the people's rail

a mutually run, publicly accountable Network Rail

Robbie Erbmann
Peter Hunt

Foreword by Louise Ellman MP
Chair of the Transport Select Committee

the co-operative party

www.peoplesrail.org.uk

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Robbie Erbmann and Peter Hunt
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The Co-operative Party is the fourth largest political party in Parliament, and the political arm of the Co-operative Movement.

We believe that people will achieve more by working together than they can by working alone. We support the efforts of those who seek success through that co-operative endeavour.

We believe that the only way to create a just and fair society is through power being spread evenly throughout society, and not arbitrarily based on wealth, class, gender or race.

We work to promote co-operatives and all forms of mutual organisation.

We work in partnership with the Labour Party as its sister party to achieve these ends. There are currently 29 Labour/Co-operative MPs including eight Government ministers.

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Foreword

This pamphlet is a valuable contribution to the current debate about the future of rail.

While Network Rail is a great improvement on the disastrous privatised Railtrack, major questions about its accountability remain.

Network Rail's failure over the New Year (2008) that left thousands of passengers stranded and led to a record £14m fine by the Rail Regulator does not seem to have impacted on Senior Executives who subsequently received massive bonuses.

The Co-operative movement has a great deal of experience in identifying accountable structures.

This pamphlet discusses possible ways forward for Network Rail. It is highly relevant to the current debate.

Louise Ellman

Louise Ellman MP

Chair of the Transport Select Committee
Labour & Co-operative MP, Liverpool Riverside

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Executive Summary

Network Rail is widely acknowledged to be underperforming. We feel that a significant factor in this is its Board's failure to be accountable to anyone but itself. We also believe there is a simple solution that would be welcomed by the train operating companies, the staff and, most importantly, the long-suffering passengers.

Network Rail was created by the Government in 2002 as a response to the failure of Railtrack, which went into administration against the backdrop of its poor safety record and financial collapse.

Since October 2002, Network Rail has reduced delays[1] and improved safety[2] compared to its predecessor. It has also performed well financially, making a £1.6 billion pre-tax profit this year. As Network Rail is a 'not for dividend' company, this will be ploughed back into the transport infrastructure. However, while Network Rail is performing better than Railtrack, it is still a long way from the service that we deserve.

Performance

A key concern is Network Rail's lack of operational efficiency. Even taking into account the historic under-investment in Britain's railways, Network Rail underperforms against the European average by £846 million per year for renewal and £263 million for maintenance.[3]

- **The Office of Rail Regulation report[4] shows that there is a total efficiency gap of over £1.1 billion.**
- **This works out as 19% of turnover.**
- **Our research suggests that this is equivalent to more than 1,000 new carriages each year. [5]**

The 2008 New Year engineering overruns caused, in the words of the Rail Regulator, 'a serious and unacceptable disruption to rail users and train operators.' While the breakdown in project management that occurred in January could have happened in any type of organisation, the manner in which Network Rail responded begs a question as to whether it is suitably concerned about the needs of passengers and the British public.

Some would say Network Rail's lack of regard for rail users was apparent even before the overruns occurred. In December, a member of the ORR Railway Inspectorate informed Network Rail that, in his view, it would be possible to keep one track open through Rugby for the entire holiday period, albeit for diesel trains only. Network Rail told him that there would

1 Delays to trains attributable to infrastructure have been reduced by almost 30%, with almost 90% of trains now arriving on time.
2 There has been a 90% decrease in the risk from signals passed at danger, and substantial reductions in the number of broken rails.
3 H. Bente, T. Kindler, K. Wittmeir, Network Rail: Rail Infrastructure Cost Benchmarking, Brief LICB-gap analysis and cost drive assessment, Final Report (Hamburg/London, 2008)
4 H. Bente, T. Kindler, K. Wittmeir, Network Rail: Rail Infrastructure Cost Benchmarking, Brief LICB-gap analysis and cost drive assessment, Final Report (Hamburg/London, 2008)
5 Average cost of a new rail carriage is approximately £1 million

be no demand for this.[6] Would the thousands of passengers forced to make alternative transport arrangements have thought otherwise?

Despite the overruns in Rugby and Liverpool Street being apparent to the company for some time, Network Rail notified the train operators only hours before services were due to come back on line. This meant that neither Virgin Trains nor 'One' were able to make any arrangements for alternative travel or inform passengers, creating chaos and misery for tens of thousands of travellers as they attempted to return to work after the festive period.[7]

This incident is just one prominent example of a broader failure to deliver. Passengers, train operators and the Office of Rail Regulation are all unhappy with Network Rail's current performance, and believe that there are fundamental issues that its management and board need to resolve. The Office of Rail Regulation imposed an unprecedented fine of £14 million for this failure, yet what was the Network Rail Board's response?...

