



***RAIL REGULATOR'S STATEMENT***

**FOR THE**

***RAILTRACK PROSPECTUS***

**This document is a statement sent by the Rail Regulator  
to the Secretary of State for Transport on 3 April 1996  
for inclusion in the Railtrack Prospectus.**



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# ***1. Regulator's Statement***

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1. In this statement I set out the general principles I have adopted in the regulation of the railway industry since my appointment as Rail Regulator in December 1993 and which I propose to continue to adopt. I outline how these principles have guided my decision making thus far, and the approach I intend to take following the flotation of Railtrack.
  
2. Section 4 of the Railways Act sets out a series of duties which define the public interest. These duties require me to pursue a number of objectives designed to protect users of the railway, but also include a requirement to have regard to the need not to make it unduly difficult for Railtrack to finance its activities or proposed activities, and to the financial position of the Franchising Director. Until 31 December 1996, I must also have regard to any guidance issued to me by the Secretary of State.
  
3. Thus, I have duties concerning protection of the interests of passengers and freight customers, duties giving safeguards to suppliers of railway services such as Railtrack, and duties concerning the Government's policy towards the railway and its contribution to railway finances. I believe that the interests of each of these constituents can be promoted to the benefit of all. Within a stable regulatory framework, suppliers and funders of railway services can work together to improve the service offered to passengers and freight customers.

## **General Principles**

4. I have adopted the following general principles:
  - I wish to ensure that the commercial freedom given to suppliers of railway services, and the incentives which result, lead to an outcome consistent with the public interest as defined by my statutory duties. It is not for me to superimpose my commercial judgement on that of industry parties. But it is for me to seek to ensure that the working of commercial incentives and market forces promotes the public interest and leads to a better railway for passengers and freight customers.



- I aim to promote a stable regulatory and financial framework for Railtrack and the rest of the railway industry. The existing framework contains a set of rules. All concerned will wish to see these develop over time. I expect this evolution to take place in a way which provides stability and clarity for Railtrack, and others, so that they are able to conduct their businesses, whilst still allowing sufficient flexibility to enable change to improve services to final customers.
- Among my other duties I am explicitly required by the Railways Act to have regard to the need not to make it unduly difficult for Railtrack to finance its activities or proposed activities. I also recognise that Railtrack, in turn, has responsibilities towards its shareholders and lenders, and that Railtrack, if it is to serve its customers efficiently, should be able fairly to remunerate those who invest in its business.
- I consider that benefits will accrue to users of the railway and to Railtrack and other industry parties from the development of competition in the supply of railway services. Railtrack by its actions affects, and is affected by, the efficiency with which markets function. I will aim to ensure that market forces work effectively and harmoniously so as to benefit passengers and freight customers and stimulate the development of innovative services.
- I believe that, as Rail Regulator, I have a central role in facilitating effective cooperation and partnership between Railtrack, train operators and other suppliers of railway services, and funding bodies (such as the Franchising Director, Passenger Transport Executives and local authorities). Such cooperation is of critical importance, and without it important public interest benefits would be denied to users.
- Railtrack, as owner and operator of the national rail infrastructure, has stewardship of that infrastructure. That status carries with it important obligations as to the safeguarding of the future of that infrastructure. I expect Railtrack to recognise these obligations and to act accordingly.

