House of Commons Committee of Public Accounts
Office of Rail Regulation: Regulating Network Rail's efficiency
Forty-first Report of Session 2010–12

Summary

"The Office of Rail Regulation (the Regulator) is the independent economic and safety regulator of the rail industry in England, Scotland and Wales. The Regulator's duties include promoting economy and efficiency in the rail industry with much of its work focusing on Network Rail, the owner and monopoly provider of the national rail network, including track, signalling and stations.

Network Rail does not face normal commercial pressures from investors and lenders to improve efficiency as it is a not-for-dividend company without shareholders, financed by debt guaranteed by the Government. It is therefore the role of the Regulator to hold Network Rail to account for its performance and to incentivise it to become more efficient. To this end, the Regulator sets efficiency targets when it determines the limits on fees Network Rail can charge train operators for use of tracks, stations and depots. It can also impose financial penalties, although the usefulness of this sanction is questionable as, by taking money away from investment in the railways, its impact falls mainly on passengers.

The Department for Transport (the Department) acknowledged the finding of Sir Roy McNulty's recent review of the rail industry[1], that the rail industry continued to fail to achieve effective value for money. In the five years to 2008-09, Network Rail reported efficiency gains of 27%, missing the target set by the Regulator of 31%, a shortfall of £204m.
Overall we do not believe that the Regulator exerted sufficient pressure on Network Rail to improve its efficiency, and that there is an absence of effective sanctions for underperformance in the system. We were particularly concerned that the Regulator did not enforce a stronger link between performance and bonus payments to Network Rail's senior managers, leading to excessive bonus and performance payments being paid to senior executives.

The relationship between Network Rail, the Regulator and their advisors appears to us to be too cosy, with some companies hired by the Regulator to provide an independent view of Network Rail also providing advice to them. We question whether this serves the interest of independent review.

We believe Network Rail should be more accountable for its use of public money, and more transparent in its operations. In 2009-10, Network Rail received £3.7 billion in direct taxpayer support, yet it is not directly accountable to Parliament. The Comptroller and Auditor General should have full access to Network Rail so that Parliament can scrutinize Network Rail's value for money.

The Regulator estimates that the gap in efficiency between Network Rail and the most efficient European operators was 34% to 40% in 2008, a position of relative inefficiencies which has not improved since 2003. The reasons for the gap are not properly understood, although Network Rail told us that they believed the single overriding factor was the difficulty of access to the railways to carry out maintenance work, which reduced its productivity and thereby increased its costs. The Regulator will need to conduct more detailed analysis to understand the reasons for the efficiency gap, and what can be done to address them. It is a concern to the committee that after 10 years in existence the Regulator has still not carried out this work.

As part of determining Network Rail's financial settlement, the Regulator takes into account the costs the company is likely to incur including the cost of inflation. In its last review in 2008, it made an assumption that Network Rail's operating costs would be 8% above inflation over a five year period. We found this to be over-generous, reducing the pressure on Network Rail to find efficiencies and reduce its costs.

Network Rail plans to reduce expenditure by about £1 billion on renewing tracks and replacing signalling over the five years to 2013-14. It is reliant on this reduction to meet most of its efficiency target. It intends to achieve this by a more selective approach to rail replacement, but there is considerable uncertainty over whether deferring this work is genuinely efficient or simply delaying costs for the future. Network Rail and the Regulator need to carry out further work to understand this, and to ensure that Network Rail is making real and sustainable efficiencies, which are safe.

Both punctuality and passenger safety have improved in recent years, with 91.3% of trains meeting the punctuality target in 2009-10, and we heard that the UK railway is amongst the safest in Europe. We agree with the Regulator that safety is paramount and must not be traded-off against other outcomes. But with growing demand for more trains, limited capacity and less maintenance, it is important that trade-offs between safety, efficiency, capacity and punctuality are made explicit.

Overall, the complex industry structure creates risks to value for money, with fragmentation, duplication of effort and misaligned incentives. This has been confirmed by Sir Roy McNulty's review. We welcome the Department's commitments to improve governance, transparency, and clarity of roles in the rail industry. We nevertheless would have expected the Department to have a clearer idea of the priorities and issues to be addressed at this stage. We look forward to the Department's response to Sir Roy McNulty's review, and will return to this issue when the Department decides on the changes required to improve efficiency. On the basis of a report from the Comptroller and Auditor General[2] we took evidence from the Regulator, Network Rail and the Department."