At a time when one might expect the future of the management to be in the balance, the Board has instead congratulated them for 'a good year for their staff and the public.' Rewards have flowed to their most senior employees; with their three executive directors each receiving performance related bonuses in excess of £350,000.

Governance

The current governance structure of Network Rail is failing both passengers and the wider rail industry.

In effect, the Board appoints Network Rail's members. While an independent panel selects the members, this is effectively appointed and remunerated by the Board as well. This puts Network Rail's Board in the unparalleled position of being able to choose those to whom it is accountable. Many criticised the unchecked powers of media tycoon Conrad Black, but even he was not in the same enviable position of being able to select his own shareholders.

The People's Rail

The People's Rail Campaign has been launched to remedy this situation. We believe that long suffering passengers deserve better than a network run for the convenience of an unaccountable Board, and that the British public deserve real control over how the network is run.

Putting all arguments around corporate governance to one side, Network Rail should be accountable to passengers and the public for one simple reason alone – because we pay for it. In 2006/07, Network Rail's subsidy cost the average household approximately £240. Passengers made additional contributions, with £4.16 of the average fare going towards the company's operations.

For Network Rail to become truly accountable, all citizens must be given the right to become individual members. As a genuine mutual venture, Network Rail would then give all of its members the right to elect governor representatives to a Members' Council, which would replace the role currently fulfilled by its existing membership. Industry members

6 Private source
7 Report of the ORR's investigation into engineering overruns, February 2008.

could continue to be nominated by their respective interest groups - be they train operating companies or trade unions.

Network Rail would be structured so that all of its members have a voice. This could provide a genuine forum for informing and, where appropriate, consulting with citizens. It would provide information that would ensure that passengers remain fully informed of its progress in improving the network, a focus for ensuring that the network's links with passengers remain strong.

A 2007 opinion poll conducted by YouGov for the Co-operative Party suggests that there is much affinity for this type of governance. 81% of regular users of public transport surveyed felt that they did not have enough of a say in how it is run.

Open membership systems deliver organisations that act in the consumer interest. If we are to get the rail network the British public want and need, Network Rail needs a structure that delivers real accountability – not just a pretence.

We believe that Network Rail has to change.

We welcome news that the ORR has launched an independent review of Network Rail's governance as an important first step. But a real transformation is in the power of Network Rail's members. They can make this happen.

This is why we are launching the People's Rail campaign, for lasting change as set out in the People's Rail Charter.

The People's Rail Charter:

- **We support the People's Rail campaign to give the British public real power over its rail network.**
- **Long-suffering rail users deserve better than a network run for the convenience of managers, with no one taking responsibility when things go wrong.**
- **We call on Network Rail to change the way it's run, to give real control to passengers and the public.**

Why we need the People's Rail

Background

Network Rail is incorporated as a company limited by guarantee. This means that it has no withdrawable share capital, and all profits made are reinvested in the railway infrastructure.

Like most other corporate entities, Network Rail's Board is responsible for the overall management of the company. There are currently eleven members of Network Rail's board, of which three are executive directors, and eight are non-executive directors.

The Board of Directors is responsible for:

- The Group's overall strategy and annual operating budget
- The interim and year-end financial statements of the Company
- The Business Plan
- Material changes to the network licence
- Key pension matters
- Appointments to the Board
- Adequacy of internal control systems
- Major capital investments and expenditure
- Reviewing Board performance and the remuneration of directors and senior management.

Some of the powers of the Board are delegated to smaller groups of board members.

As well as a Board of Directors, Network Rail also has members, who are nominally the 'owners' of the company. There are two different categories of member: 'Industry' members, who represent the train operating companies and other stakeholders; and 'Public' members, who are ostensibly selected to represent the public.

While Network Rail's current constitution does not specify a maximum or minimum number of members, its Articles of Association do require a require a majority of members to be 'Public' members. The Board's current policy is that these 'public' members should not exceed 80% of the total membership.

Under the current rules of the organisation, 'public' members are appointed by the Board on the recommendation of the Membership Selection Panel, an 'independent' committee that is, itself, appointed by the Board and funded out of an annual budget approved by the Board. Members can be sought through advertisement, as well as 'the Membership Selection Panel seeking applications from suitably qualified individuals.'[1] The Board may reject applicants recommended by the Membership Selection Panel, but may only appoint organisations and individuals that they have approved.

There are currently 104 members of Network Rail, of which there are 26 representatives of industry stakeholders, 10 representatives of 'public' organisations, 2 government representatives and 66 'public' members who have applied through the board process.

