

Alliancing: Network Rail Policy Statement

In order to achieve greater benefits for tax payers and rail users through collaborative working arrangements, Network Rail has entered into a number of alliances with train operators over the last two years. We believe this approach can deliver significant benefits to the industry, and are keen to implement alliancing arrangements with both incumbent operators and through the refranchising programme. The purpose of this policy statement is for Network Rail to set out the principles it adopts when 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 collaboration or partnering 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.

We expect to achieve these objectives 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. This includes addressing the safety culture of the business and helping to embed the concept of system safety across the industry. We expect closer collaboration 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. We 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. **Route and national activities:** The relevant route will be in the lead for Network Rail within an alliance, making decisions with the operator at a local level. Some activities will continue to be delivered nationally, for example where there are clear benefits from standardisation or economies of scale.
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 are 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, the legal requirement to maintain separation of train operations from Network Rail's capacity allocation functions and the provisions of the network code.
8. **Ultimate accountability:** Alliancing will not change Network Rail's ultimate accountability or that of the relevant operators. Network Rail as a company will continue to be accountable for its existing statutory, contractual and regulatory obligations. The alliance arrangements with individual operators are designed so that they do not prevent either party from taking necessary action to discharge their accountabilities. Even in the case of a "deep alliance" explained below, Network Rail is 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. We have signalled this willingness to explore opportunities both to existing passenger and freight train operators and to shortlisted franchise bidders. The precise arrangements will differ 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. We will 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 allancing 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 and/or downside risk against an agreed baseline for all or 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 is also of 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 CP4, Network Rail entered into one such deep alliance with an incumbent train operator, SSWT (the “South Western Railway”). For CP5, we have stated that we are willing to enter into a deep alliance arrangement with the successful bidder of the ScotRail refanchising competition¹.
13. **Refanchising:** Network Rail will continue to provide input to government in relation to the specification of franchises and will discuss appropriate allancing opportunities. Network Rail also engages with shortlisted franchise bidders on potential allancing arrangements. Allancing projects which are developed with the incumbent franchisee in advance of the refanchising process would be made transparent to bidders in the competitive process. Allancing conversations with shortlisted bidders are confidential but we cannot guarantee exclusivity. The points of contact for discussion with potential franchisees are within the Strategy and Planning (North and South) teams.
14. **Freight and open access operators:** In taking forward a range of allancing 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. We expect the principles as outlined above to apply to such arrangements, although acknowledge that the *nature* of these arrangements is likely to be different.
15. **Best practice and learning:** Network Rail will apply general lessons from allancing 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 refanchising. 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

¹ The Alliance is not mandated by Transport Scotland as part of the refanchising process.

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. **Route efficiency benefit sharing (REBS):** In CP4, track access contracts included an efficiency Benefit Sharing mechanism which provides for the 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 (referred to as REBS) and will include both upside and downside sharing with operators. Bespoke alliancing arrangements are intended to operate alongside this mechanism. As part of its Final Determination on PR13, we expect ORR to conclude that alliance performance will be taken account of before any REBS payments are made ('alliance before REBS').

Train operators' participation in REBS will not be compulsory, with the possibility to opt-out of the mechanism at the beginning of CP5 or during CP5 under specific circumstances. On entering into any alliance arrangements with operators during CP5 that include one or more elements of Network Rail's cost and/or income included in REBS, we would expect to require operators to opt-out of the mechanism.

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.