



OFFICE *of the*
RAIL REGULATOR

REPORT OF THE RAIL REGULATOR

To the Secretary of State for Transport and the Scottish Ministers

I enclose my report for the year ending 31 March 2004 as required by section 74(1) of the Railways Act 1993 and the Scotland Act 1998 (Transfer of Functions to the Scottish Ministers etc) Order 1999.

I confirm that during this period:

- (a) I made no references to the Competition Commission; and
- (b) I received no general directions under section 69(2) of the Railways Act 1993.

Tom Winsor
Rail Regulator
May 2004

Presented to Parliament in pursuance of section 74 of the Railways Act 1993

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Regulator's foreword

1. This is my fifth and last annual report as Regulator. It covers the period 1 April 2003 - 31 March 2004.

2. My five-year term of office ends on 4 July 2004. After that, the statutory position of Rail Regulator is abolished, replaced by a board to be called the Office of Rail Regulation under the chairmanship of Chris Bolt. The independence and jurisdiction of the ORR will not change as a result of this new structure, but the dynamics of the organisation's decision-making undoubtedly will; indeed, that is why Parliament has established it. Immediately upon the announcement of the members of the statutory board, I invited each to join my non-statutory advisory board, to facilitate a smooth and efficient handover. I am pleased to say that the new members have accepted my offers and, whilst the formal position of Rail Regulator remains until July, my colleagues and I are doing everything we can to ensure the new team is played in as much as possible. I wish Chris Bolt and his new colleagues every possible good fortune and success in taking forward and building on the reforms and work of the last five years, and in facing the new challenges which they will undoubtedly encounter. I earnestly hope that they will be sailing in far calmer waters.

3. In the reporting year, the access charges review which started in September 2002 was completed and my final conclusions were announced on 12 December 2003. The review was made necessary by the aftermath of the Hatfield derailment on 17 October 2000 and the decision of the Government to apply for Railtrack to be put into administration on 7 October 2001. The review's conclusion - with an overall settlement for the operation, maintenance, renewal and enhancement of the network of £24.4 billion over five years - has been a watershed for the railway industry, establishing as it has the size, quality and efficient cost of the national network for the five years 1 April 2004 to 31 March 2009. The review has harnessed the costs of the infrastructure provider, run virtually out of control as a result of Railtrack's reaction to Hatfield and the subsequent period of the administration of Railtrack when the discipline of the equity of the company in relation to the control of costs was lost. The review has set tough but fair targets for Network Rail's stewardship of the network over the next five years, including in matters of infrastructure quality, capacity and performance, and has reinforced and strengthened the incentives of the company to deliver on its obligations.

4. The review also required me to take decisions on how the regulatory settlement - an increase of over £7 billion in Network Rail's revenues over five years - should be financed. Simply raising access charges by this amount would have caused very significant difficulties for the public finances, including the budget of the Strategic Rail Authority and the Department for Transport. Accordingly, whilst maintaining the integrity of the settlement and therefore the overall amounts which Network Rail is entitled to receive, on 10 March 2004 I accepted a proposal from Network Rail, supported by government, that a higher proportion of Network Rail's income should come in the form of grants direct from the SRA, and that the money should not have to be passed through the passenger train operators. I agreed to this on the condition that there would be a release of the unnecessary and duplicatory controls which the SRA had imposed on Network Rail in the period before its acquisition of Railtrack. Network Rail's accountability is first to its customers - the freight and passenger train operators - and second, in the public interest, to its regulator. I regard it as essential that Network Rail's accountability is as simple, properly focussed



and strong as possible. The dynamics of accountability should not have been distorted as they were, and the confusion to which this policy - and other behaviours - led has done harm to the industry and to all the public institutions concerned. It had to be brought to an end. In December 2003, the Secretary of State and the Permanent Secretary at the Department for Transport publicly confirmed that the Government's policy view in this respect is the same as mine.

5. The outcome for the railway industry of the access charges review demonstrated the strength of a system in which government was able to state its priorities for the use of its discretionary subsidy budget, but in which, after that, the decision on the network outputs required, the efficiency with which they are to be delivered, and the sufficiency of the plans which support them was made according to objective, transparent and non-political criteria, in the public interest. This is the system which was devised by Parliament and has been operated as Parliament intended. It is one by which private investors have placed great store and which enables industry players and others to plan their businesses with assurance and confidence. It is the antithesis of the annualised financial settlement of the days of nationalisation and the stop-start approach to investment. It has shown its integrity and its strength. It is not a system which anyone could now afford to diminish or dismantle, least of all the railway industry itself.

6. In the reporting year, ORR completed its work on the establishment of model contracts for passenger and freight train operators, and ten train operators are now operating on the new basis. Others will follow, and in a relatively short time the relationship between Network Rail and its freight and passenger train operator customers will be more firmly grounded, with a clear specification of what each party has to do in the relationship and fair and efficient remedies for when things go wrong. I am grateful to the industry for such constructive engagement in this work and its warm acceptance and take-up of the new arrangements. I am sure that its confidence in them will be shown to be well founded.

7. The reporting year has seen welcome improvements in Network Rail's stewardship of the network, with an intensity of concentration on operational performance not seen in several years and real successes. The December 2003 performance summit held at ORR demonstrated the strong will on the part of the whole industry to co-operate in determining and fixing the causes of performance failures, and I was greatly encouraged by the co-operative spirit and constructive approach of all concerned. Network Rail has intensified its efforts to make the necessary improvements, but of course it has still some way to go and will continue to face regulatory scrutiny and pressure in this respect. The industry is taking real and positive steps to meet the legitimate expectations of the people it serves and who pay for it, and Network Rail is well on course to get close to the challenging performance targets I have set for it. The position is improving in a steady and sustained way, which is to be welcomed. We have also seen the lowest number of broken rails since detailed records began, and track quality improvements are real and substantial. Of course there are no grounds for complacency. The present strong progress must be maintained and intensified. However, the vigour, energy and imagination of the industry in this respect is to be commended, and the work which has been done so far deserves strong support.

8. As this is my last annual report, it is appropriate that I offer some observations and reflections on the last five years, and express a view on what lies ahead. For the railway industry and its users, they have been turbulent years - unnecessarily so. The industry has gone through a period of considerable upheaval, turmoil and uncertainty. It has been through five serious accidents, two major pieces of primary legislation, the destructive stewardship of Railtrack, the disintegration of the integrity of the network after Hatfield, the financial collapse of the infrastructure provider, a remarkable and unconstitutional threat to independent economic regulation, the restructuring of the network provider on an entirely unforeseeable basis, an explosion in costs, intense politicisation and sustained assaults by the artillery of the media.

9. What the industry now needs is stability, predictability, clarity of responsibility and accountability, sound incentives and an environment which is friendly to investment. It is bruised and battered, reorganised and restructured, pressed and criticised. But the professionalism and dedication of the people who work in the railway industry has not been suppressed, let alone wrung out of them. The contrary is true. They have hung on and intensified their efforts to provide a service of which they and we can be proud, and they deserve our support and our thanks for their work.

10. There is now little argument that the years of Railtrack were largely wasted ones, with the national railway network in the hands of a company which in too many respects was hostile to its customers and neglected its assets. When I took office, I was determined to use the jurisdiction of my office to try to make the company strong, competent and successful, despite its internal contradictions and its obvious failings in its abilities and its external relationships. But Railtrack resisted hard and sought to frustrate measures which would have made it a better, more competent and profitable company. The improvements to its accountability to its customers and the public interest, through its contracts and its network licence, and the significant improvements in its financial framework through the 2000 access charges review, were wrongly set aside. Despite the beginning of a regime of higher funding and much better incentives, when it should have taken full advantage of these considerable improvements in its regulatory and contractual environment, the management of the company and government chose to follow a different path, one in which these essential reforms were disregarded and played no part. Indeed, under Railtrack's proposals to government, they would have been suspended for several years. The ink was hardly dry on the 2000 review and the stronger accountabilities which were established as part of it - and they had no time at all to work - before a misconceived and hopeless policy of attempted circumvention of the new regime was pursued to destruction. The administration of Railtrack was as unnecessary and expensive as crucial aspects of its initiation were unconstitutional. It led to an unprecedented explosion in costs, an effective suspension by government of the necessary controls and restraints, and a sharp fall in operational performance, things which have taken us well over two years now to put into reverse. The administration of Railtrack having effectively extinguished the equity in the company, its substantial overspending since Hatfield and during administration all fell to the government and must be paid out, through the amortisation of the regulatory asset base, over the next 30 years.





11. Railtrack should have engaged in and with the regulatory and contractual regime which was improved for its - and the industry's - benefit. The checks and balances of the system had been enhanced, and the company had a financial framework and rights of appeal which were far better than it had enjoyed before. If the interim access charges review which Railtrack had a right to expect had not produced an adequate financial settlement, the company had a right of appeal to the Competition Commission. If that had failed, its shareholders and the markets could still have provided a way out. It is of course possible that, after the established system had run its course, the company would still have faced insolvency and government would then have reacted by petitioning for its administration. But Railtrack had quite a few more rolls of the dice before that happened. Instead, the management bet the company on a single option which in my view had no prospect of being accepted or working.

12. The measures which were taken in the preparations for Railtrack's administration involved an extraordinary threat to independent economic regulation, endangering private investment in the industry through its proposed undermining of the constitutional position not only of my office but also of all the other independent economic regulators, and casting real doubt over the sanctity of contract between the state and the private sector. The resistance of the railway industry and the financial institutions of the UK and Europe caused government to draw back from this proposed policy, and rather than facing a reduction in its jurisdiction - as had also been proposed - the powers of my office were considerably enhanced to deal with the consequences of government's policy that the equity in the infrastructure provider be removed. Moreover, since then the Secretary of State has made four statements to Parliament stressing the importance which the Government attaches to the maintenance of independent economic regulation and providing assurances to investors and others that its jurisdiction will not be materially diminished in the present rail industry review. These statements and assurances have been relied upon by financial institutions in their recent decisions to advance very considerable sums to Network Rail, and, despite the scepticism of others in the railway industry, I do not believe there is any appreciable prospect of their being dishonoured.

13. In the face of the turbulence which the industry has been through in the last five years, ORR has taken considerable steps to stabilise it and its internal and external relationships - with one another and with the outside world - through the framework reforms which we have been pursuing and have almost completed, and through the use of our powers in a fair, proactive and proportionate way.

14. The contractual and regulatory matrix established in 1994 - when the industry was restructured in preparation for privatisation - was in too many respects weak, uncertain or ineffective. Some of those shortcomings were a function of the haste with which privatisation was being pursued. Others were put in deliberately, in order to ensure a successful sale of the assets. These faults were compounded by an excessively light touch approach to their use, and the result was that in too many respects Railtrack's abuses went unchecked. Upon taking office in 1999, I set about using the mechanisms for change which had been built into the system to improve the matrix, to increase Railtrack's accountability to its customers and the public interest and incentivise the company to do better. Since then,

ORR has carried out two reviews of the financial framework of the infrastructure provider (2000 and 2003), strengthened the contractual framework between infrastructure provider and users, and enhanced the public interest protections in the company's network licence.

15. These reforms have been about putting right the shortcomings of the past. They have been about empowerment of the private sector operators, replacing the need for intrusive enforcement regulation with commercial incentives to improve. They have been about reforming the relationship between infrastructure provider and user, replacing a culture of conflict with one of true co-operative joint venture in which both parties have a real and positive interest in making the relationship work, improving performance and serving the ultimate user.

16. It is frequently said that to operate properly the railway industry must be vertically integrated, and nothing else will work as well. Yet most mature private sector industries are not organised in this way. There is nothing objectionable about an efficient and well-performing chain of supply. Such arrangements work well - and have always worked well - in other complex, safety-critical industries. Transport is no different in any fundamental respect. The essential factor is that the interfaces between the links in the chain must be properly designed and efficiently and competently operated. It is in this respect that the railway industry has not worked well, in some crucial respects because its privatisation endowment was a poor one.

