



OFFICE *of the*
RAIL REGULATOR

**RAILTRACK'S INVESTMENT
PROGRAMME**

STATEMENT BY THE RAIL REGULATOR

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1. Railtrack's Investment Programme - Statement by the Rail Regulator

Introduction

1. In this Statement I am setting out my overall response to Railtrack's 1997 Network Management Statement. My detailed assessment is in the Annex to this Statement. But I am also going one step further. Railtrack's investment in the nation's railway infrastructure is critical to the future of railway services. It has important stewardship duties. Its 1997 Network Management Statement, produced under its Network Licence, is an important step forward. However, I believe it is timely, now that Railtrack has been in the private sector for one year, to consider strengthening its existing contractual and licence obligations to ensure it achieves three key purposes: timely maintenance of the railway network; timely renewal and replacement of the network in modern equivalent form; and improvement, enhancement and development of the network. I have, therefore, commenced discussions with Railtrack in order to seek to agree with them an appropriate modification to Railtrack's Network Licence which would meet those purposes without prejudicing the effective management by Railtrack of a properly directed capital investment programme.

The Regulator's role in respect of Railtrack investment

2. Railtrack, formerly in the public sector and now in the private sector, is subject to regulation for one principal reason. It has been established by and on behalf of the State to own and to be responsible for the care and development of the nation's railway infrastructure which is largely funded by the State or other public authorities. Every train operator, passenger and user is entirely dependent upon Railtrack for access to that infrastructure. Railtrack has no competitors. The role of regulation, therefore, is to provide, through *systems of controls*, what a competitive market should be expected to secure through *incentives*: continuous pressure to innovate, to provide new and better services, to invest in new, more productive network assets, to cut costs, to reduce prices, to improve performance. Regulation is here to ensure that the railway network works in the public interest. It has a particularly important role to play in respect of Railtrack's investment in the renewal and development of the nation's railway infrastructure - its *stewardship* responsibilities.

Is regulatory approval of commercial contracts sufficient to promote the public interest?

3. Railtrack's position is in marked contrast to that of most other regulated utilities which supply services *direct to consumers*. Some ninety per cent of Railtrack's income is 'regulated' under 24 access contracts with *passenger train operators*. Railtrack's contracts with its freight customers are also regulated. Those track access agreements have been approved by the Regulator. They all contain strong incentives to improve performance. They allow train operators and Railtrack to make changes in their mutual interest, subject to approval by the Regulator on public interest grounds. And all franchised passenger train operators, under contract to the Franchising Director, require from Railtrack a commitment to enable them to achieve better performance. But the contracts are not, in my opinion, sufficient for the effective regulation of Railtrack's investment and stewardship duties.

The obligation to produce a Network Management Statement

4. The contracts themselves do not provide sufficient controls in two areas. First, they do not guarantee that train operators get the *modern equivalent railway* that they and the Government (and Passenger Transport Authorities) are paying for. Second, in part because most contracts are relatively short-term, they do not provide sufficient incentives for required long term enhancement of the nation's railway infrastructure.
5. That is why Licence Condition 7 in Railtrack's Network Licence is of critical importance. It is set out in full in the Appendix to this Statement. It requires Railtrack to prepare and publish annually in a form, and covering a period, *approved by the Regulator* a statement showing projections of future network capacity requirements, planned modifications to Railtrack's network and the method proposed for financing such requirements and modifications within Railtrack's overall financial framework. Before Railtrack was in the private sector, its obligation under Licence Condition 7 was to comply with the requirements of the Secretary of State for Transport as to form and period.
6. The force of this Licence requirement is that Railtrack must go beyond the requirements of its individual commercial contracts and publicly set out its plans to *deliver* on its investment and stewardship role. Its published Statement must conform with requirements I have set down in terms of form - that is, the coverage and degree of detail - and period - that is, how far ahead the published plans should look. This statement is called the Network Management Statement.

