

THE OFFICE OF RAIL AND ROAD

125th BOARD MEETING

08:30-14:30, TUESDAY 26 APRIL 2016

HILTON DOUBLETREE HOTEL, MANCHESTER

Non-executive members: Stephen Glaister (Chair), Tracey Barlow, Bob Holland, Justin McCracken,

Executive members: Joanna Whittington (Chief Executive), Ian Prosser (Director Railway Safety),

Executive directors: John Larkinson (Director Railway Markets and Economics), Graham Richards (Director Railway Planning and Performance)

In attendance, all items:, Peter Antolik, (Director Highways), Dan Brown (Director Strategy and Policy), David Dingwall (Administrator), Russell Grossman (Director Communications), Juliet Lazarus (Director Legal and Competition), Tess Sanford (Board Secretary), David Dingwall (Board Secretariat)

Other ORR staff in attendance are shown in the text.

Item 1 WELCOME AND APOLOGIES FOR ABSENCE

1. Michael Luger had sent apologies as he was out of the country.

Item 2 DECLARATIONS OF INTEREST

2. Bob Holland had previously declared a relevant interest in the ECML access application process and would withdraw from the meeting for that item.

Item 3 APPROVAL OF PREVIOUS MINUTES

3. The minutes were approved subject to some corrections.

Item 4: MONTHLY HEADLINES

4. Ian Prosser reported on:
 - There had been no industry caused fatalities on the main network in 2015-16. He particularly focused on the fact that no workforce fatalities had been identified.
 - An update on West Coast Railways safety performance.
 - Updates on two recent incidents at Bath Spa and in Norfolk. The incidents were still under investigation.
 - His attendance at Network Rail's SHE¹ committee and a debate there about the right level of safety specification.
 - An anticipated approach from the RSSB² to trigger our review of them.
5. Graham Richards reported on:
 - Regular inspection work by RPP³'s engineers on GSMR⁴ asset condition which had resulted in an increase in NR's understanding of the assets.

¹ Safety and health executive

² Railway Safety and Standards Board

³ ORR's rail performance and planning team

⁴ Global System for Mobile communications – Railways

- Work by RPP's information and analysis (I&A) team to deliver statistical information on TOC delivery against commitments under their DPPP⁵s. This was an important evidence base and supported our transparency objectives.
6. John Larkinson highlighted:
- Work being done with NR's route managing directors (RMDs) to monitor current issues and explore issues around route devolution in PR18.
 - NR's request for a discussion on the regulatory implications of their emerging plans for key asset sales. The board noted the importance of NR thinking about the regulatory issues around any proposals and consulting us on them promptly. [**Action:** JW to re-circulate the February board paper on ORR's statutory role in asset sales and how staff would approach NR's plans].
 - Work being done by the consumer team to approve CHPs⁶ and DPPPs for all the TOCs.
 - The status of progress made by Alliance in procuring rolling stock to run the West Coast Main Line services for which ORR had granted access rights last year.
7. Joanna Whittington reported on:
- A shift in her own engagement programme to a more external focus including speaking engagements.
 - Work with DfT, NR and HMT on implementing the Shaw recommendations and with DfT on an MOU.
 - There would be an item on the May Board agenda to consider representations on the board's 'minded to' decision on HAL⁷.
 - The Highways team were working on the first annual report on Highways England: one key area of concern was the lack of clarity on the capital programme baseline.
 - The Credo report on supply chain issues in highways had been published alongside HE's response.
 - The full year end report against ORR's business plan would be reviewed at the May board: she included headline figures here.
 - A review of communications around the super-complaint and lessons learned from this broadly successful work.

Item 5 REGULAR REPORTS

8. The Board discussed monthly reports on rail safety and the NR CP5 Tracker, SAFETY
9. The board discussed questions raised in external conversations that the railway was spending too much on safety because of ORR's approach. The

⁵ Disabled people's protection policies

⁶ Complaint handling procedures

⁷ Heathrow Airport Limited

HSRC⁸ had asked for a report and this would be brought to the board [**Action IP**]. There was plenty of research available that showed ‘good safety is good business’ but we needed to be able to show how it applied to our actions and role.

10. The board welcomed the publication by RSSB of the industry’s health and safety strategy.
11. Ian highlighted that although the implementation of the *planning and delivery of safe work* programme had been patchy, the organisational focus on behaviours did seem to be supporting improvement. The board noted the leadership role played by Mark Carne (CEO NR) in driving this.
12. The board discussed the meaning of the phrase ‘industry caused’ in the context of ‘no industry caused fatalities’. ORR uses it to mean that no breach of safety law was found in relation to the fatality.

