Efficiency, delivery and growth

ORR's draft determination for Network Rail

Richard Price
Chief Executive, Office of Rail Regulation,[1]
Rail Strategies Live, London, 27 June 2013

Two weeks ago, we published our draft determination for Network Rail[2], setting out the conclusions of our Periodic Review for Network Rail's deliverables and its financial framework in the five years to 2019-20.

The context of our Periodic Review

Our framework for the next five years builds on the success of the railway over the last decade, and puts customers and taxpayers firmly at the centre of the development of the railway.

The Periodic Review comes at an important moment for the railway as it is faces the challenges of raising standards for customers, improving efficiency, and continuing to grow. Growing demand is a nice problem to have, but the pressures of growth - which are showing up in variable punctuality and more crowded trains - need to be addressed.

This determination helps to put Britain's rail network onto a more sustainable basis. It makes a big contribution to addressing the legacy of decades of under-investment throughout the post-war period in renewing the system's earthworks, tunnels and bridges. It also equips the network to meet remarkable growth in demand from passengers and freight, as well as rising customer expectations.

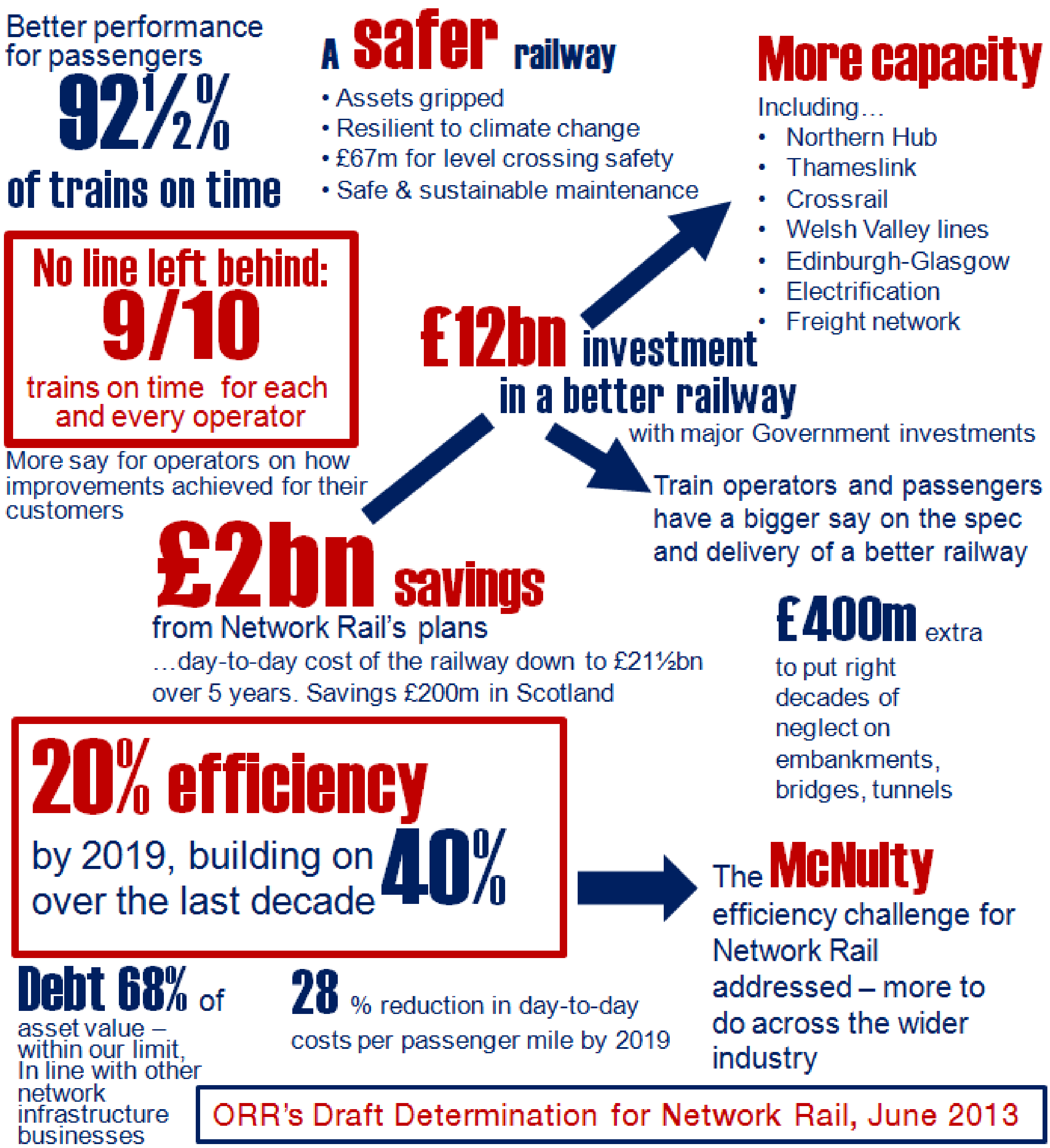
---

[1] Office of Rail Regulation, 1 Kemble Street, London, WC2B 4AN.
www.rail-reg.gov.uk

[2] Office of Rail Regulation: Periodic Review 2013: Draft determination of Network Rail's outputs and funding for 2014-19 (June 2013).
See www.rail-reg.gov.uk/pr13 for our briefing on and guides to the Periodic Review; as well as links to all of the documents and supporting evidence.

It challenges Network Rail to achieve excellence in its asset management; and to manage changes in the way the railway is maintained to make sure it is safe and that improvements in both cost and quality can be sustained. It encourages Network Rail to work more closely with its customers and suppliers to raise the efficiency and performance of the rail industry as a whole.

Figure 1: ORR's Draft Determination, on a page



It meets the demands of the next five years, and in doing so prepares for the following decades, which will see even more change as innovation transforms the way the network is managed and maintained.

So this Periodic Review sits in the context of an industry which has achieved a lot over the last decade. Rail is a success story. On an increasingly complex and busy network passenger numbers are up by nearly 50 per cent in the last decade; in challenging times with the macroeconomic situation, freight on rail is growing; passenger satisfaction is at record levels; 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. By March 2014, Network Rail should have improved its efficiency by around 40 per cent since April 2004.