- Railtrack is the owner of an essential facility. Train operators (and hence their customers) are dependent on it for delivery of the services provided. I expect that Railtrack will not use this monopoly position to act against the public interest and I would take appropriate action against any abuse of this position.
5. These general principles have the effect of conferring upon Railtrack a substantial degree of independence in decision making. But, with this independence come responsibilities. Over the years following flotation I will be monitoring Railtrack's performance with a view to ensuring its actions are not inconsistent with the public interest. The first seven years of the Railways Act 1993 (two of which have seen Railtrack in the public sector) will be the proving ground for the railways of the twenty-first century. The more Railtrack recognizes the public interest in its conduct during these years, running up to the next periodic review of Railtrack's charges, the less likely that they will be followed by a substantially different regulatory approach.
  6. It is also right that Railtrack, and others, should expect clarity and accountability from me, and my office, in the exercise of regulatory functions. I attach great importance to fair and efficient regulation, and the processes by which the interests of those affected by regulatory decisions are taken into account. I have been appointed, under the Railways Act, as Rail Regulator, independent of Government. However, as stated in my Annual Report for the year ended 31 March 1995, I consider that this independence carries with it commensurate responsibilities involving openness, transparency and predictability.
  7. These responsibilities are all aspects of my accountability. I am accountable through the Courts if there is illegality, irrationality or procedural impropriety, and my actions and decisions come under the remit of the Parliamentary Ombudsman. I am accountable to Parliament through the scrutiny of the Select Committees; and in a broader sense to all those to whose interests the Regulator must have regard.
  8. I have adopted, and intend to continue to adopt, a policy of openness in the development and implementation of regulatory policy. This has involved extensive consultation with Railtrack and other industry parties on matters which affect their interests. I also consider that regulatory processes should be as transparent as possible to those involved, and that I should give full reasons for my decisions.

9. As part of my accountability, I believe it is important that regulatory decisions should be predictable and not such as to create uncertainty in the industry. To that end, I have published, and will continue to publish, extensive consultation documents. Where I have taken policy decisions, I intend to provide full policy statements and guidance papers as to the criteria and procedures I propose to follow in taking subsequent decisions in these areas.

### **Key areas of regulatory activity**

#### *Safety*

10. Ensuring the safety of those who travel and work on the railway should be an overriding concern for all involved in the provision and regulation of rail services. The Health and Safety Executive (HSE) has primary responsibility for the regulation of safety on the railway. Nevertheless, in exercising my functions, I am required by the Railways Act to take into account the need to protect all persons from dangers arising from the operation of railways, taking into account, in particular, any advice given to me by the HSE. I have worked closely with the HSE to satisfy myself that this duty has been discharged at all times, particularly in the development of the new contractual arrangements for the restructured railway industry. To this end I have agreed a Memorandum of Understanding with HSE which clearly defines each of our roles and which establishes a framework of effective working relationships based on cooperation and consultation.
11. I would emphasise the key role played by Railtrack in managing safety on the network in its capacity as infrastructure controller and through its compliance with and operation of the Railway Group Standards Code (as required by its Network Licence) in an efficient manner.

#### *The Level of Railtrack's Charges for franchised passenger services*

12. Following extensive consultation, I have issued policy statements on the structure of charges (November 1994) and the future level of charges (January 1995), both in respect of franchised passenger services. The conclusions I reached are now reflected in access agreements which I have approved. In setting the current level of charges, my principal considerations were to:

- give greater stability to Railtrack in its finances for the period to 2001, and enable it to plan effectively for investment in renewal of the network;
  - achieve a better balance over the review period between Railtrack's costs and its revenues; and
  - satisfy myself that it would not be unduly difficult for Railtrack to finance its activities at the new level of charges.
13. Access agreements for passenger services which have been, or are intended to be, franchised contain provisions for a review of charges to take effect from 1 April 2001. I anticipate conducting an extensive process of review and consultation, beginning in 1998, before making any decision so that, in accordance with the contractual provisions, conclusions can be published by 31 July 2000. I stated in the review of charging levels that at this next periodic review I would, among other things, have regard to market evidence on Railtrack's cost of capital. Where I have already approved access agreements, I have no powers unilaterally to amend the contractual level of access charges prior to the periodic review.

*The Structure of Railtrack's Charges for franchised passenger services*

14. My conclusions on the future structure of Railtrack's charges reflected a widespread concern that there should be more information available to operators about what they pay. I believe that such information will act as a solvent to help Railtrack and operators break down the large mass of fixed charges. Access agreements therefore now include a process to facilitate Railtrack and train operators identifying, evaluating and negotiating changes in access rights and charges. This offers an opportunity to create a more commercially based charging regime, which will bring benefits to both Railtrack and train operators through more efficient use of the network. I look to Railtrack and operators to make full use of this opportunity, and look for considerable progress between now and the next periodic review. To facilitate this progress, I will, if appropriate, publish further clarification of the criteria for approval of changes to access rights to ensure that the provisions now in access agreements can operate in the mutual interests of Railtrack and train operators.