Railtrack's 1997 Network Management Statement

7. Railtrack published its first post-privatisation Network Management Statement in February 1997. It followed full consultation on its appropriate form and period. The Statement now contains much more information, presented in a more systematic form, about Railtrack's plans for the renewal and development of the railway network than has hitherto been published. If carried out, the planned expenditures will be in excess of those I assumed when I approved Railtrack's charges. That is most encouraging and reflects the substantial work which Railtrack has devoted to this task. However, although the Statement formally complies with the Form and Period which I have required, I consider that its detailed content does not yet satisfy the *Regulatory Objectives for Railtrack* I published in January 1997. I therefore expect Railtrack to make significant further progress in the course of 1997 in setting out *detailed plans* in respect of :
- (a) forecasts of demand to use the network and the actions Railtrack is taking to provide capacity to meet those demands;
 - (b) specific action in respect of investment in Stations and Depots;
 - (c) a much more specific set of proposals in respect of Freight;
 - (d) a positive commitment to network development and enhancement; and
 - (e) a positive commitment to working with its customers on establishing their needs for the renewal programme.
8. The Statement is thus a set of Plans. However, there remains a substantial backlog of expenditure on network assets, stations and depots which Railtrack must now eradicate as a priority. In certain areas, in particular stations, its delivery against its plans to date has been disappointing. Significant improvement is needed. I shall therefore be monitoring Railtrack's performance very closely to ensure *delivery* of a continuously improving railway.
9. Moreover, these plans do not yet set out the *results* - in terms of improved quality and capability - which should be expected from Railtrack's investment programme. I intend to work with Railtrack to develop measurable benchmarks and targets for what Railtrack should be achieving.

The need for further reform of the structure of controls

10. To summarise, Railtrack's investment programme must, in my view, be directed to achieve three purposes:
 - (a) timely maintenance of the railway network;
 - (b) timely renewal and replacement of the network in the appropriate modern equivalent form; and
 - (c) improvement, enhancement and development of the network.
11. The existing structure of regulatory controls in respect of Railtrack's investment and stewardship obligations involve regulatory approval of commercial contracts together with an obligation to publish plans for investment. At present Railtrack's obligations under its Licence Condition 7 are extremely light. I have concluded that it is now timely to consider strengthening these obligations in two ways.
12. First, there is at present no obligation on Railtrack to demonstrate how it proposes to link its investment programme to *output targets of quality and capability*. A revised Licence Condition would require Railtrack to show to its customers how it would achieve the three purposes I have set out above.
13. Second, there is no direct means of ensuring that Railtrack complies with its acknowledged duty to spend the money it receives for investment and to spend these large sums wisely. Assurances that the capital and maintenance programme will be carried out, the more especially when most of the annual expenditure in effect is funded by the State, require something more bankable than the expression of intentions or the short-term pressures to meet contractual obligations.
14. I have therefore commenced discussions with Railtrack in order to seek to agree with it an appropriate modification to Condition 7 which would meet 'public interest' concerns without prejudicing the effective management by Railtrack of a properly directed capital investment programme. I would then consult with interested parties to ensure that their concerns were being properly addressed. The new Licence Condition should safeguard and promote *their* interests as partners of Railtrack in a better railway, and their views will be particularly important.

Conclusion

15. Railtrack's Network Management Statement for 1997 is a big improvement in demonstrating its commitment to planning and future investment. The sums committed are in excess of those contemplated by Railtrack's original plans when I approved its charges in January 1995. The way forward now is to ensure delivery and proper accountability in the interests of the State, customers, passengers and users.

JOHN SWIFT QC

Rail Regulator

May 1997

Annex - Railtrack's 1997 Network Management Statement - Regulator's Detailed Response

Introduction and objectives for Railtrack's Network Management Statement

1. In February 1997 Railtrack published its annual Network Management Statement, a requirement of its Network Licence, setting out its plans for the renewal and development of the railway infrastructure. This Annex contains my detailed assessment as to whether the Statement meets my objectives for it.
2. In my statement of Regulatory Objectives for Railtrack (January 1997) I stated that I expected Railtrack to deliver an effective infrastructure renewal and investment programme which followed four key regulatory principles:
 - (a) Railtrack should, in a timely fashion, renew the railway infrastructure in the appropriate modern equivalent form;
 - (b) Railtrack should take a proactive and positive approach to the development of the railway network in a way which reflects the needs of its customers and of rail users;
 - (c) Railtrack should make good the current shortfall in expenditure in an efficient and effective way;
 - (d) Railtrack's plans and investment approval processes should ensure delivery of these objectives.
3. I further stated that I expected Railtrack in its Network Management Statement to demonstrate - publicly - its commitment and capability to deliver an infrastructure investment programme meeting these objectives.

General comments and approach

4. The Network Management Statement represents a significant step forward in improving understanding of plans for the renewal and development of the network. Furthermore I welcome the explicit public recognition by Railtrack in the Statement that it is subject to duties in respect of the stewardship of the railway for the benefit of users and funding bodies.

