



OFFICE *of the*
RAIL REGULATOR

**A FAIR DEAL FOR CONSUMERS
MODERNISING THE FRAMEWORK FOR
UTILITY REGULATION**

COMMENTS BY THE RAIL REGULATOR

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A Fair Deal for Consumers: Modernising the framework for utility regulation

Introduction

1. As the Green Paper notes, rail regulation is currently the subject of a review by the Deputy Prime Minister. The conclusions of that review have yet to be published, but are expected to lead to the establishment of a Rail Authority, with some reallocation of responsibilities between that authority and the Rail Regulator ¹.
2. In the circumstances, it would not be appropriate to comment on those proposals in the Green Paper which relate to the structure of regulation, the duties placed on the regulators and the statutory framework for accountability. Nevertheless, a number of the proposals in the Green Paper are relevant to the ongoing work of the Rail Regulator. This is particularly relevant to the regulation of Railtrack, for example in reaching decisions on the periodic review of Railtrack's access charges which was initiated last December.

Responses to individual proposals

Proposal 3.5 - Framework for price regulation

3. The Rail Regulator will be undertaking a detailed consultation later this year on the framework for controlling Railtrack's access charges. The overall objective for that review, as proposed in the initial consultation paper published last December, is 'to establish a financial framework which provides challenging targets for future efficiency and for improvement in network performance and capability, and strikes an appropriate financial balance between Railtrack, its customers and its funders'.
4. Railtrack is currently subject to an RPI-X control on access charges (which are individually approved by the Rail Regulator in access agreements, under the provisions of the Railways Act 1993). The charging framework includes some elements of profit sharing and error correction. For example, Railtrack is regulated on a 'single till' basis, with income from its property assets reducing access charges to franchised passenger train operators. Any additional net income secured by Railtrack from those property assets, over and above the levels assumed by the Rail Regulator

¹ These issues have, for example, been considered by the Transport Sub-Committee of the Environment, Transport and Regional Affairs Committee - 3rd report session 1997-98

in establishing the initial level of access charges, are shared between Railtrack and its customers. In addition, certain changes of law may lead to modifications of access charges. Beyond this, there are no provisions for modifying access charges before 1 April 2001; in particular, because access charges are contained in access agreements rather than licences, the Rail Regulator is unable to refer changes to the MMC.

5. As part of the periodic review, which will be the first following Railtrack's privatisation, the Rail Regulator will wish to review Railtrack's performance to identify whether it has delivered the objectives assumed in setting the original level of access charges - in essence, to enable Railtrack to maintain the existing capability of the rail network and, where necessary, to carry out renewal in the form of modern equivalent assets - and its efficiency in doing this. In his statement in the Railtrack prospectus, the Rail Regulator made it clear that Railtrack should have an incentive to secure improvements in performance, and that he did not propose to clawback retrospectively any additional savings it is able to make. However, he said that 'where Railtrack's financial performance is better than expected for reasons other than greater efficiency, [he] would not consider it appropriate for the entirety of such benefits to be passed onto shareholders to the exclusion of Railtrack's direct and indirect customers'. A key issue for the review, therefore, will be to decide the treatment of those factors impacting on financial performance which do not reflect greater efficiency.
6. In deciding the future financial framework for Railtrack regulation, one important question, raised in the periodic review consultation paper, is the balance between adjustments at periodic reviews and more frequent fine-tuning of the regulatory framework. Railtrack is already obliged under its network licence to publish annually its forward expenditure programme, and this provides a basis for reviewing whether its plans meet the reasonable requirements of customers and funders, and whether the company is delivering on those plans.
7. As indicated above, the Rail Regulator will be consulting on these specific issues later in the year. In doing so, he will have regard to the conclusions which emerge from the Government's review of utility regulation, of which this Green Paper forms a part.

Proposal 3.7 - Service standards

8. Railtrack's access agreements with train operators include performance regimes which result in financial penalties or rewards if punctuality deteriorates or improves. These arrangements are based on a detailed monitoring and fault attribution system. They do

not, by themselves, necessarily provide adequate incentives on Railtrack to maintain and in particular enhance the overall capability of the rail network in line with the reasonable requirements of customers and funders. Accordingly, the Rail Regulator modified Railtrack's network licence in 1997 to impose a general duty on the company in respect of the maintenance, renewal and improvement, enhancement and development of the national rail network.

9. A key element in the process for delivering this general duty is a requirement on Railtrack to develop criteria which it will apply in complying with the duty, including its methods of determining the priority and timing of different types of work, the parts of the network on which it will be carried out and the basis for reviewing such priority. Railtrack must also publish an annual statement, in a form and covering a period approved by the Rail Regulator, including in particular the expected effect of its plans on the quality and capability of the network. Railtrack also currently publishes, on a six monthly basis, indicators of network performance and capability. This framework of output measures is being developed, with output targets appearing in the annual statement for the first time in 1998.
10. The Rail Regulator regards this development of an output target framework as a key to Railtrack's stewardship obligations.
11. The Rail Regulator is also responsible, through the licences he has issued to train operators, for ensuring the promotion of 'network benefits' which exist in the rail industry. These include the National Rail Enquiry Service and the impartiality and accuracy of ticket retailing activities. The Rail Regulator has already established enforceable service targets in respect of the former (and has taken enforcement action - see below), and is proposing to set similar targets in respect of the latter.

Proposal 3.8 - Imposition of monetary penalties

12. The Rail Regulator, like the Director General of Gas Supply, already has the power to impose fines on licence holders for breach of licence conditions as well as requiring licence holders to undertake specific actions. The Rail Regulator has imposed such financial penalties on train operators in respect of their failure to meet service targets in respect of the National Rail Enquiry Service.
13. 13. The Rail Regulator regards the ability to levy fines as an important addition to other enforcement powers. However, he believes there is a case for considering whether fines could be levied in a form which allowed for financial recompense or additional service commitments to the benefit of those materially and directly affected

by the poor service which led to the original enforcement action or, as in the case of the railway industry, to the benefit of the funders of services.

