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## Briefing note on the development of the HLOS

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### Introduction

The 2004 white paper, [The Future of Rail](#) proposed a number of changes to simplify and clarify the governance of the railway. One of the key changes proposed in the white paper was to make the Secretary of State responsible for setting the strategic direction for the railway in England and Wales and determining the level of funding it receives from Government.

2 What follows explains how this element of the white paper is being implemented.

### The legislation

3 The Railways Act 2005 abolished the Strategic Rail Authority (SRA), imposed a new duty on the Secretary of State and redefined the role of the Office of Rail Regulation (ORR). It set out the process to be followed once the ORR has initiated a periodic review of access charges. In summary, the process runs as follows:

- the Secretary of State must set out his expectations of what he wants the railway to deliver over the five years covered by the periodic review (2009-14 for the next review), and the funding available from central government;
- ORR satisfies itself that the Secretary of State's expectations are affordable and that they are consistent with the reasonable requirements of other funders of the railway;
- if ORR is not satisfied on both counts, the Secretary of State would have to revise either his expectations or the funding. Ultimately, if ORR does not believe the two can be reconciled, it must give priority to the funding available and decide which outputs should be revised;
- if and when ORR is satisfied on both counts, the Secretary of State's expectations become reasonable requirements which are enforceable by the ORR to the extent that their delivery depends on action by Network Rail;
- ORR establishes Network Rail outputs and access charges based on the most likely costs (including the cost of finance), taking account of any improvements in efficiency it is reasonable to expect from Network Rail. This determination will be consistent with the Secretary of State's statement of funding available and the ORR's public interest duties.
- If Network Rail considers the ORR reasonable requirements are not in the public interest, it may object. The ORR may then either modify its proposals or refer the matter to the Competition Commission.

4 The effect of this new regime is that the Secretary of State has the sole responsibility for specifying what he wants the railway to deliver in England and Wales and for setting the funds available from central government. The independent economic regulator assesses whether the two are consistent and determines the outputs required of Network Rail, and the funding necessary, to deliver them in the most efficient way.

5 The Railways Act 2005 also provides for devolution of rail responsibilities in Scotland. To this end, Scottish Ministers have the same duty as the Secretary of State to tell the ORR what they want the railway to deliver and what funds they have available. However, since safety is a matter reserved to the UK Government, the delivery of an acceptable level of safety will be covered by the Secretary of State's reasonable requirements. Scottish Ministers may then choose to buy a higher level of safety should they wish.

## **The high-level output specification (HLOS)**

The Secretary of State must set out the High Level Output Specification (HLOS) and the Statement of Funds Available (SoFA) by July 2007. This will be done after due consideration and will follow the comprehensive spending review. The timetable, leading to the determination of the periodic review outcome, has been set by the ORR.

Summer 2007	ORR publishes its statement of implications of the HLOS and funds available for Network Rail, for consultation and to give Network Rail initial assumptions for its cost submission.
October 2007	Network Rail submits a detailed submission to ORR for the Control Period in the form required by ORR, indicating how it will deliver the HLOS. ORR commences a review of the submission and consults on it
February 2008	ORR produces and consults on an initial assessment of Network Rail's submission and implications for access charges and industry outputs
April 2008	Network Rail makes revisions to its October submission in response to the ORR's initial assessment. ORR makes a statement about early start funding for 2009/10
Summer 2008	ORR publishes draft conclusions on review
October 2008	ORR publishes final conclusions on review
April 2009	Start of control period 4, the five years to March 2014, covered by the first HLOS.

6 The Secretary of State intends to discharge his statutory responsibility by publishing in summer 2007 a high-level output specification for the passenger railway.

7 The HLOS will be framed at a **high-level**. It will not go into more geographical or other detail than is absolutely necessary to make the Secretary of State's requirements clear and unambiguous. It is not the Secretary of State's wish to become involved in those details that should properly be left to Network Rail and train operator management to settle.

8 The HLOS will be cast in terms of the **outputs** the railway is to deliver, not the inputs. For example, it will specify the improvement that the Secretary of State wishes to secure, not the investments that need to be undertaken to secure such an improvement. This is a different approach from the one adopted under the 2003 review of access charges. During the period from the framing of the HLOS in summer 2007 to its expiry in March 2014, existing risks to safety and reliability will be addressed, but new risks will emerge. Similarly, Network Rail can be expected to identify more cost-effective options for addressing demand growth on the railway. The Secretary of State does not wish to lock the industry into delivery of inputs that may become irrelevant to the delivery of the desired outcomes.