The role of members

According to Network Rail's Membership policy, the role of its members is 'similar to that of shareholders in a public limited company,' save that members have no financial interest in Network Rail. Members perform this corporate governance role by receiving regular reports on Network Rail's performance and by participating in members' meetings and in general meetings of Network Rail. However, it is not the role of members to set the strategic direction or engage in the management of Network Rail. In particular Members participate in:

- Receiving the accounts of Network Rail;
- Approving changes to Network Rail's constitution;
- Approving the appointment and re-appointment of directors;
- Approving the appointment and re-appointment of Network Rail's auditors.'[2]

1 Network Rail, Policy and Procedure for the Selection and Appointment of the Members of Network Rail

2 Network Rail, Policy and Procedure for the Selection and Appointment of the Members of Network Rail

The importance of good governance

Good governance is currently high on the agenda across the public, private and voluntary sectors. Debated in numerous forums, conferences and publications across the globe, the issue of governance is a live one for all organisations, whatever their size or ownership structure. Organisations that have reviewed their governance over the last year range in scale and purpose, with BP, the Co-operative and the United Nations all looking at ways to improve how they are run.

In a nutshell, corporate governance can be described as 'the systems and processes concerned with ensuring the overall direction, effectiveness, supervision and accountability of an organisation.'[3] Rather than being an end in itself, it represents a mechanism through which an organisation can ensure that it fulfils its purpose and objectives.

These may vary significantly from one type of organisation to another. For a PLC, the object of corporate governance will be to ensure that a firm acts in the interests of its shareholders, which will almost always be defined in terms of profit maximisation and share value. For other organisations, such as voluntary organisations or co-operatives, purpose may be defined differently, with charitable aims, member benefit or specific community objectives being the specified goals.

Theories of corporate governance

Most contemporary theories of corporate governance have been modelled to apply to the private sector. While there may be a clear difference between the corporate purpose of the PLC model and that of a public interest company such as Network Rail, these organisations have enough in common that these models can be usefully applied, albeit with certain caveats.

3 Cornforth C (2003), The Governance of Voluntary Organisations

Until now, the dominant theory of the corporation and corporate governance arrangements has been agency theory. This assumes the separation between the ownership and control of organisations, and suggests that despite the fact that shareholders may own large corporations, control tends to reside with the management. As the interests of managers and owners can diverge, this can lead to firms being run in the interests of managers rather than shareholders. While under this model free markets are seen as the best restraint on managerial discretion, corporate governance arrangements are also seen as another means to ensure that the management acts in the best interests of the company's shareholders. It therefore suggests that the main function of governance arrangements is that of control, to ensure that a firm is run for the benefit of its owners, rather than its management.[4]

By contrast, stewardship theory suggests an entirely different role for governance. It assumes that the management will want to do a good job, and will act as an effective steward for the corporation's resources. Instead of seeing a conflict of interests between senior managers and shareholders, it sees these interests as complementary. It therefore sees the main function of governance as not to ensure compliance, but strategic; in short, to work with management and help them add value to key decisions.[5]

Stakeholder theory is based on the idea that an organisation should be accountable to a range of groups, outside of its immediate owners, all of which have a 'stake' in how it is run. It suggests that the representation of a broad range of stakeholders is necessary to ensure that a

4 Keasey K, Thompson S and Wright M (1997), 'The corporate governance problem – competing diagnoses and solution,' in Corporate Governance: Economic and Financial Issues; Berle A and Means G (1932), The Modern Corporation and Private Property; Fama E and Jensen M (1983), 'Agency Problems and Residual Claims,' Journal of Law and Economics, 26, 2:327-349

5 Davis JH, Schoorman FD and Donaldson L (1997), 'Toward a stewardship theory of management,' Academy of Management Review, 22:20-4; Muth MM and Donaldson L (1998), 'Stewardship theory and board structure: a contingency approach,' Corporate Governance, 6, 1:5-28; Hung H (1998), 'A typology or theories of the roles of governing boards,' Corporate Governance, 6, 2:101-111

firm is likely to respond to the needs of all those who have an interest in its success, not just its owners. This sees the primary role of governance as playing a political role, negotiating and resolving the potentially conflicting interests of different stakeholder groups in order to determine a strategy that will benefit them all.[6]

The problem with all of these approaches is that they tend to be rather one-dimensional, and ignore the complexities involved in the governance of modern organisations. Another way of looking at these issues can be to take a multi-faceted approach and explore the tensions and differences between these models rather than arguing in favour of any one in particular.[7]

Any attempt to design an 'ideal' system of governance will need to encompass all of these approaches and find ways in which it can minimise the tensions inherent in these contrasting models.

Why does it all matter?

