Rail Delivery Group

The Shaw Report
Zone 6.03
Sanctuary Buildings
Great Smith Street
London
SW1P 3BT

24 December 2015

Dear Nicola

THE FUTURE SHAPE AND FINANCING OF NETWORK RAIL

Following my letter to you of 02 December 2015, I am pleased to attach the RDG response to the specific questions you raised in the scoping report.

Your questions rightly address the challenges and opportunities facing our industry and provide a holistic description of the key issues. There remains strong support for the changes proposed by Network Rail and the flexibility which allows for further evolution. However, there is a broad range of views within the RDG about the appropriate pace and extent of any further changes.

I have attached two appendices for ease of reference – the overarching RDG submission dated 02 December 2015 and the RDG Freight Group submission dated 21 December 2015.

As mentioned in my previous letter, RDG is very keen to work with you in the next stages of your review.

Yours sincerely

Paul Plummer
Chief Executive, ATOC
Chief Executive, Rail Delivery Group

This page is intentionally left blank

Rail Delivery Group

Response to:

The Shaw Report

The Future Shape and Financing of Network Rail

Date: 24 December 2015

www.raildeliverygroup.com
Rail Delivery Group Limited | Registered Office: 2nd Floor, 200 Aldersgate Street, London, EC1A 4HD | 020 7841 8000
Registered in England and Wales, No. 08176197

Rail Delivery Group response to The Shaw Report: The Future Shape and Financing of Network Rail

Name: RDG
Organisation: Rail Delivery Group
Address: 200 Aldersgate Street, London EC1A 4HD

Business representative organisation

Introduction: The Rail Delivery Group (RDG) was established in May 2011 to lead the industry in delivering a higher performing, more cost effective and sustainable rail network for Britain's rail users and taxpayers.

The RDG brings together the chief executives of passenger and freight operator owning groups with Network Rail. RDG develops policies, strategies and plans for the coherent management of the rail industry and advances the provision of a safe, efficient, high quality rail service for users and taxpayers.

The RDG mission is to promote greater co-operation between train operators (passenger and freight) and Network Rail through leadership in the industry and by working together with Government, the supply chain and stakeholders.

It is committed equally to the long-term health of the railway as well as the need to see improvement in the shorter term.

It does this by developing strategies for the industry to put into practice and by proposing solutions for policy makers to implement.

Introduction

The Rail Delivery Group (RDG) is pleased to respond to the questions raised in the report on 'The Future Shape and Financing of Network Rail'. This should be read alongside the overarching RDG submission (dated 02 December 2015 and attached as an appendix to this document). There is strong support within RDG for the changes proposed by Network Rail and the flexibility which this allows for further evolution. However, there is a broad range of views within the RDG about the appropriate pace and extent of further changes. The RDG is very keen to contribute to the next stages of this review so that this can lead to an even better railway which is focused clearly on the needs of rail users, and the economy.

Q1 and Q2
What are your views on the scope of Network Rail's functions?
Have we failed to mention any specific or important factors?

The rail industry is a success story and RDG recognises this success as well as the challenges and opportunities presented by growth and the devolution agenda. In the light of this, RDG is focusing its work on the following five portfolios:

- Enabling continuous improvement in today's railway
- Transforming the customer experience of the railway
- Industry reform to enable excellence in the railway
- Planning tomorrow's railway
- Communications and engagement

One possible omission from the list in the report is consideration of how RDG can support improvements in the railway and to bring the industry together with government, the supply chain and other stakeholders.

Q3
What are your views on these accountability arrangements and their effectiveness?

As explained in the overarching RDG submission dated 02 December 2015, RDG members are in broad agreement that there are steps that Network Rail can take to strengthen its relationships with customers and that this ought to be a key area of focus in the work that the Shaw review team are carrying out (see Q5 and Q6 below).

Network Rail is one part of an extremely successful commercial industry. While there can legitimately be differences of views about whether the owner of essential infrastructure should sit within the public or private sectors, it is very difficult to conceive of an argument that Network Rail ought to be a central government body as opposed to a public corporation, as the much more familiar structure for commercial businesses that the government opts to keep in public ownership.

As a matter of some priority, RDG members consider that the review team should be assessing the steps that need to be taken to move Network Rail to the more logical public corporation classification. This would free the company from some of the constraints that it faces under public spending rules and create an opportunity to look again at the breadth of the controls that Network Rail faces under the terms of the Framework Agreement with the DfT. It might also pave the way for a transfer of responsibility for managing Network Rail as owner from the DfT to the Shareholder Executive, thereby bringing about a helpful separation of the role of government owner (to be taken on by the Shareholder Executive) and the role of government policy maker and funder (which can continue to be performed by the DfT).

Changes within Network Rail, as well as the rest of the industry, government and ORR should enable NR Routes to become businesses which are clearly accountable to their customers, clients and stakeholders whilst retaining the benefits of a national network with operators that cross Route boundaries.

Network Rail's accountabilities to ORR are now the subject of a separate DfT review. RDG members will be providing input into this work early in the New Year. As things stand, it is certainly reasonable to ask whether ORR's role has been 'crowded out' by the greater oversight that the DfT is giving Network Rail now that it sits within central government. However, the position changes again if all or parts of Network Rail are to move back out of central government in the future, making it extremely important that the Shaw review team feed their emerging thoughts into the DfT's work as early as possible.

Perhaps the most notable feature of the description of accountabilities in the scoping document is how few entries there are for Network Rail's accountabilities to its customers. In most industries, the supplier-customer relationship would get far greater prominence, which reinforces the sense that priorities have become confused in the railway. A greater focus on TOC and FOC customers can help deliver more benefits to passengers, freight customers and taxpayers.