In order to sustain this progress and to retain the support and confidence of funders and customers, the industry must continue to improve. It needs to raise efficiency, and get more out of the existing capacity on the network. It needs to keep improving customer satisfaction by meeting the rising expectations of passengers. It needs to improve the reliability of the assets, including their resilience to climate change, and enhance the network in a more cost effective way. And businesses across the industry need to work together in a more commercial way.

All of this is necessary if expansion to meet growing demand is to be financed and delivered in a way which is sustainable.

A balanced and affordable package

Firstly, our review had to establish whether the deliverables the Governments in London and Edinburgh have said they want from the industry are affordable within the funds they have said they will make available. Our analysis shows that they are.

So this is a balanced package - the settlement should be considered and judged as a whole – our view is that this determination is challenging but achievable for Network Rail in terms of efficiency, value for money and deliverability It sets Network Rail and the wider industry up to succeed.

Deliverables: better punctuality, extra capacity, a better customer experience

The starting point for the package is the outputs that we are requiring the company to deliver.

We are reaffirming the targets the Governments set in their High-Level Output Statements of 92.5 per cent punctuality and reliability by 2019-20 as measured by the public performance measure (PPM). You will have heard me talking about unacceptable variations in performance, with some passengers getting a great service, but on some lines too often being let down. So we are proposing to set a floor target: for each and every train operator, Network Rail must make sure that nine out of ten trains run on time by the end of the period.

We will expect Network Rail to work more closely with train operators to establish how these targets should be achieved in the best interests of passengers.

On *enhancements and improvement funds*, there is a huge investment, backed by the governments in London and Edinburgh, as well as the Welsh Government and other funders, amounting to £12 billion across Britain in the next five years. This reflects the Governments' confidence in and commitment to rail.

There is a long list of projects to be delivered – helping among other things to accommodate the 14 per cent growth in passenger journeys expected by 2019; allowing longer and more frequent trains to address existing overcrowding; and improving journey times.

The electrification programme will continue apace, improving both capacity and journey times. This will include the Trans-Pennine York to Manchester route, routes in the north west of England, the Edinburgh to Glasgow Improvement Programme, the Midland Main Line, the Great Western Main Line, and South Wales including the valleys lines. The Electric Spine from the South Coast to Yorkshire will pave the way for much greater take-up of electric traction for freight in the future – a key part of reducing the railway's carbon impact.