9 It will also be **specific** about the improvements which the Secretary of State requires. It is not sufficient for the Secretary of State to say that he wants the railway to "deliver improved reliability" or "be as reliable as practicable", because it would not be possible for ORR to cost such a vague requirement. So, the Secretary of State will need to quantify the improvement he is looking for in each area covered by the HLOS.

## Issues to be covered in the HLOS

10 There are three key issues which DfT have agreed with ORR and Network Rail must be covered by the HLOS - reliability, safety and capacity. Unless the HLOS covers these three, it will be impossible for ORR to cost the HLOS, which would therefore not comply with the requirements of the legislation.

11 The Secretary of State's aim in relation to **reliability** is to secure a reduction in delays experienced by passengers and an improvement in their ability to predict with confidence their end-to-end journey time. However, the passenger's experience of delay is not currently measured, and could only be measured on a sample-basis which would not be robust enough for the purposes of the HLOS. Accordingly, the Secretary of State is minded to specify the improvement in reliability he seeks by the 'public performance measure' (PPM), supplemented by a requirement to reduce the percentage of services which are subject to lengthy delays (eg 30 minutes or more). The PPM has the merit of being well-established and well understood by the rail industry, and of covering both delays to trains and cancellations. As a cross-check that the improvement in PPM is delivering a commensurate improvement for passengers, the DfT and Passenger Focus are working on the development of a sample-survey of the passenger experience of delay.

12 The Secretary of State envisages his output specification for **safety** being framed in terms of a reduction in the risk of death or injury to passengers and to staff working on the railway. Serious rail accidents are so infrequent that an output specification based on actual deaths and injuries would not be robust, and the rail industry's ability to quantify risks has improved to the point where the Government is satisfied that a risk-reduction index is an appropriate output measure.

13 Specifying the increase in carrying **capacity** to be delivered by the railway is one of the most important and difficult challenges in framing the HLOS. It is important because demand has increased rapidly over the last decade and is forecast to continue. No single measure can capture the carrying capacity of the network. It is therefore the Secretary of State's intention to specify:

- the forecast increase in the volume of demand to be accommodated, measured in terms of passenger-kilometres and, for peak period travel, in passenger numbers; and
- the maximum acceptable level of crowding for planning purposes.

14 Applying the principle that outputs should be specified at as high a level as possible, the Secretary of State anticipates that:

- safety will be specified as a single national measure, ie a reduction in risk to be achieved across the whole of Great Britain;
- reliability will be specified as a level of improvement to be achieved on each of the principal sectors in England and Wales, ie inter-city, regional and London & South East; and
- capacity will need to be specified at the level of the 23 individual Network Rail routes, because both the demand forecasts and the options for accommodating demand will vary significantly from route to route.

15 The Railways Act 2005 allows the Secretary of State to specify other areas where he is looking for an improvement in rail performance. This guidance will be given in a longer term Rail Strategy that will accompany publication of the HLOS and will explain what improvement is sought and why. Most of the obvious areas for improvement (e.g. reductions in noise or emissions, quality of passenger information,

improvements in the cleanliness and facilities at stations) are currently difficult to quantify and cost, so they do not lend themselves readily to output specification. Although there is a clear need for continued improvement in all these areas, it can be more appropriately secured by other means - regulation (in the case of environmental issues), commercial pressure (in the case of some information requirements), and franchise specification (in the case of cleanliness). There are two cases where the rail industry is likely to face significant costs and needs clear steers from Government on how far and how fast it is expected to go. The first is the improvement of accessibility for those with reduced mobility. The second is the implementation of the European Rail Traffic Management System (ERTMS) signalling system.

## Statement of funds available

16 The Secretary of State's statement of funds available will need to set out for ORR the public financial resources available to contribute towards the achievement of the HLOS. In essence this will be the Government funds available to support the franchised railway over the five year period.

17 In order to determine the level of Government funding for the railway, ministers will have to take account of the overall public expenditure position and the competing claims on funding. But they also need to know what benefits they would secure for different levels of funding. This means establishing the answers to the following questions:

- what is the base-line cost of maintaining passenger service levels and the quality and capability of the network at 1 April 2009 levels?
- what additional Network Rail investment is justified on sound value-for-money grounds, even though it may not contribute directly to the achievement of the HLOS?
- what are the Network Rail financing costs?
- what are the incremental costs of reducing safety risk, improving reliability and increasing capacity?