17. The contract reforms we have established recognise and fully support the intensity of the interdependence of the two parts of the track-wheel interface. They are about enabling the parties to work properly together, using their talents to create a better railway. They provide for the first time a clear specification of what each party has to contribute to the venture, how it is to be remunerated, how improvements are to be brought about, and fair and efficient mechanisms for putting things right when they go wrong. In short, they have been strengthened, simplified and streamlined, and are now - at last - fit for purpose. The amendments and enhancements to the network code which I will make before the end of my term of office - in particular in the areas of local output commitments (providing for stronger and more specific local accountability), changes to access rights, changes to the network itself and to the rolling stock which may be operated on it, the handling of operational disruption and the provision of information - will complete these reforms.





18. It is often suggested that the railway industry needs a single directing mind, one ‘fat controller’, a central authority which will tell everyone else what to do. For the reasons I have given, in my view as a general proposition this is misconceived. The private sector operators can make this joint venture work if they are given the framework and the tools, and if they have the ability and the will. They do not need anyone - least of all a public official - telling them how to make this industry work or controlling its day-to-day operations. Why would a private sector industry accept such a degree of intervention? The framework for virtual - not vertical - integration is already in place. The reforms which have been made in the last five years have integrated train and track as they should be, without the need for common ownership. Industry players need to understand the framework and operate it properly. There is nothing stopping them but themselves, and the alternative is deeply unattractive.

19. However, in the case of operational disruption when it occurs, there is of course a need for clear and single authority to ensure that remedial action is as swift and effective as possible. The network code already provides for this; it has done since 1994. It is regrettable that for so long too many in the industry were unaware of a facility of real power and utility in this respect. And it is a good thing that the industry is now taking the steps necessary - for instance, through the establishment of integrated control centres and improved train regulation arrangements - to put this right. It is an instance of the existing apparatus being put to proper and efficient use, obviating any need to design more mechanisms to do what is already provided for.

20. The reforms to Network Rail’s network licence have been just as important. I have introduced new conditions and strengthened existing ones so as to establish the Rail Safety and Standards Board, provide for the establishment of a register of the capacity, capability and condition of Network Rail’s assets, enable the appointment of network stewardship reporters to assist in holding Network Rail to account, put in place controls over the disposal of land for non-railway purposes, and make improvements in the way in which Network Rail deals with its dependent customers. The discredited network management statement regime for Network Rail has been replaced by an annual business planning regime. Other improvements have been made. This is the network licence which Railtrack should have had when it was established in 1994. It is at last fit for purpose. It should be given a chance to work.

21. Independent economic regulation has established a financial framework for Network Rail which provides the company with a stable revenue stream for the competent and efficient operation, maintenance and renewal of the network. The 2003 access charges review involved a very thorough analysis and assessment of Network Rail’s business, the work it is doing and intends to do, its procurement and asset management policies and practices, and its efficiency. The unnecessarily high costs of the railway brought about in the wake of Hatfield and Railtrack’s administration have now been brought under control, and the company has fair and stretching targets for what it must achieve, and the security of the knowledge that it will be paid fairly and reliably for its work.

22. The access charges review gave Network Rail - and everyone who depends on it - new breath and life, the ability to plan and carry out investment and operations in a sound, competent and efficient way, free of undue political intervention which will always turn the money supply down or up year by year according to priorities which have nothing to do with the railway and the needs of its users. It is acknowledged by all that, in the present climate, the railway industry would never have achieved a five-year settlement of this kind - and the certainty and security which goes with it - if it had had to operate as many would have it do. Independent economic regulation, operating precisely in accordance with its statutory remit (not exceeding it, as some have mistakenly asserted), and with the input which government (including its agencies) chose to provide, has given the industry the certainty and predictability which will always be denied if the promoters of greater political control have their way. Now the industry must use that precious endowment wisely and well, with skill, care and diligence, to repay the trust which has been invested in it.

23. In too many respects, some parts and players in the railway industry - and others - have been in a state of virtual denial about restructuring and privatisation. They appear to long for a return to the days of nationalisation, even though they involved almost perpetual capital starvation by the Treasury, patch-and-mend maintenance and severe operational limitations, with short-term political priorities taking precedence over efficient, economic engineering and operational judgments. The paternalism of state control is, in their view, to be preferred to the freedoms and disciplines of the private sector. And so they pretend it has not happened. Because of this mistaken notion, in the last five - indeed the last ten - years, we have seen so many missed opportunities, suboptimal solutions, business lost, waste and inefficiency. The maturing of the railway industry in the private sector has been significantly slower than in the gas, water, electricity and telecommunications industries, and its performance and investment have been pulled down because of it. This is profoundly regrettable. It is essential that the companies in question achieve the competences of true private sector operators, and that these unnecessary, self-imposed drags on achievement - both operational and financial - are thrown off. The talent, energy and ideas of people of ability should be brought out and exploited, not hidden away or suppressed. The railway industry has some way to go before it achieves a true private sector mindset and competence, one which is not tethered to state control and the inappropriate intervention and direction of public officials. In achieving this, the industry has to swim against the current of opinion in some quarters who would like nothing better than a return to nationalisation and short-termism.



24. The railway industry is now facing another review - this one being conducted by the Department for Transport - to be completed in July 2004. ORR is participating fully in the review, providing written and oral evidence and discussing the issues openly and constructively. The focus of the review is plain, however. It is about establishing a way in which government will be able to avoid facing an unexpected or unaffordable rise in the subsidy required for the railway industry as a result of a future regulatory review of the costs of the provision of infrastructure services. This is of course a perfectly legitimate objective for the government to have. In the final analysis, all government expenditure on the railways is



discretionary, and government must decide what kind of railway it wishes to support. But having made its decisions, in its own interests and those of the industry and the end users it needs to stick to them. The solution is not to curtail the powers or jurisdiction of the regulatory authority, with the inevitable attendant harm to private sector confidence and therefore investment. It is to ensure that government transport policy as it applies to the railways, including its priorities for spending, are clearly established and communicated in a sound, competent and timely way so that the regulatory authority can take them fully into account as it does its essential job. This has not happened in the past. It is now time for the role government should play in this respect to be spelled out in legislation.

25. Some players advocate more radical reforms, but they are reforms which would unjustifiably intrude into the private sector status of the railway companies and cause the Government to break the assurances it has already given to Parliament, the capital markets and others about the scope of the review.

26. In the last five years, ORR has taken very seriously the need to adhere to high standards of public administration in what it does. We are publicly committed to them, to hearing all relevant points of view before a decision is made, to considering the case, the objections and the alternatives in an open and transparent way, to applying the right criteria, consistently and proportionately, to conducting a demonstrably thorough analysis, and then the publication of a decision which is clear and accompanied by full written reasons. These things are necessary - not just desirable - if the industry and others are to be able to see that, whilst they may not always like the decisions, they have been listened to and understood, and the outcomes are soundly based, fair and rational. This is the surest way of ensuring that there is confidence in and respect for difficult decisions which can have material effects on the interests of many companies and people.

27. The British experience with its railway industry is one which is instructive and valuable to other countries contemplating reforms in order to improve efficiency, quality and performance and to attract private investment. It is often supposed that our experience is all bad, because of the problems we have had and the mistakes which were made ten years ago in the design and implementation of the industry restructuring and privatisation. The reality is that it has been far from all bad. We have unprecedented usage of the railway, with high degrees of public confidence in the system. Our rolling stock fleet - freight and passenger - has been substantially renewed, hundreds of stations have been improved and the stewardship measures which I have mentioned are, in several important respects, the best they have ever been. Of course there are many more things to be done as we recover from the legacy of the past, and there is no room for complacency. But these successes are too often overlooked or ignored by commentators who want to decry or denigrate the system we have. And as European and other railways separate infrastructure from operations, to a greater or lesser extent, they realise that what we have done in Britain is shine a very bright light into the darkest and most inaccessible recesses of the economics and operation of our railway system. We have exposed and faced truths which other railways will one day also have to tackle. How we did this, and what we did as a result, contains lessons which others would do well to attend to. It is wasteful and worse to run the risk of having to go through the difficulties we have experienced, and like us to have to make the corrections and reforms to the system in the ten years after restructuring when so much of it could have been got right at the beginning.

28. I should like to place on record my strong appreciation and warmest thanks to all my staff for their loyalty, commitment and hard work over the last five years. We have been through some stormy times, with the existence of the organisation in doubt, often under fire for the difficult and important decisions which have had to be made, and always in the midst of controversial issues. They have performed marvellously well, and the record of this office is one which I am proud to defend, to promote and to say is ours, not mine. My senior team has been strong, resolute and has performed to the highest standards. My thanks also go to all my non-executive directors over these five years, including Peter Warry, Stephen Glaister, Richard Gillingwater, Chris Stokes and Robin Saunders. Their wise counsel has been of immense value. My greatest appreciation, however, is due to a public servant whose name has rarely if ever come to public attention but whose talent, skill, loyalty and application have surpassed every standard I could have expected of him. Keith Webb, my Chief of Staff and Director of Corporate Affairs, has discharged the highest standards of the public service to which he has given his 35-year career, and the transport industry will probably never know just how much it is in his debt.

29. In conclusion, I believe that the future of the British railway industry is a bright one. With the reforms we have made, sound finance, clear specifications and fair accountabilities, and with competent and honourable public institutions playing their full, appropriate parts, our system can be one which could well endure and provide good service at a fair and affordable cost for the next twenty or thirty years, or even longer. The industry now has the means and, I believe, the will to work together in an integrated and competent way, to release and use the energy and the talent of the very able and committed people who work in it, to attract the brightest and the best of the new generation, and to serve well the people who use and pay for it.

TOM WINSOR
Rail Regulator



The Rail Regulator signing the review notice beginning the implementation of the access charges review on 23 December 2003, accompanied by John Thomas, Deputy Director, Economic Regulation.



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Way out

- 1 Lift
- 2 Tickets & information
- 3 Retail & tourist centre
- 4 Bus station
- 5 Underground
- 6 Specialist Express
- 7 Customer Service
- 8 Cycle store
- 9 Airport tickets
- 10 Left luggage
- 11 Lost & Found

Overview

Introduction

This report details the achievements of the Office of the Rail Regulator (ORR) in delivering the outputs required to meet the three objectives set out in ORR's Business Plan 2003–2004.

The year has been extremely demanding, with the need to complete and implement the access charges review (ACR 2003) the main task. This review added considerably to the use of resources during the year and this is reflected in the expected out-turn expenditure figures reported in the table in paragraph 4.1. In addition to this and the need to manage day-to-day business, a significant programme of other work has been carried out, including the development of the stations code and completion of the passenger and freight track access model contracts.

At the end of the reporting year, ORR was preparing for the transition to a statutory board on 5 July 2004. The Department for Transport (DfT) has already appointed the Chairman, Chief Executive and three of the four non-executive members in readiness for this change. A considerable amount of work will be required to make this a seamless transition. This work will be reported on in the next annual report, which will cover the last three months of the term of office of the present Rail Regulator and the first nine of the statutory board.

Events in the annual reporting year

► *April 2003*

The Regulator launched the Rail Safety and Standards Board (RSSB) by announcing that Denis Tunnicliffe CBE and Len Porter would be the Chairman and Chief Executive of the new organisation respectively. He modified Network Rail and TOC licences to provide the necessary underpinning to RSSB's constitution. The establishment of RSSB implemented one of the key recommendations made by Lord Cullen following his inquiry into the accident at Ladbroke Grove on 5 October 1999. RSSB took over safety leadership and standard setting functions from Railway Safety.

The Regulator published his provisional conclusions in his review of Network Rail's programme of station improvements proposed by the Strategic Rail Authority (SRA).

The Regulator issued directions under section 17 of the Railways Act 1993 to London & Continental Stations & Property Limited (LCSP) requiring the company to enter into a new station access contract with Midland Main Line Limited (MML), to provide MML's trains with continued access to St Pancras Station. The new contract included the terms under which LCSP would compensate MML for the disruption to its business at the station caused by construction work for the international terminal of the Channel Tunnel Rail Link. LCSP did not enter into the directed agreement and accordingly the Regulator issued proceedings for the enforcement of his directions. LCSP applied to the High Court for judicial review of the Regulator's decision.