15. I expect Railtrack to facilitate the development of new passenger rail services by franchised passenger operators and others. I recognise that in return for this Railtrack should receive an appropriate share of the benefits of expansion of passenger services by franchised operators and others. My approach on freight charging is outlined in paragraph 40 below.

*Maintenance and Renewal of the Network*

16. In my conclusions on the future level of access charges, I allowed Railtrack sufficient income from its charges to enable it to maintain the existing capability of the rail network, and, where necessary, to carry out renewal in the form of modern equivalent assets. In addition to annual maintenance provided for as part of operating costs, this allowance included £3.5 billion (at 1995-96 prices) for investment in the renewal of the network over the period of the review. These conclusions provide Railtrack with a level of certainty as to its ability to fund the maintenance and renewal of the network which the railway industry has not had before. With this stability of funding, I expect Railtrack to deliver an effective infrastructure investment programme fulfilling its obligations to maintain and renew the network. I recognise there will be year to year variations in the location and level of spending, but I will be monitoring carefully the results in this area. I will wish to be satisfied that Railtrack achieves the significant increase in expenditure on railway infrastructure provided for in my decisions on access charges and which has yet to take place, partly as a result of the time needed to plan such an increase in expenditure effectively and partly as a result of having to operate within public sector financing limits.
17. To help me and Railtrack's customers to monitor the effectiveness and implementation of these plans, Railtrack has agreed with me that it will publish on a regular basis key performance indicators showing the capability and reliability of the network. I welcome this important development.
18. I also attach great importance to the provision of appropriate financial information. The form and content of Railtrack's statutory accounts are for the directors, and the company's auditors, to determine, not for the Regulator. But I will want to ensure that Railtrack publishes the necessary information to allow me, Railtrack's customers and others with a legitimate interest, to understand the underlying financial position of the company. Thus, under the terms of its Network Licence, Railtrack is required to

maintain its accounting records in accordance with accounting policies that I may specify in order to allow me to take decisions on the level of access charges. I have advised Railtrack that these supplementary accounting records should be in the form of current cost accounts using a modified form of the financial capital maintenance concept. I believe that this form of accounting provides the most appropriate means for me to monitor Railtrack's financial strength in line with my duty not to render it unduly difficult for the company to finance its activities.

19. I have agreed with Railtrack that it will publish an analysis of its profit and loss account which distinguishes network activities and other activities, including operation of major stations and ownership of other stations, depots and other property. I have also agreed with Railtrack that it should identify clearly the amounts which it is spending on the maintenance and renewal of the infrastructure and indicate whether this relates to the Asset Maintenance Plans or to the property maintenance backlog and environmental liability provisions established in the 1994/5 accounts, or is an addition to capital, so that any change in the level of expenditure or adjustment of the provisions already made is clear to readers of the accounts.

*Investment in the enhancement of the network*

20. Over time, demands on the rail network will change. I have published (March 1996) a policy statement of the approach I am minded to take in exercising my functions to facilitate investment in the enhancement of the rail network. Such investment is critically dependent on effective partnership between Railtrack, train operators and other suppliers of railway services, and funding bodies. I expect Railtrack to be proactive in the development of investment proposals, and moreover expect that if Railtrack is able to negotiate charging arrangements for an investment project which enable it to recover its costs (including fair remuneration of its investment) and where appropriate receive a fair share of the benefits, Railtrack will carry out such a scheme unless there are clear public interest reasons to the contrary.