Q4
Have we correctly identified and defined Network Rail's customers?

We agree that Network Rail's primary customers are the train operators who pay Network Rail to use its infrastructure. Government funders are key stakeholders too, especially in respect of new enhancement projects, although their interactions with Network Rail may not necessarily take the form of a conventional customer-supplier relationship.

Network Rail should be clearly accountable to their customers, clients and stakeholders. Where possible, the ORR should focus on creating the conditions for the market or industry parties to meet the requirements of end users rather than acting as a direct proxy for these requirements.

Q5
How effectively are customer needs and expectations met by Network Rail at present?

This has been identified as an area in which there is room for improvement. Part of the motivation for the latest round of devolution within Network Rail is that local Route managers will be better able to listen to local customers, clients and stakeholders and respond to their needs. Network Rail would continue to be sighted on and guided by the needs of end-user customers, (passengers and freight users) but the industry owners of the relationship with the end-user is with the operators.

Q6
Should direct customer pressure on Network Rail be strengthened? If so, how might this be achieved?

Consistent with Network Rail's recent organisational changes, RDG members are expecting in the months ahead to see Routes nurture and bring the supplier-customer relationship much more to the fore in everything that they do. This will ideally mean that customer pressures come more clearly to bear on Network Rail's decision-making.

With resource and control transferring to the Routes, they will become more clearly accountable and have greater control to deliver the outputs. The success or failure of the Routes would be measured by their delivery of the outputs they have agreed with their customers (passenger and freight train operators), clients and stakeholders.

In order for customer pressure to have a meaningful impact on behaviours, it will be important that:

- Route managers use the autonomy that they are being given, including by seeking further decentralisation where this will be benefit customers;
- once the system operator and technical authority capabilities have been clearly established there should be no further ability to reshape a Route decision;
- train operator customers have basic information with which to compare the service that they are getting from their Route with the services that other Routes are providing to their customers; and
- Government and ORR leave room for the supplier-customer relationship to develop, rather than directing managers' attention to funders and the regulator as the stakeholders to whom Network Rail has primary accountability.

There ought in time to be reward for the Routes that show the greatest responsiveness to customers' requirements. This might be captured in the remuneration packages that managers receive or, if private capital is reintroduced, in the calibration of investor returns.

Q7
Are there more positive incentives for delivery which would be useful? Are any of these incentives more effective than others?

The incentives that currently impact on Network Rail's behaviours are almost all reputational in nature. There is a huge focus on cost and performance (PPM), but financial incentives and 'bottom line' business performance are given lesser importance, as trade-offs occur. This is perhaps partly a consequence of the absence of risk-bearing capital. It is clear however that reputation does suffer if Network Rail is not able to manage to budget.

Looking ahead, there will be opportunities for the Network Rail board, ORR and the DfT to sharpen reputational incentives as part and parcel of the devolution of responsibilities down to the Network Rail Routes. One of the key benefits of a more regional structure is that it becomes possible to compare the performance of businesses doing essentially the same job at the same time. It is well worth all parties thinking innovatively about how benchmarking and league tables can bring pressure to bear on local managers across the areas of efficiency improvement, operational performance, delivery of physical work programmes and customer satisfaction, drawing as much as possible on the successes that other sectors (e.g. energy and water) have had with comparative performance regimes.

Many RDG members are of the view that Network Rail's incentives to facilitate growth and otherwise advance the interests of its customers could be given particular attention as part of any new approach to incentives. As things stand, there is often a feeling that Network Rail has an overarching incentive to minimise the risk of failure, which can sometimes encourage a risk averse mentality. Train operators need a supplier that is as focused as they are on growth and improving the journey experience, which suggests that the quality of each Route's customer engagement and the outcomes achieved in terms of customer satisfaction should be elevated towards the top of new comparative performance measures.

Q8

Is there are a case for changing the route structure and what are the advantages and disadvantages of different approaches to disaggregating the network, for example on the basis of: physical, political or economic geographies; service type, e.g. commuter services, inter-city services and regional services?

The RDG is keen to engage with devolved bodies and understand the prioritisation and requirements of regions and devolved administrations whilst recognising the need to deliver these efficiently as a network. RDG members are not inclined towards a fundamental redesign of Network Rail's current Route structure. It may be that one can conceive of different regional groupings, however the disruption that a reorganisation would cause at a time when Network Rail is implementing some important changes in national vs Route responsibilities means that the costs of a reorganisation would most likely outweigh the benefits.

Q9 - 11

Does the current balance of responsibilities between the routes and the centre seem at the right level? Are there any further responsibilities that should be devolved or centralised?

Can you point to any specific economies of scale that should be protected at national rather than route level?

What processes and capabilities need to be put in place (at both the centre and route level) to support Network Rail's current devolved structure?

As set out in the overarching RDG submission dated 02 December 2015, the RDG members are strongly supportive of Network Rail's recent efforts to give its Routes greater control over the means of delivering outputs that are expected of them, as well as the flexibility that there is for further evolution. There is a broader range of views about the pace and extent of further change beyond the initial changes with some members much more concerned about potential unintended consequences.

Network Rail is proposing significant changes to the centre by distinguishing between the roles of System Operator, Technical Authority and Route Services. Because the railway is an integrated network which is run and used by a large number of different companies, it is naturally the case that there are a whole series of activities that go on in the industry which contribute to the effective and safe operation of the network as a single integrated system.

Going forward, there ought to be a unified, network-wide approach to timetable development, train planning, signalling rules, engineering access, incident management and certain aspects of planning. Routes would be expected to comply with standards, but these standards should be reduced to the minimum necessary so that Routes have increasing flexibility over how to deliver their required outputs and their bottom-line financial performance.

We have previously set out these views in our response to the ORR consultation on the 'system operator'.

