

SECRETARY OF STATE FOR TRANSPORT
GUIDANCE TO THE OFFICE OF RAIL REGULATION

The Legislative Context

1. Section 4(5)(a) of the Railways Act 1993 (as amended) (“the 1993 Act”) enables the Secretary of State to give general guidance to the Office of Rail Regulation (ORR) about railway services or other matters relating to railways. In addition, Section 4(5B) of the 1993 Act enables the Secretary of State to give guidance to ORR in relation to the ORR's exercise of its safety functions, other than in relation to the ORR's functions as an enforcing authority for the purposes of the Health & Safety at Work etc. Act 1974.
2. This document replaces the guidance issued in May 2007. The Secretary of State has consulted the Welsh Government in preparing this guidance.

The Secretary of State's Priorities

3. In March 2012, the Command Paper, *Reforming the Railways: Putting the Customer First (Cm 8313)*, set out how the passenger and freight railways support the Government's overall vision for a transport system that is an engine for economic growth, is more environmentally sustainable and improves the quality of life within our communities by relieving congestion on the road network, providing a greener transport option than road and aviation, and facilitating business, commuting and leisure journeys.
4. The Secretary of State recognises the improvements to safety and reliability that have been achieved by the railway industry and wants to see continuous improvements in these areas. By 2019, she wants the railway to achieve performance and efficiency that compare favourably with the best European railways, and subsequently to maintain such levels. She wants the railway to develop its capacity and capability to support economic growth by meeting the key elements of forecast demand growth. However, she also wants the railway to become more financially sustainable. She therefore wishes ORR to support the Government in requiring the rail industry to reduce dependency on public subsidy and to improve value for money for customers, as set out in the Command Paper.

Role of the ORR

5. The Command Paper set out the Government's vision for moving towards a more unified regulatory structure for the railway. The Government's immediate focus will be on bringing together those areas of rail regulation which impact most directly upon the passenger experience.

Engagement with Government

6. Section 51 of the Railways Act 2005 Act (“the 2005 Act”) contains a specific duty on the ORR to provide information, advice and assistance to the Secretary of State and information and advice to the Welsh Government, as required. Section

4(5)(ca) of the 1993 Act requires the ORR to have regard in exercising its functions under Part I of that Act or the 2005 Act that are not safety functions to have regard to any notified strategies and policies of the Welsh Government, so far as they relate to Welsh services or to any other matter in or as regards Wales that concerns railways or railway services.

7. The Secretary of State and the Welsh Government wish to maintain close working relations with the ORR, while recognising the boundaries between their respective responsibilities. The Secretary of State wishes ORR to share information with them and consult with them, except where statutory exceptions or commercial confidentiality require otherwise. In particular, to promote timely, well informed decision making, the Secretary of State wishes ORR to share information and analysis as soon as is reasonably practicable about anything that is likely to be material to policy development or implementation, or to forward financial planning, by the Secretary of State or the Welsh Government.
8. Addressing the Secretary of State's priorities also requires the Secretary of State, the Welsh Government and the ORR to work closely. Therefore, the Secretary of State wishes ORR to have regard, in the exercise of its functions, to relevant strategies, policies and objectives published by the Secretary of State, or strategies and policies which are notified to the ORR by the Welsh Government, from time to time.

Reducing the regulatory burden

9. The Secretary of State notes that the ORR has a duty under section 4(1)(f) of the 1993 Act to impose on the operators of railway services the minimum restrictions which are consistent with the performance of its functions under Part 1 of the Act. The ORR also has a duty under section 72 of the Regulatory Enforcement and Sanctions Act 2008 not to impose or maintain unnecessary burdens when exercising its regulatory functions. The Secretary of State wishes ORR to have specific regard to these duties and to demonstrate a proportionate approach that is consistent with the principles of better regulation¹ when developing new and amending existing regulatory processes.

Safety

10. The Secretary of State wants rail safety to be maintained and improved in the most efficient way, recognising the diversity of the railway network, and which also makes the best use of the money available and provides value for money for both farepayers and the taxpayers.
11. The Secretary of State wants ORR to oversee the rail industry continuing to improve passenger and worker safety through maintaining the 'so far as is reasonably practicable' (SFAIRP) approach to risk control, enforcing other relevant safety legislation and delivering EU Common Safety Targets.

¹ <http://www.bis.gov.uk/policies/bre/better-regulation-framework/regulatory-decision-making/general-principles>