CP5 TRACKER

13. Graham reported that the tracker was being updated to make it more accessible.
14. NR and Six TOCs would not meet this year’s performance targets and discussions were under way with those companies and others to gauge their views on regulatory next steps.
15. Asset volumes had been met in most areas except under bridges. This was a significant recovery against the previous year.
16. Financial performance continued to be poor against NR’s plans and far from PR13 targets. The board discussed whether the figures were accurate and levels of scrutiny by ORR and the NAO. Efficiency gains were very low and financial management looked poor. The board noted the importance of better financial information and more transparency.

ITEM 6 FEEDBACK ON STAKEHOLDER DINNER AND VISITS

17. The board discussed the themes they had identified during the previous day’s interactions.
 - a. There had been a number of negative comments on the quality of timetable planning from NR.
 - b. The board acknowledged the variety of additional stakeholder pressures that would apply to route managing directors as a result of route devolution. This was an area they wished to explore actively [**Action: Board Secretariat**].
 - c. The board discussed the impact that HS2 would have on the classic network and the need to think about the options for regulating the new railway. They asked for a paper in the autumn to begin exploring the issues. [**Action: JW**] The executive would also be embedding references to HS2 into the PR18 consultation documents and working papers to ensure that issues were understood at an early stage. [**Action Jlk**]

⁸ ORR’s Health and Safety Regulatory Committee

- d. The board discussed some of the issues arising from devolution of funding to the regions in particular the way that local focus might make national planning and an integrated network more difficult to deliver. The national regulator might need to play a role in protecting the central functions for the benefit of users outside the devolved regions.
 - e. Members discussed what they had heard about HE and NR around delivery and planning of major infrastructure works. They noted a similar approach to engineering solutions which did not obviously deliver clear benefits to the user.
 - f. The agenda for the north was very ambitious with some TOCs already investing heavily. However there were limited funds available for infrastructure and some of that had already been committed for future periods. The board agreed that part of ORR's role would be to ensure transparency on the financial questions as the new arrangements developed.
18. The board agreed that the two days had been very helpful in coalescing issues and in adding to their knowledge. They agreed to repeat the exercise in other regions in due course.

ITEM 7 TRANSPORT LANDSCAPE 2024

- 19. Joanna Whittington introduced the paper which built on discussions among the board about planning for ORR to respond to the shifting wider environment.
- 20. External changes that were likely to have particular significance for ORR were regional and route devolution, moves towards the digital railway (including cyber security implications), and passenger growth. JW suggested that external views of ORR might increasingly fail to distinguish between our rail and road responsibilities. We needed to work actively and engage to promote a joined up approach to both transport modes and behave in a demonstrably coherent way across the two networks.
- 21. The board discussed the paper and areas for further development. These included the articulation of an underpinning framework of regulatory principles to support ORR's decision makers and enable swift, consistent and reasonable decisions in a 'mixed economy' of funders.
- 22. It was noted that major projects could take many years to deliver and run across funding periods which meant that the risk of loss of corporate knowledge during delivery should be actively managed.
- 23. The board noted that the paper could also have referenced government pressure on regulators.
- 24. JW would produce a note setting out staged outputs from this work stream with a timetable. **[Action: JW]**

ITEM 8 NR MIP⁹ LETTER 2015/16

25. Graham Richards introduced the paper. The board agreed to issue a letter along the lines proposed this year to be agreed by the chair and chief executive. The board would consider later the need for such a letter in future years. It was noted that a similar process was being applied to HE (through a letter to advise the DfT) and that letter would come to the May board for consideration. It might be useful in future to use a similar mechanism following route devolution.
26. Members were asked to make any detailed comments in email after the meeting.

Bob Holland left the meeting

ITEM 9 DETERMINATION OF EAST COAST MAIN LINE (ECML) APPLICATIONS

Rob Plaskitt, Liz Thornhill, Chris Hemsley, Emily Bulman joined the meeting

27. John Larkinson introduced the paper, which was the executive's final assessment of several longstanding applications. The Chair thanked the team for a very helpful paper which would enable the board to work through the issues in a methodical way.
28. John said that board members were given an opportunity to ask questions in advance, which some of them had done, and he would refer to these as the issues arose in the discussion.
29. Since dispatch of the Board paper and annexes, the team had circulated to members two letters received in the last few days from VTEC and one from the Secretary of State as funder. John summarised all the other last minute representations, which were not judged to add any new information.

