

Role of regulation in an evolving rail freight sector

**Rail Freight Group speech, Joanna Whittington, CEO, ORR
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[TITLE SLIDE]

Thank you for the opportunity to speak today.

As you may know, I took up the role of Chief Executive of ORR in January – but this is my second time at the regulator. I first worked for the regulator in the 1990s as an economist.

My first role was to set access charges for charter trains. This went reasonably well and after that I was allowed to start working on freight track access charges and the first section 17 application the office had to consider. This culminated in my first visit out of the office in the cab of one National Power's class 59s on a run from Selby to Drax Power Station.

I tell you this not because it was my best day in the office – although it clearly was – but because I was able to see first-hand what a significant contribution rail freight made to the UK economy as a whole.

[SLIDE 1]

Sadly there may not be many more opportunities for travelling in the cab of a loco hauling 2000 tonnes of coal but as the work of the Rail Delivery Group published in 2014 has evidenced, the economic and environmental benefits of rail freight are significant. The RDG report estimates that:

- The rail freight industry is worth £1.5bn year in benefits to the UK economy, nearly double the annual revenues of the freight operators.
- Each freight train removes between 43 and 76 HGVs from the road
- Transporting goods that in 2012/13 would otherwise have needed 7.6 m road journeys.
- Rail freight produces over 10 times less small particulate matter than road haulage and 15 times less nitrogen oxide for the equivalent mass hauled – reducing air pollution.
- with the noise reductions from rail freight estimated to be worth £60m a year in the UK.
- and finally by reducing HGV journeys, the report estimates that rail freight prevents around 600 casualties a year.

And it is for these reasons I am glad that in one of my first speaking opportunities in the role I can talk about how the benefits that rail freight delivers for the UK economy as a whole should be secured for the future both:

- as the structure of Network Rail evolves and which Paul has and Nicola will talk about; and
- as the pattern of freight and the requirements of rail freight customers change.

The opportunity for the regulator to help secure these benefits for the UK economy comes through the periodic review process and is what I will look to focus on in the rest of my talk – a process which we are shortly due to kick off for the period from 2019 with the publication of our initial consultation document – the regulatory short hand for this process being ‘PR18’.

[SLIDE 2]

As those of you who have been involved in periodic reviews previously will understand, this is a really important opportunity for all those involved in the railways to have a say in what its future looks like for the following five years.

Unlike periodic reviews in other sectors which have historically focussed on the relationship between the regulator and the regulated company, the periodic review in railways has always been a bigger beast – an opportunity to determine not only the outputs and cost of those outputs to be delivered by Network Rail but to look much more widely at the incentives it creates on railway users. I would argue this places a real onus on the regulator

- to engage effectively with a very wide audience
- to do more than publish long consultation documents
- but to properly consult with the whole industry including freight operators, with passengers and freight customers, with funders and of course with NR
- to take opportunities when they arise to get out and see what is happening on the ground
- and in turn to really listen to what audiences like you are saying and to demonstrate that we understand the implications of our decisions for the sectors in which you operate
- so that when we come to take decisions we do so in a way which we think best fulfils our statutory duties

Each periodic review needs to reflect the current context in which it is being carried out and in particular to reflect changes which have taken place since the last review – I will touch on 4 important areas but there are clearly others before going on to consider the implications for our regulation. Those areas include:

- growing use of the network
- the performance and efficiency of NR over the current control period
- the implications of reclassification of NR as a public sector organisation
- and finally, operational devolution

Turning to the first of these - **growth** - Network Rail's network is increasingly busy. Capacity improvements have benefitted customers

and allowed more services to run, but passenger numbers are forecast to grow further. A busier network increases the challenge for Network Rail across its roles: there are more constraints on the time available to maintain and renew the infrastructure; timetabling and accommodating additional services are more complex; and capacity constraints limit the expansion of services even where there is strong demand for them.

This will have implications for the freight sector as it continues to evolve, responding to the shift towards intermodal freight and relative decline in coal and steel volumes. In particular it raises issues around how the network might offer the flexibility of operation that freight customers increasingly need.

If we look now at **performance and efficiency** - Between 2004 and 2012 Network Rail made significant improvements in its financial performance and efficiency, but this has not continued.

On network performance freight operators have seen improvements with performance against the Freight Delivery Metric (the number of trains which arrive within 15 minutes of their scheduled time) now exceeding 94 per cent although this has not also been reflected on passenger performance.

And there have also been questions asked about NR's ability to deliver major enhancements which in turn have a number of implications, including: the need for the regulatory framework to adapt and learn lessons; and how to encourage Network Rail to deliver more effectively with the resources it has, where it has the most impact for users.

More generally, the expectations which we all have for the company will need to be realistic and so be conditioned by the likely level of performance at the end of the current review period.

The third area I want to talk about is the change in **NR's classification** - Network Rail was reclassified as a public-sector organisation in September 2014. This led to some important changes, including greater involvement by the UK Government in the company and the treatment of Network Rail's debt as public sector debt.