*Thameslink 2000*

21. In that policy statement, I recognised that some network enhancement projects may involve different levels of risk from the rest of Railtrack's business. I also said that I would be willing to consider giving guidance on whether I would be minded to

approve special arrangements for identified major projects giving protection at future periodic reviews but that I would need to be satisfied that access beneficiaries (which could include the Franchising Director) are prepared to enter into a long term commitment to meet charges on such a basis and that the additional certainty that such protection provides for Railtrack is necessary to enable the project to proceed. I have indicated to Railtrack and the Franchising Director that I would be willing to consider giving such guidance in respect of the Thameslink 2000 project. However I have not at the date of issuing this statement seen a final proposition on which such guidance is being sought.

#### *West Coast Main Line*

22. I attach great importance to Railtrack developing and implementing an effective strategy for the renewal, and to the appropriate extent, upgrading of the West Coast Main Line.

#### *Network Management Statement*

23. In December 1995 Railtrack published its first Network Management Statement showing its plans for maintenance, renewal and enhancement of the network. This is an important new development, which fulfils a requirement on Railtrack, under its Network Licence, to publish such a statement annually in a form, and covering a period, approved by the Secretary of State while Railtrack is in the public sector and by me when Railtrack is in the private sector. I am currently in discussion with Railtrack over the form of this statement in future years. I will want the statement to achieve the following objectives:

- to help me, Railtrack's customers (such as train operators and funding bodies) and the wider public, to monitor the effectiveness of Railtrack's plans for, and achievement of, maintenance, renewal and enhancement of the capability of the network;
- to achieve a shared understanding among those involved in the industry of the plans Railtrack has for the management and development of the network and the criteria it has adopted to produce these.

To this end I will wish to see Railtrack developing the form of this annual statement from its initial start point. I would expect to see a greater degree of detail and disaggregation in the statement so that Railtrack's customers are better able to understand the implications for them. I have agreed with Railtrack that we should consult jointly with customers, funding bodies and other interested parties on the form and period of the statement in September 1996.

24. I wish to encourage the development of a shared understanding between Railtrack and its customers and funding bodies on investment plans for specific parts of the network and I expect Railtrack to play a leading role in facilitating this understanding. The annual Network Management Statement is intended to be an important means by which this will be achieved, but is in itself no substitute for effective cooperation between Railtrack and industry parties.

#### *Track Access Agreements*

25. I have approved track access agreements between Railtrack and all the present or formerly British Rail-owned passenger train operating companies (other than Island Line) which have been, or are intended to be franchised to private sector operators. My decisions were based on published criteria, and followed extensive consultation with those affected. I proposed modifications to the agreements (which were accepted by the parties), the main purpose of which was to seek to ensure that commercial agreements would not operate against the public interest, and in particular that capacity was shared in accordance with the public interest as defined by my statutory duties.
26. I have no current intention of making material changes to the criteria I have published for the approval of passenger track access agreements. I intend to publish during the course of 1996, and after consultation with industry parties, a document outlining the procedures and criteria for approval of any amendments to passenger access agreements which may be negotiated between the parties. I do not anticipate that these procedures and criteria will be materially different from those I have adopted hitherto.
27. I have also approved arrangements in track access agreements which give financial incentives to improve punctuality and reliability on the railway. In approving these arrangements I have made it clear to Railtrack that I expect a material improvement in

the performance of the railway in respect of punctuality and reliability over the next five years as a result of improved management and the commitment to maintenance and renewal of the network. This expectation of improved performance is reflected in the access charging arrangements which I have approved. I believe that these incentive arrangements will operate in the public interest. However, if there are any effects on the behaviour of Railtrack or train operators which go against the public interest I expect, if the parties do not voluntarily agree to remedy these effects, to raise these matters with the parties for the purpose of ensuring the public interest is safeguarded.