It would be wrong, however, to think that Network Rail has sole responsibility for system operation. Elsewhere in the industry, important contributions come from the likes of RSSB, the National Task Force, RDG, the DfT and ORR. The Network Code also acts as a very effective umbrella for a whole series of processes which coordinate and regulate the actions of different parties.

In the context of the current debate about the future structure of Network Rail, it would concern many RDG members if the benefits of having an integrated, coordinated, national network were to be lost. Equally, it would be of just as much concern if there were to be a presumption that the importance of system operation points naturally towards there being a 'thick' national centre to Network Rail.

Insofar as some of the options that the Shaw review team may be considering involve separation of Network Rail, it is, of course, reasonable to ask exactly which of Network Rail's functions ought to be kept in a single, national organisation. However, it is worth bearing in mind that:

- most RDG members favour a 'thin' centre to maximise the benefits that come from having a multiplicity of ideas emerge from independently managed routes;
- there is no obvious reason why work that is currently undertaken by organisations other than Network Rail or under the Network Code should transfer across; and
- the Network Code, more generally, illustrates that system operation can take place through well-designed, multi-party processes and rules without necessarily creating a single organisation.

Further thoughts from RDG members may be found in the responses that the industry gave to the recent ORR consultation. The RDG response, in particular, sought to highlight that ORR requires a clearer problem definition if its work on system operation is to make a meaningful contribution to better industry outcomes. We make the same point here. Without a clear sense of the potential detriment we are seeking to avoid, there is a danger that the review might arrive at sub-optimal conclusions in this area.

Beyond the system operator functions, the extent of any economies of scale needs to be assessed on a case-by-case basis. In certain instances, it may be that there are cost savings if one organisation takes responsibility for activities on a nationwide basis. However, it can also be that multiple companies bring innovation and a multiplicity of ideas, which more than offset any potential diseconomies of scale. Further steps in devolution might therefore conceivably encompass asset policies, maintenance strategy, procurement and HR.

Q12-18
Drawing on your previous experiences, where relevant, what would be the potential impact on your organisation of further structural changes within Network Rail?

What are the strengths and weaknesses of Network Rail's current approach to planning enhancements?

What are the strengths and weaknesses of Network Rail's current approach to delivering enhancements?

How well do the current delivery and planning processes work for projects of different sizes?

Are there any useful models or precedents from other sectors or countries for long term infrastructure planning and delivery processes that we should consider, including in relation to management of and engagement with suppliers during the planning process?

What would be the most important structural features of any future infrastructure provider?

Are there any other processes which we have not highlighted, either within Network Rail or the wider industry, which could be improved?

RDG members recognise that the industry must play a leading role in coordinating long term planning to inform governments and devolved bodies about their decisions on the required outputs from the railway and to be confident that the resulting plans are deliverable and affordable.

The repositioning proposed by Network Rail of Investment Projects as a supplier to the Routes is welcomed by RDG. This change presents an opportunity for Routes and operators to adopt alternative delivery mechanisms for projects and where appropriate to introduce private capital into improvement programmes. Financing investment in this way and improved contestability has the potential to act as a driver of efficiency.

The RDG is establishing a 'task and finish' group to look at alternative delivery and financing arrangements, looking at case studies and lessons learned from previous attempts to bring third parties into enhancement schemes. We will be pleased to discuss this work with the review team.

Individual RDG members will have specific experiences in relation to the planning and delivery of enhancements.

Q19
Do you have any views on how the relationship between the periodic review process and other processes with which you are involved could be improved?

The recent Bowe report highlights that it will be important to deal better with enhancement projects at future reviews. We played an active role in the Penny Boys review of PR13 and identified how the process did set a challenging but acceptable funding and outputs framework with good opportunity for stakeholders to comment on emerging themes. (Note: part of that framework was a more flexible borrowing limit than was imposed by NR's reclassification. With that taken away, CP5 became significantly more challenging than was anticipated when NR accepted ORR's Final Determination.)

We also highlighted a need for issues to be closed out more effectively throughout the process, for decisions to be dealt with in a more holistic manner and for there to be greater regard to the Better Regulation principles of proportionality, accountability, consistency, transparency and targeting implementation.

Q20
What criteria should be used to assess structural options under consideration? How, if at all, should these criteria be prioritised?

RDG set out in our response to the CMA consultation on competition how any changes should be consistent with the objectives which the rail industry is seeking to achieve over the long term which are as follows:

- Deliver service quality and capacity requirements for passengers and freight;
- Fund investment, through a sustainable funding model;
- Maximise economic return from the industry as a whole;
- Promote dynamism and innovation;
- Encourage an aligned approach between different segments of the industry;

- Provide a stable and predictable environment for commercial businesses to enter and operate satisfactorily in the market; and
- Enable wider economic growth and regeneration.

These objectives are important when appraising and determining the appropriate operating framework for the industry.

In the RDG response to the Department of Business, Innovation and Skills consultation on the Government's strategic steer for the CMA we set out the value for consumers and taxpayers of early impact assessments, the need to adhere to Better Regulation principles, the requirement for an evidence-based approach and the importance of strong stakeholder engagement.

In this context, the RDG considers that the criteria to assess changes to the structural model options should be evaluated against the above industry objectives and against criteria which determine the extent to which any structure:

1. Meets customer needs
2. Promotes efficiency
3. Improves safety
4. Can be practically implemented (including timescales and transaction costs)
5. Delivers wider economic and societal benefits for funding investment in rail

Q21
Do you have any views on whether the RAB remains a relevant concept in the railway and, if not, what should replace it?