► *May 2003*

The Regulator published his annual report for 2002–03, and his business plan for 2003–04, together with a consultation document on the process for setting licence fees.

► *June 2003*

The Regulator approved Network Rail's dependent persons' code of practice, covering its dealings with its dependent customers wishing to provide rail services or facilities.

The Regulator published a new model track access contract to cover the relationship between passenger train operators and Network Rail. The contract provided a basis for stronger, simpler and streamlined contractual arrangements.

► *July 2003*

The Regulator welcomed the first independent assessments of Network Rail's stewardship of the national network by Halcrow Group Limited and Mouchel Consulting Limited, in their reports on the 2002 annual return submitted to him by Network Rail.

The Regulator published his emerging conclusions in ACR 2003, identifying potential substantial savings on planned rail infrastructure costs in a number of areas for Network Rail over the next five years. This included a separate document on West Coast Route Modernisation outputs.

The Regulator published a consultation document on changes to access rights and moderation of competition. The proposals set out the circumstances in which it might be appropriate for the Regulator to approve contractual protection from competition, and mechanisms for the surrender of rights not being used by an operator.

The Regulator consulted on his proposal for developing a model track access contract for freight operators, building on the model contract already published for passenger operators.

► *August 2003*

The Regulator published his final conclusions in his review of Network Rail's programme of station improvements. The Regulator's assessment established that £25.6 million would be the efficient cost for which a programme of improvements covering 68 stations required by the Strategic Rail Authority could be delivered.

► *October 2003*

The Regulator consulted on his draft final conclusions in ACR 2003. The draft conclusions proposed that Network Rail would be allowed £22.7 billion for the operation, maintenance and renewal of the network over five years, in return for delivering genuine improvements in the overall condition of the network.

► November 2003

The High Court upheld the Regulator's decision in respect of his directions to LCSP, under section 17 of the Railways Act 1993, on the terms under which the train operator, MML, would gain access to St Pancras Station.

► December 2003

The Regulator published his final conclusions in ACR 2003 setting out Network Rail's revenue requirements. Network Rail would receive £22.2bn – a saving of £500,000 on the October 2003 announcement in the Regulator's draft final conclusions – for the operation, maintenance and renewal of the rail network for the five years from April 2004. The Regulator's conclusions provided for a mechanism by which he could reduce the resulting increase in track access charges payable by franchised passenger train operators if Network Rail brought forward proposals to change the balance in its income between access charges and direct grants from the SRA.

The Regulator served on Network Rail and the relevant train operators the legal document (a review notice) that began the process of implementation of ACR 2003 with effect from 1 April 2004.

The Regulator consulted on a draft model track access contract for freight operators. The Regulator highlighted the value of the proposed contract in establishing a joint venture in the provision of rail freight services, describing it as a partnership of equals between the infrastructure provider and the infrastructure user.

The Regulator approved a new Railway Group Standards Code, with the full support of RSSB's members, drawn from across the railway industry. The new code provides for much greater involvement of rail industry players in the Railway Group Standards process.

The Regulator held an industry performance summit with the aim of establishing whether Network Rail was taking all steps reasonably practicable to meet its obligations concerning freight and passenger train performance.





► *January 2003*

The Secretary of State for Transport announced a review of the structure for running the railways. In a Commons statement, he said he planned to publish proposals in summer 2004 for a new structure and organisation for Britain's railways. He reaffirmed the Government's commitment to independent economic regulation.

The Regulator began consultation on draft proposals for a new stations code for Britain's 2500 mainline railway stations. The proposals would replace the current structure of contracts between train operators and Network Rail, with stronger, simpler and more effective contractual arrangements for managing stations, providing clarity in the expression of the rights and obligations of each of the parties.

The Secretary of State announced the appointment of Chris Bolt as Chairman of the Office of Rail Regulation, the statutory board which takes over from the Rail Regulator when his five-year term of office ends in July 2004.

► *February 2003*

The Regulator consulted on ORR's draft business plan for 2004-07. This set out ORR's planned programme of work for the year ahead and identified key work priorities for the following two years.

In a further statement to Parliament, the Secretary of State ruled out of his rail review any change which would affect the rights of third parties. On the basis of this, Network Rail began the successful first tranche (£6.5 billion) of its capital raising programme.

The first model contract-based track access agreement, between Network Rail and First/Keolis Transpennine Limited, came into effect.

► *March 2003*

The Department for Transport announced the appointment, from 5 July 2004, of Suzanne McCarthy as Chief Executive, and Chris Stokes, Professor Jeffrey Jowell QC and Jane May as non-executive directors, of the Office of Rail Regulation.

The Regulator approved financing arrangements proposed by Network Rail which result in more of its income being received in grants from the SRA and less in track access charges from train operators. They also result in some income being reprofiled from 2004-05 and 2005-06 to later years. The Regulator issued the review implementation notice formally implementing his conclusions in ACR 2003, with effect from 1 April 2004.

The Regulator published the model track access contract for freight operators, alongside an updated version of the criteria and procedures to be employed in the scrutiny and approval of track access applications from freight operators.

ORR external relations

The culmination of another busy year came with the publication of ACR 2003 in December following a root and branch look at Network Rail's financial and incentive framework. During the 15-month review there was extensive consultation with the rail industry and relevant public institutions.

The Regulator carried out an extensive programme of speaking engagements with the highlight in February when he gave the 2004 Sir Robert Reid Memorial Lecture. The full programme, which included speeches in Washington, Paris, Lisbon, and Shanghai is listed in Appendix 2. The Regulator also received visitors from a number of countries all wishing to discuss UK regulatory experience, including delegations from the United States, China, France, Pakistan and Russia.

Rail industry

The Regulator and his staff held regular meetings on general industry issues, and also specific subjects, with industry parties. This is a key element of ensuring transparency of regulation, understanding by the industry of regulatory policies, and industry input into policy development. The Regulator is a member of the Group of Six (G6) industry leaders (the others are the Chief Executive of Network Rail, the Chairman of the Association of Train Operating Companies, the Chief Executive of English Welsh and Scottish Railway Limited, the Chairman of the SRA and the Director-General of the Health and Safety Executive) who meet on a regular basis for informal discussion of key industry issues.

ORR has maintained close contact with other railway industry stakeholders, such as the Passenger Transport Executives (PTEs), the Scottish Executive and the railway supply industry. ORR was also a member of the project board set up to oversee a joint study by the Department for Transport and the Cabinet Office Regulatory Impact Unit with the aim of reducing and removing unnecessary bureaucratic and administrative burdens relating to data and information requirements placed on Network Rail by the Department for Transport and other key stakeholders. The project board supported the project team to deliver agreed changes to practices and procedures. A report setting out these changes was produced in March 2004.



Strategic Rail Authority

The Regulator and executive directors continued to meet regularly with the Chairman of the Strategic Rail Authority and his senior team. There was also regular dialogue at all levels between ORR and SRA. During 2003–04 a key part of this was the work on ACR 2003, where there was extensive bilateral discussion, as well as meetings also involving Network Rail in addition to HSE, DfT and HM Treasury.

Department for Transport

The Regulator continued to meet the Secretary of State and senior DfT officials on a regular basis. There was also dialogue between ORR and DfT officials on specific issues, in particular performance, infrastructure stewardship and the rail review.

Health and Safety Executive

ORR had a regular high level dialogue with HSE to discuss current industry issues. In addition, there were regular contacts and exchanges of information on specific issues, in accordance with the memorandum of understanding between the two organisations.

Rail Passengers' Council and Committees

The Regulator continued to meet the Chairman and National Director of the Rail Passengers' Council on a regular basis, and also spoke at certain meetings of the Council. ORR officials attended Rail Passengers' Council and Committee meetings as observers so as to inform the office of current areas of concern to passengers.



Liaison with other bodies

The Regulator continued to meet his counterparts in the other regulatory authorities to address current issues. The Regulator attended the European Commission's annual convention of European rail regulators, in Vienna, at which EU and accession country rail regulatory authorities meet to exchange information and share best practice. This is especially valuable as Europe's railways face similar issues and each can learn worthwhile lessons from the experience of others. The Regulator is hosting the next meeting of European rail regulators, in June 2004, in London.

In the reporting year, the Regulator co-operated with the House of Commons Select Committee on Transport in its review of the future of the railway, including by giving oral and written evidence. Regrettably, the Committee chose to criticise the jurisdiction and record of ORR in unjustifiably extreme terms, basing its conclusions - a blueprint for nationalisation and a material diminution in independent economic regulation, to the considerable detriment of private sector confidence in the industry - on numerous elementary errors of fact, plainly ignoring evidence given to it or published by ORR and refusing the Regulator's offer of additional evidence in relation to the access charges review after it had been announced. The criticisms and conclusions of the report, insofar as they concern ORR, were fundamentally flawed and misconceived.





Objective 1

Objective 1 – To ensure the monopoly infrastructure provider’s effective and efficient stewardship of the national rail network

1.1. The major event during the year was the completion of the Regulator’s comprehensive review of the amount of money needed by Network Rail to operate, maintain, renew and enhance the national rail network. The review determined the overall level and profile of access charges paid by franchised passenger train operators to Network Rail and established a sound financial and regulatory framework for Network Rail’s management of the network. The access charges review (ACR 2003) began on 25 September 2002, was completed on 12 December 2003 and took effect on 1 April 2004.

1.2. Following publication of Network Rail’s business plan on 31 March 2003, the Regulator published his third consultation document on ACR 2003 on 24 July 2003. This document contained the Regulator’s emerging conclusions on his expenditure assessment (unit costs and activity levels), incentives and financing arrangements. At the same time, the Regulator published a consultation document on the West Coast Route Modernisation (WCRM) project (see paras 1.24 -1.27.)

1.3. The responses to these consultation papers and Network Rail’s revised business plan, received in June 2003 (with a further update on certain issues in September 2003), informed the Regulator’s draft conclusions which were published on 17 October 2003. The draft conclusions provisionally set the outputs that Network Rail would be required to deliver to its customers up to April 2009 and the funding that Network Rail would require to deliver these outputs efficiently.

1.4. The Regulator consulted the industry on his draft conclusions before making his decisions and publishing his final conclusions on ACR 2003 on 12 December 2003¹. The final conclusions document established for the five-year period beginning 1 April 2004:

- (a) the income Network Rail will need to cover its expenditure;
- (b) the outputs Network Rail must deliver (for example, in terms of reducing delays and improving asset condition);
- (c) the funding and outputs for the WCRM;
- (d) transparent performance incentives; and
- (e) tightly defined criteria for future access charges reviews.

1.5. The Regulator concluded that the company would need £22.2 billion over five years to fund its operations, maintenance and renewals expenditure. The Regulator also determined that a further £2.2 billion should be allowed for enhancements to the network (principally WCRM and the Southern Region new trains project) and £7.1 billion as a return on the regulatory asset base (to service debts and to allow a buffer against future cost shocks). Network Rail’s total expenditure over the five-year period will be funded by a combination of access charges and grants, single till income (principally from property, freight operators and station access charges) and borrowing.

¹ *Access charges review 2003: final conclusions*, Office of the Rail Regulator, London, December 2003.

1.6. Following the publication of his final conclusions, the Regulator began the process of implementing the review conclusions by issuing a review notice on 23 December 2003 specifying the relevant changes to the track access agreements between Network Rail and the franchised passenger train operators. He subsequently issued a notice of agreement in February 2004 following Network Rail's decision to accept the review conclusions (which would otherwise have resulted in a reference being made to the Competition Commission) and a review implementation notice on 10 March 2004 stating that the review conclusions would be implemented on 1 April 2004.