Value for money and efficiency

12. Under Section 4(5)(c) of the 1993 Act the ORR is “to have regard to the funds available to the Secretary of State for the purposes of her functions in relation to railways and railway services.” Under Section 4(5C), the ORR must also have particular regard to the interests, in securing value for money, of users or potential users of railway services, those providing railway services and those funding railway services.
13. Public resources available to spend on the railway are constrained. In having regard to the funds available to the Secretary of State, the ORR is asked to note that the Secretary of State is required to live within allocated resource and capital budgets and to secure value for money from public expenditure. The Secretary of State wishes ORR to note in particular that her statement of funds available to secure the High Level Output Specification (HLOS) represents the maximum level of funding the Government is able to commit, and that wherever possible she wishes expenditure to be below this level. Securing value for money, improving industry efficiency and reducing industry unit costs are the most significant challenges facing the rail network. The Secretary of State will want to secure substantive improvements in each of these areas.
14. Accordingly, where the ORR is taking decisions which may have actual or potential financial consequences for the Secretary of State, the Secretary of State wishes the ORR to note particularly that she does not wish to incur additional expenditure beyond allocated budgets and that she wishes to be consulted about expenditure which is not, or is low, value for money.
15. If, in the exercise of its statutory functions, the ORR considers that it is necessary to exercise its functions in a particular way that is likely to have either material negative or positive financial consequences for the Secretary of State, the Secretary of State wishes to be advised of this by the ORR as soon as is reasonably practicable so that she may consider the matter and, if appropriate, make representations. In doing so, the Secretary of State wishes ORR to co-operate in allowing her the opportunity to consider, where appropriate, making amendments to the HLOS or any other strategies and policies.
16. The Secretary of State notes the importance of retaining the flexibility that exists within the framework of government accounting rules, including over the balance between payment of grant and access charges in future years. Consistent with its duty under Section 4(5C) above, the Secretary of State wishes the ORR to facilitate this, providing always that the financial position of Network Rail remains neutral, and that there is no adverse impact on other funding authorities or on freight or passenger operators.
17. The Secretary of State wishes to work closely with the ORR in monitoring Network Rail's financial position to minimise the risk of the credit support arrangements provided by the Secretary of State being called upon.

18. The ORR is asked to note that the continued effective operation and sustainability of the franchising regime is of major importance to the Secretary of State. In particular, the Secretary of State wishes to ensure that franchises remain within their allocated budgets, and that franchise bids made by bidders are deliverable, both operationally and financially.
19. The Secretary of State wishes ORR to have regard, in exercising its regulatory functions, to the outcomes that she is seeking to secure through franchising, including the possible exposure of franchise operators to a proportion of changes in Network Rail charges arising from periodic reviews, for example by means of any relaxation of the Schedule 9/clause 18.1 regime contained in the franchise agreements that she may be minded to make.

The five case business case

20. When considering the use of funds made available by the Secretary of State she wishes ORR to use the five case business case approach. Specific guidance on the economic, strategic and financial cases is supplied below.

Economic case

21. The Secretary of State asks ORR to ensure that Network Rail delivers value for money in its incorporation of the Government's HLOS into the industry's Strategic Business Plan and its subsequent delivery. Specifically, the Secretary of State will publish her illustrative option for the enhancements she considers could be used to deliver the HLOS and will look to ORR to ensure that further industry work on enhancements refines this approach to secure the best possible value for money solution to achieve the HLOS outcomes at the lowest efficient cost, except where ORR and the Secretary of State agree that the DfT is better placed to undertake the appraisal. Should the industry choose to take forward elements of the illustrative option, the Secretary of State wishes to be consulted about whether any output is to be purchased if the value for money of achieving it is materially worse than was indicated in the illustrative option, or if it represents poor value for money (i.e. a benefit to cost ratio (BCR) broadly equivalent to less than 1). Where DfT had not estimated the value for money for a particular illustrative option then the value for money guidance set out below for the funding pots applies. Where the industry moves away from the illustrative option the Secretary of State expects the ORR to ensure that replacement schemes offer at least equivalent value for money to those they are replacing in the illustrative option (unless it is agreed with DfT that a lower value for money alternative is clearly justified by reference to the other cases, particularly financial). In addition, the Secretary of State wishes to be consulted where the industry and ORR believe a scheme is most efficiently delivered by allowing its completion date to extend into CP6.
22. In addition, there are to be a number of industry-led funding pots and the Secretary of State would like ORR to monitor and ensure value for money for these. The Secretary of State does not expect any scheme to be taken forward using the pots which offers 'low' value for money or worse (broadly equivalent to a BCR of less than 1.5) (unless relevant to a decision on compliance with reasonably practicable health and safety requirements). She would like ORR to ensure that average

outturn value for money is better than this minimum standard, and expects that value for money will play a key role in prioritising the use of the pots.

Strategic and financial cases for the funding pots

23. Where funding is obtained from non-DfT sources this will enable DfT's funding to go further. The Secretary of State wishes this to be taken into account in prioritisation decisions through the strategic and financial cases. She wishes ORR to use an indicator which has the present value of benefits on the top line (with private sector and local authority contributions showing as negative benefits), and the present value of DfT costs (impacts on capital and franchise budgets) on the bottom line. This can be used alongside the conventional BCR when determining priorities for the use of the pots.