The reason that achieving good governance is so important is because it is the means through which the 'owners,' however they are defined, ensure that the organisation achieves its purpose. Doing things right can ensure that organisations are being managed effectively, goals are being met and decisions are being taken in the interest of the most important stakeholders.

While organisations with good management and poor governance may succeed in the short term, in the long term they remain vulnerable to poor performance, decision making focused on managerial interests and possible collapse (see Enron and Northern Rock). Getting governance right is thus vital to ensuring that an institution performs efficiently, effectively and in its stakeholders' interests over the long term.

6 Kimberly J, Norling R and Weiss JA (1983), 'Pondering the Performance Puzzle: Effectiveness in Interorganisational Settings,' in Hall RH, and Quinn RE (eds.), Organisation and Public Policy; Freeman RE (1984), Strategic Management: A Stakeholder Approach; Wheeler D and Sillanpaa M (1997), The Stakeholder Corporation: A Blueprint for Maximising Stakeholder Value

7 Sunderamurthy C and Lewis M (2003), 'Control and Collaboration: Paradoxes of Governance,' Academy of Management Review, 28, 3:397-415

The significance of governance in a public interest company

Corporate governance literature would suggest that good governance is more important to a public interest company such as Network Rail than to a PLC. While both face a range of agency conflicts, managers in organisations owned by members tend to be even more powerful than they are in PLCs. The major interests of shareholders are to maximise profitability. Even if there are some failures in governance, it is felt that the price signals of share prices, along with pressure from major shareholders and the threat of takeover will keep them aligned to this goal.

Yet Network Rail operates in an entirely different reality. The company exists to provide the train operators, passengers and ultimately the British public with the most effective rail network at the best value for money; and profitability may represent a means to an end rather than an end in itself.

Given that the company has no withdrawable share capital, its members are likely to have less interest in its profitability or return on capital. Improvements in service performance are likely to be deemed as more important and can often be less tangible than indicators such as share price and the level of profit. The lack of tradeable shares means that there are not the same external pressures for a company such as Network Rail to perform. In the private sector, merger and acquisitions are considered an important institutional mechanism for waking up cosy manager/board relationships, but this is obviously impossible in a company limited by guarantee.

There are clearly benefits to Network Rail's status as a not for dividend company that outweigh these disadvantages. For a start, it is in the company's interests to provide the public with a service, whereas the fiduciary duty of directors of private companies is to maximise profits for their shareholders. It also means that any profits generated by Network Rail will be reinvested into its core purpose, the maintenance, renewal and development of the UK's rail network. But this also makes getting its corporate governance right much more important as well, as it assumes a far greater role in driving corporate performance than we would see in the private sector.

Network Rail: a governance failure?

At a casual glance Network Rail's corporate governance would seem to be in line with the major governance theories previously outlined. From a stewardship perspective, its board is composed of capable independent directors in charge of the strategic control of the company. From a stakeholder perspective, its membership appears to represent the wider stakeholders of the business, even giving the chosen public representatives a majority say in decision-making. Agency theorists would note the powers that the members have in approving Board members and changes to Network Rail's constitution. Its annual report refers to the Combined Code of Governance, the Cadbury and Higgs Reports[8] and seems to paint a picture of an organisation that takes its governance seriously.

But there is one fatal flaw in Network Rail's governance. As a result of the way in which it selects its members, its Board is not accountable to anyone in any meaningful way. While Network Rail was constructed with a majority of 'public' members in place to ensure its accountability, in reality the only people to whom these members are accountable are the members of the Board.

The application process to become a member of Network Rail is an immensely time consuming one, on par with an application for a well-paid job in the city. With an application form stacking up at 14 pages long, applicants are required to fill a half page on their career/background, as well as a page on what they will bring to the role and their understanding of corporate governance. They also have to provide references, which will be checked in the event of the candidate being short-listed.

According to Network Rail's membership policy 'the selection process involves finding a balanced slate of individuals.' The Membership Selection Panel is instructed to consider the 'range of skills and experience that individuals can offer' as well as 'the active contribution individuals make to the corporate governance of organisations with which they are involved.'

Reading between the lines, this does seem as if the real criteria for selection are having worked in a high achieving job, and having sat on a number of committees or boards of organisations. While one would not want to deter such capable high fliers from seeking membership, it does seem as if the entire membership policy has been put in place with one idea in mind – for the Board to be accountable to a membership that is made in its own image.