1.7. The review notice issued on 23 December 2003 included a provision for Network Rail, by 29 February 2004, to propose to the Regulator alternative financing arrangements which would entail a reprofiling of its allowed income (resulting in increased borrowing by Network Rail) and a different mix of access charges and grants. The Regulator specified in his final conclusions the four key tests against which he would assess that proposal, which were:

- (a) given that additional borrowing is a transitional measure, by no later than April 2006 Network Rail must be in a position where it is receiving the full revenues that the Regulator has established in the review;
- (b) whether the level of borrowing which the company would incur would make it unduly difficult for the company to finance its relevant activities during the next five years;
- (c) whether the amount of debt thus built up would threaten the long-term viability of the company, and thus prejudice the interests of the users of railway services; and
- (d) whether all parties accepted that any additional short-term borrowing must be reflected in the Regulator's calculation of the regulatory asset base.

1.8. On 27 February 2004, the Regulator received from Network Rail a proposal in this respect. On 10 March 2004, the Regulator announced that, as he was satisfied that the proposal met the tests specified above, he was willing to accept the proposed alternative financing plan and he adjusted track access charges accordingly. The adjustments took effect from 1 April 2004.



Network Rail: refinancing of existing debt



1.9. Network Rail's long-term financing plans are based on a proposed securitisation of its track access and grant income. The company's aim was to initiate the programme in 2003–04 but it has since postponed this refinancing until 2004–05. The Regulator continues to work closely with Network Rail to ensure that any new financial structure is consistent with the five tests which he has specified in relation to stewardship, sustainability, flexibility, land disposals and ring-fencing of the core business, as set out in his statement on Network Rail's acquisition of Railtrack, published on 27 June 2002.

1.10. In the meantime, Network Rail is refinancing existing debts (in particular the bridge facility which it raised at the time it acquired Railtrack in October 2002) through a £10 billion medium term note programme (backed by a £10 billion SRA facility). This was successfully launched in March 2004 with strong demand for the notes.

Monitoring and review of Network Rail's stewardship plans and delivery

Business plan

1.11. Condition 7 of Network Rail's network licence requires it to publish an annual business plan in which it must demonstrate how it plans to operate, maintain, renew, replace, enhance and develop the network. Network Rail published its first business plan on 31 March 2003. The document included key information, which the Regulator had required Network Rail to provide, on stewardship, expenditure and outputs, in order to facilitate analysis of the company's requirements for the purposes of ACR 2003. As discussed above, Network Rail published additions and revisions to its plan in June and September 2003 as part of the ACR 2003 process.

1.12. On 15 December 2003, following consultation with Network Rail and the SRA, the Regulator served a notice specifying the format and structure for the 2004 business plan. This required Network Rail to provide key information on its planned expenditure and outputs and how it plans to meet its stewardship obligations, in particular Network Rail's plans to improve performance and its plans to deliver the outputs set out in ACR 2003 within the expenditure determined by the Regulator.

Network Rail's annual return

1.13. The regulatory reporters, Halcrow Group and Mouchel Parkman, carried out their second audit of Network Rail's annual return for 2003. They conducted an extensive assessment of the robustness of Network Rail's data collection processes and confirmed to the Regulator that, on the whole, he could rely on the accuracy of the data within the annual return. A number of recommendations were made on how the reliability and accuracy could be improved and these are being followed through with Network Rail.



Regulatory accounts

1.14. Network Rail is required to report on its financial position and performance in the regulatory accounts, on a basis consistent with regulatory determinations and policy. The company's accounts for the year 2002-03 were delivered to the Regulator in July 2003 and published on Network Rail's website shortly afterwards. This was consistent with the timescale set out in Condition 22 of the company's network licence. The accounts presented clearly the additions to the regulatory asset base which were used in the calculation of access charges in ACR 2003.

1.15. The accounts are governed by policies set out in the regulatory accounting guidelines re-issued by the Regulator in June 2003, which reflect experience from the first regulatory accounts published in December 2002. Accounts for 2003-04 are due to be published in July 2004.

Review of Network Rail's network stewardship

1.16. The assessment of Network Rail's network stewardship lies at the heart of regulation. It is the means by which the Regulator judges the extent to which the company is meeting the obligations in its network licence in respect of the operation, maintenance and renewal of the existing infrastructure.

1.17. Network Rail's weekly, four-weekly and annual reporting of asset serviceability and network condition provides the Regulator with a wide range of information that reflects the diversity and the size of the asset that makes up the network. The Regulator uses this data to monitor key aspects of network stewardship, and the evaluation of the stewardship quality combines analysis of trends in asset-related safety statistics, data about asset performance and reliability, and trends in underlying component condition.

1.18. While a number of measures are showing positive improvements, ORR's monitoring of Network Rail's stewardship has not yet been able to confirm a clear and sustained improvement across every asset category and across the whole network. Although it is encouraging that there have been significant reductions in some of the most common types of infrastructure incident such as points and track circuit failures, these improvements have been largely offset by increasing numbers of incidents elsewhere. At the year end, the total number of infrastructure failure incidents in 2003-04 was 0.4% higher than last year. Certain types of incident, such as cable faults, power supply failures and electrification contact system failures have shown a deterioration in performance during the year and ORR is investigating the reasons for these trends.

1.19. The evident difficulty in driving down the long-term number of temporary speed restrictions (TSRs), the impact of the hot weather in August 2003 and the indications of deterioration in some particular asset categories, all lead ORR to conclude that the network continues to lack resilience in several respects.

1.20. This perspective was crucial to the Regulator's ACR during 2003. Network Rail's plans for future asset maintenance and renewal activities and expenditure were analysed and challenged in depth. Much of this work demonstrated that Network Rail has made some good progress in assessing and forecasting future levels of infrastructure activity, and the Regulator was satisfied that there was a justifiable need for increasing the levels of maintenance and renewal activities in a number of areas.

1.21. The conclusions of ACR 2003 therefore provided the funding necessary for substantial increases in maintenance and renewal activity. This includes a major programme of renewal of the network's telecommunication equipment (much of which is approaching obsolescence), increases in track renewal activities and structures maintenance, and the provision of new plant and equipment that will improve the inspection and maintenance of the infrastructure.

1.22. In concluding ACR 2003, the Regulator also established regulatory expectations of how Network Rail would meet its stewardship obligations in the future. In respect of stewardship monitoring, ORR held detailed discussions with Network Rail and the independent reporters in order to continue the development of the regime by which Network Rail is held to account for the effective and efficient delivery of its activities and committed outputs.

1.23. For the future, the review also highlighted areas where there is a need for still better asset information, better understanding of the behaviour of assets in service, and better criteria for determining the most appropriate form and timing of interventions. These points have been incorporated into ORR's business plan for the coming year.

West Coast Route Modernisation

1.24. During the year, the Regulator's consultants (Booz Allen Hamilton) conducted an extensive review of Network Rail's plans for the West Coast Route Modernisation (WCRM) project, and in particular the efficiency of those plans. The Regulator also mandated his independent reporters (Mouchel Parkman) to review a number of options for timing and delivery of the outputs of the project, as part of ACR 2003.

1.25. Major cost reductions between Network Rail's March and September 2003 business plans were achieved through reviews of the project by Network Rail, SRA and ORR, which resulted in the removal of a substantial amount of unnecessary work from the plans. However, the Regulator remained concerned about inefficiency in delivery and risks to delivery caused by the project schedule. In ACR 2003, the Regulator set the funding of the WCRM project (renewals and enhancements) at £2.8 billion over the five years to 2009 and concluded that in order to give Network Rail time to address inefficiencies, ensure deliverability and reduce the risks of non-delivery and cost escalation, some of the later stages of the project (work on the route between Rugby and Stafford) should be rephased by 18 months to 2 years later.





1.26. This is consistent with delivery of the outputs set out by the SRA in its June 2003 West Coast document² by 2009, and reflects Network Rail's own concerns about deliverability and risk associated with the proposed scheduling. The Regulator's conclusions enable Network Rail to plan work on the project more efficiently and carry it out at lower unit costs.

1.27. The Regulator commissioned his regulatory reporters, Mouchel Parkman, to advise on delivery of the September 2004 outputs (a new timetable, with improved journey times) for the WCRM. Mouchel Parkman's reports indicated that significant risks remained to the delivery of the September 2004 timetable. Specific areas of concern included lack of clarity over delivery arrangements and over Network Rail's ability to ensure that all necessary approvals and acceptances would be in place for 125mph running. In the latter part of the year, however, changes in the way Network Rail was managing work on the WCRM gave cause for cautious optimism that it would deliver the September 2004 outputs.

Asset register

1.28. With the active encouragement of ORR, Network Rail has continued to develop its strategy for asset information and has completed a number of initiatives. These include:

- (a) implementation of the Mincom Information Management System (MIMS), a work scheduling system, across the network;
- (b) introduction of a similar MIMS system for property;
- (c) introduction of a new measuring train to provide essential data on track geometry and condition;
- (d) developing decision support tools to help predict renewals and maintenance volumes for track, structures and signalling, three major areas of spend;
- (e) developing a new fault management system (FMS) to ensure that faults are dealt with efficiently and so that trends can be detected and faults prevented in the future;
- (f) improving the Raildata database which holds key information on all rail faults;
- (g) verifying and substantially improving the main track database, GEOGIS;
- (h) development of a Corporate Network Model (CNM) to be used for a variety of purposes including network capacity calculations;
- (i) introduction of a corporate geographical information system, Marlin, currently for railway estates but to be expanded for other assets; and
- (j) developing procedures for ensuring that all required information is retained as maintenance is taken in-house.

² *West Coast Main Line Strategy*, Strategic Rail Authority, London, June 2003.

1.29. In addition to this, Network Rail has developed a number of the major building blocks for the final corporate asset data information system. These include the Asset Data Dictionary (ADD), the Asset Data Viewer, the Data Warehouse and the procedures for transferring asset data to the new system.

1.30. ORR's work on the asset register during the year was to monitor and review Network Rail's progress towards developing its strategy for asset information. In particular, ORR sought to understand how asset information was being used throughout Network Rail's business. This process involved regular dialogue, briefing, challenge and investigation throughout the year, including two formal progress reports from Network Rail which were submitted to ORR in April and October 2003.

1.31. ORR has carried out detailed assessments of a number of components and initiatives. In particular, FMS, GEOGIS, ADD and MIMS components have all been reviewed and the results of ORR's scrutiny have formed the basis of continuing regulatory action to ensure adequate progress on the register.

1.32. With a project as complex as the Asset Information Strategy, it is not simple to define a point at which Network Rail will be able to show that the asset register is complete and supporting the business processes. Nevertheless, it has proposed a compliance matrix for regulatory review so that objective measurement of progress can be demonstrated.

1.33. ORR is also monitoring the improvement in availability of information to external stakeholders to ensure that Network Rail can respond to legitimate enquiries in a sufficient and timely manner.

Vehicle and route acceptance

1.34. In its report on the introduction of new trains published in February 2004³, the National Audit Office recognised the potential value of Vehicle and Route Acceptance Contracts (VRAC) in smoothing the rolling stock acceptance process and, in particular, in incentivising Network Rail to undertake its activities in a timely and efficient manner. The Regulator continued to take informal industry soundings on the form of an appropriate model VRAC and to work on the development of a contract for use by manufacturers. The Regulator expects to publish a model contract by summer 2004.

Performance

1.35. Besides an ongoing programme of monitoring and analysis of Network Rail performance data, ORR's work in 2003–04 covered two main areas.

1.36. First, the performance regimes in franchised passenger operators' track access agreements were recalibrated as part of ACR 2003. This work was carried out with the assistance of consultants, and had the broad aim of reducing the very large outflow of payments from Network Rail that had been made since the collapse of performance after the Hatfield derailment in October 2000, whilst maintaining effective incentives for good performance and compensating train operators adequately for poor performance. In order to avoid large payments in future, Network Rail will



³ *Strategic Rail Authority: Improving passenger rail services through new trains*, Comptroller and Auditor General, London, February 2004.



have to achieve a challenging trajectory of improvement year-on-year. The trajectory was set after careful analysis of the likely effects of the overall ACR 2003, including rates at which assets would be renewed and anticipated trends in traffic volumes.

1.37. The second main activity was the continuing assessment of whether Network Rail was meeting its licence obligations relating to efficient operation of the network. After an extremely unsatisfactory performance in 2002-03, when the number of Network Rail delay minutes (14.8 million after final dispute resolution) was over three million more than its original projection, 2003-04 started poorly. Delays were running at a similar level, with no obvious progress towards Network Rail's more cautious target of 13.25 million minutes, largely due to continuing growth in delay per incident and the effects of the very hot summer weather for which Network Rail was poorly prepared.