Paragraphs 30 and 31 have been redacted as covered by Legal Professional Privilege

32. The board considered the statutory framework which applied to these applications. In respect of the Secretary of State's guidance that we should consult him before determining applications that might impact the funds available to him, the extensive contact the team had had with DfT officials during this process met that requirement.
33. In respect of the duty to consider future users of the railway, the board discussed emerging plans for service improvements being considered by others including TPE's franchise requirement to extend a Liverpool – Newcastle service to Edinburgh and Scottish government's desire to increase local services including, potentially, to two new stations. If the board chose to approve access rights for all the available capacity on the ECML there might or might not be space for these developments later. However, the board

⁹ Management incentive plan

needed to take decisions on the information and applications before it today; each on its own merits. The board did not consider it appropriate to include either proposal in this process because ORR had not formally received applications.

34. The board agreed it was clear about the statutory framework that applied to these access decisions.

35. The board noted that the additional proposed VTEC services were mostly in the off-peak but with some on the shoulder. The rights sought were all for up to ten years (though with different start dates).

36. The board agreed it was clear about the applications before it and the main issues relevant to the cases.

37. The board discussed questions around capacity and our request for further information from DfT about the implications for the connectivity fund. However, DfT had not provided any further information that allowed us to understand the strength of the business case for the fund or details of how the business case might be affected by our decision.

38. The board was content with the analysis of capacity offered, noting the related uncertainties, and agreed to allocate capacity on the basis of NR's current plans taking no account of DfT's comments on the connectivity fund.

39. The board discussed issues around future performance risk. They noted that future performance targets and timetabling would reflect any new rights approved. The team's assessment was that an average of 7.5 paths an hour could be allocated without unacceptable impacts given Network Rail's infrastructure plans, but 8 paths an hour could put freight performance and connectivity at risk. The board noted the assumption that all applicants were equally capable of using capacity effectively.

40. The board agreed to note the uncertainty about future performance risks and to allocate up to around 7.5 paths an hour out of Kings Cross.

41. The board noted no concerns about the operational feasibility of the applications.

42. The board discussed the way that comparisons between applications depended on modelling to show them in a consistent framework. The board noted that the analysis included user and non-user benefits including those from lower fares. The analysis was also broadly in line with industry models, although it was not identical to DfT's preferred methodology as used by its consultants, SDG. The board discussed these differences which included the treatment of the IEP rolling stock order. They discussed the difficulty in predicting the extent of competitive response, although they agreed that there would be some competitive response.

43. The board agreed that the approach taken was based on reasonable modelling choices. The methodology used by our consultants was well-established in the industry, had been consulted on extensively and the final report had undergone independent audit.

44. The board discussed how the models represented demand, the speed of services, any competitive response and fare levels. The team noted that the

results were sensitive to underlying assumptions and should be taken as indicative rather than absolute.

45. **The board agreed that the CH2M results were a key source of evidence about the costs and benefits of the applications (noting the importance of modelling uncertainty, the use of sensitivities, the potential for non-modelled factors and differences to the DfT's approach).**
46. **The board agreed the options offered for decision with their variations were appropriate.**

Lunch break

47. **The board agreed the recommendation to reject the Alliance Edinburgh application as its costs were likely to exceed its benefits and the benefits were low relative to alternatives.**
48. The board discussed the benefits that the Alliance Cleethorpes/West Yorkshire services could bring to passengers with no direct rail travel options to London and more widely. The board had seen the positive impact of similar open access initiatives in other areas. The team reported that Alliance had said a Cleethorpes service was not viable on its own. The overall level of abstraction and the impact on the Secretary of State's funds made the option unattractive, even with a slightly reduced service frequency.
49. **The board rejected the Alliance Cleethorpes/West Yorkshire option due to the impact of the high absolute level of abstraction on the Secretary of State's funds, and the impacts relative to alternatives.**
50. The team explained that there was a strong presumption in ORR's policy in favour of extending rights which were already in use by the franchisee. The VTEC core option included such rights plus an additional hourly path to Edinburgh, thus expanding the franchise while potentially reducing the scope for additional open access services. The value of the additional path could be identified in Option 3. The applicant was also seeking to maximise use of the IEP rolling stock the Government had bought.
51. The board discussed the modelled impact on Grand Central's published operating profit. The team explained the figures produced were based on reasonably conservative assumptions about future cost and revenue growth. Moreover, the model did not include any competitive response by Grand Central to the new VTEC services, but it would be reasonable to assume there would be some response. The figures therefore showed a greater impact than was likely in practice.
52. The board discussed the treatment of sunk rolling stock costs and noted the risk that they might in some cases create perverse incentives to commit costs too early, with a knock-on effect on competition. Given the decision below, the treatment of these costs was not relevant in this case, but the board would look at each future case on its merits.
53. **The board approved the VTEC core proposal given the evidence of strong net benefits and its judgement that it was unlikely Grand Central would be forced to withdraw services to any significant extent as a result.**
54. **The board approved the VTEC extensions to Bradford, Lincoln and Harrogate on the basis of the evidence of net benefits.** The modelled