In Scotland, you should expect to see faster journey times and longer trains between Glasgow and Edinburgh; improvements and new stations between Inverness and Aberdeen, completion of the Borders Railway; and faster and more frequent services on the Highland Main Line, including better freight connections.

In London and the south east of England, customers will benefit from more trains, less congestion and better journey times through the major investments in both Thameslink and Crossrail.

Elsewhere, you will see improvements in the north east of England on the East Coast Main Line. The Northern Hub will transform travel into and between the

Northern cities; while in cities like London, Birmingham, Nottingham and Leeds, upgrades and platform extensions will create enough capacity for 140,000 passengers at peak times. And we will see the completion of station improvements including those at Reading, Birmingham New Street, Derby, London Waterloo and Bristol Temple Meads.

In delivering this major programme across the network, we want to see the industry working together and consulting its customers. So we're introducing a new approach for enhancements at an early stage of specification – about two-thirds of the total £12 billion enhancement programme – so that train companies have a bigger role in the specification and delivery of the railway on behalf of passengers. Passenger groups will also be part of the decision-making for use of improvement funds – for example the funds for station enhancements (including £100m for disability access in England & Wales, £30m in Scotland); and the passenger journey time fund for England & Wales, £300m

Freight will also benefit, with £200m being invested in the Strategic Freight Network in England & Wales, and a further £30m in Scotland.

Delivering the outputs

Safety improvements will continue to be a priority and extra funding has been approved in certain safety critical areas including civil renewals. We have protected Network Rail's maintenance budgets in the early years of the new Control Period so the company has time to make further sustained efficiency savings. This will mean that that the delivery of efficiencies can be based on sound change management so that new practices are both safe and sustainable

We have also looked carefully at Network Rail's record on *delivery of its outputs*. We have developed a determination which allows tighter scrutiny of some things – particularly asset management – but also takes a more flexible approach on capital programmes so that they can be specified and delivered by Network Rail to give the best value for money for taxpayers and consumers. The determination gives Network Rail more flexibility to make sure it can implement sound change management in its maintenance functions. Network Rail will also have every reason to improve its management of network capacity, with incentives to supply more to train operators where it is sensible to do so.

Our determination also challenges Network Rail to achieve excellence in its *asset management*. We will strengthen the regulation of Network Rail's asset management. As Network Rail gets a clearer sense of the condition of its bridges, embankments, cuttings and tunnels, we will release more money to allow it to focus work where it is most needed, and gives the best value in reducing overall risk, a major step towards addressing half a century of underinvestment in civil structures, and making them resilient to more extreme weather events as the climate changes.

For the first time, ORR is setting enforceable targets for asset knowledge and asset management to underpin the progress we expect Network Rail to make through the period, and we expect that this will contribute to greater resilience and punctuality across the network, and as the company uses better asset information to plan ahead proactively, greater scope for more efficient maintenance and renewals.

Efficiency and value for money

Our detailed analysis shows that Network Rail can deliver its outputs in CP5 for £2bn less than it proposed in January in its own submission to the Periodic Review (the Strategic Business Plans[3]), including £200m in Scotland. We find that Network Rail has the opportunity to improve its efficiency by 20 per cent over the next five years. Allowing for expected usage growth, this is a 28 per cent improvement in the Network Rail's day-to-day costs per passenger mile.

Through our last two Periodic Reviews, over the last decade, Network Rail has improved its efficiency by around 40 per cent in the previous decade. So this further challenge is stretching for the company: many of the low-hanging fruit have gone, and they will need to achieve it through a period of more intensive investment on the network.

You will remember the findings of the McNulty review two years ago, which we co-sponsored with the Department for Transport. In this Periodic Review we been able to establish and draw on a much deeper and robust base of studies, with newer evidence and analysis, than was available to the McNulty study. We have looked at Network Rail's costs and benchmarked them in a detailed, disaggregated way, activity-by-activity. The analysis we have drawn on is a detailed and high-quality body of work. Our review sets a strong efficiency challenge and our plans for enhancements efficiency develop this challenge further. Taking all this into account we believe that the efficiency challenge identified by the McNulty study for Network Rail itself will have been

[3] Network Rail: Strategic Business Plan for England and Wales 2014-19 (CP5); and Strategic Business Plan for Scotland 2014-19 (CP5) (January 2013)

fully addressed by 2019-20, though there is more to do across the wider industry.