1.38. The Regulator invited all industry parties to a performance summit in December 2003 with the aim of establishing whether Network Rail was taking all steps reasonably practicable to meet its obligations. Besides oral evidence at the summit, the participants were also invited to make written submissions. Following the event, the Regulator concluded that Network Rail was taking reasonable steps to improve performance, provided that it continued to demonstrate that it was improving management of the network and involving its customers. Actual performance in the second half of 2003-04 significantly improved with clear evidence of much better autumn preparedness and more effective response to incidents. At the end of the year, Network Rail delay minutes totalled 13.7 million, an improvement on the previous year but still short of the target.

Local output commitments

1.39. Following extensive consultation with the industry in 2002-03, in the reporting year the Regulator published his final conclusions on local output commitments in his final conclusions document on the model passenger track access contract⁴. Local output commitments will improve

⁴ *Model clauses: the template passenger track access contract: Regulator's final conclusions*, Office of the Rail Regulator, London, June 2003.

Network Rail's responsiveness to its customers. Initially, they will concentrate on a key concern of train operators and their customers – improving train performance. The Regulator proposed a new Part L of the network code, which was submitted to the industry's Class Representative Committee in November 2003. At the same time, the Regulator consulted on draft criteria to be used in the event of an appeal.

1.40. Part L establishes a mechanism in the network code - and so in the access contract itself - which provides for the establishment of a binding set of commitments by Network Rail to each train operator - on an individual and local basis - in respect of performance and, in time, other measures. Local output commitments are not separate contracts and it is not necessary for them to be agreed. If Network Rail and a train operator fail to achieve a consensus on them, the matter is resolved by appeal, if necessary to ORR. Network Rail's initial local output commitments will contain obligations as to specific reductions in the level of delay which it causes to its train operator customers. The overall forecast reduction in delay should be equal to the network-wide target established in ACR 2003 for reducing Network Rail-attributable delay. Each local output commitment will be supported by a performance plan.

Land disposals

1.41. Condition 26 of Network Rail's network licence ensures that land needed for the development of both the passenger and freight railway network is protected from disposals by Network Rail which would not be in the public interest. In 2003-04, the Regulator consented to 22 of Network Rail's proposed land disposals, in many cases attaching conditions to his consent to ensure that the purpose of the condition was achieved and to address concerns raised by industry consultees in the consultation process. The Regulator directed Network Rail not to proceed with its proposed disposal on three occasions.



Licence consents

1.42. Following Network Rail's acquisition of Railtrack PLC in October 2002, the Regulator introduced a number of new conditions to strengthen Network Rail's network licence, including a new provision in Condition 12 requiring the company not to engage in business other than permitted business (as defined in the network licence, essentially the core railway business) without the consent of the Regulator.

1.43. During the year, the Regulator has considered a number of applications for consent from Network Rail under Condition 12 and related provisions of its network licence. These included: funding of a spare train set to improve performance of First Great Western services; a number of ongoing property management activities; funding for an alternative service to Manchester via the Midland Main Line to mitigate the effects of major works being carried out as part of the WCRM project, and Network Rail's operation and maintenance of section one of the Channel Tunnel Rail Link (CTRL).

Incremental Output Statements (IOS)

1.44. The Stations Incremental Output Statements (IOS) programme (also known as the Modern Facilities at Stations – MFAS – programme) is intended to deliver new facilities at stations across the network including improvements to passengers' personal security, and to information systems, waiting facilities and toilets. In December 2002, following positive responses to an initial consultation exercise, the Regulator initiated an interim review of the efficient price for delivering the Stations IOS outputs. The Regulator published his provisional conclusions on the efficient price for the first stage of the programme in April 2003.

1.45. Following the provisional conclusions and negotiations between Network Rail and the SRA, Network Rail identified management actions which would produce significant savings. These savings were reflected in the Regulator's final conclusions, published in August 2003, which established the efficient price for improvements at 68 stations. Work is now well under way on delivering the first stage of the programme.



Enhancement policy framework

1.46. The access charges review 2000 set out the main principles for the Regulator's enhancement framework. However, the Regulator has been concerned by lack of progress in this area. In the course of the reporting year, the Regulator has therefore been developing a consultation document whose purpose is to update his policy on enhancements, taking due account of changes in the industry, policy discussions with industry stakeholders and the Regulator's treatment of the WCRM and other major enhancement schemes.

1.47. The Regulator has been closely involved in industry discussions on an approach to streamlining processes for implementing enhancements not sponsored by the SRA. Network Rail has now set out its intended approach to these schemes including suggestions on how to address obstacles to implementing them. The Regulator will set out his requirements of Network Rail in relation to these schemes in his forthcoming consultation document, due to be published in the first quarter of 2004.

Dependent persons code of practice

1.48. In June 2003, the Regulator published his final conclusions on Network Rail's code of practice covering its dealings with dependent persons as required under Condition 25 of its network licence. This included the Regulator's approval of the code of practice, the timetable for submission by Network Rail of supplemental sections of the code to deal with specific categories of dealings, and the criteria used for devising and reviewing the categories and timetable.

1.49. The approved code of practice, covering all of its dealings with all of its dependent customers, commits Network Rail to "act with due efficiency and economy and in a timely manner, including in all respects with that degree of skill, diligence, prudence and foresight which should be exercised by a skilled and experienced network facility owner". In addition to this overarching principle, the code contains principles and procedures relating to communication and responsiveness, management of information, and charges and resourcing. These principles and procedures are being applied to specific categories of dealings in eleven supplemental sections of the code prepared by Network Rail, which the Regulator is currently considering.





Objective 2

Objective 2 – To ensure fair and efficient consumption of rail capacity, and promote effective and efficient working relationships between players in the rail industry

Track access applications

2.1. Under the Railways Act 1993 (the Act), the Regulator is responsible for the fair and efficient allocation of capacity of railway facilities through his determination of the terms of the access agreements under which train operators gain access to the rail network, stations and light maintenance depots. The Act provides for applications to be made on an agreed basis between an applicant and Network Rail (or any other facility owner) under section 18. When the applicant has not reached agreement with the facility owner, it can apply under section 17, which gives the Regulator the power to determine the form of the access contract and direct the facility owner to enter into it. The Act contains similar provisions covering the approval of amendments to existing agreements.

Passenger agreements

2.2. At the beginning of the year, the Regulator was considering applications from Great North Eastern Railway Company Ltd and Arriva Trains Northern Ltd, made under section 17 of the Act, proposing the extension of both agreements. Subsequently, as the result of negotiations, both applications were withdrawn and replaced by agreed amendments to the existing access agreements. The Regulator approved the amendments in June 2003.

2.3. During the year, the Regulator received and considered an unusually large number of applications requesting his approval of new track access contracts, in most cases to follow the expiry of the original post-privatisation contracts (details are set out in the table in Appendix 3). He scrutinised rigorously the proposed new contracts before approving them (subject to the parties modifying those contracts as required by the Regulator). The new passenger contracts approved following this process were those between Network Rail and: c2c rail Ltd; First/Keolis Transpennine Ltd; Chiltern Railway Company Ltd; Arriva Trains Wales/Trenau Arriva Cymru Ltd; Central Trains Ltd; Wales & West Passenger Trains Ltd; and West Anglia Great Northern Railway Ltd. He also approved amendments to existing agreements (Arriva Trains Northern Ltd, North Western Trains Company Ltd and Great Eastern Railway Ltd) to reflect the remapping of the franchised services provided by those operators.

2.4. At the end of the year, the Regulator was considering section 17 applications from ScotRail Railways Ltd, Thameslink Rail Ltd and from Grand Central Railway Company Ltd, and section 18 applications from South West Trains Ltd and South Central Ltd. Decisions on all four applications are expected early in 2004–05.

Freight agreements



2.5. During the year, the Regulator considered and approved a number of supplemental agreements covering changes to the services run by English Welsh and Scottish Railway Ltd and Freightliner Ltd, as well as approving an extension of the agreement of Direct Rail Services Ltd. He also approved agreements for three new freight operators: Freightliner Heavy Haul Ltd; Advenza Freight Ltd and Jarvis Fastline Ltd, and directed, under section 17 of the Act, a new contract for GB Railfreight Ltd to replace its initial, relatively short term contract.

2.6. At the end of the year, the Regulator was considering an application to amend Network Rail's contract with Freightliner Ltd and to extend its term until 2009.

Model clauses for track access contracts

2.7. In June 2003, the Regulator published his final conclusions on a model passenger track access contract, along with the final version of the contract itself and a document setting out the criteria and procedures he intended to follow in dealing with applications for the approval of passenger track access contracts⁵. These documents followed prolonged consultation with the industry. The model contract has been widely welcomed for its clarity and the way that it should reduce transaction costs, align parties' incentives and encourage train operators and Network Rail to work together as part of a joint venture in order to improve services for rail passengers.

2.8. The Regulator requires new passenger track access contracts submitted to him for approval to be in the model contract format unless there are sound reasons for a different approach. He also expects that existing contracts will be put into the model contract format if their duration is extended or other material amendments to them are made. The first agreement to use the model contract terms was between Network Rail and First/Keolis Transpennine Limited and came into effect on 1 February 2004. By the end of 2003–04, six new or extended agreements had been approved in the model contract format.

2.9. A number of existing passenger track access contracts also contained a retrofit mechanism, under which the Regulator could trigger a process that would lead to an agreement being put into the model contract format, following negotiations between the operator and Network Rail on provisions that were operator-specific. The Regulator initiated this process in respect of four agreements (those of c2c Rail Limited, Gatwick Express Limited, Great Western Trains Company Limited and Merseyrail Electrics 2002 Limited) on 23 December 2003 and these agreements were translated into the model contract format from 1 April 2004.

2.10. The Regulator also developed a corresponding suite of model contract documents for freight operators. These are based closely on the passenger model contract documents, but recognise that there are some freight-specific matters that also need to be covered. Following consultations

⁵ *Model clauses: the template passenger track access contract: Regulator's final conclusions, Model passenger track access contract and Criteria and procedures for the approval of passenger track access contracts: third edition*, Office of the Rail Regulator, London, June 2003.

in July and December 2003, he published in March 2004 his final conclusions on a model freight track access contract, along with the final version of the contract itself and a document setting out the criteria and procedures he intends to follow in dealing with applications for the approval of freight track access contracts⁶.

2.11. All but one of the six existing freight track access agreements between operators and Network Rail contain a retrofit mechanism to enable the agreements to be put into the model contract format. The Regulator triggered the retrofit process in these cases in March 2004 and, subject to the parties' progress in negotiating operator-specific provisions (such as the description of an operator's access rights), the Regulator expects these agreements to have been put into the model contract format by June 2004.

2.12. Two other elements of the model clauses project also neared a conclusion in 2003–04: the Regulator's policy on moderation of competition and his proposal to introduce a new Part J of the network code dealing with changes to access rights.

2.13. On moderation of competition, in July 2003 the Regulator consulted on his draft conclusions, which were generally welcomed by the industry. The key draft conclusions were that contractual moderation of competition protection may be justified to support investment, but only in exceptional cases, and that, in considering applications for new competing services, the Regulator would not expect to approve rights whose effect would be primarily abstractive of the revenue of incumbent operators. He expects to publish his final conclusions in May 2004.

2.14. On changes to access rights, the Regulator published his draft conclusions in July 2003, including his proposals on the voluntary and mandatory surrender and adjustment of access rights and a "use it or lose it" mechanism to deal with rights that an operator is not using at all or is using only very infrequently. In December 2003, the Regulator's draft conclusions on a freight model contract also set out some freight-specific proposals on changes to access rights, including a mechanism to ensure that rights switch between freight operators when the associated freight haulage contract is lost by the incumbent and won by another operator. Both sets of proposals were generally welcomed by the industry. The Regulator expects to publish his final conclusions in May 2004, bringing together his proposals from these two earlier documents and including an updated version of the proposed Part J of the network code, which the Regulator will then incorporate in the code.



