On track towards an integrated railway?

Following Chris Grayling's recent announcement to unite track and train operations, **Tammy Samuel** and **Zoe Harris** explore how the government might approach integration – and some of the challenges that may lie ahead

The secretary of state for transport, Chris Grayling, recently announced that he intends to bring back together the operation of track and train on Britain's railways. He wants Network Rail to share its responsibility for running the tracks with private train operators to help the railways 'run better on a day-to-day basis'.

Integration of operations is not a new idea – the recommendation was put to the Department for Transport (DfT) five years ago by Sir Roy McNulty. While the secretary of state has made it clear that integration of management is only on the cards for now, the details are yet to be fleshed out. If the full vision is brought to fruition, the announcement could present an exciting opportunity for the rail industry – an opportunity to consider how best to integrate track and train operations on Britain's railways.

A more substantial alliancing model?

Chris Grayling's indication is that he expects new franchises to implement joint management teams, which will include representatives from both the private train operator and Network Rail. Both entities will continue to exist independently of one another for the time being. It is envisaged that the South Eastern and East Midlands franchises will be the first franchises to implement these joint management teams when they are re-let in 2018.

At the moment, it is unclear how an integrated management structure will work in practice. Legal and regulatory constraints mean that a joint venture model is not possible to implement in the short-term. The DfT is therefore likely to fall back on some form of an alliancing model, but it will be interesting to see whether this model will differ at all from the Network Rail alliance currently in place with Scotrail (and the previous alliance on South West Trains that has now been dissolved). One of the commonly accepted issues with the current alliance models is that in order to achieve synergies between track and train, Toc's may need to take additional financial risk (*e.g.* by not claiming under possessions or delay regimes). Toc's are unlikely to look favourably on an alliancing model that involves risk sharing where only the Toc is taking financial risk or the incentives are not correctly aligned. A move towards a more substantial alliance model may therefore result in increased subsidies in franchise agreements to offset such financial risks – unless the benefits are clearly defined and achievable and there is a balance between the Toc and its Network Rail partner.

Any alliance will also need to carefully consider the relationship between Toc's across the network. Many Toc's run services across multiple routes – will this mean that they will have to enter into multiple alliancing arrangements with Network Rail, or even alliances with other Toc's? Similarly, if an issue arises on a particular route, the alliancing model will need to ensure that the views of all interested parties are taken into consideration, including all Toc's that use the particular route (even if they are not a party to the alliancing arrangement). Freight operators will be particularly alive to these issues given that the nature of their business is to run across a number of routes. They will not wish to see a particular Toc on a route being given priority by Network Rail which may then impact on the ability of the freight operator to manage its business.

It naturally follows that this kind of model is better suited where there is one predominant operator on a network and fewer interfaces with other Toc's. A strong regulator will also be needed to ensure that capacity allocation and charging is managed in a fair and transparent manner to allow other operators to access the tracks in the each area. Longer-term, if Network Rail is broken up and an integrated joint venture type approach is adopted, a review of how the law and regulation will be required, to adapt to an environment where there are multiple infrastructure managers and the interfaces that this would create.

Opportunities arising from Brexit

Having Network Rail and Toc's working together in the same office is far less radical than a complete 're-unification' of the railways. But with the United Kingdom's exit from the European Union slowly looming, this could be the right time to consider removing the strict separation of train and infrastructure operations (soon to be regulated in a more substantial way with the introduction of the Fourth Railway Package) and consider some form of vertical integration.

Whether the United Kingdom is in a position to move towards vertical integration will of course depend on the outcome of the negotiations to leave the European Union. Compliance with the Fourth Railway Package could also very well be a condition to the United Kingdom's access to the single market.

Care would also need to be taken to ensure that the railway's legal and regulatory framework is ready for such a new structure. As noted above, vertical integration would inevitably result in multiple infrastructure managers across the network. The United Kingdom's current regulatory framework is only designed to regulate one major infrastructure manager – Network Rail. How periodic reviews and charging will work in practice with multiple infrastructure managers will be particular areas for future discussion. It is also worth noting that although integration of the track and train partly removes an important interface (between the rail and the wheel), other interfaces will arise that will need to be considered – for example the interfaces between two or more vertically integrated entities – and there will still be a wheel/rail interface for *e.g.* freight operations.

Whatever the approach, integrated management of operations will probably see Toc's taking a different approach to franchising – perhaps drawing on different expertise from within their wider group structure to manage infrastructure operations, enter into joint ventures with existing construction/maintenance contractors or even bringing in financiers to inject third party investment into the industry.

The industry will be looking to the ITT documents for East Midlands and South Eastern (due to be released to shortlisted bidders in 2017) to see what approach the DfT intends to take on integration. Given that Network Rail is on the government's balance sheet, this may provide the DfT with the incentive that it needs to develop a structure that will bring down costs and result in better day-to-day running of the railway. It may also generate new opportunities for the injection of new finance and encourage new parties to invest into the rail industry.

Tammy Samuel is a partner and Zoe Harris is an associate in the rail team at Stephenson Harwood LLP