28. Each passenger and freight track access agreement contains the Railtrack Track Access Conditions which provide for the management of the timetabling, operation and development of the network within the framework of the access agreements and in accordance with public interest criteria. Though the Conditions are contained in the contracts which are enforced by the parties and not by me, I do expect Railtrack to comply with the provisions of these Conditions, as a key element in the contractual framework. In certain key areas the ultimate appeal on decisions by Railtrack is to me. No such appeals have been made so far. I am bound to consider any such appeals in accordance with my public interest duties.
29. I will be keeping the Railtrack Track Access Conditions under review to see that they remain consistent with my public interest objectives. As stated in my policy document on enhancement investment, I will wish to be satisfied that the Conditions do facilitate such investment. I have advised Railtrack and other industry parties that I will wish to review the provisions concerning operational disruption and train regulation if it appears that the introduction of performance incentives creates behavioural consequences which operate against the public interest. I have also advised Railtrack and other industry parties that, working with them, I will aim to ensure that the provisions concerning timetabling work effectively to facilitate the production by Railtrack of a timely and accurate timetable which meets customer needs. I intend to consult publicly on this during autumn 1996.
30. I anticipate these reviews being carried out jointly with Railtrack and the industry parties with any necessary changes agreed through the processes contained in the Access Conditions. I also have reserve powers to require changes (against defined criteria and subject to procedures defined in the Track Access Conditions) but I would

only use these powers if I considered the public interest demanded it, no other approach was effective and the relevant contractual criteria were satisfied.

31. I plan to carry out a programme of consultation over the next few months to enable me to issue a number of general approvals to the making of amendments to access agreements for track, stations and depots. These will give prior approval to the making of specified amendments or types of amendments, by agreement between the parties, without the need for them to seek specific approval by me. The intention is to reduce the administrative burdens on Railtrack and others associated with regulatory approval where there is no public interest requirement for such scrutiny of individual changes.

### *Competition*

32. I have a duty to promote competition in the provision of railway services, and I am satisfied that such competition (or the likelihood of competition) will bring benefits to users, and to Railtrack. I recognised in my policy statement on this issue (December 1994) that an immediate significant increase in the level of competition between passenger service operators, over and above that implied by the original boundaries of the franchises, would have an unduly adverse effect on the ability of the Franchising Director to achieve his objectives (including the securing of the supply of passenger services) and on his financial position. Therefore a staged approach to the introduction of competition was essential. In the first stage (up to 1999) arrangements have been put in place to limit competition almost entirely to that between franchisees. The second stage (from 1999 to 2002) *will* permit some expansion on routes where competition already exists, and opportunities to open up new flows to competition, subject to a ceiling on the proportion of a franchisee's revenue which would be exposed to such competition. Track access agreements for franchised operators extending beyond 2002 *will* contain provision for a formal review of competition policy, and I would intend to consult Railtrack, train operators and funding bodies on the development of that policy.

### *Licensing*

33. Railtrack has been operating since 1 April 1994 under Network and Station Operator's Licences issued by the Secretary of State. To date I have not taken any enforcement

action under these licences; nor am I aware, at present, of any matters which would warrant my taking enforcement action. Should evidence of a breach of these licences come to my attention I would take action in the form prescribed by the Railways Act.

34. I have so far agreed with Railtrack one modification to Railtrack's Network Licence, designed to facilitate the management and development of railway computer systems. I have no current intention of seeking any further modifications to Railtrack's licences, but would consider seeking such modifications if I considered that, on balance, they were required to further my public interest duties and the general principles outlined in paragraph 4 above.

#### *Property and stations*

35. In my review of Railtrack's access charges I took into account Railtrack's income from its property estate. I took the view that property income (rentals and disposals taken together) in excess of the amount allowed for in setting the access charges should be shared with train operators, and have subsequently determined the principle that Railtrack should retain 75% of such additional property revenue, while passing 25% back to franchised train operators. I am currently consulting the industry on the implementation of this.
36. I look to Railtrack to develop its property assets where commercial opportunities arise and believe the arrangements I have agreed give an appropriate incentive. I will exercise my functions, both statutory functions in respect of closures, and functions under licences and access agreements, with a view to ensuring that development of property assets does not operate against the public interest.

#### *Network benefits for passengers*

37. A key element of the cooperation between the parties in the new railway industry is the maintenance and development of network benefits. I expect Railtrack, in view of its central position in the industry, to play its full part in the provision by the industry of network benefits, including improved timetable information (such as any developments from the Informed Traveller initiative launched by the Secretary of State), good connectional arrangements and provision of passenger information.