While, according to Network Rail, its 'public members are drawn from a cross section of the public,' one would suspect that given the small number of places that it has for its thousands of applicants, Network Rail's Board get the type of members that it wants, and the type of members that are the easiest to please. Just in case any unpalatable options slip through the Membership Selection Panel, the Board does, of course, have the right to reject 'individuals whom it feels wishes to pursue concerns or objectives which are inconsistent with the overall purpose of the company.' [9]

To put it simply, the Board effectively appoints Network Rail's members. While there is an independent committee and a chair of the Membership Selection Panel, they are effectively appointed and remunerated by the Board as well. This puts Network Rail's Board in the effectively unparalleled position of being able to choose those to whom it is accountable. Many criticised

8 The Combined Code on Corporate Governance (2003); Cadbury A (1992), The Financial Aspects of Corporate Governance and Higgs D (2003), Review of the Role and Effectiveness of Non-Executive Directors

9 Network Rail, Policy and Procedure for the Selection and Appointment of the Members of Network Rail

the unchecked power of media tycoon Conrad Black, but even he was not in the enviable position of Network Rail's board, which can effectively select its own shareholders.

Additionally, the Board can also decide the length of time that each member will serve for. It is in their power to decide whether the initial appointment will be for any period between two and five years, as well as in their gift to make further reappointments for anywhere between one and five years. This obviously creates an unhealthy dynamic amongst the membership, as the members who approve Board appointments and remuneration are each dependent on the very same individuals for their own positions.

Insufficient statutory powers

Another problem is the size of the membership. A group of over 100 people cannot effectively organise themselves into an effective voice without some structure; Network Rail ensures that they remain unstructured, following the accepted view that, the larger the organisation, the more easily it can be controlled externally. In organisations where two tier boards exist, including in many companies in Germany, the executive much prefers large supervisory boards since they are much easier to 'control' than smaller ones.

Equally important, the functions of the members are as constrained and therefore as wrong as the method of selection. There are severe limitations on the powers of the members themselves, which go only a short distance beyond appointing the auditors and approving the appointment of non-executive directors. While they can ask questions, and receive good briefings, they play no strategic role in the organisation, either by an involvement in the company's strategy or in ensuring that it operates in accordance with its aims and objectives, and have no real powers (beyond a rubber stamp) over the appointment of Board members or in setting remuneration.

The result

It therefore comes as no great surprise that Network Rail's four executive board members remained a constant between 2002 and 2007, and that their continuous presence was only interrupted by John Arnitt (the previous Chief Executive)'s journey onto bigger and better things. It may come as even less of a surprise to discover that he was replaced, out of a very competitive field, by his Deputy Chief Executive Ian Coucher.

Unsurprisingly, the Chair and senior IPNED have also been in place since 2002, along with two of the other non-executive directors. While we are not suggesting that these people have failed to perform capably in their roles or that their services should have been terminated, the lack of turnover in key positions would fit well with the thesis that all power in Network Rail lies firmly in the hands of the Board in general, and the management in particular.

It may be time for change.

Poor performance

For many people, there may be a question as to whether this all really matters. We've already seen that Network Rail is performing significantly better than its predecessor, and that any profits that it makes are being reinvested in the railway, rather than being distributed to shareholders.

Yet while Network Rail is performing better than the Railtrack disaster, this does not mean that there is no room for improvement. As the ORR has stated in its recent report, 'in order to become world class, Network Rail must make bigger and faster improvements than it has [previously] proposed.'[10]

Efficiency

Efficiency of operations is certainly one area in which Network Rail can improve. According to work undertaken on behalf of the Regulator, Network Rail's costs are significantly higher than average European maintenance costs, and even more so for renewal. As the ORR has stated, 'we know… that when benchmarked against other railways, Network Rail's costs for managing its infrastructure assets are considerably higher than most, if not all, of its comparators.'

Even when the historic lack of investment in Britain's railways is taken into account, Network Rail underperforms against the European average by £846 million per year for renewal and £263 million for maintenance. New research for this pamphlet suggests that this is a total efficiency gap of just over £1.1 billion, which works out at approximately 19% of turnover. This works out at £38.46 for each British household, or an extra 1,109 carriages for rolling stock on the network each year.

And this is only in comparison to the European average, with many continental renewal projects often 50% less expensive than those undertaken in the UK.

10 Office of Rail Regulation, Periodic Review June 2008

Part of this is a problem of basic preparation and organisation. As one UK contractor who had worked in other European countries suggested, 'we in the UK are relatively unproductive in work-site preparation and follow-up, we may get 3.5 productive hours out of a 6 hour possession (and…it's often less), the Swiss would typically get 7.5 hours out of an eight hour possession.'[11]

Reliability

Network Rail is also still underperforming in terms of providing a reliable service to both train operators and passengers. While Network Rail has recently highlighted the fact that it has exceeded its target for the overall 'passenger public performance' it has neglected to mention the fact that this occurred despite its own shortfalls.

