

Alliancing: Draft Network Rail Policy Statement

ORR has published a statement on alliancing which confirms its support for the aim of alliancing and sets out some of the key regulatory principles so that alliances are worthwhile not just to the parties involved but so that benefits also accrue to rail users and taxpayers. Network Rail welcomes the statement from ORR and the purpose of this draft statement is for the company to set out the principles it is adopting in negotiating and agreeing alliances with train operators.

1. Purpose: Network Rail sees its purpose (i.e. why we exist) as to generate outstanding value for taxpayers and users by continually improving the railway; and we see our role (i.e. what we do) as to develop, maintain and operate rail infrastructure in partnership with our customers, suppliers and other stakeholders. We consider that two of the key obstacles to improved value for money are the lack of alignment of incentives between industry parties and their lack of flexibility to deliver the required outputs in the most efficient way. Accordingly, we consider that the ultimate purpose of alliancing with passenger and freight train operators is to achieve improvements in value for money by enabling more effective cooperation or partnership with these customers. Separately, we are also seeking to develop relevant alliances with our suppliers.

2. Objectives: Network Rail's objectives from alliancing with its customers are to:

- drive continuous safety improvement;
- deliver financial benefits beyond that which could be achieved without alliancing;
- drive improved performance and user satisfaction through alignment of incentives around the market and customers; and
- apply learning from alliancing to other parts of the business.

Network Rail expects to achieve these outcomes by using alliancing to:

- challenge constraints which would otherwise be regarded to be outside the control of the parties;
- reduce interface inefficiencies and duplication of resource with operators;
- transform behaviours and interface management away from being driven by defending current contractual positions towards collaborating to improve industry outcomes; and
- drive positive change across the industry by improving Network Rail and operator understanding of each others' business.

3. Safety issues: Network Rail is committed to continuous improvement in safety including by addressing the safety culture of the business and helping to embed the concept of system safety across the industry. We would expect closer working to result in improved safety. Alliance parties will retain their existing safety management systems under which relevant changes will be subject to safety validation both in establishing alliances and in operating an alliance.

4. Network issues: To varying degrees all routes are used by multiple operators. In addition, many operators operate across more than one of our routes. Our approach to alliancing will ensure that any arrangements with individual operators do not compromise our ability to provide excellent service to other operators on a route or to plan, develop and operate the network as a whole so that it is seamless to individual operators or rail users. This reflects Network Rail's role as system operator.

5. **National activities and support services:** Devolution is based on a principle that Network Rail is devolving decision making to a local level except where there is a strong case for doing otherwise. Some activities will continue to be delivered nationally for example where there are clear benefits from standardisation or economies of scale. This is also reflected in our approach to alliancing.
6. **Stewardship issues:** Part of Network Rail's role involves it taking a whole-life approach to stewardship of the infrastructure. Our approach to alliancing is intended to maintain this focus while gaining greater input from operators to help inform tradeoffs. This includes network wide asset policies and assurance processes.
7. **Legal issues:** Alliances will be encouraged to promote innovation which will ultimately benefit taxpayers and rail users. However, any alliancing arrangements will comply with Network Rail's existing statutory, contractual and regulatory obligations. This includes the prohibition on undue discrimination in our network licence and the provisions of the network code.
8. **Ultimate accountability:** Network Rail has sought to reconcile the purpose and objectives outlined above with the other issues referred to above by maintaining the principle that alliancing should not change Network Rail's ultimate accountability (or that of the relevant operators). Thus, for example, Network Rail as a company will continue to be accountable for its existing statutory, contractual and regulatory obligations. Moreover, the alliance arrangements with individual operators are designed such that they do not prevent the company from taking necessary action to discharge Network Rail's accountabilities. Even in the case of a "deep alliance" explained below, Network Rail will be able to determine that additional costs should be incurred or other actions should be taken locally to meet longer term requirements or the requirements of other operators using the route. The company will continue to be held to account by the ORR.
9. **Bespoke alliances:** Network Rail is keen to explore mutually beneficial opportunities with any passenger or freight train operator. The company has signalled this willingness to explore opportunities both to existing passenger and freight train operators and to shortlisted franchise bidders. The precise arrangements will differ, however, according to the characteristics and use of the relevant parts of the network, the characteristics and markets served by the relevant operators' train services, the challenges facing this part of the network and the relevant operators over the period in question, and the aspirations and approach of the operators concerned.
10. **Framework alliance agreement:** Network Rail has developed a framework alliance agreement which has evolved through discussions with a number of operators. This framework agreement template approach need not constrain discussions and it will continue to evolve in the light of experience. The current framework agreement provides for transparent sharing of information on the performance of the respective businesses to help identify mutual opportunities; for the establishment of a code of conduct to underpin the mutually desired changes in behaviour; and for the identification of specified alliance projects which the joint teams intend to progress. Where the identified projects result in proposals for change, these changes are still subject to the existing industry change processes. Our intention would be to engage

as early as possible with all operators where they would potentially be impacted by a change. The nature of the projects which are included and the way in which they are progressed will vary depending upon the circumstances of the case.