The RAB is a device which enables an economic regulator to signal to a company and its investors that customers/funders will pay in future years for expenditure that is being incurred today. Across the other regulated industries (aviation, energy, water), the evidence is that the regulatory 'promise' contained within RABs provides a very effective foundation for private-sector investment and has contributed to the very low costs of capital that one observes in these sectors.

In a railway context, there is a view that the Network Rail RAB has since 2001 come to be something fundamentally different from the RABs that are seen in other sectors. In particular, since Network Rail's debt has been backed by a guarantee from the DfT, the RAB has come to serve less as an underpinning of private-sector capital and more as a 'credit card' that has enabled funders to push payment for railway infrastructure back to later years (sometimes for logical reasons).

Looking ahead, the role of the RAB cannot be sensibly discussed without first being clear about the extent to which future railway investments will be financed by private capital. In the event that there is agreement that private capital should play a part, RAB-based regulation is very clearly one structure that can give potential investors confidence to make investments. (Note that this does not necessarily mean that the existing RAB should be rolled forward without adjustment; there would be an opportunity to 'right-size' the RAB (or RABs, in the event that there is some form of structural separation) to the specific amount(s) of capital that the government is seeking to obtain from outside investors.)

In the alternative, if infrastructure investment is financed wholly by government, policymakers would need to make it clear what the monetary value of the RAB (or RABs) represents and what it means if or when the value of a RAB increases or decreases.

Irrespective of whether a formal RAB continues or does not continue to exist, RDG members are agreed that the industry ought to have access to financing and funding mechanisms which enable the infrastructure provider to finance new investments in long-lived assets when customers (a) identify schemes that they wish to be taken forward and can demonstrate a strong benefit-cost ratio and (b) make clear their willingness to pay their fair share of the costs of the scheme over the life of the assets or the life of a franchise (if shorter). Such mechanisms existed prior to 2015, but have arguably been lost as Network Rail has hit up against government-imposed borrowing constraints.

Q22
How should financial risk be managed in Britain's rail infrastructure in the future?

It is in all railway stakeholders' interests that financial risks around infrastructure investments are contained to the maximum extent possible. Normally this will be achieved by allocating risk to the party that is best able to manage it. In practical terms, this would typically mean that:

- risks around OM&R expenditure are primarily the responsibility of the infrastructure manager, and should not "spill over" to customers and funders (whilst recognising that train operators can help to minimise these risks through collaborative working);
- planning and design risks in the early stages of enhancement projects fall on project sponsors (which may, according to the situation, be either be customers or government funders); and
- execution risk, once enhancement projects have an agreed scope and an agreed target cost, fall primarily on the firm that is tasked with delivering that work.

One of the weaknesses of the current structure is that Network Rail does not have any real ability to absorb financial risk. This means that cost overruns impact on either government (via demands for additional funding) or customers (via reduced outputs). Arguably, there needs to be a more explicit understanding up front about what steps are to be taken if risks materialise.

Insofar as the possibility of reintroducing private capital is being considered as part of the current review, RDG members consider that one of the key objectives should be to ensure that customers and clients are not in future so directly exposed to unforeseen cost escalation.

Q23
Do you have any views on how Britain's railway infrastructure should be funded in the future, regardless of corporate structure?

The two main sources of funding for the railway have historically been farebox revenues and taxpayer subsidy.

There may be scope in future to further exploit the opportunities that the industry has to generate non-farebox revenues from stations, properties and other Network Rail owned assets and/or from third parties that will benefit indirectly from new investment. This is happening already, but there should be opportunity to expand it further.

The Hendy report and the Shaw review scoping paper have also both highlighted asset sales as a possible source of additional funding. RDG members are in principle supportive of such sales, especially where acquiring parties are in a better position than Network Rail to extract value from assets (which one would expect to be reflected in sale prices). However, it is important to be careful to avoid sales which inject extra complexity or extra cost into the industry or which act inadvertently as a constraint on the future development of the railway, e.g. because they take away land which might otherwise be used for future expansion.

Even with new initiatives in the above areas, it will in the end still be necessary for the government to decide on the balance between fare increases and continuing taxpayer support. RDG would impress on all parties the importance of continuing to increase the farebox contribution in a sustainable way, i.e. by profiling the gradual reduction in government subsidy in such a way that does not unduly inhibit growth. Our recent research shows that industry revenue is now practically covering the day-to-day running costs of the railway such that Government funding is almost all contributing to long term investment in the railway.

Q24

What positive case studies are there (e.g. international examples in the railway sector, other sectors internationally/in the UK), where more affordable and sustainable funding and financing structures have been implemented, with or without private sector capital input? And how do you think the lessons learned could be applicable to Britain's railway infrastructure?

There are different examples of successful funding and financing structures in other industries including:

- PFI/PPP structures;
- the RAB-based financing structures in the UK's regulated aviation, energy and water sectors;
- the funding and financing arrangements for the public-sector Scottish Water.

Common features of these case studies include:

- upfront clarity in the regulatory or contractual rules for fixing future charge/funding entitlements;
- arrangements that take any government funding as far as possible out of annual budgeting exercises and the politics of election cycles; and
- the minimisation more generally of political and regulatory risk, especially around any future interference in the payback of investments.

These success factors may serve as a useful checklist against which to evaluate any proposals that the review team may be contemplating.

Q25

What are your views on the enabling factors facilitating a sustainable and affordable capital structure for Britain's railway? What factors would be required specifically for private sector capital introduction?

If private capital is to be used to finance investment in railway infrastructure, it is important to RDG that:

- there is clear evidence in advance that the injection of private capital offers value for money – i.e. that the benefits that private capital brings outweigh its higher cost;
- capital injections are sized optimally – i.e. they are not so small as to defeat genuine transfer of risk, yet not so big as to impose an unnecessary and avoidable cost burden on the industry; and
- steps are taken to secure the desired capital at the lowest achievable rates of return, including by exploring fully the possible contractual and regulatory structures that can support private-sector investment and by carefully timing equity and debt-raising exercises.