As the ORR has made clear, 'the reduction in delay achieved by train operators continued to be significantly greater than that achieved by Network Rail,' and the company has, in fact 'underperformed its own reliability metric target by around 2%.'[12]

They are also failing to satisfy some of their most important stakeholders, the train operators themselves. Network Rail's latest survey of its customers has 'revealed a deterioration in satisfaction with the company's performance,' which was flagged by the Regulator as being 'disappointing and needs addressing.'[13]

New Year Disruption

Yet the way in which poor governance has led to poor performance can be seen most clearly in the managerial failure that was to occur over the 2007/8 New Year. While the breakdown in project management that occurred in January could have happened in any type of organisation, the manner in which Network Rail responded begs a question as to whether Network Rail is

11 H. Bente, T. Kindler, K. Wittmeir, Network Rail: Rail Infrastructure Cost Benchmarking, Brief LICB-gap analysis and cost drive assessment, Final Report (Hamburg/London, 2008)

12 Letter from the ORR to Jim Cornell, Senior Non-Executive Director of Network Rail, 9th May 2008

13 Ibid

suitably concerned about the needs of its stakeholders, and whether concern for the interests of the public is its true driver as an organisation.

As most readers will know, the New Year saw overruns of engineering works at Rugby, Liverpool Street and Shields Junction which caused, in the words of the Regulator, 'serious and unacceptable disruption to rail user and train operators.' Engineering works that overran by four days at Rugby severed the West Coast mainline, which in tandem with the subsequent 13 weekend closures affected the journeys of approximately 390,000 people. The failure to complete works at Liverpool Street station also meant that trains operated by the 'One' network were also out of operation for half a day, causing untold misery for thousands of London commuters on their first day back after the New Year. According to the Regulator, 'most of the disruption should have been avoidable with better planning and management of the projects involved.'[14]

Passengers' needs

It could be argued that the response of Network Rail to the failure of these projects that maximised the disruption to train operators and passengers. While the delays could have happened to any type of organisation, one could certainly suggest that Network Rail's apparent disregard to any possible mitigation of these problems demonstrates that it is an organisation that seems to be insufficiently focused on the needs of passengers and the public.

Some would say a lack of regard for the needs of passengers was evident even before the overruns occurred. In December a member of the ORR Railway Inspectorate informed Network Rail that, in his view, it would be possible to keep one track in each direction open through Rugby over the entire holiday period, albeit for diesel trains only. Network Rail told him that there was no demand for this.[15] One would have to question whether the thousands of passengers forced to make alternative transport arrangements would have thought otherwise.

As the ORR's report stated, 'on the 27th December, it became clear to the Rugby/Nuneaton team that its contractor was not on course to deliver the programme of works on time…to mitigate the impact of adverse events, Network Rail had a number of options to reopen the railway with reduced functionality…'

Yet it took a further four days, until 14:00 on the 31st December, for Network Rail to actually declare that the works would overrun, which at that stage was meant to only be for about six hours into the next day. Operators were only informed on the morning of the 2nd January that the railway would not be open till the 3rd, and at 13:00 on that same day that it would not open till the fourth.

Impact on passengers

The impact that this had on services to both passengers and freight customers, as reported by the Regulator, is damning, and is therefore reprinted almost in full:

'Freightliner said that as Network Rail initially only declared a six hour overrun, it didn't think it was worth taking its wagons back to the depot to run on the diversionary routes available. This meant that its wagons were then effectively out of use for the full three days on the overrun. Virgin Trains said that it would have made arrangements to run some of its diesel Voyagers on the non-electrified diversionary routes if it had known the extent of the problem earlier.'

'London Midland said that there were not enough Train Service Database staff available to deal with the changes in services so even where information was available it was not being uploaded to the database which drives the systems making information available to the public through websites and enquiry services. This added significantly to the confusion affecting operations and passengers.'

14 Report of the ORR's investigation into engineering overruns, February 2008

15 Private source

Passenger Focus also said that the information to passengers on the overrun was poor. Industry websites were out of date, inaccurate, and were not offering adequate alternatives. Display boards and customer information systems at stations were showing wrong information, which led to a lack of confidence in all information. Ticketing services were still selling tickets on trains that weren't running.'

At Liverpool Street, the first declaration of a likely overrun was made on the morning of 2nd January, despite the fact 'that the project was at least 12 hours behind schedule by the evening of the 31st December.' According to the Regulator, 'the late notice of the overrun meant that 'One' was not able to make any arrangements for alternative travel or to inform passengers not to travel, leading to problems at station on the morning of the 2nd January.' The lack of notice for the Shields Junction overruns also meant that Scotrail were unable to plan contingencies on their Ayrshire line.

