the whole system of travel by rail and passengers' experience,

- by promoting transparency,
- by making progress on developing a new code of practice to ensure passengers get the information they need when choosing, buying and using tickets, and
- by kicking-off a wide-ranging review of the ticket selling market and working with TOCs to improve industry plans for passenger information.

Research shows that after punctuality, these elements are at the heart of the passengers' trust in the industry. So ORR is working to help address these issues, looking to the industry to develop and lead solutions wherever it can, and with ORR encouraging – and where necessary- applying sensible pressure on behalf of consumers.

The second challenge: increased competition for funding

We will protect the public interest but the industry needs to do more to demonstrate how it is working for passengers and customers as government weighs up choices about how it spends money.

However when experts on all sides are telling us that we are only halfway through austerity, not only does the rail industry face competition for investment from other areas of transport industry such as roads, but against other vital public services, such as schools and hospitals.

A collaborative approach is essential, with the whole industry working together with a strong drive to improve performance and genuinely to improve services for passengers and freight customers. Only if it can demonstrate it is addressing these issues will the industry calls for investment be heard.

The whole industry needs to work together to operational issues to improve timetabling, reduce delays, and improve asset reliability so that customers experience better reliability.

To secure future investment, the delivery of CP5 is critical.

Long term challenges

Let me tell you how I see some of the longer-term challenges.

When we think about the future of rail, we need to think about how we can make sure investment and delivery meets customers' needs. A key part of this is through improved consumer engagement – including the basics like letting passengers know what's going on when things do go wrong. Passengers waiting on the platform on their way to work want to know how long they will be waiting. Tell them. And tell them how they can claim refunds if there are significant delays, or when they buy their ticket, which trains they can travel on.

As we begin to shape Control Period 6 (CP6) – it is important not to forget these basics- to improve legitimacy of the sector when tough investment choices have to be made.

Incentivising the provision and use of capacity

This is a long-term sector. We need to think now, not just about CP5 but also the next Control Periods - CP6, CP7 and beyond. Last year Network Rail accepted our final determination for CP5 but we are already thinking about 2019 and beyond and I tell you about our plans in a moment.

Of course we are looking to the industry to lead the development of plans for the improvements for next control period -involving passengers, freight customers and funders and reflecting their view -but incentives and finance of the industry need to be addressed too.

We need to tackle these questions head on. Network Rail is currently incentivised only to improve punctuality, and there are very weak incentives to ensure it is making the best use of increasing spare capacity. One question that needs to be tackled is how can Network Rail and industry be incentivised for the use of capacity as well as for improving punctuality?

Reclassification of Network Rail

As well as risks to sustained investment and to the industry's credibility for delivering, there are also risks arising as a result of reclassification of Network Rail as a public company. It is important that the regulator is able to continue to provide a robust regulatory framework which recognising that Network Rail is a monopoly, whether private or publically owned and therefore needs to be held to account for delivering efficiency for its customers.

As a regulator we need to make sure Network Rail gives sufficient flexibility to be able to achieve value for money and to deliver efficiently. However, the company already faces a degree of micromanagement in some areas, and the risk is that civil servants will become ever more embroiled in the running of the business – unless the company can restore its reputation on performance, delivery and cost management.

It is also important that Network Rail's funding does not fall back to the British Rail days of annualised budgets and stop-go spending. We need long term decisions for the major infrastructure which so many people and businesses rely upon. The regulatory framework, with 5-year control periods, helps to build this in. And I have to say that so far, since reclassification, government has recognised how important it is that Network Rail retains both the ability to budget across the 5-year control period and has made provision to allow the business sufficient headroom in its borrowing limit to deliver a large multi-annual programme with the flexibility needed to achieve efficiency and value for money.

What we're doing to tackle long term challenges: the 2018 Periodic Review (PR18)

Finally, let me turn to a regulatory perspective on how we are considering these longer term challenges for PR18.

Last year, we made our final determination for CP5 we did not sit down and pat ourselves on the back and plan to sit back for another five years. We are already thinking about PR18 for CP6.

The regulator’s role is and will remain to focus on safety and to protect the public interest – both passengers and taxpayers- when markets do not work efficiently.

This means giving the industry incentives and room to work together to deliver, and only intervening when it falls short – whether on performance, safety or value for money. We have stepped up our scrutiny because we see real risks to delivery and we need to be sure that they are being well managed. It is right that we do that, in the public interest. We will continue to monitor Network Rail performance very closely, but with less intrusive regulatory scrutiny in future when we see sustained improvements.

It is our role to shape the regulatory framework for PR18 and therefore a key area which we want to tackle is the interaction between charges and incentives.

This will mean looking closely at the existing structures and assessing how different market segments such freight and open access will be best incentivised.

We welcome early discussions with the Rail Delivery Group and other stakeholders on this. We are also looking at how to get a better understanding of the value for money of different proposals for extra capacity, how to manage technological change efficiently, and what further improvements can be made to improve the resilience of the existing network.

Route devolution

We will look at how Network Rail can make the best of route devolution, and learning from best practice in the best performing routes.

There are things that Network Rail can do to get closer to its customers - getting a better grip on the basics; improving standards but also to make better use of devolution. We saw Network Rail move to route based structure and there are many benefits emerging from this – including the ability to draw out comparisons and best practice from across the different routes, and decisions being taken closer to the railway’s customers and local funders. Steps are being taken to make sure Network Rail needs to be more responsive to customers but more can be done.