In the overarching RDG submission dated 02 December 2015, we explained that there is broad support among RDG members for directing private capital at specific investment projects. Some RDG members are also in favour of the sale of one of the English Routes (perhaps through a long term infrastructure concession). Such a sale could introduce an alternative source of finance with a greater local focus on customers, clients and stakeholders as well as creating a truly independent comparator to help provide more effective incentives for improvement in the remaining Routes.

These sorts of targeted approaches to the introduction of private capital may be more consistent with the above principles in comparison to a company-wide redesign of Network Rail's financing. Indeed, financing certain investment projects with private capital is one way of providing for risk transfer.

As a general observation, RDG members would expect to see that the recommendations in this area are supported by a detailed, quantified impact assessment, and cover the full spectrum of options.

RDG is establishing a 'task and finish' group to look at alternative delivery and financing arrangements, looking at case studies and lessons learned from previous attempts to bring third parties into enhancement schemes. We will be pleased to discuss this work with the review team.

Q26, Q27
What are the types of investors that may be interested in investing in Network Rail, any of its functions, or in select parts of it? And for these types of investors, can you identify: key attractions; risk appetite; required enabling factors?

What characteristics do you think that enhancement projects would need to have to attract private sector investment and in what form would public sector be needed? What types of financing structure could be brought to bear?

Experience shows that there is a strong appetite to invest in stable regulated assets or income streams and that we can learn lessons from both the past and other industries.

A key point is that private capital must always be a means to an end – e.g. greater cost efficiency, timely delivery of projects – and should not become an end in itself. It should not be the case that investor demands impact adversely on customers, especially the relationships that customers have with their suppliers.

Q28
What incentive mechanisms or control structures on Network Rail would facilitate third party investment in the financing of enhancement projects?

As the likely sole supplier of vital asset information, enabling works, assurance, etc., it will be important that Network Rail is able to work collaboratively with third party deliverers and provide sufficiently robust information.

Well-designed incentives that align the interests of an incumbent company and its staff to the interests of the third-party enhancement provider will therefore have considerable value. Such incentives may conceivably be either financial or reputational in nature.

The RDG is considering these matters further as part of the 'task and finish group' referred to earlier.

Q29

Do these feel like the right concerns? Has anything been missed that it is a vital to consider at this stage?

Over the last few decades the rail industry has undergone a number of changes. These have been largely evolutionary and have driven significant benefits, including:

- Growth in freight and passenger traffic and revenue;
- High levels of passenger satisfaction;
- Best safety record among major railways in Europe;
- Major investment in infrastructure, stations and rolling stock;
- Reduction in cost to the taxpayer.

We have set out the wider contribution of rail to the UK economy in a report produced with Oxera[1] dated July 2014. Also, we direct you to the annual data set produced with KPMG[2] (published summer 2013, 2014 and 2015). In addition, 'Keeping the lights on and the traffic moving'[3] is a paper published in May 2014 that sets out the value of rail freight to the UK economy.

There are currently a number of potentially significant changes and reviews occurring in the industry, including: the Office of Rail and Road's (ORR) review of the structure of charges, the CMA study into competition, reviews of the structure and funding of Network Rail, government's plans to direct further funding through train operators and devolution of the rail network. There are also other major developments in the industry, such as electrification and the construction of HS2.

The timing of the Shaw review therefore provides an opportunity to ensure that all of the elements of the industry are considered together to provide a consistent and aligned approach going forward. It is important that any changes occur in an appropriate order and reasonable timeframe.

For enquiries regarding this consultation response, please contact:

Jonathan Chatfield
Manager, Regulation
Rail Delivery Group
2nd Floor, 200 Aldersgate Street
London EC1A 4HD

jonathan.chatfield@raildeliverygroup.com
020 7841 8007

[1] http://www.oxera.com/Latest-Thinking/Publications/Reports/2014/What-is-the-contribution-of-rail-to-the-UK-economy.aspx
[2] http://www.raildeliverygroup.com/files/Publications/2015-09_rail_industry_dataset.pdf
[3] http://www.raildeliverygroup.com/files/Publications/2014-05_keeping_the_lights_on.pdf

Appendix 1

RDG submission dated 02 December 2015

Appendix 2

RDG Freight submission dated 21 December 2015

Rail Delivery Group

Nicola Shaw
HS1
12th Floor, One Euston Square
40 Melton Street
London NW1 2FD

02 December 2015

Dear Nicola

THE FUTURE SHAPE AND FINANCING OF NETWORK RAIL

I was very pleased to read your scoping document, which provides an excellent summary of the recent history of the railway, and explains to a wider audience how we have reached today's position. It was good to read a balanced description of the challenges and opportunities facing the industry, and a holistic description of the key issues.

I attach a short note which summarises the position reached by the Rail Delivery Group (RDG) as an input to your thinking. There is strong support for the changes proposed by Network Rail and the flexibility which this allows for further evolution. However, there is a broad range of views within the RDG about the appropriate pace and extent of any further changes. The paper therefore attempts to explain our group's thinking on the underlying issues rather than provide a single view.

Whatever changes are proposed as a result of your review (and the other reviews currently underway), it will be critical to make sure that there is clarity about what we are seeking to achieve, to make sure that changes to different parts of the framework are applied consistently and to manage change. A key test for any changes is whether they assist in making things simpler and in managing the challenges identified in your scoping report.

It will be particularly important to make sure that the proposed changes are supported by key industry players so that they can be implemented smoothly. RDG and its members are therefore very keen to work with you in the next stages of your review so that this can lead to an even better railway which is focused clearly on the needs of rail users, and the economy.