18 The answers to the first three questions effectively establish the base cost of the railway, onto which the incremental improvements in the HLOS are built. There are a number of reasons for expecting this base cost to decline. The continuing increase in passenger demand reduces the subsidy requirement for the TOCs. [ORR's initial assessment of Network Rail's 2009-2014 revenue requirements](#) showed that the net revenue required could be between 12 - 25% less than the revenue required for 2004 - 2009.

## Estimating the cost of increasing capacity

19 Work is now in hand - jointly with the ORR and Network Rail - to establish the base cost of the railway and to build the integrated suite of models which will help us establish the incremental cost of improvements in reliability and safety. Estimating the cost of increasing the capacity of the railway requires us to look beyond models. The approach we shall adopt here is to build up a route-by-route picture of the likely trend in demand and the options available to address demand-growth (informed by both the Regional Planning Assessments and the Route Utilisation Strategies).

### **A Regional planning assessments**

A key factor in development of the long-term strategy is DfT's programme of regional planning assessments (RPA). RPAs are designed to develop an understanding of the challenges and assess the options for the development of the railway in each region over the next 15-20 years set in the wider spatial planning context

This means that full account is taken of regional and sub-regional strategies and plans, including forecasts of future population and employment changes. Stakeholders are involved as each RPA is drafted so that regional and sub-regional authorities can use the assessments in determining how heavy rail can play an effective role in addressing future local transport issues.

The RPAs' forecasts for future demand feeds into the long-term strategy for the national network.

RPAs are being produced for each of the English Regions and for Wales.

### **B Route utilisation strategies**

Network Rail is responsible for operating, maintaining, renewing and enhancing the network. Since April 2005, the company also has the industry leadership role for performance and timetable planning. As part of this responsibility, Network Rail undertakes route utilisation strategies (RUSs).

RUSs are short to medium term industry plans for routes which look at making better use of existing capacity and, where appropriate, some network improvements. RUSs are produced in accordance with the requirements of Network Rail's network license and guidelines set by the ORR. The process involves consultation with regional and local authorities.

Stakeholder briefings take place firstly when analysis of the difference between what the railway needs to deliver and what it can deliver has been completed. Following this, Network Rail publishes a draft RUS to elicit stakeholder feedback. This is incorporated in the final RUS which is published along with a second briefing to stakeholders that presents findings and recommendations.

The RUSs are used as one of the building blocks of the HLOS, particularly in relation to capacity considerations.

20. The options to address demand-growth may include any of the following:

- increased service frequency, where capacity exists;
- more efficient timetabling and reductions in station dwell-time;
- different pricing of the shoulder of the peak, where there is an acute short-term peak period of demand;
- lengthening trains and platforms;
- reconfiguring rolling stock, for example by introducing 'metro stock' for shorter journeys or double-decker trains for longer ones;
- increasing the capacity of stations to handle increased passenger volumes;
- eliminating congestion pinch-points - for example by providing grade-separated junctions, increasing the number of tracks, or making route enhancements;

- major upgrades, such as that proposed for Thameslink; or
- construction of new lines.

Clearly, some options are more costly than others, and may take longer to deliver, because they need more planning and may also require legal powers. Such routes would require partial short-term solutions, as well as fuller long-term ones.

21 It is important to stress that, although detailed work is necessary to establish the options for a route and their likely cost, the end-product of the work is an output specification as described in paragraph 13. The purpose of the detailed work is to establish that there is **an affordable** solution for the route, and **not** to constrain Network Rail's freedom to pursue a more cost-effective solution if one is identified subsequently.

## Joint working and modelling

22 As a matter of law, DfT, ORR and Network Rail have very distinct responsibilities and rights, which must be respected. Framing the HLOS and funding statement is the sole preserve of the Secretary of State. Determining the outputs that Network Rail has to deliver in contributing towards delivery of the HLOS (consistent with available funds), and the access charges that Network Rail will receive to fund the costs of these outputs, is the preserve of ORR, as the independent economic regulator. Network Rail, as a regulated company, has a right to reject ORR's final determination, if it believes that the outcome of the periodic review is unreasonable. ORR can then either revise its determination or refer the matter to the Competition Commission.

23 However, none of the three parties sees this as an obstacle to joint working. It is in the interests of all that the HLOS and SoFA produced by the Secretary of State in July 2007 are, as far as possible, consistent and realistic, reflecting emerging thinking on likely future efficiency gains and financing. It would not be helpful, for example, if the Secretary of State's HLOS and/or SoFA had to be materially revised because they were based on assumptions about Network Rail efficiency gain or financing cost which differed significantly from those used by the ORR in its final determination.