Proposal 3.10 - Publication of information on performance

14. 14. As indicated above, Railtrack's annual Network Management Statement must be in a form, and covering a period, approved by the Rail Regulator. This enables the Rail Regulator to require publication of appropriate performance information by Railtrack.
15. 15. Much of the performance information of train operators is within the area of responsibility of the Franchising Director, who publishes regular performance bulletins. The Rail Regulator is developing the framework for publishing information on those aspects of performance for which he is responsible. He will, for example, shortly be publishing for the first time detailed information on complaints received by train operators.

Proposal 3.11 - Investment regulation

16. 16. The Rail Regulator accepts the need to develop and adopt best practice measures on investment regulation. He supports the proposal that this should be taken forward on a cross-office basis.

Proposal 4.5 - Scale monopoly provisions

17. 17. The Rail Regulator welcomes this proposal, and considers that it is essential that it applies to the rail sector as well as to the four sectors covered by the Green Paper.

Proposal 7.1 - Use of individual regulators

18. 18. The Rail Regulator recognises the value that external advice can bring to regulatory decisions, and described in his initial submission the arrangements for this within ORR. Development of regulatory procedures (as discussed under other proposals in chapter 7) will enhance arrangements for accountability of individual regulators. The objective should be to ensure that regulators can take the right decisions in the right timescale. Changes to the current framework - whether to introduce Boards, Commissions or externally appointed advisers - will need to balance additional bureaucracy, with its consequent implications for the speed of regulatory decisions and possible loss of focus of regulatory decision-making, against the expected improvement in the quality of decisions.

Proposal 7.2 - Resources

19. The Rail Regulator welcomes the recognition that adequate resourcing is important in ensuring effective regulation.

Proposal 7.3 - Code of Practice on consultation and decision-making processes

Proposal 7.4 - Consultation and publication of forward programme

Proposal 7.5 - Publication of reasons for key decisions

20. The Rail Regulator recognises the importance of establishing effective and transparent procedures as a basis for increasing confidence in regulatory decisions. Regulatory procedures are under constant review, to identify and adopt best practice. In particular, the Rail Regulator undertakes extensive consultation on significant new policies and when the exercise of his licence and access functions raises novel or contentious issues (including consulting on major individual access agreements) and publishes the reasons for decisions on those matters.
21. The Rail Regulator recognises the case for developing a code of practice, and is discussing this matter with other regulators to identify best practice.
22. Although a formal forward plan is not yet published, the Rail Regulator has published a series of statements of his objectives - for Railtrack, passenger operators and freight - which set out the issues which regulation is seeking to achieve in these various areas. These statements of regulatory objectives are kept under review.

Proposal 7.6 - Disclosure of information

23. The Rail Regulator accepts the importance of access to adequate information on the performance of regulated companies. He welcomes the proposal that information provided by monopoly businesses to him should generally be disclosable, provided that this does not restrict the amount of information available or the speed of its provision. There may, therefore, also be a need to review whether the information gathering powers in Acts and licences are adequate.

Proposal 7.7 - Presentation of regulatory accounts

Proposal 7.10 - Common format for regulatory accounts

24. The Rail Regulator recognises and accepts the need for regulatory accounting information to be clearly presented, and to address the matters of concern to customers and funders. ORR is participating in further work on these issues.

Proposal 7.8 - Encouraging consistency and spread of best practice

25. As indicated in his original submission, the Rail Regulator supports the need for dialogue between utility regulators to debate methodological issues and to identify best practice. Although there has been considerable dialogue between offices on a number of such issues, the Rail Regulator accepts that these discussions could be more transparent, and involve wider interests. He is concerned that if a formal technical advisory committee was established, this could confuse accountabilities. He considers, therefore, that the benefits of greater transparency and involvement of external interests could be achieved through commitments in codes of practice in respect of consultation on cross-office issues, with a forward programme for such consultation and publication of the conclusions, without going so far as to establish any formal committee.

Proposal 7.12 - Coverage of annual reports

26. The Rail Regulator welcomes feedback on the format of his annual report, both as a vehicle for providing a record of significant developments during the year and of important forthcoming developments, as well as providing various performance information. The Rail Regulator will, therefore, wish to take account of other responses to this proposal.

Proposal 7.13 - MMC procedures on licence modification references

Proposal 7.14 - Regulators' discretion following modification references

Proposal 7.15 - Sector specific panels

27. The Rail Regulator has not made any licence modification references to the MMC, and therefore has no direct experience of their procedures. However, the development of best practice on regulatory procedures, and of new procedures in the Competition Tribunal which will be part of the reformed Competition Commission, make it timely to review the role of the commission and its procedures on regulatory references. There are a number of reasons - including the development of methodological best practice - which make regulatory references different from other MMC references.
28. It would be more consistent with regulatory best practice for the MMC to publish draft conclusions and to seek views on those conclusions before reaching final decisions. However, the Rail Regulator recognises the need to reach timely decisions and to maintain clear accountability for licence modifications and enforcement, and on balance considers that a requirement for regulators to consult with the MMC on the

terms of proposed licence modifications following a reference (option a) is to be preferred.

29. There is no MMC railways panel, and the Rail Regulator considers that the most appropriate way of achieving consistency in regulatory references would be to rely on the MMC Chairman to appoint general members with utilities expertise to serve on licence modification panels (option c). If a single cross-utilities panel were to be established (option b), it would be important for this also to cover the rail industry.