I am copying this letter to all RDG members, and I expect that they will provide further submissions which build on elements of the attached submission. We will also respond to the specific questions raised in your scoping report.

Yours sincerely

Paul Plummer
CEO, Rail Delivery Group and Association of Train Operating Companies

Encl

RDG Submission to Shaw Review

December 2015

1. Introduction

1.1 The Rail Delivery Group (RDG) brings together Network Rail (NR) and the passenger and freight train operating companies (TOCs and FOCs) to lead and enable improvements in the railway which are ultimately for the benefit of passengers and freight users, as well as the taxpayer and the wider economy.

1.2 Nobody in the rail industry is in any doubt about the need for constant improvements in the service to passengers and freight users as well as improvements in value for money to the taxpayer. Rail plays a critical role in the economy and the nation needs a successful railway industry. At the same time, however, it must be remembered that our railway is the safest major railway in Europe and it is increasingly recognised internationally as one of the most efficient, fastest growing, intensively used and punctual with among the best passenger satisfaction. It is important that these improvements are understood and to provide confidence in the industry so that it can address the significant challenges ahead and build on progress over the last two decades.

1.3 This paper therefore represents RDG's overarching submission to the Shaw review on the future shape and financing of NR. Responses to the specific questions asked by the review team will follow. The views expressed are the result of analysis, discussion and challenge between members of RDG and there remains a range of views about some issues.

1.4 While RDG believes that changes are required in order to build on progress, the industry needs to be clear as soon as possible about the nature of these changes to avoid an extended period of uncertainty which could compromise delivery to customers, stakeholders and industry partners. The required changes are largely about behaviours and organisation change is only an enabler to help catalyse these changes. The changes need to be designed to 'add simplicity' to contractual structures, then managed in a controlled way to avoid unintended consequences, distraction or risk to existing progress and investment. A key test for changes is to ensure they assist in managing the challenges already facing the industry. In many cases the issues highlighted by Collette Bowe, Peter Hendy and Nicola Shaw relate to the overall system and the importance of aligned incentives which means that any recommended changes are likely to require support from all industry players.

2. Immediate changes - devolution to Routes and reform of the NR centre

2.1 NR has set out the changes which it is now making to give greater accountability to its Routes while still retaining the benefits of a national network and genuine scale economies where appropriate. To enable this change in accountability, NR has proposed significant changes to the centre by distinguishing between the roles of System Operator, Technical Authority and Route Services. Investment Projects and Digital Railway are also repositioned to make it clear that they are providing a service to the Routes.

2.2 The intent of NR's proposed changes is that as much resource and control as possible is transferred to the Routes so that they have greater control over the means of delivering the outputs which are expected of them. The Routes would become more clearly accountable, bottom-line focused businesses with the authority and resources to deliver their commitments with minimum constraints. The success or failure of the Routes would be measured by their delivery of the outputs they have agreed with their customers (passenger and freight train operators), clients and stakeholders. NR would continue to be sighted on and guided by the needs of end-user customers, (passengers and freight users) but the industry owners of the relationship with the end-user is with the operators.

2.3 There is strong support among all RDG members for the changes proposed by NR and the flexibility which this allows for further evolution. There is a broader range of views about the pace and extent of any further change beyond the initial changes with some members much more concerned about the potential unintended consequences referred to above.

2.4 Freight operators have emphasised the importance of Network Rail carrying out the System Operator and Technical Authority roles partly as a safety net to counteract the risks of devolution of a national network, to prevent unintended dislocation of national services and retain national network optimisation and network benefits. All members recognise these concerns and agree that the industry must play a leading role in coordinating long term planning to inform governments and devolved bodies about their decisions on the required outputs from the railway and to be confident that the resulting plans are deliverable and affordable. The current ORR review on the functions of System Operation should seek to clarify roles in this area in conjunction with the Shaw Review.

2.5 Initial thinking by TOC owning groups concluded that there were problems stemming from NR being too far from customers, its incentives being misaligned with customers' needs and opportunities, and its capabilities being insufficient to meet today's challenges. The main priority of most TOC owning groups is therefore to make sure that the changes proposed by NR make enough of a difference to behaviours on the ground and that these changes are made rapidly and sustained. Regardless of whether NR continues to own all the Routes, most members consider that the right behaviours would emerge if Routes are increasingly allowed the flexibility that would be required under separate ownership subject only to the need to comply with minimum standards (Technical Authority) and network requirements (System

Operator). Even if there was no further change, this would also enable an effective track record for these businesses to be established which would help to attract or retain talent and improve the effectiveness of regulation by comparison.

2.6 In considering how the changes proposed by NR are implemented and how they evolve over time, most members are therefore keen that there should be a presumption in favour of greater local accountability with central roles having to justify their existence with a strong focus on customers, clients and stakeholders. For example, Routes would initially be expected to make collective decisions about whether they want to buy Route Services from the NR centre but over time there may be areas where greater flexibility should be allowed for Routes to make individual decisions in more areas. This could also create opportunities, for example, from more of a direct relationship between Routes and their suppliers over time. Similarly, Routes would be expected to comply with standards but these standards should be reduced to the minimum necessary so that Routes have increasing flexibility over how deliver their required outputs and their bottom-line financial performance.

2.7 The repositioning proposed by NR of Investment Projects as a supplier to the Routes is welcomed by RDG. This change presents an opportunity for Routes and operators to adopt alternative delivery mechanisms for projects and where appropriate to introduce private capital into improvement programmes. NR has supported these alternative options and the RDG can play a role in enabling this where appropriate. It will be particularly important to learn lessons from recent attempts both where this has been successful and also where difficulties which have been encountered. This change therefore has the potential not only to provide financing for investment but for improved contestability to act as a driver of efficiency.