24 DfT, ORR and Network Rail are therefore working together - very much in line with the more joined-up and collaborative approach called for in the 2004 white paper - on establishing the base cost of the railway, on the preparation of DfT's HLOS and SoFA, and on Network Rail's business planning. A key element in the joint work-programme is the development of an integrated set of models for demand forecasting, safety, reliability and infrastructure and franchising cost. These models need to be capable of working together to answer the questions which have to be addressed to frame the HLOS. For example, an increase in carrying capacity will have (in addition to its cost) the effect of stimulating demand, and may also have an impact on reliability and safety. The development of such an integrated set of models is a major challenge. DfT believes that they will be a more powerful tool for joined-up decision-making than was available in previous periodic reviews or spending reviews.

## **The HLOS and freight**

25 It is the Secretary of State's intention that the HLOS should focus on what government wishes to be achieved by passenger services which are operated under the franchises let by DfT. The HLOS will not cover the reliability of services provided by freight or other open access operators or the capacity which they require.

26 The reasonable requirements of the freight operators and the charges they pay is determined by the ORR, in the light of the industry's forecasts of demand and Network Rail's assessment of the options for accommodating demand, which it will deliver via its Freight Utilisation Strategy. The ORR is considering the charges paid by all operators, including freight and open access passenger operators, as part of its periodic review for 2009 -2014.

27 Ministers are keen to ensure that the passenger HLOS is consistent with the reasonable requirements of the freight operators, and they are also keen to promote the use of rail for freight movement, wherever it is commercially and economically justified, because of the substantial environmental benefits. Although the funding available is currently highly constrained, the Government is also willing to provide support to secure environmental and road-decongestion benefits. The Department is therefore working closely with ORR, Network Rail and the Rail Freight Operators' Association to understand the freight demand forecasts and the options for accommodating demand growth. This is not intended to infringe the rights of freight operators, but to ensure that capacity enhancement options pursued are the ones which make the most sense from a passenger and freight perspective.

## **The HLOS and the other rail funding authorities**

28 The 2004 white paper proposed that the Welsh Assembly Government, Transport for London and the PTAs should have a 'right to buy' or a 'right to sell'. This means that they can request a higher level of rail service provision than envisaged by the Secretary of State (in which case they transfer funds to his rail budget) or a lower level (in which case funds are transferred to their budgets). The right will normally be exercised at the point where the Secretary of State is letting a franchise, and is the subject of a separate guidance note. The funding authorities' rights extend to seeking infrastructure changes, eg the closure of a line or an increase in capacity beyond that proposed by the Secretary of State. Such rights can only meaningfully be exercised once the HLOS is in place, but the Department will need a close dialogue with these authorities ahead of the HLOS in order to understand their requirements.

29 As far as Network Rail is concerned, the business plans produced after the ORR periodic review should reflect any increments or decrements which have already been committed, and will provide a baseline against which other funders can decide on future increments or decrements to services.

## **A broader and longer-term strategy**

30 The HLOS will be a technical document, focused on the key deliverables, and covering a relatively short time-horizon in rail-planning terms. It is an essential planning tool for the railway, but it needs to be set in context.

31 The Secretary of State is therefore minded to accompany the HLOS by a broader and longer-term strategy document, looking ahead to about 2035 and informed by the outcome of the Eddington review. This might cover:

- the base-case forecast for passenger and freight demand, distinguishing between the main types of demand - eg travel to work in the principal urban sub-regions, inter-urban travel, and more local or cross-country movements;
- the scope for demand to be significantly higher or lower than these base-case forecasts, depending on the level and pattern of demographic and economic growth, changes in energy price, societal attitudes, etc;
- the contribution which rail can best make to the changing pattern of demand and to fostering economic growth, the strategy and plans for increasing carrying capacity by rail over the first five to ten years, whilst retaining flexibility to adapt;
- the contribution which rail should make to the achievement of environmental goals, particularly the reduction in CO2 emissions;
- the changes in the expectations of passengers and freight operators to which the rail industry will need to respond, and the changes in technology available to them.

## **How to get involved**

32 DfT will not be consulting specifically on the HLOS but it will be informed by work already carried out or in progress on RPAs and/or RUSs. Both involve a high degree of stakeholder participation. DfT will also have a dialogue with funding authorities to understand what their requirements for change might be. We expect to draw from this work in arriving at the HLOS.

"This document is an explanation of how the Secretary of State intends to implement the provisions of the Railways Act 2005 and the Railways Act 1993 (as amended) so far as they relate to access charges reviews. It is not intended to be a substitute for that legislation or to affect the Secretary of State's rights and obligations as set out therein. In the event of any conflict between this document and the provisions of the legislation, the latter will prevail."