SHAW REVIEW OF NETWORK RAIL'S FUTURE SHAPE AND FINANCING

PA RESPONSE TO CONSULTATION

We have read with interest the scoping document of November 2015 and in responding we have focussed on a small number of questions where we believe we can offer greatest value.

General perspective

Throughout 2015 there has been a great deal of commentary on the virtues of separating Network Rail into its component parts and creating separate route based companies. We believe that the high level of fragmentation within the industry is already problematic and any rapid movement in this direction would be misguided because of the risk to an integrated railway. In short, although Network Rail, and other industry bodies, have been fulfilling system authority and system operator roles since their inception, these processes are not fully mature. Moreover, it is only recently that the system authority and operator roles have been recognised by Network Rail's own internal structure – through the creation of the Technical Authority and the Network Strategy & Planning (System Operator) directorates. In our view, this lack of maturity would make it difficult to introduce independent route-based companies without risking performance across the railway, whilst the quantum of change involved would divert management effort from making more important changes. Our following points are therefore based on the assumption that Network Rail will continue as one industry body.

Question 8: Is there a case for changing the route structure and what are the advantages and disadvantages of different approaches to disaggregating the network?

The current route structure in England and Wales takes a very London centric view which we believe makes it hard for Network Rail to respond adequately to political agendas such as the Northern Powerhouse and Midlands Engine.

A further challenge facing Network Rail is the range of services run on the same network. Other European railways have a more segregated approach. Britain could move in this direction with HS2 running parallel to the existing railway. However the existing network remains a challenge both in terms of funding and performance frameworks.

Transparency of funding

- Disaggregating the network (which would include HS2 for this purpose) by services, such as intercity (either in additional to or including high speed), commuter and rural would create far greater transparency of funding.
  - Presumably intercity would be proven to be profitable but requiring substantial infrastructure and more expensive maintenance due to the significant geographies. Investment in intercity could be economically driven through business charges and risk capital
  - Similarly most commuter routes would be profitable, perhaps highly profitable, due to the intensive use of their network. Investment could in the future be funded by regional transport organisations and local governments, who would benefit directly from the enhancements

- Rural lines will often be visibly loss making and the subsidies provided by the government would be better understood and decision making could be more strategic as a result.

Performance regimes

- Better performance regimes could be developed too:
  - Intercity lines would remain focussed on keeping to timetables, and avoiding cancellations
  - Commuter lines would be concerned with regularity of service, as with the London Underground – whether or not your specific train was on time is irrelevant as long as a suitable train arrived at about the same time
  - Rural lines would seek to prevent cancellations and significant delays, but minor delays would be tolerated more than on other parts of the network, if it kept the railway at an affordable level.

Question 11: What processes and capabilities need to be in place to support Network Rail's current devolved structure?

In addition to the Technical Authority and System Operator central functions, the Infrastructure Projects, Digital Railway and Route Services directorates also need to strengthen capabilities in key respects.

Technical Authority and System Operator

- Network Rail needs to clarify its contribution to system operation and acting as the Network Authority. These roles are at present undertaken by various industry bodies but a large part of both currently sits with Network Rail. Where they have been fulfilled they have sometimes lacked the correct emphasis and decision making has suffered. For example, if Network Rail's role is to balance trade-offs between increasing network capacity, with performance and financial impacts, it has struggled to do so. Arguably, when it has tried, it has not adequately been supported by external stakeholders
- The regime for charges and incentives is overly complex and poorly understood. An example involves the additional funding Network Rail receives to reflect TOCs using the capacity of the network more intensively. The funding is aimed to protect performance levels. However, it is unclear that this money is always used as intended.

Infrastructure Projects

- As referenced in the consultation document, Network Rail needs strong capabilities in supply chain management given the degree of outsourcing used in the delivery of capital projects.

Digital Railway

- We believe that Network Rail needs a more sophisticated systems engineering approach in designing and delivering complex system-wide initiatives. This capability would be particularly valuable for the Digital Railway programme.

Route Services

- Network Rail's centre needs to simplify and clarify the services it provides to routes (and the service standards they can expect). This will allow for a stronger 'supplier-customer' type relationship that will drive efficiencies and ensure that services add substantial value to the routes.

Question 22: How should financial risk be managed in Britain's rail infrastructure in the future?

Financial risk in the industry has been defined by two dominant features for a number of years. Firstly, prior to its reclassification as a public body, Network Rail debt was backed by government guarantee and following reclassification this has of course become axiomatic. Secondly, franchise agreements have protected operators financially – with little or no exposure to Network Rail efficiencies or inefficiencies (and, notwithstanding the Wessex experience, limited incentives to work together for mutual benefit).

Government guarantee

- While government guarantees provide stability, particularly during dips in financial markets, the introduction of risk capital and the corresponding external pressures may provide an additional stimulus to use resources effectively. For example, one of the greatest success stories for Network Rail is performance (including punctuality and passenger flow) during the London Olympics of 2012. The external pressure and resulting focus this brought should not be underestimated

Franchise agreements

- Presently the franchise agreements are weighted in favour of the TOCS, in terms of financial risk, a suitable risk sharing mechanism between Network Rail and the operators would drive better industry wide behaviours
- We suspect that Network Rail has realised most of the efficiencies it can without needing greater operator involvement (though further analysis is needed).
- Regardless of this, franchise agreements should encourage collaboration without transferring an untenable level of risk and corresponding expectation of return on investments to the franchise organisations or their investors.

Question 23: Do you have any views on how Britain's railway infrastructure should be funded in the future, regardless of corporate structure?

Current funding arrangements lack transparency. For example, it is not clear whether the taxpayer is subsiding operator profits on lines which have overcapacity or rural services connecting economies that would not otherwise exist. Nor is it clear whether they are paying for future improvements in capacity or underwriting today's services. Having a set of simpler, more comprehensible, funding mechanisms will make the cost of running the railway more palatable to the public and open to accurate external scrutiny.

The tension between providing long term funding stability to support long term projects and retaining flexibility to adapt to changing requirements also creates challenges.

Transparency

- Disaggregating Network Rail by service type rather than physical geography would allow for a greater range of financing mechanisms and transparency for investors (including taxpayers) in which parts of the network they are funding.

Stability and long term planning

- Regardless of corporate structure, Network Rail should be funded in a way which improves transparency, and provides sufficient stability for schemes to be properly implemented. An example of this is the Network Operating Strategy, which now forms a significant part of the Digital Railway programme. The component of this that involved migrating from thousands of smaller signal boxes to a small number of signalling centres was often delayed as the 5 year business case was not acceptable, even though the long term business case was very strong
- In our view, enhancement funding should not form part of the periodic review process. It should in our view be a portfolio which is managed on an on-going basis, with schemes removed or paused based on changing requirements.