2.8 There is though a concern that changes could have unintended consequences in the light of the enormous changes already facing the industry and that this could undermine network benefits, investment or progress with business performance. There is also a desire and need to ensure that the industry remains focused not just on cost reduction but also on growing revenue and delivering wider economic benefits for the nation. Sustained conditions to enable investment are critical to a successful industry which meets the needs of users and enables economic growth. All members are therefore keen to work with NR through RDG as well as locally to help implement the proposed changes in an effective way.

3. Potential further evolution

3.1 The changes outlined above therefore provide the opportunity for the structure to evolve in a way which drives greater accountability and resulting variability between Routes while retaining the benefits of a national network and exploiting scale economies where the value of these continues to be demonstrated by evidence. There are also further areas where the model could evolve as appropriate. As noted above, however, there is a broad range of views within RDG about the appropriate pace and extent of any further change beyond the initial changes outlined by NR.

3.2 Beyond the opportunity for alternative project delivery mechanisms, there are options for early sale of an English Route (perhaps through a long term infrastructure concession). Such a sale would introduce an alternative source of finance and greater local focus on customers, clients and stakeholders as well as creating a truly independent comparator which could help to create more effective incentives for improvement in the remaining Routes. If this option is implemented, it will be important to learn the lessons from the past to ensure that this does not undermine the focus on the business's customers and long term (as opposed to short-term) value for money. Sale of a smaller Route with more limited investment requirements would be more straightforward but would bring reduced benefits. Following any initial sale, it would be possible to sell further Routes but a decision on this could be made in the light of progress and results.

3.3 Once the NR system operator and technical authority capabilities have been clearly established with greater transparency about their distinct roles there would be an option to make these independent of the rest of NR. There is no need for this to be the first step or for a decision about such a change to be made immediately. Consolidation of these roles with other cross industry bodies could allow some consolidation of industry governance but they should not become too detached from the rest of the industry which they are intended to support.

4. Changes in regulation and government

4.1 The government, in thinking through the roles of the department, franchising, the regulator and the infrastructure manager, must design objectives, goals and targets, and roles and responsibilities to align the incentives on all parties to focus on their customers.

4.2 The ORR should focus on incentives to deliver outputs to customers rather than inputs. Where possible it should also focus on creating the conditions for the market or industry parties to meet the requirements of end users rather than acting as a direct proxy for these requirements. It also has an important role to play in protecting the benefits of a national network.

4.3 The effectiveness of regulation can be enhanced by greater transparency about NR's central roles and comparative performance information relating to the Routes. This can help enable government to adopt a clearer arm's length role which can, in turn, help to enable industry performance. However, ORR should not become a proxy customer or shareholder for the Routes and should not undermine accountability to customers or the NR holding company.

4.4 Where appropriate, ORR should act as a facilitator to the introduction of third party financing as in similar infrastructure sectors. The effectiveness of regulation is widely recognised as being fundamental to achieving a low cost of capital for such investments as well as being important in creating aligned incentives for improved efficiency across the whole system.

4.5 These changes in regulation require significant attention such that the ORR's role, competence, mind-set and behaviours are fit for purpose. A strong and confident regulator is critical so that industry parties can be effectively held to account. But this is also needed so that everyone concerned can be assured that the expectations placed on the industry are clear and realistic. Clarity of purpose is needed for the appointment of the ORR Chair.

4.6 Consideration of regulation and the role of the ORR also needs to include the way in which NR is managed as part of the public sector so that routes are able to act in a commercial way with their customers. Creating more customer focused Route businesses will not be possible unless NR has the flexibility to empower these businesses. At the very least, there is therefore a need to revisit the terms of the NR-DfT Framework Agreement and the way in which the principles of Managing Public Money are applied to NR in the public sector. Network Rail should be directly accountable for delivering outputs and for meeting the needs of customers, clients and other stakeholders rather than being managed in detail by DfT.

5. Conclusion

5.1 The railway industry of today is an amazing success story which was not anticipated two decades ago but it is equally clear that continuous improvement is essential. It is important to recognise this success as well as the challenges and opportunities presented by growth and devolution of government.

5.2 Responding to these changes requires changes in NR as well as in the rest of the industry, government and ORR to enable NR Routes to become businesses which are clearly accountable to their customers, clients and stakeholders while retaining the benefits of a national network with operators that cross Route boundaries.

5.3 RDG is therefore keen to work with the Shaw Review team and with governments to help develop the proposals for change which can be clearly supported by the industry to facilitate smooth transition and continued evolution as appropriate.

Nicola Shaw
HS1
12th Floor, One Euston Square
40 Melton Street
London
NW1 2FD

21 December 2015

Dear Nicola

Rail Delivery Group – Freight Group – The future Shape and Financing of Network Rail

On the 2nd December 2015 the Rail Delivery Group forwarded a short submission to your team outlining the collective thinking of the Rail Delivery Group members, including freight operators. The Rail Delivery Group – Freight Group is sub group of the Rail Delivery Group and is constituted of the five main UK rail freight operators and Network Rail as well as members of the RDG Executive.

The rail freight operators carry out their business in a different arena to franchised passenger operators. Freight is moved by rail with a wholly competitive and commercial backdrop; rail freight operators compete with each other, the national road network and ship on a continuous basis and trains are operated in reaction to demand rather than in anticipation of demand.

The freight operators have articulated in a very short paper their key requisites from any future changes to the structure of Network Rail. Individual freight operators will be responding to the scoping document in more detail, but we hope that you find it useful to receive this brief summary of thoughts.