We are examining ways in which we can improve the way we regulate by using route-based comparisons to establish systematically the relative effectiveness and efficiency of the routes, so that we can understand what is the potential for all routes to operate at the level of the best, and how that can be achieved. This ‘comparative competition’ has been used in other sectors, such as water and energy infrastructure, where ‘real competition’ does not exist, to drive improvements in efficiency and service for customers. This is a promising option for the way we conduct our next periodic review.

And we are interested in the way Network Rail and train operators could be incentivised to work better together – for example by channelling more of the company’s revenue through access charges, rather than government block grant . (See chart 5 for an overview of the current flow of funds through the industry). This could encourage Network Rail and its routes to become more commercially responsive to its customers, who in turn have more reason to work with the company to reduce its costs and improve performance for passengers and freight. Incidentally this more commercial behaviour, improving delivery for rail users, matters, whether the industry is in the public or private sector.

Conclusion

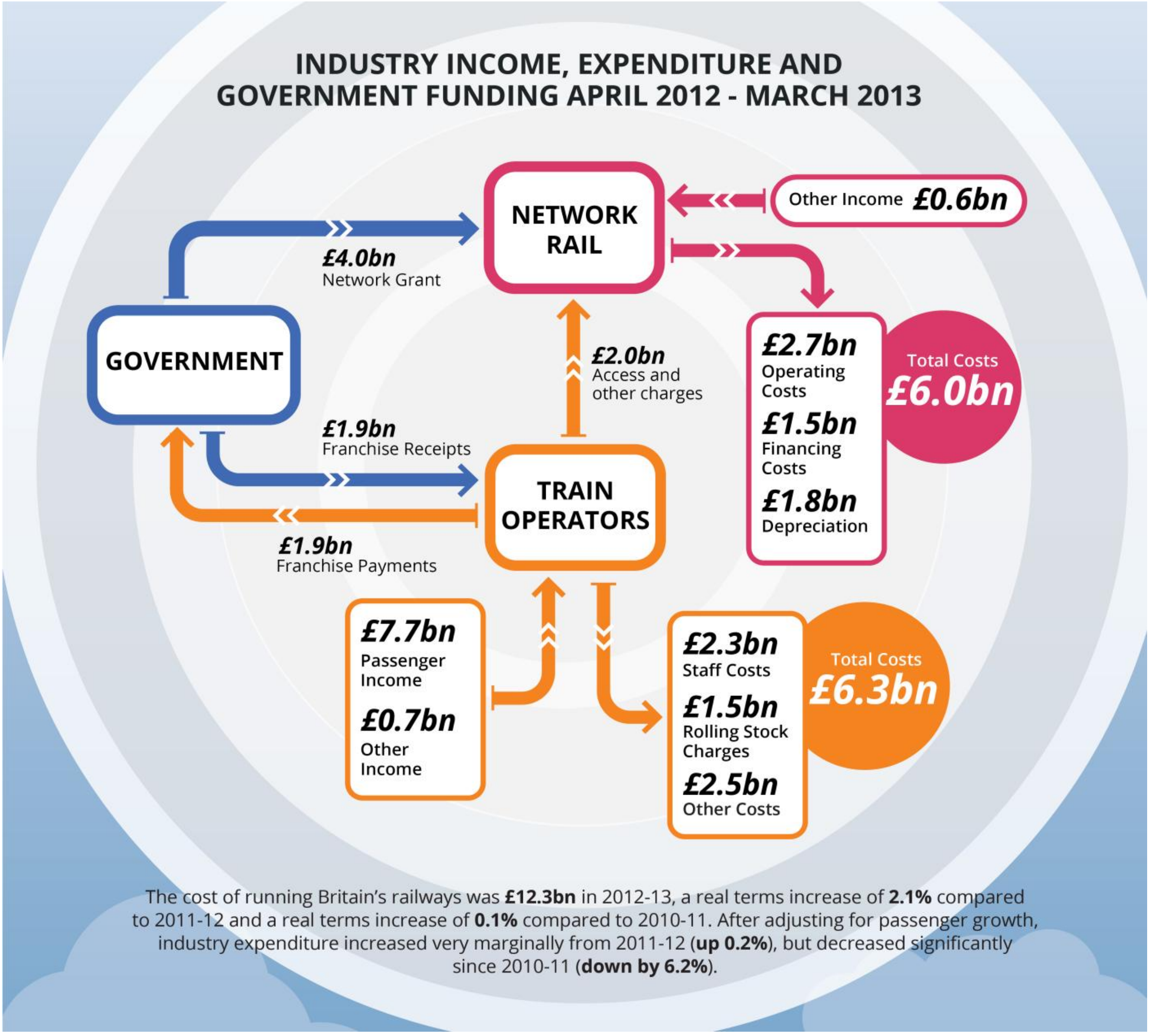
To conclude, we are already working with the industry as we develop our thinking for the future, but I have shown why the industry also needs to demonstrate it can deliver CP5, and contribute to future agenda which makes the space for greater industry leadership and responsiveness to customers. Successful delivery is the industry’s licence to grow.

This is an industry of capable and talented people, and I have confidence that you will rise to the delivery challenge. And I hope many of you will engage with us as we develop our thinking for the longer term.

RICHARD PRICE
Office of Rail Regulation
27 November 2014

Chart 5: Funding flows in the rail industry

Around 60 per cent of Network Rail's revenue is through government grant, 40 per cent from access charges and other commercial sources.



Source: Office of Rail Regulation: GB rail industry financial information 2012-13

Annex: A summary of delivery in CP5