5. The key questions for me are:
- (a) Does the Statement comply with the form and period which I have approved, and is this form and period appropriate for future statements?
 - (b) Do the plans contain the right commitments in respect of the capacity of the infrastructure and its timely renewal in modern equivalent form?
 - (c) Will these commitments be delivered?
 - (d) Will the programme result in a better railway network?
 - (e) Does the Statement show sufficient evidence of a positive and proactive approach to the development of the network by Railtrack?
 - (f) Does the Statement show sufficient evidence that Railtrack is planning in a positive way to develop the use of the network for freight?
 - (g) Does the Statement comply with the form and period which I have approved and is this form and period appropriate for future statements?
6. As a requirement of Railtrack's Network licence the form and period of the Statement must be approved by me. Following joint consultation with the railway industry I required a form and period which involved the publication of much more information, presented in a more systematic way than hitherto.
7. I consider that the Statement does comply with the form and period I approved but I will wish to consider whether to approve the same form and period specification for subsequent years or to amend it in the light of the current Statement and reaction to it. I certainly will expect future Statements to enable readers to establish more easily the progress made by Railtrack against previous Statements and to link figures in the Statement with corresponding ones in Railtrack's Annual Accounts. I also note that Railtrack has set out a process of consultation with its customers and others on the contents of the Statement, and I have asked Railtrack for a report on the initial results of this consultation by the end of June. Railtrack is also committed to reviewing the effectiveness of the disaggregation of information in the current Statement, and I am seeking proposals from Railtrack on this by 31 July.

Do the plans contain the right commitments in respect of the capacity of the infrastructure and in respect of its timely renewal in modern equivalent form?

Capacity

8. A key purpose of the Network Management Statement is to require Railtrack, with its central role in the railway, to demonstrate to users and others what its projections of future demand on the network are, and what it is proposing to do to meet them.
9. I am disappointed that Railtrack has not yet been able to produce a view of the future demands on the network arising from the plans and aspirations of newly privatised operators, and of funding bodies; the implications for the capacity of the network especially at current and future bottlenecks and what actions Railtrack is taking to deal with them. Railtrack has stated to me that a reason for this is that the privatisation of train operators has only recently been completed, and it has assured me that it is seeking to establish the needs of its customers and their implications.
10. Recognising the importance I attach to this issue, I expect significant progress to be made on this over the next year to be reflected in the 1998 Network Management Statement, with regular progress reports to me in the intervening period.

Renewal

11. Section 4 of the Statement effectively commits Railtrack to a policy for the renewal of assets which involves maintaining each infrastructure asset for as long as it gives reliable service and then replacing it in the appropriate modern equivalent form when it no longer meets the needs planned on it. I welcome the commitment to renewal in modern equivalent form, but I would expect to see:
 - (a) significant development of the criteria for timing and form of renewal to ensure that renewal is undertaken at the optimal time in the asset life cycle, linked to the work on whether the plans are producing a better railway; and
 - (b) a systematic approach to ensuring that decisions on renewal take effective account of the views of train operators and funding bodies. I understand Railtrack is setting up such a process for train operators and I am therefore asking Railtrack to provide me with regular progress reports on this. I expect the initial report to explain Railtrack's plans to involve Passenger Transport Executives and the Franchising Director.

12. Furthermore, I will wish to review in more detail with Railtrack the policies it has adopted in respect of renewal of specific asset categories. In particular, I will wish to understand how Railtrack has established that the overall renewal strategy for signalling is robust and efficient, and how this relates to current renewal schemes.
13. In publishing their half yearly accounts for 1996-7, Railtrack revealed that very little of the provision made for property backlog expenditure had actually been spent. In the Network Management Statement, the renewal programme for stations and depots is only set out in the most general terms. I expect significant progress to be made over the next six months to produce a more clearly specified renewal programme for stations and depots, in consultation with train operators, and I am seeking a report from Railtrack on progress by 31 July 1997, and subsequent regular progress reports.
14. If delivered, the plans set out in the Statement will broadly achieve in the period up to 2001 the level of expenditure judged to be necessary at the time Railtrack was floated, and somewhat more than I allowed for when I set Railtrack's charges in 1995. I welcome this important public commitment from Railtrack.

Will the commitments be delivered?