The Rail Delivery Group – Freight Group is keen to continue to engage with you and your team as further thinking and concepts emerge.

Yours sincerely

Russell Mears

Russell Mears

Chair, Rail Delivery Group – Freight Group

cc. Paul Plummer – Chief Executive RDG

The value of rail freight

The movement of freight by rail is economically and strategically important to the UK; it supports UK businesses in moving goods worth £30 billion per year from high end whiskies and luxury cars to steel, cement and coal.

Many of the benefits of moving freight by rail fall outside the railway balance sheet. £1.6 billion of economic benefits for UK are generated by rail freight through improved productivity benefits to UK business and wider benefits such as reduced road congestion and emissions and improved safety.

The characteristics of rail freight

Rail freight is a national business and as such any railway route or regional boundaries have no relevance to the rail freight market. Rail freight services are operated in response to demand, unlike passenger services which operate in anticipation of demand. Rail freight services have to be high quality, flexible and competively priced in order to compete with road and to react to the dynamic requirements of business.

Rail freight operates in the private sector environment, carrying its own risk and continually competing for new contracts and business. Rail freight operators have collectively attracted over £2 billion of investments in locomotive, wagons and other capital equipment since the mid-1990s to enhance capacity and improve reliability and performance. A stable operating environment is essential for freight operators and other private sector organisations to be able to make these continued long-term investments.

Rail is already more complicated for users than road. The freight operators, alongside Network Rail work hard to manage these complexities for customers in order to offer as simple a product as possible. Road is available for use at any time of day, on any route with no controls, restrictions or boundaries and the charge to use the road is fuel duty.

Network Rail

Network Rail is an essential supplier to rail freight operators. Since the central freight team was formed in Network Rail, and through the Rail Delivery Group - Freight Group, real and tangible improvements to freight services are being delivered through more collaborative working. At a time when the benefits of having centralised freight services are beginning to materialise, it is vital that this impetus of joint improvement is not lost through the restructuring of Network Rail.

To act as the organisational solution to greater devolution a strong, national Network Rail freight team is required - this could either be part of, or alongside, the System Operator. In order to have the ability to ensure that the Routes take on the responsibility for servicing the requirements of freight operators and their customers, the freight team must have strong and effective leadership of this team, at Director/Executive level.

Rail Infrastructure Structure - Requirement for a Safety Net

The rail freight operators recognise that there are benefits of increased local focus on delivering passenger services and of being able to benchmark performance and delivery between different regions of Network Rail. Whereas most train operators operate services across one principal Route, and therefore perceive greater devolution to the Routes as being a means to become closer to customers, many rail freight flows cross multiple Routes boundaries, and therefore a degree of centralisation is required to deliver a consistent, timely, reliable and simple product to customers. It will also be increasing important, with the backdrop of structural changes in the freight market that the freight operators and Network Rail work ever closer together to optimise the capacity and capability of freight corridors (which cross existing Route boundaries).

A framework should be put in place to counteract these increased risks from devolution of a national network, in order to prevent unintended dislocation of national services and maintain national network optimisation and network benefits. A framework should include financial, operational, and planning and guidance elements.

Financial

Any rail infrastructure manager should be structured to recognise external wider benefits, not just internal finances. Route Managing Director's should have objectives (and re-numeration) referenced in Network Rail's Duties and Guidance linked to freight, of sufficient weight to influence behaviour.

Any network grant deemed to be relevant to freight should continue as now to be directed via the infrastructure manager (to avoid issues of state aid).

A national charging and incentives framework should be retained. There is a risk that geographic charges could result in differing local direct costs with the unintended consequence of dislocating existing traffic to road.

Certain strategic functions should be retained in order to minimise duplication of overhead costs and inefficiencies and secure value for money from specialist equipment and workforce.

Operational

Freight services usually cross many Network Rail routes, driving the fundamental requirement for clearly defined, centralised system operation functions. There is a risk that too much local focus could create unnecessary borders and blockages for national services and impact on system optimisation.

Early clarification on the role of the System Operator would help to provide a more certain environment and support continued investment by freight operators, customers and the rest of the supply chain.

A System Operator should be responsible for and able to mandate certain activities including:

- Timetabling
- Co-ordinating possession planning over routes
- Control and operational management regimes that facilitate cross-route operations
- Oversight of one national track access and charging regime (that is decided by the Independent Regulator)
- National incentives regime(s)
- Ensuring joined-up cost reduction

Planning and Guidance

Transport policy should be planned holistically, recognising the cross-modal impacts of policies, not just the impact internally to the railway.

A clear strategy and appropriate guidance from Government and other funders referencing their expectations from freight as well as clear specification of what they are willing to fund (e.g. via the SOFA) would give clarity throughout the industry of expectations and frameworks.

Some enhancements need to be planned and managed nationally as they span route boundaries, e.g. the Strategic Freight Network and need to have clearer outputs such as capacity increases and/or improved network efficiency.

Opportunities for change

Freight operators recognise that Network Rail is facing challenges and is under pressure from a range of stakeholders. Freight operators' believe that there are opportunities to make improvements and to refocus the workforce; these could be taken forward whatever the outcome of structural change. These include:

Increase the understanding and transparency of the cost base, and track and infrastructure quality on a dis-aggregated basis. This will enable more efficient decisions to be made and enable operators to work more closely and collaboratively with Network Rail to identify efficiencies, cost savings and opportunities.

Increase the clarity of expected outputs and outcomes, especially from enhancements, and work more closely with operators to optimise renewal and enhancement design and spend.

Focus more on long term planning of skills e.g. signal design, electrical engineers, train planning, and project management

Focus more on timetable planning as a core national product of the infrastructure manager. Improve the skills base and systems to support decisions about making the best use of capacity and better decisions about enhancements.