Network code reform

2.15. In March 2004, the Regulator published a consultation document seeking views on his proposals for reform of the network code – the common set of rules covering matters such as timetabling, management of operational disruption and changes to the network and the trains used on it⁷.

2.16. Although the network code is a key element of the legal and economic

⁶ *Model Freight track access contract: Regulator's final conclusions, Model freight track access contract and Criteria and procedures for the approval of freight track access contracts: second edition*, Office of the Rail Regulator, London, March 2004.

⁷ *Reform of the network code: an initial consultation document*, Office of the Rail Regulator, London, March 2004.



architecture of the rail industry, it has remained largely unchanged since it was established in April 1994. During that time the rail industry has undergone considerable change, and experience suggests that the existing arrangements could and should be improved and adapted better to fit the current needs of the industry and to foster a true co-operative joint venture between Network Rail and the train operators.

2.17. The Regulator believes that the network code reforms will produce major benefits for the industry, particularly by creating a greater element of co-operative working between the different parts of the industry, leading to improved efficiency and performance across the network. The views of the industry are important to the success of the review and the Regulator will ensure that they are involved throughout the process. The Regulator expects to complete the highest priority aspects – and to have made significant progress on the remaining parts – of it before the end of his term of office in July 2004.

Stations code

2.18. Significant progress was made during the reporting year in taking forward proposals to simplify and improve the station access regime. In January 2004, the Regulator published his draft conclusions for the establishment of a stations code to replace the current station access regime⁸. These draft conclusions set out the Regulator's proposed new contractual framework for stations, including a full draft of the proposed stations code. The proposals also contain a wide range of proposed improvements to the key provisions, such as those relating to the division of maintenance and repair responsibilities, station change, incentives and enforcement.

2.19. Also in January 2004, the Regulator held a well-attended industry seminar to enable consultees to gain a better understanding of the stations code proposals and to facilitate responses. A wide range of constructive and detailed responses were received. These are being analysed and considered before the Regulator publishes his final conclusions during summer 2004.

Station access casework

2.20. During the reporting year, the Regulator was asked to approve and direct a significant number of new station access contracts and to approve a large number of amendments to existing station access contracts, see Appendix 3.

2.21. Many of the applications for new or amended access rights were associated with the franchise re-mapping programme being implemented by the SRA and with the replacement of existing franchises (including the creation of the new Merseyrail Electrics 2002 Limited concession operating in the Liverpool conurbation). A significant proportion of station access casework also arose from the implementation of station enhancement schemes such as installing customer information systems, closed circuit television, new passenger lounges, and extensions to car parks.

⁸ *The Stations Code – draft conclusions (volumes 1 and 2)*, Office of the Rail Regulator, London, January 2004.

2.22. In addition to this routine casework, the Regulator concluded his consideration of the application under section 17 of the Act by Midland Main Line Limited (MML) relating to the terms of its access to London St Pancras station. MML had been unable to agree with London & Continental Stations & Property Limited (LCSP), the station facility owner, an appropriate level of compensation to be paid to MML for the effects of construction work at St Pancras station relating to the new northern terminus for the Channel Tunnel Rail Link.

2.23. After an open and consultative process, in April 2003 the Regulator issued directions to LCSP to enter into a station access contract on specified terms and published his reasons. Because LCSP refused to comply with the Regulator's directions, the Regulator commenced legal action against it for their enforcement in the High Court. In response, LCSP applied for judicial review of the Regulator's decision. The judicial review took place in October 2003 and LCSP's case failed. LCSP signed the contract as directed by the Regulator immediately afterwards.

Depots code

2.24. During 2003, ORR undertook a programme of visits to depot facility owners, the purpose of which was to identify any issues and problems faced by them in administering and operating the depot access regime. This work was supported by input from an industry working group, chaired by ATOC, involving a wide range of parties such as train operators, maintenance providers, funders and Network Rail. ORR then commenced preparation of a consultation document to bring together the issues raised and set out the Regulator's provisional conclusions for simplifying and streamlining the depot access regime, including proposals for a depots code. The Regulator intends to publish this consultation document in the first quarter of 2004-05.

Depot investment guidelines

2.25. The industry working group, chaired by ATOC, was also keen to address ways of facilitating third party investment in light maintenance depots. A sub-group, drawing upon the specialist knowledge of its members, produced a set of draft investment guidelines intended to reflect industry experience of the construction and enhancement of a range of depots and to facilitate the implementation of such projects in future. The draft guidelines are currently being assessed by members of the sub-group.

Depot access casework

2.26. In the reporting year, the Regulator approved new depot access agreements and amendments to existing depot access agreements which facilitated multi-million pound investments in new depot facilities for Chiltern Railways, South Central and South West Trains. He also commented on proposed customised arrangements, yet to be submitted for approval, that will help facilitate further new depot facilities for South Eastern Trains, Chiltern Railways and Thameslink. Much of this investment is to enable the introduction of new trains and/or new services. Depot casework activity is summarised at Appendix 3.





Licensing and licence exemptions

2.27. The reporting year saw a 60% increase in the volume of licensing casework received and a more than threefold increase in the number of licences granted (see Appendix 3). This was in part a result of the SRA's franchise re-mapping and replacement programme and ORR again worked closely with the SRA to ensure that licensing requirements were met in accordance with the key deadlines.

2.28. Of particular note was the licensing of Merseyrail Electrics 2002 Limited in July 2003 and the subsequent change of control in favour of Merseyrail Services Holding Company Limited. Working with the SRA and Merseytravel (the relevant PTE), ORR put in place a suite of licences with bespoke obligations for this former franchise let by the PTE as a local concession. Licences were also granted to Arriva Trains Wales/Trenau Arriva Cymru Limited, First Keolis Transpennine Limited, First Thames Trains Limited and London Eastern Railway Limited.

2.29. There was also significant activity outside the franchised sector. For example, on 25 April 2003 the Regulator granted licences to Wensleydale Railway Plc allowing the company to acquire and operate a former Network Rail branch line. In addition, licence exemptions were granted to a number of Network Rail subcontractors, freight customers and heritage-focused operators.

2.30. During the year, the Regulator approved amendments improving the effectiveness of the Claims Allocation and Handling Agreement. The amendments were designed to ensure that the rail industry continues to handle claims from injured and aggrieved parties in an equitable, expeditious, and efficient manner, and were approved following consultation with the SRA, the industry (through ATOC) and its insurers.

Safety and standards

2.31. To be effective, rail regulation must be fair, predictable and proportionate. And it must be well informed. That is why ORR works closely with key stakeholders across the industry including the safety regulator, the Health and Safety Executive (HSE), and the SRA.

Rail Safety and Standards Board (RSSB)

2.32. RSSB was established with effect from 1 April 2003 as an independent industry body to provide safety leadership. During RSSB's first year of operation ORR has built good working relationships with this new industry safety body. In addition to regular contact with senior RSSB staff through bodies such as the cross-industry Standards Strategy Group, ORR has also initiated regular liaison meetings with RSSB's chief executive and other executive directors. RSSB has been undertaking a thorough review of its organisation and activities and during the latter part of the year the Regulator approved, in accordance with RSSB's Constitution Agreement, changes to RSSB's functions.

Railway Group Standards Code

2.33. Railway Group Standards are technical standards and operating procedures compliance with which contribute to the safe operation of the rail network. Railway Group Standards are developed in accordance with the Railway Group Standards Code (RGSC), which is approved by the Regulator. When RSSB was established it was required to bring forward for approval by the Regulator a wholly revised RGSC which would make the Railway Group Standards development process more transparent and provide for greater industry involvement, reflecting the new structure of RSSB. The broad principles for this revised RGSC were set out in the Regulator's conclusions on the establishment of RSSB. In December 2003, RSSB submitted a new RGSC to the Regulator following an exhaustive cross-industry development process and consultation. Following his own consultation with the HSE, SRA and RSSB members, the Regulator approved the revised RGSC subject only to a small number of minor amendments.

Standards Strategy Group

2.34. The cross-industry Standards Strategy Group (SSG), under the chairmanship of the SRA, was set up at the same time as RSSB, to provide support and advice to RSSB and to facilitate achievement by the industry of optimum safety and economic solutions to interface issues. ORR has played an active role in the work of SSG, not least in taking the lead in identifying an appropriate form of organisation to address system interface matters. Whilst the Wheel Rail Interface Systems Authority (WRISA), set up with active participation by ORR following a recommendation from the Southall inquiry, had made good progress in identifying the causes of problems such as rolling contact fatigue, it had found itself hampered in taking forward any possible solutions, partly due to insurance difficulties. SSG asked ORR to take the lead in identifying a suitable replacement body for WRISA and in identifying a template organisation to deal with the other system interfaces. Following informal industry consultation and discussion at SSG, the concept of System Interface Committees, set up under the umbrella of RSSB and with an SRA nominated chairman, was agreed. The first of these, the Vehicle Track System Interface Committee, started work in March 2004.





Objective 3

Objective 3 – To prevent anti-competitive agreements and practices in the rail industry and promote competitive markets for the benefit of users of the railway

Competition Act 1998

3.1. The Regulator continued to receive requests to investigate complaints about the supply of railway services. His initial review of each complaint determined whether there was potential anti-competitive behaviour or conduct which merited investigation under the Competition Act 1998 or whether the matter was more appropriately dealt with using his powers under the Railways Act 1993 or should be referred to other bodies such as the SRA or the HSE. ORR dealt with thirteen complaints over the course of the reporting year. Nine complaints were closed without a finding of an infringement, one case was considered potentially more appropriate for handling under licence conditions, and investigations into the remaining three complaints are continuing.

3.2. On 3 December 2003, the Regulator published his decision in relation to a complaint against English, Welsh and Scottish Railway Ltd (EWS) which alleged that EWS had engaged in predatory pricing or selective discounting in the market for charter passenger train services.

3.3. On the basis of the Regulator's initial factual review of the allegations, further enquiries of market participants (customers and competitors) and a review of the market for charter passenger train services, the Regulator concluded that he did not have reasonable grounds to suspect that EWS had engaged in conduct that would constitute an infringement of the Chapter II Prohibition.

3.4. Under modernisation of European competition law, UK competition authorities will have jurisdiction over competition cases that affect trade within the EU from 1 May 2004. This will enable ORR to investigate cases that affect trade between Member States, in some cases involving co-operation with other EU competition authorities. On 16 March 2004, ORR signed a joint statement with other UK sectoral regulators and the Office of Fair Trading (OFT) committing it to abide by the principles set out in the European Commission's "Notice on co-operation within the Network of Competition Authorities". The European Competition Network (ECN) is a key feature of the European competition modernisation programme. It brings together the national competition authorities of the EU to allocate and exchange information on competition cases that affect trade between member states. The Notice covers the rules and procedures under which the ECN will operate.

3.5. ORR continued throughout the reporting year to liaise with other sectoral regulators and the OFT, and to participate in the Concurrence Working Group (made up of representatives of UK regulatory bodies that have concurrent powers with the OFT to investigate competition cases under the Competition Act 1998). These provide opportunities to exchange information and best practice to ensure consistency of approach.

Merger advice

3.6. The OFT asked the Regulator for advice on five acquisitions affecting the rail industry, namely Transpennine Express, ScotRail, Wales and



Borders, Thames Trains and Greater Anglia. ORR also provided advice to the Competition Commission (CC) following the OFT's decision to refer the proposed ScotRail acquisition by First Group for a detailed CC investigation.

Implementing EC Directives

3.7. ORR was actively involved in continuing work to implement fully the three EC Directives⁹ that make up the First Infrastructure Package covering the development of the Community's railways including the separation of certain essential functions and requirements for open access for some international freight services; the licensing of train operators; and capacity allocation and charging. Domestically, this involved participating in meetings and discussions with the DfT (responsible for implementing the package), the SRA, HSE and other industry parties.