- incremental impact of this approval on Grand Central was noted; the board again judged it unlikely Grand Central would be forced to withdraw services to a significant extent as a result.
55. **The board approved the VTEC Middlesbrough proposal on the basis of small but positive net benefits and the potential for additional benefits in the form of reduced crowding.** The incremental impact of this service on Grand Central was noted and again the board judged it unlikely Grand Central would be forced to withdraw services to a significant extent as a result.
 56. The board reviewed the cumulative impact of these three decisions on Grand Central. Overall the board was satisfied it was unlikely Grand Central would be forced to withdraw services to any significant extent as a result.
 57. The board discussed the applications from FirstGroup for 5/day off-peak return service between London and Edinburgh.
 58. In discussing this application, the board noted the Secretary of State's indication that he was intending to legislate as soon as possible to enable a PSO levy to be imposed on open access operators. This mechanism would in principle then be available to the Secretary of State to mitigate the impact on his funds. However, we could not say for sure if legislation would be enacted or the extent to which it would mitigate the impacts so we did not take this possibility into account when reaching our decision.
 59. ORR had also indicated that the structure of NR's charges might change for PR18 and that one change might be to require open access operators to make a greater contribution to the costs of the network.
 60. These public statements meant that the risk of changes in charging were clear to the applicant and the wider industry.
 61. The service was on a route which was already well served but the single-class, low-cost offer had innovative aspects, a new operator on the route would give passengers more choice and could lead to competition on the quality of service as well as price. There were also benefits for passengers through new rolling stock, though this applied to all the applications.
 62. The board discussed the risk that the capacity, if approved, would not be used promptly and how that might be mitigated. Times by which rolling stock should be ordered could be contractualised, as in other cases. However, it would not be simple to specify pricing in any award of rights and a price promise could be hard to enforce.
 63. The board discussed the likely abstraction from the current franchisee, VTEC. The board's decisions to approve VTEC rights would impact other operators, notably Grand Central. The scale of abstraction here was not disproportionate to those impacts but it might prove significant in the final years of the franchise. However, some competitive response by VTEC was likely which could reduce the modelled abstraction. The board also noted the abstraction figures for FirstGroup services had been calculated against a base assuming VTEC secured all of its additional services, i.e. had been calculated in a less advantageous way than the Alliance applications.
 64. The board acknowledged the additional pressure that FirstGroup's services would put on the franchisee's margins and discussed the overall profitability of the franchise. It was not possible to gauge how significant a part this decision

might play in the overall business's viability compared to other financial risks. The possibility of open access was known to the franchisee when it prepared its bid. From a broader perspective, a decision to approve might lead to reduced margins being offered in future franchise competitions – or additional protection being sought against regulatory decisions.

65. The board noted that the approval of one hourly additional path to VTEC would help protect the Secretary of State's funding position. ORR's duties in favour of competition, promoting the use of the network, promoting railway service performance and protecting passenger interests all pointed in favour of approving this new service by FirstGroup and needed to be balanced against the impact on the Secretary of State's funds.
66. The board also reviewed its earlier discussion about capacity. This application was for off-peak paths, but would add to the overall pressure on capacity.
67. **The board agreed to approve the application from FirstGroup. The team was asked to ensure as far as possible that the applicant actively pursued setting up the new services at a reasonable pace.**
68. **The board instructed that the decision letter should make clear that no operator should take comfort from our decisions in respect of future reform to the structure of charges.**
69. The board reviewed the overall package of the rights approved during the discussion and agreed that they represented the best achievable balance of ORR's statutory duties.
70. The rights would all be firm from May 2021 with some contingent rights granted for certain services able to start in advance of that date.
71. The board noted that this decision was being treated as market sensitive and agreed the line to take in the event of enquiries. The process of drafting decision letters could take some time.

Paragraph 72 has been redacted as covered by Legal Professional Privilege

ITEM 10 ANY OTHER BUSINESS

73. The board noted the items below the line.
74. There was no other business.

Meeting closed 2.30pm