15. The Network Management Statement is a series of plans. Railtrack will be judged on the delivery of these plans. I have already expressed concern about Railtrack's achievement of its plans and commitments in a number of key areas of expenditure as revealed in its half-year results for 1996-7. I shall be studying its full year financial results for 1996-7 carefully to establish whether there has been a satisfactory degree of improvement and I shall be monitoring Railtrack's performance in 1997-8 very closely. In particular I shall be seeking to confirm that there is an effective link between policies and plans set out in the Statement and the actual activity of renewal.

Will the programme result in a better railway network?

16. The Statement does not set out what the results of the programme it contains will be in terms of reasonable effects on the *performance and capability of the network*. I believe that it should do. To address this need, I expect to develop, working with Railtrack, measurable benchmarks and targets of what Railtrack should be achieving. I expect this to build on the existing Network Maintenance and Renewal Quality Indicators published every six months by Railtrack following discussion with my Office. It will focus on the outputs of the network, but will also need to consider the long term health of the assets.

17. I expect the results of this work to be reflected in due course in Railtrack's planning and investment appraisal processes, alongside Railtrack's own commercial requirements and the needs of its customers.

What progress is Railtrack making in terms of a proactive and positive approach to the development of the network?

18. I welcome the commitment Railtrack has made to the Thameslink 2000 project and improvements on the West Coast Main Line. However, more generally, I am not yet satisfied that Railtrack is taking a sufficiently proactive approach to identifying what it can do in its key position as owner and operator of the national railway infrastructure to promote and facilitate development of that infrastructure for passenger and freight users.
19. I expect that with the completion of the franchising process and the privatisation of freight operations, together with the crystallisation of plans by train operators, Railtrack will now work with train operators, and funding bodies to identify potential enhancements and create commitment to them. I am therefore asking Railtrack for a progress report on this process by 30 June 1997 and subsequent regular progress reports.
20. I also expect Railtrack to make significant improvements to the processes whereby it facilitates network enhancements funded by local authorities and Passenger Transport Executives, by setting out clear procedures and criteria based on my policy statement "Investment in the Enhancement of the Rail Network" (March 1996) and I would expect this to be covered in the June 1997 report to me.
21. I welcome the commitment in the Statement to improve the processes for the approval of rolling stock safety cases. I am asking Railtrack to ensure that these processes make clear the rights and obligations on Railtrack and the other parties involved. These new arrangements should be clearly documented, and have the support and commitment of those affected by them.

Does the Statement show sufficient evidence that Railtrack is planning in a positive way to develop the use of the network for freight?

22. I am concerned in particular that the plans set out in the Statement for freight do not reflect a commitment by Railtrack to doing all it can to promote the development of the network for freight to the extent economically practicable.

23. The assumptions Railtrack has employed in respect of likely demands on the network for freight are couched in excessively general terms. There is no geographically (i.e. route or location based) quantified assessment of these demands leading to the identification of network priorities in respect of freight. The Statement fails to demonstrate a willingness by Railtrack to share any risk with other parties in developing rail freight, even in the context of the single major project identified (the freight upgrade element of the West Coast Mainline project).
24. Subsequent to the publication of the Network Management Statement, and following discussion with my Office, Railtrack has published a ten point plan for freight ("Promotion of Rail Freight, April", 1997). This represents a more positive start point for the development of a comprehensive freight strategy by Railtrack and promises greater commitment to full involvement in the promotion of rail freight. The plan offers some specific targets in important areas of service improvement and investment. However, the proposals are at a very early stage. They need to be better defined and expanded in order to explain how, in collaboration with its customers, Railtrack intends to carry out the improvements it promises. They also need to be *delivered*. The proposed Code of Practice is an important step. It should bring to the proposals a commitment by Railtrack to develop its relationship with its customers in order to implement the plan successfully for the benefit of rail freight users.
25. I welcome the ten-point plan as an expression of Railtrack's determination to play its part in the development of rail freight. I expect Railtrack now to develop its proposals in more detail, and to report to me on progress in delivering the commitments it has made by 31 July, and on a regular basis thereafter.

JOHN SWIFT QC

Rail Regulator

May 1997

Appendix

Network Licence Granted to RAILTRACK PLC

Condition 7: Statement of Future Network Capacity Requirements

"The licence holder shall prepare and publish annually in a form, and covering a period, approved by:

- (a) at any time when the licence holder is a public sector operator, the Secretary of State; or
- (b) at any other time, the Regulator,

a statement showing projections of future network capacity requirements, planned modifications to the licence holder's network and the method proposed for financing such requirements and modifications within its overall financial framework."