38. I expect Railtrack to maintain a constructive relationship with the Rail Users Consultative Committees and to play a full part in the improvement of railway services for disabled passengers. I also expect Railtrack to cooperate with the Association of Train Operating Companies in the development of industry wide arrangements including those concerning the handling of complaints involving more than one industry party, and lost property. I will wish to keep under review whether the delivery of network benefits through voluntary cooperation is effective and to discuss with Railtrack and other operators whether there is a need for voluntary arrangements to be underpinned by changes to contractual arrangements or licence obligations.

### *Freight*

39. One of my key objectives is the promotion of the use of Railtrack's network for freight, and in exercising each of my functions I have paid particular attention to the needs of the freight market. Specific areas include the development of my policy on track access charges for freight, the development of a competitive market for rail freight services, and the development of short term access arrangements for freight.
40. In my policy statement (February 1995) on Railtrack's freight track access charges, I endorsed a framework based on negotiated charges, and set out the criteria on which I would consider approval of such charges. My key objectives were to give Railtrack incentives to increase the attractiveness of the rail network to freight customers, and encourage the transport of freight by rail. I also stated that I would keep the policy under review, and amend it if necessary better to achieve my public interest duties.
41. Since establishing the policy, more than 100 freight track access agreements have been approved. This experience has identified improvements which have been agreed with Railtrack to the detailed processes which support the implementation of the policy. I have no current intention of changing the policy. I have also agreed with Railtrack the range of additional information that it will publish annually to its freight customers and potential customers for the purpose of initiating successful negotiations.
42. I welcome the emergence of the first open access freight operators, with the attendant spur to innovation and competition this should bring to the freight market. In

consultation with the industry I have encouraged the reduction of barriers to competitive entry for new operators.

43. I set out in my policy statement of December 1994 the principles and processes I would adopt in approving freight track access agreements. Recognising the need of the freight market to react quickly to market opportunities, I have issued a general approval which allows, in certain circumstances, immediate access to the network while regulatory processes take their course. This mechanism is now widely used to develop such business opportunities, and, in consultation with the industry, I am looking to extend this approach to other access approval areas, to create freer and speedier processes for the freight industry while affording proper protections for all users.

#### *Monitoring of Railtrack*

44. Railtrack's performance in the efficient and effective operation, maintenance and renewal of the rail network is critical to the future success of the rail industry. I will be monitoring this performance over the period to the next charging review to see that the benefits derived from it flow through to Railtrack's customers, and ultimately to the users of railway services. I will expect to receive the appropriate information from Railtrack to enable me to do this. Where appropriate such information should be made available to a wider public. I accept that Railtrack must have an incentive to secure improvements in performance even greater than those I assumed in approving its access charges, and I would not propose to claw back retrospectively any additional savings it is able to make. But where Railtrack's financial performance is better than expected for reasons other than greater efficiency, I would not consider it appropriate for the entirety of such benefits to be passed on to shareholders to the exclusion of Railtrack's direct and indirect customers. I will in particular want to be satisfied that the amounts included in Railtrack's plans for bringing the network up to standard, and for maintaining and renewing it, are properly spent for the benefit of all rail users.

#### **Channel Tunnel Rail Link**

45. If the proposed Channel Tunnel Rail Link Bill is passed by Parliament as currently drafted, I will have a new, overriding, duty in the exercise of my functions not to impede the performance of any development agreement. This will override all my

other public interest duties including that covering Railtrack's finances. I have not seen the development agreement which has been entered into, or the processes whereby it may be changed.

## **Conclusion**

46. Railtrack has a central position in the railway industry. Thus not only is the future success of the railway in Great Britain dependent on Railtrack, but the success of Railtrack is dependent on those who provide services to Railtrack and on those who as train operators or funding bodies purchase services from Railtrack. Railtrack and other industry parties have new commercial freedoms within a set of public interest rules and standards set out in the contractual framework. I aim to work with them to achieve improvement and thereby a better railway for all the railway's customers.

**JOHN SWIFT QC**

**Rail Regulator**