In addition to notifying operators late about possession overruns, many services were actually disrupted over the holiday period despite the fact that no work was to take place there at all. Network Rail's planned work at Stevenage was only cancelled by the company on the 14th December, leaving the National Express East Coast without the sufficient time to reinstate trains at such short notice. EWS complained of a number of late possession requests, and disruptive possessions, which were not completed as planned.

And performance up to this point was little better. As part of the investigation, 'One' were able to provide a list of 145 overruns, which directly impacted on travel into Liverpool Street between August 2007 and January 2008, with some 30 of these causing more than two hours of delay. London Midland claims to have faced overruns on every weekend since the start of its franchise, and First Group has highlighted four projects that are not being managed effectively.

There are many other examples affecting the management of closures for maintenance where world best practice offers solutions that would reduce costs and keep the lines open for the use of Network Rail's customers.

Closing for unnecessarily extended periods of maintenance is a last resort – as other railway stakeholders have pointed out to Network Rail.

The role of the Regulator

Perhaps the only way that Network Rail remains accountable to the public is through the Office of Rail Regulation. It is not the intention of the authors to level criticism at the Rail Regulator, who we see as doing an excellent job in exposing the failures of the Company and trying to enforce changes in its corporate behaviour. Indeed, were there to be a change in Network Rail's governance there would still be the same role for the ORR, whose work in assessing the Company's progress is vital to driving corporate performance and ensuring that both the UK and Scottish Governments' objectives are met.

Yet in reality, the Regulator has few tools in his armoury to deal with poor performance, especially as the Office is required to act in the public interest. The primary sanction that the ORR has is the ability to fine the company. This has been used twice: once in the case of the problems with the Portsmouth re-signalling (£2.6 million) and a much larger fine of £14 million for the events over New Year.

However, as Network Rail is a not for dividend company, all this means is that there is less money to be reinvested in track improvements. This was well expressed in a letter from Network Rail's Strategy Director to the Office of the Rail Regulation earlier this year. In it, he stated that 'in the case of penalties applied to Network Rail, we share the general concern that, as a non profit making organisation, payment of any fine results either in less money being available to spend on the rail network or additional taxpayer funds having to be made available. There are no shareholders to take the pain or hold directors to account.'[16]

The degree to which this is apparent can be seen in the recent bonuses awarded by Network Rail Board to their own executives for the year's work. Despite the ORR expressing all the concerns in this pamphlet (and more) about the performance of Network Rail in a letter to the Chair of Network Rail's remuneration committee[17], substantial bonuses were paid out to the three Executive Directors. Ian Coucher is to receive just over £510,000, with the other two top directors receiving well over £350,000 each. Ex Chief Executive John Arnitt also received a £178,000 bonus for being at the helm for the past three years.

If there is anything that illustrates the weakness of accountability in Network Rail's corporate structure, it is this. Despite being fined twice by the Regulator, causing disruption to hundreds of thousands of passengers and freight customers, underperforming on operating maintenance and renewals and customer satisfaction in the company's performance declining, huge bonuses have been paid out.

If there was any doubt about the degree to which the management have the capacity to run the business in their own interests before this bonus payout, there is none now.

It is therefore clear that the role of the ORR in holding the company to account, although important, is not sufficient. Network Rail claims that it meets the ORR targets and other requirements and that no further oversight or increased governance is necessary. Although the role of the ORR is vitally important, it is inevitably somewhat retrospective and, in any case, is not sufficient to perform the role of 'owner' as described above.

16 Letter from Malcolm Pheasey, Rail Strategy Director, National Express to Sukhinder Mhi, Office of Rail Regulation, 31st January 2008
17 Letter from Bill Emery, Chief Executive, Office of Rail Regulation to Jim Cornell, Non-Executive Director, Network Rail, regarding the 'ORR initial assessment of Network Rail performance to inform your remuneration committee meeting,' 9th May 2008

Making Network Rail accountable to us all

Putting all arguments around corporate governance to one side, Network Rail should be accountable to passengers and the public for one simple reason alone – because we pay for it. In 2006/07 Network Rail's subsidy cost the average householder approximately £240. Passengers were also additional contributors, with £4.16 of the average fare going towards the Company's operations.

When the usual choice is between a traditional public sector or traditional private sector provider, the issue of accountability for taxpayers' money becomes problematic. It is clear that in a state or municipally provided service, the ultimate accountability for that service lies with the democratically elected representatives of the relevant government body. Although in practice, for example in nationally provided services, this can be something of a tenuous relationship, it is known and understood in our political culture.

Once a service is outsourced however, the public accountability that existed is moved to arm's length and then depends on the strength of the contract between the commissioning public body and the private sector provider.