3.8. At European level, ORR continued to be represented at the Developing European Railways Committee, chaired by the European Commission, and participated in relevant subgroups of the Committee looking at some of the specific outputs from the First Infrastructure Package such as the establishment and role of regulatory bodies, the production of network statements, the development of a standard European licence for train operators and the content of track access agreements.

3.9. ORR also contributed to the DfT's development of regulations to implement the conventional interoperability Directive¹⁰ and took part in a government/industry forum to deal with the practical issues associated with implementation in the UK.

Contributing to the development of new EC Directives

3.10. Negotiations continued during the year on the Second Infrastructure Package which contains proposals on safety, freight liberalisation, the alignment of high speed and conventional interoperability requirements, the establishment of a European Rail Agency, and the convention concerning international carriage by rail (COTIF). ORR contributed to the UK negotiating position and, towards the end of 2003, when the package entered the conciliation process, provided advice as to the UK's position on proposed amendments, particularly in respect of the liberalisation proposals. The Second Package is due to be adopted around May 2004 and the agreement reached at the end of conciliation fully met the UK's objectives.

3.11. ORR was also involved in preliminary discussions within the UK on the Third Infrastructure Package, prior to the Commission formally announcing its proposals in March 2004. This package covers passenger market liberalisation, international rail passengers' rights and obligations, freight quality contracts and train driver licensing.

⁹ Directive 2001/12/EC, 2001/13/EC and 2001/14. Directive 91/440/EEC is amended by 2001/12/EC, 95/18/EC is amended by 2001/13/EC and 2001/14/EC replaces 95/19/EC.

¹⁰ Directive 2001/16/EC.

International access and licensing

3.12. In November 2003, the International Rail Regulator (IRR)¹¹ was notified of a track access agreement between CTRL (UK) Limited and Eurostar (U.K.) Ltd. No representations were received following the publication of the notice advertising the agreement on the ORR/IRR website. One application for an international licence was received during the year but this was subsequently not pursued by the applicant.

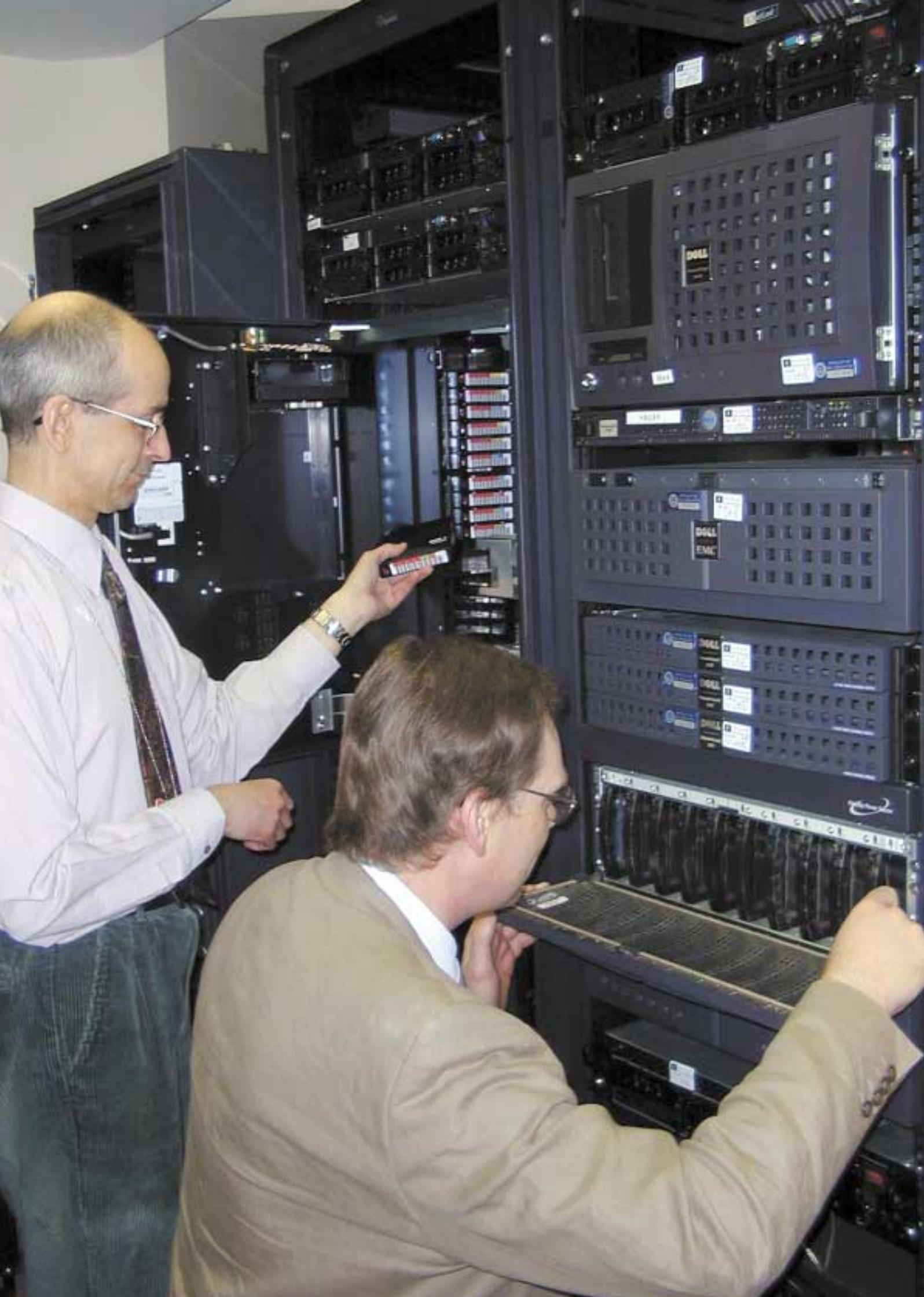
General European/international issues

3.13. ORR also received a number of visits during the year from representatives of other countries including Taiwan, South Korea, Norway, South Africa, Pakistan, Germany, the Netherlands and Kazakhstan who all wished to hear about the UK's rail and regulatory experiences. A representative of ORR also participated as a national expert in a European Commission-sponsored review of implementation of European legislation in the Czech Republic, Estonia and Hungary before their accession into the EU.

3.14. ORR representatives gave a number of presentations on European and international issues during the year and ORR participated in a European-focussed session of the House of Commons Select Committee on Transport.



¹¹ The International Rail Regulator is currently a separate legal entity, established to fulfil functions in Great Britain in relation to international services. The offices of both the domestic and the International Rail Regulator are held by the same person.



Finance and corporate governance

4.1. ORR is a Non-Ministerial Government Department, funded through charges to licence holders. The totals of expenditure and income have to be planned through the Treasury and accounted for to Parliament. The Rail Regulator is the Accounting Officer for these funds.

	01/02 Outturn (£ million)	02/03 Outturn (£ million)	03/04 Forecast* (£ million)	04/05 Plan (£ million)	05/06 Indicative (£ million)	06/07 Indicative (£ million)
Administration Costs	10.3	13.6	14.9	14.1	14.4	14.7
Licence Fee Income	10.3	13.1	14.9	14.1	14.4	14.7
Net Administration Cost	0	0.5	0	0	0	0
Capital	0.4	0.3	0.3	0.5	0.5	0.5

* Cash licence fee income of £14.8 million will be received in 2003-04. The balance of the accrued income will be recovered in the 2004-05 licence fee.

4.2. ORR's business plan for 2003-04 set out a commitment to developing corporate governance arrangements in a bid constantly to review the effectiveness of the organisation as a whole.

Business planning processes

4.3. Throughout the reporting year ORR has sought to improve its overall business planning process. This has included improvements in directorate planning and linking personal objectives to directorate and ORR objectives more closely. ORR has developed improved methods of business planning monitoring and produces reports on progress against the delivery of business plan objectives, which are received by ORR's senior team monthly. In February 2004, ORR published a three-year high level business plan for consultation, which set out ORR's programme of work for 2004-07. This business plan and budgets were prepared in consultation with all members of ORR staff through a more robust planning process.

Risk register

4.4. During the second quarter of the reporting year, ORR established a high-level risk register which identifies those principal risks that could affect the achievement of ORR's objectives. The risk register also sets out what controls for mitigation are in place, and what controls need to be developed. Formal reports to ORR's Board on risk and the risk register were initiated in the final quarter of 2003-04, and will continue quarterly. ORR's business plan reflects the necessary actions to mitigate the identified risks to the delivery of regulatory outputs detailed in the risk register. These will be reviewed in the first quarter, 2004-05, in the light of ORR's Business Plan 2004-2007.



Resource management

4.5. The reporting year has seen the implementation of tighter controls on ORR expenditure through the introduction of the Budget and Consultancy Committee. This committee, chaired by the Principal Establishment and Finance Officer, and made up of all Directors, Deputy Directors, the Head of Resources and Head of Finance, meets monthly to monitor and set ORR budgets, and direct financial and procurement strategy for the organisation. During the year it was necessary for ORR to take a Supplementary Estimate of £500,000 to meet additional pressures and uncertainty resulting from ACR 2003 and the St Pancras section 17 judicial review (see Events in the annual reporting year – November 2003) although latest forecasts indicate that only £173,000 will be required. This increased budget is reflected in the table in paragraph 4.1 above, and the excess of income over expenditure will be treated as accrued income and recovered in the 2004-05 licence fee.

Audit Committee

4.6. ORR's commitment to effective corporate governance is underpinned by the work of the Audit Committee. Chaired by the Regulator, this committee has a mix of internal and external members; independent lay members provide the external membership. In addition, the National Audit Office and Internal Audit attend every meeting. The Audit Committee has met every four months and considered and helped to direct ORR's development of corporate governance, as well as agreeing the forward work programme for Internal Audit. ORR purchases Internal Audit services from the Department for Transport's Audit Risk and Assurance Division.

Prompt payment initiative

4.7. ORR aims to pay all bills in accordance with agreed contractual conditions, or, where no such conditions exist, within 30 days of receipt of goods and services or the presentation of a valid invoice, whichever is the later. During the reporting year, 88% of invoices were paid within the target period compared with 90% for the previous reporting year.

Communications

4.8. Located within the Corporate Affairs Directorate, the Communications Division includes the Press Office, the e-communications team, the Library and Reception. During the reporting year, ORR published 23 press announcements and 28 documents of which the most important was the access charges review final conclusions in December 2003. This announcement, as with earlier consultation documents in the review series, proved particularly newsworthy and the Regulator gave over 30 media interviews for the final conclusions document alone. Over the year, the Library welcomed 78 external visitors and dealt with 2372 external enquiries.

Website and intranet

4.9. Significant enhancements to ORR's website capability were made over the course of the reporting year. Among additional features, a search engine was introduced following the implementation of a content management system. The number of daily visits to the site increased from an average of 934 in April 2003 to 1340 in March 2004.

4.10. Preparatory work was put in during the reporting year in readiness for the launch of ORR's intranet, due to be introduced in the first quarter of 2004-05.

Information technology

4.11. IT continues to provide a vital service to the office and is key to the delivery of effective regulation. Over the reporting year, we have maintained a secure and robust operating environment.

4.12. As with all government departments and agencies, ORR is working towards compliance with the security standard ISO 17799. Our programme of compliance is now drawing to completion to ensure security is maintained at a high level. We have also undertaken a project to upgrade our server environment and operating system and will conclude with a rollout of new desktop PCs at the end of April 2004. The office has just completed testing and initial administrators training for our new contacts database, which has enhanced the functionality of our previous package, allowing industry contacts more efficiently to be kept up to date with all new developments.

Electronic records management

4.13. A number of successful projects have been undertaken during the reporting year which have helped the office deliver the overall business plan, by improving information technology. These include the introduction of electronic records systems to allow vital information to be stored efficiently and retrieved when required via a comprehensive search. This will continue through 2004 as we deliver more services to staff.

Human resources



Managing and developing our people

4.14. We have continued to develop our workforce to ensure they are fully skilled and capable of delivering ORR's objectives. Our training and development strategy has ensured that our people have been able to access a comprehensive range of training and development activities that have been delivered at all levels in the organisation.