So what is the impact of the review on the industry and its customers?

The impacts of this determination

Firstly, passengers will benefit from increases in capacity through a major programme of enhancements, from high standards of punctuality across all routes, and improvements at stations; and more say in what is delivered and how.

We want Network Rail's delivery to be more commercially responsive to the needs of its customers. So we are giving train operators, as the businesses closest to passengers, more say in how the end-period punctuality targets are met, including the PPM trajectory they want through the period. Train operators will also have more say in the specification and effectiveness of enhancement projects and over how punctuality is delivered.

Freight will see further investment in infrastructure across Great Britain, with £230m ring-fenced for freight specific schemes: there will be a continued focus on improving the provision of infrastructure services for the freight sector.

Rail freight is important to us because it beings significant environmental and economic benefits to Britain. As with other charges, we want to see the price operators pay for access to the network to be a better reflection of the costs they impose on the infrastructure. At the moment, freight imposes £280m of costs on the network, and pays less than a third of that, with taxpayers, Network Rail and other network users making up the difference.

We have listened carefully to what freight operators and customers have told us in response to what we consulted on. Charges will go up but charges framework in this draft determination is nothing like some of the numbers being discussed around the industry a few months ago. Charges will rise by – on average – 4 per cent a year across the five-year control period as a whole, but with no increase in the first two years so businesses have time to plan ahead. There will be no freight-specific charge for biomass in the new control period.

Taxpayers will see the railway grow in a more cost effective, transparent and sustainable way, with £2bn of savings identified

The supply chain will benefit from the large capital programme, including the increased volumes, and on the back of that, the opportunity to forge better, more innovative relationships with Network Rail and the rest of the industry. I am also pleased to see the work that Network Rail has done to signal purchasing volumes ahead, and to avoid the hiatus we saw between CP3 and CP4.

The long-term, and next steps

We are also looking to the longer term. This Periodic Review sets out what we expect Network Rail to achieve in the next five years, but rail is a long-term industry, with decisions and investments made now having effects which last decades. We will shortly publish our Long-Term Regulatory Statement which sets PR13 in that longer-term context, and looks at regulatory choices for the future. Among other things it will consider

- The industry's longer-term financial sustainability: Network Rail's debt rises in this five-year period in a way which is sustainable; but if further substantial investment is needed in the following periods, how could that be financed?
- The further alignment of incentives to deliver greater value for money by ensuring commercial collaboration across the industry;
- how passenger and freight train operators are exposed to changes in Network Rail's charges, so that they have incentives to use capacity efficiently and reduce the costs they impose on the infrastructure; and
- how government funding flows through the industry.

The Long-Term Regulatory Statement will set out the issues and choices in each area, where we believe a wider debate is needed over how the railway can be set up to succeed on a sustainable basis in the longer term.

On the next steps for our review: this is draft determination. That means that Network Rail – and all of you – have the opportunity to comment to us on it between now and 4 September. In October we publish our final determination, and Network Rail has to decide then whether to accept what we put on the table. There is a huge amount of work to do to implement this review, including a lot of work by Network Rail itself in producing its delivery plan before the start of the new Control Period in April 2014.

Conclusion

To conclude, I would like to thank everyone who has contributed to the work and thinking that has gone into this periodic review. It isn't over yet – please contribute to the consultation.

I want to recognise the work that the industry, rail users and Network Rail itself has put in – including from Network Rail a very positive response to the McNulty Review, which meant that they came into this Periodic Review with a very firm commitment to improving efficiency which I welcome.

This review does good things for the railway, and its customers; and it sets Network Rail and the industry as a whole to succeed. It addresses the pressures of growth, and also the resilience of the existing network.

It makes a demanding but realistic challenge on efficiency. It sets demanding targets for punctuality on every route across the country, so passengers get the reliable service they expect. With the strong support of the Governments, it funds investment in growth not seen since at least the early part of the last century. It drives better asset knowledge and management and puts sustainable asset management at the heart of a vision for a future railway with is more efficient, more sustainable, and delivering even better for its customers. It's a massive opportunity for the industry and the people it serves.

Richard Price
Chief Executive
Office of Rail Regulation
June 2013