Access rights

24. The Secretary of State believes that greater certainty about access rights is an important element in planning franchises and securing value for money from franchise bids. The Secretary of State recognises ORR's independent role in setting the policy framework and making decisions in respect of access but asks ORR to ensure that the granting of access rights is considered within the context of its duty to have regard to the funds available to the Secretary of State, and of the Secretary of State's objectives of securing value for money, improving industry efficiency, reducing industry unit costs and securing the best overall outcome for passengers generally. The Secretary of State wishes to see a fair pricing regime for train service paths which covers both franchised and open access operators and is designed to mitigate any financial risks to the Secretary of State arising from open access passenger operations. The Secretary of State wishes ORR to engage with her at an early stage in the development of any policy in this regard. In particular, if ORR proposes to make a decision in respect of access rights that would have the effect of increasing the net cost to Government of GB rail services, including as a result of the impact on the financial viability of any franchisee as well as long term franchise value, the Secretary of State wishes to be advised as soon as reasonably practical by ORR about its proposed course of action and its reasons and to have an opportunity to make representations.

Industry alignment

25. The Secretary of State notes that while the gross cost of the railway has declined from its peak in 2006-07, the incentives that will drive further cost reduction need to be significantly strengthened. In particular, the Secretary of State notes that more needs to be done to create leadership in the industry and to align the incentives of Network Rail and train operators around the key objectives of improving outcomes for passengers and reducing costs. The Government is committed to exploring the full menu of options for promoting greater alignment.

26. The Secretary of State wishes to work closely with ORR in facilitating the options for partnership arrangements between Network Rail and train operators. The Secretary of State wishes ORR to take into account, in exercising its regulatory functions, her desire to secure such partnership arrangements where they

demonstrate compatibility with the requirements of the regulatory and competition regime, transparency and long term benefits to rail users.

Performance

27. The Secretary of State asks ORR to ensure that the incentives framework for and between Network Rail and the train operating companies facilitates industry co-operation to deliver railway services in the best interests of passengers and freight users, while continuing to improve industry efficiency, maximise whole system whole life value and value for money for taxpayers. In addition, the Secretary of State wishes ORR, in exercising its regulatory functions, to have regard to her desire that the operational management of services takes into account the economic value of different services.

Network Rail's asset management

28. The Secretary of State wishes to receive assurance from ORR that Network Rail's asset management strategy secures the best value for money over the whole life of the railway's assets. The Secretary of State also looks to the ORR for assurance that such a strategy is being delivered to a challenging timetable - applying, monitoring and enforcing appropriate obligations through the Network Licence to that end.

29. Information about rail assets and their condition and capability is a cornerstone in the delivery of a safe and efficient railway system. In light of this, the Secretary of State wants Network Rail to secure expeditious improvements in its asset knowledge and wishes the ORR to maintain a strong focus on this aspect of Network Rail's delivery. She also wishes to be assured by the ORR that in developing and maintaining asset information Network Rail has tested alternative models to determine the best outcomes depending on the type of asset, and that any model it employs reflects best practice and the opportunities that new technologies present, in all cases having regard to efficiency, affordability and value for money. The Secretary of State wishes to be assured by the ORR that Network Rail is making appropriate use of this asset information when planning and resourcing its asset stewardship obligations.

Passenger interests

30. The Secretary of State notes that in an industry where service delivery is spread across many organisations ORR can play an important role in protecting network-wide passenger benefits. Therefore the Secretary of State wishes ORR to give particular consideration to its duties under sections 4(1)(ba) and 4(1)(e) of the Act to contribute to the development of an integrated system of transport of passengers and goods, and to promote measures designed to facilitate the making by passengers of journeys which involve use of the services of more than one passenger service operator.

31. Following the conclusions of the consultation on *A greater role for ORR regulating passenger rail franchises in England and Wales*, ORR is asked to work with DfT with a view to the transfer to ORR of the administrative functions relating to

Disabled People's Protection Policies and Passenger Complaints Handling procedures in a cost effective way.

Rail Freight

32. The Government recognises the important role that rail freight plays in the nation's logistics and in the achievement of the Government's sustainable distribution objectives. The Government wishes to facilitate the continuing development of a competitive, efficient and dynamic private sector rail freight industry and is committed to ensuring that policies and regulations should work to this end and should not create unnecessary transactional costs or other obstacles to the achievement of these objectives and future growth.
33. In an industry where planning and operational decision-making are increasingly devolved, the Secretary of State wishes ORR to have regard, in exercising its statutory functions, to the importance of sustaining efficient and commercially predictable network-wide freight operations, including in decisions about access rights and charging structures.
34. The Secretary of State wishes the ORR, in developing any proposals, and in making decisions in relation to rail freight, to note particularly the Government's rail freight policy². The Secretary of State wishes to be advised by the ORR of, and to discuss with the ORR, any material measure which the ORR proposes to take or policy which it proposes to pursue which would adversely affect the competitiveness of rail freight compared to other modes.

Transparency

35. Transparency and open data are at the heart of the Government's efficiency and reform agenda. The Secretary of State asks ORR to continue its work to develop transparency on whole industry costs, revenues and efficiency, whole industry performance, and real time data, ensuring that the information that reaches rail users or the wider public is meaningful to them. The Secretary of State also wishes ORR to benchmark all relevant costs of all relevant parties, and publish the results.

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² Key policy documents setting out the detail of the Government's rail freight policy include: Strategic Rail Freight Network: The Longer Term Vision, September 2009; and Strategic Rail Freight Interchanges (SRFI) Policy Guidance, November 2011.