- 11. Non-framework alliancing projects:** In some routes, specific projects are being progressed without a framework agreement of the nature described above. These specific projects could potentially change the way in which Network Rail works with operators on the routes but this would still be subject to the same principles as described above. There is therefore no requirement for a specific alliance agreement in order to progress such initiatives.
- 12. Deep alliances:** A “deep” alliance can be defined as one in which one of Network Rail’s routes (or potentially part of a route) and a train operator share upside or downside risk against an agreed baseline for all and most of their activities. In Network Rail’s view, this would only be appropriate where an operator has a very strong geographic alignment with the route – such that it has very little traffic on other routes and other operators have a small proportion on the route in question. Network Rail has also taken the view that it would be inappropriate and impractical to enter into such an arrangement with an incumbent franchisee except where there are several years remaining on the franchise term. In addition, it has taken the view that for the duration of Control Period 4 it was only practical for it to enter into one such deep alliance with an incumbent train operator. Network Rail has been exploring the possibility of a deep alliance between the Wessex Route and SSWT. There is expected to be an integrated management team with a single Managing Director who is accountable to both companies. The principles outlined above around Network Rail’s ultimate accountability would continue to apply and the Alliance Board would include an independent Network Rail Director from outside the alliance team. Other operators have been consulted on the detailed arrangements including the interface arrangements for these other operators to ensure that they continue to receive fair treatment.
- 13. Refranchising:** Network Rail will continue to provide input to government in relation to the specification of franchises and in future we would hope to agree with government the basis for alliancing opportunities which would be encouraged through the franchise specification and evaluation processes. In addition, Network Rail has increasingly sought to engage with shortlisted franchise bidders on potential alliancing arrangements and in future we would expect this engagement to build upon whatever arrangements are included in the franchise specification. Alliancing projects which are developed with the incumbent franchisee in advance of the refranchising process would be made transparent to bidders in the competitive process. By contrast, alliancing conversations with shortlisted bidders would be non-exclusive and would be treated as confidential where appropriate. The points of contact for discussion with potential franchisees are within the Network Strategy and Planning teams.
- 14. Freight and open access operators:** In taking forward a range of alliancing opportunities with franchised train operators, Network Rail will remain focused on providing service to freight and open access operators. In addition, Network Rail welcomes the opportunity to explore mutually beneficial commercial opportunities with freight and open access operators. The nature of the arrangements is likely to

differ since the circumstances are different but the same principles as outlined above would apply to such arrangements.

- 15. Best practice and learning:** Network Rail would expect to apply general lessons from alliancing arrangements to other parts of its network. In addition, alliance arrangements with an incumbent operator would be expected to inform the potential for opportunities from refranchising. The precise model from one situation is, however, unlikely to be applicable elsewhere.
- 16. Transparency:** Network Rail is committed to transparency in relation to its financial and operational performance. While the commercial terms of an alliance may be commercially confidential, any aggregated financial flows as a result of alliancing for each of Network Rail's routes would be identified through the regulatory accounts. This would therefore be subject to independent audit and potentially further review by ORR or the independent reporters.
- 17. Efficiency benefit sharing:** The Efficiency Benefit Sharing mechanism in the track access agreement provides for sharing of OM&R (operations, maintenance and renewals) efficiency benefits with operators pro-rata to their use of the network. In CP5 it is expected that this will be applied on a Route basis rather than nationally. Bespoke alliancing arrangements are intended to operate alongside this mechanism. Where bespoke alliances result in the sharing of benefits between Network Rail and operators, Network Rail will negotiate any baseline such that this incorporates improvements which it considers can be achieved without such an alliance. Network Rail has proposed in response to ORR's consultation that Network Rail's relevant payments and receipts arising from the alliance would be included in the Efficiency Benefit Sharing Mechanism. If accepted, this would mean that any further benefits from the alliance over and above the baseline referred to above will be shared with other operators.
- 18. Concessions:** Network Rail is also considering the potential benefits and issues which would need to be addressed for it to let a long-term concession for part of the infrastructure. This is independent of alliancing and the implications would be quite different. Unlike an alliance, letting an infrastructure concession would involve the creation of a new company and that company would be accountable for the relevant infrastructure. In such a scenario, however, Network Rail would expect to continue to act as system operator for the network as whole. Network Rail currently has no plans to let an infrastructure concession but any decision to proceed with this option would take account of the same issues as described above. It would therefore need to be justified in terms of additional benefits to rail users and taxpayers, it would need to enable continued whole-life optimisation of the whole network, and it would need to conform with the relevant legislation.

This draft statement is subject to modification following consultation with the industry, ORR and governments. Comments on the draft should be sent to Cara Stimson (cara.stimson@networkrail.co.uk) by 30 March 2012.