4.15. This year we have provided comprehensive training focussed on management and personal development, ranging from a management development programme and management master classes for our senior managers to 'Managing your Career' and 'The Effective Manager' workshops for our executive and administrative staff.

4.16. To underpin our railway and regulatory knowledge and awareness we have provided both internal awareness sessions, to increase understanding of the contributions that each part of ORR makes to the business, and externally commissioned training events, including events on competition law, judicial review and the Human Rights Act 1998, as well as railway operations training.

4.17. We are continuing to undertake a comprehensive review of the policies that are incorporated into employees' contracts of employment, to ensure that our working practices meet statutory changes to employment law and best practice. These changes have been underpinned by training and briefings on topics such as equality and diversity, health and safety in the workplace, and performance management.

4.18. The table below shows our workforce profile as at 31 March 2004.

	SCS*	Level 1	Level 2	Level 3	Level 4	Total
Total staff	8	7	34	52	16	117
Male	6	6	28	31	8	79
Female	2	1	6	21	8	38
White	8	7	33	39	10	97
Ethnic Minority	0	0	1	13	6	20
Disabled	0	0	3	3	3	9

* Senior Civil Service (excludes Regulator)



Customer Correspondence

ORR receives a substantial volume of public correspondence on a variety of different issues arising from railway services. These typically include punctuality and reliability of services, the cost and complexity of rail ticketing, the quality and cost of train and station facilities, safety and personal security, timetabling issues, and staff conduct. In the reporting year, ORR received 1,368 items of correspondence, about 90% of which received a full response within our target time of 20 working days.

ORR has a dedicated customer correspondence team (CCT) which handles all public correspondence. CCT investigates cases that directly pertain to Network Rail's stewardship of the national network. We encourage contact by letter, telephone and by e-mail (contact.cct@orr.gsi.gov.uk); we have a minicom facility and are ready to respond to blind or partially-sighted correspondents on audiotape or with letters in large print.

Investors in People

4.19. Our commitment to developing our employees was recognised when we successfully achieved Investors in People re-accreditation in November 2003.

Recruitment

4.20. ORR has continued to attract and retain skilled and talented staff. There are systems in place to ensure that recruitment is carried out on the basis of fair and open competition and selection on merit in accordance with the Civil Service Commissioners Recruitment Code. These systems are subject to internal and external checks. ORR did not make any applications for exceptions to the Code. The table below shows the number of appointments made through external recruitment during the reporting year.

	SCS	Level 1	Level 2	Level 3	Level 4	Total
Total staff	1	0	4	2	4	12
Male	1	0	4	2	4	11
Female	0	0	0	1	0	1
White	1	0	4	1	0	8
Ethnic Minority	0	0	0	2	2	4
Disabled	0	0	0	0	1	1

Appendix 1: ORR Board



Chris Bolt
Non-executive director

Robin Saunders
Non-executive director

Tim Martin
Director of Infrastructure and
Economic Regulation

Keith Webb
Director of Corporate Affairs



Chris Stokes
Non-executive director

Tom Winsor
Rail Regulator

Michael Beswick
Director, Rail Policy

Appendix 2: The Rail Regulator's speaking engagements and oral evidence to parliamentary committees

13 May 2003	Institution of Electrical Engineers conference: Law and the Railways : Effective independent economic regulation of the railways
21 May 2003	Speech at the D Group on the future of the railway
23 May 2003	Speech at the Fourth Friday Group of railway professionals on the access charges review 2003
4 June 2003	Rail Freight Group annual conference : Independent economic regulation working in the interests of rail freight
11 June 2003	Oral evidence to the House of Lords Constitution Committee investigation into the accountability of regulators
25 June 2003	Oral evidence to the House of Commons Select Committee on Transport on the future of the railway
26 June 2003	Institute of Economic Affairs conference on the future of UK rail : Interim Review of Access Charges
2 July 2003	Railway Industry Association lunchtime address on access charges review 2003
10 September 2003	Rail Passengers' Council annual conference: speech on access charges review 2003
19 September 2003	Law Society of Scotland In-house Lawyers' Group and European Company Lawyers' Association dinner : Address on regulation and the future of the railways (Edinburgh)
25 September 2003	Waterfront Conferences : Why Rail is Important : Economic Regulation and Incentives for Success
21 October 2003	City and Financial Conferences : Rail Finance Summit : Sound Finance and Incentives for a Strong Framework for Performance and Investment
22 October 2003	Oral evidence (as International Rail Regulator) to House of Commons Select Committee on Transport in its inquiry into the future of the railway
23 October 2003	European Rail Infrastructure Managers lunchtime address : Privatisation and Regulation - the UK Experience (Brussels)
29 October 2003	Oral evidence (as Rail Regulator) to House of Commons Select Committee on Transport in its inquiry into the future of the railway
4 November 2003	Royal Institution of Chartered Surveyors : PPP and the Railways : Economic Regulation and Incentives for Success
5 November 2003	Institution of Electrical Engineers conference: Law and the Railways : Effective independent economic regulation of the railways (repeat of May 2003 presentation)
7 November 2003	Convention of European rail regulators : speech on the regulation of UK railways (Vienna)
13 November 2003	Portuguese Strategic Council on Transportation and University of Coimbra : speech on the regulation of UK railways (Lisbon)
18 November 2003	Standard & Poor's Infrastructure Finance Ratings Group conference: Regulating the Railways - Getting to Grips with Network Rail's Costs

18 November 2003	Institute of Economic Affairs and London Business School: Beesley Lectures 2003: rapporteur on paper by Chris Bolt, PPP Arbiter, on London Underground
20 November 2003	Rail magazine: Controlling Infrastructure Costs : Access Charges Review 2003
26 November 2003	Adam Smith Institute: Power Lunch : Current Issues in Britain's Railways
7 January 2004	Railway Study Association: Delivery Through Effective Regulation
12 January 2004	US Congressional Staff and others: The Lessons of the UK Railway Industry (Washington DC)
13 January 2004	World Bank : Restructuring Railways : The UK Experience (Washington DC)
19 January 2004	All-party Parliamentary Rail Group and West Coast Main Line Group: Regulation of the Costs of the British Railway Network
21 January 2004	Centre for the Study of Regulated Industries Occasional Lecture: The Future of the Railway Industry Through Effective Independent Economic Regulation
26 January 2004	Institution of Railway Operators : Regulating the National Infrastructure and Controlling Costs
30 January 2004	The Ditchley Foundation: Conference on Integrated Transport Policy (Oxfordshire)
3 February 2004	Associate Parliamentary Transport Forum : The Regulation of the Railways
6 February 2004	McKinsey & Co: lunchtime seminar: The Experience of Five Years Regulating Britain's Railways
10 February 2004	Chartered Institute of Transport and Logistics: Sir Robert Reid Memorial Lecture 2004: The Future of the Railways
11 February 2004	Rail magazine: National Rail Conference 2004: Access Charges Review 2003
1 March 2004	Adam Smith Institute: The Future of European Rail: The Regulation of the Railways in Britain and Prospects for the Future (Paris)
4 March 2004	Major Projects Association: The Future Role and Function of Regulation in the UK
9 March 2004	Merrill Lynch International: European Transport Conference 2004: Railways in Britain - The Lessons of the Last Five Years
19 March 2004	Ministry of Railways, China: presentation on UK rail experience to Vice-Minister of Railways (Beijing)
23 March 2004	Asia Pacific Rail 2004 conference: Restructuring Railways: The UK Experience (Shanghai)

Locations are London unless otherwise stated

Appendix 3: Casework activity tables

Access contracts: 1 April 2003 – 31 March 2004

	Track	Stations	Depots
New access agreements approved under section 18 of the Railways Act 1993	25	167	62
Agreements directed under section 17 of the Railways Act 1993	1	1	0
Amendments to existing agreements approved under section 22 of the Railways Act 1993	74	109	4
Amendments to existing agreements covered by general approval	68	160	16
Directions varied under section 144(3) of the Railways Act 1993	0	1	2

Licence and exemption applications received: 1 April 2003 – 31 March 2004

Applicant (licence)	Date received	Passenger licence	Non-passenger licence	Station licence	Light maintenance depot licence	Network licence
Arriva Trains Wales/Trenau Arriva Cymru Limited	26/08/03	•	•	•	•	
GrantRail Limited	09/09/03				•	•
First/Keolis Transpennine Limited	09/10/03	•	•	•		
Arriva Trains (London & Anglia) Limited	04/11/03	•	•	•	•	
London Eastern Railway Limited	14/11/03	•	•	•	•	
Grand Central Railway Company Limited	18/11/03	•	•			
Cambrian Railways Society Limited	18/11/03	•	•	•	•	•
First Thames Trains Limited	26/11/03	•	•	•	•	
Merlin Rail Limited	03/12/03		•			
Eurostar International Limited	05/12/03			•	•	

Applicant (exemption)

The Potter Group Limited	09/04/03		•		•	•
Wyvernrail Plc	09/05/03	•	•	•	•	•
Gloucestershire Warwickshire Steam Railway Plc	16/05/03	•	•	•		•
Guardian Industries UK Limited	21/05/03					•
AWG Rail Services Limited	26/06/03		•			
McAlpine Capital Projects Limited	18/09/03		•			
Weardale Railways Limited	30/09/03	•	•	•	•	•
Deeside Railway Company Limited	04/12/03	•	•	•	•	•
Avon Valley Railway Company Limited	16/01/04	•	•	•		•
West Coast Railway Company Limited	17/02/04		•			

Change of control approved by the Rail Regulator: 1 April 2003 – 31 March 2004

Licence holder	Approved (date)	Control by
Amey Rail Limited	17/07/03	Ferrovial Servicios, S.A.
Merseyrail Electrics 2002 Limited	13/08/03	Merseyrail Services Holding Company Limited
Anglia Railways Train Services Limited	09/10/03	FirstGroup Plc
Hull Trains Limited	09/10/03	FirstGroup Plc
GB Railfreight Limited	09/10/03	FirstGroup Plc

Licences and/or exemptions revoked by the Rail Regulator: 1 April 2003 – 31 March 2004

Licence/exemption holder	Date	Passenger licence	Non-passenger licence	Station licence	Light maintenance depot licence	Network licence
Licences						
Jackson Civil Engineering Limited	21/07/03		•			
Arriva Trains Merseyside Limited	08/10/03	•	•	•	•	
Mendip Rail Limited	26/11/03		•			
Connex South Eastern Limited	02/02/04	•	•	•	•	
Exemptions						
The Rail Management Services Limited	22/03/04				•	
The Rail Management Services Limited (Meldon Quarry Station)	22/03/04			•		

Licences and exemption applications withdrawn by applicant: 1 April 2003 – 31 March 2004

Applicant	Date withdrawn	Licence type(s)
Buxton Lime Industries Limited	13/08/03	Network licence
Eurostar International Limited	12/03/04	Station and light maintenance depot

Licences and exemptions granted by the Rail Regulator: 1 April 2003 – 31 March 2004

Licence/exemption holder	Date	Passenger licence	Non-passenger licence	Station licence	Light maintenance depot licence	Network licence
Applicant (licences)						
Pre Metro Operations Limited	03/04/03	•			•	
Wensleydale Railway Plc	25/04/03	•	•	•	•	•
Merseyrail Electrics 2002 Limited	17/07/03	•	•	•	•	
Arriva Trains Wales/Trenau Arriva Cymru Limited	03/12/03	•	•	•	•	
First/Keolis Transpennine Limited	28/01/04	•	•	•		
Harsco Track Technologies Limited	13/02/04		•			
Merlin Rail Limited	27/02/04		•			
London Eastern Railway Limited	26/03/04	•	•	•	•	
First Thames Trains Limited	26/03/04	•	•	•	•	
Applicant (exemption)						
East Lancashire Light Railway Company Limited	29/08/03	•	•	•	•	•
DMQA Technical Services (UK) Limited	19/09/03		•			
The Potter Group Limited	01/10/03					•
Guardian Industries UK Limited	17/10/03					•
Gloucestershire Warwickshire Steam Railway Plc	01/03/04	•	•	•		•
Dartmoor Railway Limited	22/03/04	•	•	•	•	

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