This has a number of significant implications. Firstly, the company is now subject to different and less flexible financial constraints, notably through a binding borrowing limit in England & Wales and Scotland set by the UK Government (in consultation with the Scottish Government). Given the cost pressures Network Rail has faced in the current five year

settlement, these constraints have led Network Rail to defer renewals spend, defer and re-scope some enhancements projects and start an asset disposal programme.

Secondly, funding of the railway now has the same impact on public finances as, say, spending on education or health. This has increased UK Government focus on a range of spending decisions that were previously left to the company and sharpens the decisions government will take in future on how rail investment compares to the other alternatives.

If you take these factors together our feeling is that it will make it increasingly important to get the most out of the existing rail network and to target the limited capital spending where it will have the biggest impact.

And perhaps in this context it is now worth turning to the question of devolution and in particular **operational devolution**.

[As we have heard from Paul,] in November 2015, Network Rail reorganised itself to put a stronger focus on its devolved route businesses (referred to as 'routes'), increasing the discretion that route managers have over operational decisions. This has been accompanied by the reorganisation of some central functions, including the creation of a directorate undertaking 'system operator' functions and one focused on providing services to routes, so as to pool certain resources.

This approach was reinforced by The Shaw Report which went on to recommend that rail infrastructure management should be centred around the needs of passengers and freight customers. In particular, this should come through strengthened route-level devolution within Network Rail, supported by a strong national system operation function and independent regulation. As part of this, it suggested the creation of a 'virtual freight route'.

ORR is strongly supportive of the work NR has undertaken and which is supported by Nicola in devolving operations further into the routes – we think that it provides a real opportunity for NR to improve the way it is able to meet the needs of its freight customers, passengers and funders.

We think in due course that we as regulator will be able to make much better use of the information coming out of routes:

- to set price controls which are based on a realistic and achievable set of outputs and

- that comparison of routes will provide on an on-going basis stronger incentives on those working within NR to improve.

While we have increasingly focused our attention on routes since PR13, to be effective, our regulatory approach going forward will need to reflect these changes in how Network Rail operates. We also need to ensure our approach responds to the opportunities for greater route-level engagement that increased devolution brings for customers and local stakeholders.

[SLIDE 3]

But routes won't work without strong system operation – a system operator that excels at timetabling capacity management and analysis – as freight well understands – effectively mitigating the risk that increased devolution to routes could undermine the quality of service to those operating across the routes - the virtual freight route will retain the clear focus on freight within NR but how we look to regulate NR as system operator will help as well.

While there are a range of different approaches we could adopt to our regulation of system operation one way to target and adapt our regulatory approach to a centrally based system operator might involve a combination of:

- financial information **about the system operator**, including data about its costs and assets and how these might be expected to evolve over time.
- A **set of performance measures**. These might include some quantitative measures (e.g. national performance, performance of cross-route operators, timetable conflicts) and customer-facing measures (e.g. satisfaction with timetabling).
- **Greater transparency about performance**, to allow customers and funders to challenge how well the system operator functions are being delivered.
- **Financial incentives on the system operator**, reflecting key aspects of performance and potentially linked to the remuneration of relevant staff.

We started our thinking on system operation over the summer last year and were very grateful for the input of the freight companies at an early stage we now need to move on to consider how our regulation could support getting the most out of this function and in this context we would welcome the continued involvement of the freight sector.

[SLIDE 4]

I have talked through in some detail some of the things which we see as being important context for the next review – growth, NR’s current performance overall, reclassification and operational devolution and there are clearly other factors. Understanding all of this is important because only then will we be able to put together a programme for the periodic review which is fit for purpose – it will require a step forward in our regulation of NR.

To deliver this change we propose to embrace the opportunity of regulating at a route-level. We want to explore making greater use of reputational incentives by formally and transparently recognising the achievement of route management teams in driving forward improvements.

Alongside this shift towards routes, there will be a greater focus on tailored regulation of Network Rail’s system operator role: its timetabling, capacity management and analysis functions. This will improve information and incentives to make better use of the current network, while protecting the ability of all train operators to move passengers and freight across the entire network. As the freight sector continues to expand into the intermodal market, a system operator with strong analytical capabilities able to identify the paths available will be increasingly important. This could support further traffic and revenue growth within the current network.

This will require us to update the approach to measuring the different aspects of performance: at route-level and for the system operator. We will also want to ensure that our monitoring of maintenance and renewals provides effective oversight of asset quality and safety.

We will also build on the work already underway to improve the information available on what drives cost on the network, explore how changes to track access charges might support industry-wide cost reduction.

This is an exciting and important opportunity, but it is not one that we can deliver alone. We need the thoughts, ideas and involvement of Network Rail, train operators, governments, other funders and of course freight operators and their customers to name but a few.

This will be key in enabling us to deliver a review that is firmly rooted in the practicalities of the industry and which can make a real contribution to ensuring that the railways support freight users, passengers , taxpayers and the economy, both now and in the future.

Thank you for listening.