In a culture where the electorate is increasingly disengaged from the political process and election turnouts continue to fall, this might not seem to make much practical difference. It would, however, be a mistake to conclude from this that direct public accountability is less important.

Much more effort needs to be put into devising ways of ensuring meaningful public accountability of public services which are paid for with taxpayers' money.

When Network Rail was established, it was recognised that the company needed to provide an essential public service, would be dependent upon state financial support, and ought to be run in the interests of rail users – both passengers and train operators. Yet, it was not a nationalised company under state control, and the Government turned away from this option in favour of creating an independent company.

The company limited by guarantee structure had merit in that it ensured that Network Rail could concentrate on its service mission rather than on maximising shareholder value, which Railtrack plc was obliged to do. The company was set up with a corporate Board much the same as its predecessor, but in place of shareholders, Members were appointed to act as the collective owners of the Company, although they hold no personal equity interest.

The composition of the membership is significant, with a majority drawn to be representative of 'public members'; train operators are represented and government retains a small stake.

In the sense that the structure is attempting to balance the different interests, it could theoretically be made to work, but much depends on the manner in which it is administered.

Bringing real accountability

It would be much better if there were a chain of accountability that gave rights and responsibilities to each stakeholder group, making each dependent on the others for their position and power.

In any public service environment, a range of stakeholders can be identified. These will be users, staff, customers, funders and a whole range of other partner organisations. Each of these individuals and organisations has a stake in the service being provided to a greater or lesser degree. It is important that the providing organisation has the correct relationship with each stakeholder and that stakeholders have a relationship with each other that is not controlled by the company. It may be that there is merely a requirement for information sharing or that it should be a more hierarchical relationship with real decision-making capacity. There is no 'one size fits all' solution for this and each type of service will need to be considered separately.

What is essential in all cases is that the level of accountability is meaningful and taken seriously by all those involved.

Why an organisation's structure matters

As stated previously, corporate governance is a mechanism through which an organisation can ensure that it fulfils its purpose and objectives. The structure used should define the principal stakeholders that it serves, and ensure that ultimate corporate power will be vested in them.

For example, a private company exists to create value for its shareholders, and its governance form reflects this. In doing so, it may provide a range of goods and services to the public or even for a social end, but ultimately it exists for one primary purpose: the delivery of profits to the owners of capital. This will always have an effect on the motivations and drivers of private sector providers of public services. It does not mean that they cannot provide excellent services, just that their motivation is self-interest. It is often argued that these pressures ensure greater efficiency and better managed services.

In a state or municipal service environment, the ultimate client is the taxpayer. However, in practice the relationship with the taxpayer is somewhat convoluted. Government agencies and bureaucratic bodies will often act as a regulator and end up being seen as clients by those providing services in most circumstances. Consequently a natural buffer is placed between the service provider and the end user and, although this is supposed to work in their interests, it often results in paternalistic, top-down decision making.

In the worst cases, the interests of those providing the services dominate, perpetuating the view that the 'man in Whitehall knows best.'

Ultimately, it surely has to be important that public services operate in the best interests of the public. This must be demonstrated by the outcomes achieved for users, customers and commissioners, rather than any dogmatic view of the state or private ownership of services.

The key objective therefore must be to create an environment in which public services are demonstrably delivered in the public interest. Some organisational forms will find this easier to do than others.

Every corporate entity has members. The members of a company are its shareholders; the members of the traditional mutual organisations often comprise customers and employees. The members of the new NHS foundation trusts, for example, are public, patients and staff.

The role of members in a corporate entity is, in practice, limited and it is defined in the constitution. It normally comprises:

- the right to receive information about the organisation's performance
- the right to take part in the election of some or all of the board members
- the right to attend and speak at an annual and other occasional or special members' meetings
- the right to decide on the remuneration of board members
- the right to vote on any resolution put to the members. Usually there are narrow limits on the issues that can be put to the members, namely changes to the constitution, merger with another entity, and the decision whether or not to wind up the organisation.

Whilst these members' rights are limited, they are nevertheless highly significant if combined with open membership. Members are ultimately the owners of an organisation, and the ability to prevent it being captured by others (including commercial enterprises, or the state as well as political or special interest groups) lies in the hands of members. It is these rights that give members a sense of ownership of the body.

Experience shows that membership-based bodies carry significant weight and credibility, both within communities and in dealing with external organisations. It is more difficult to challenge the aspirations of an organisation based on wide membership that has used that membership to form its aspirations.

Membership also provides a powerful base for reaching out into local communities. An increasing element of the health agenda now involves educating and informing people about health and healthy living issues. Changing attitudes about responsibility for one's own health is an important long-term aim, and the engaged memberships of foundation trusts are starting to play a significant part in that. The same could apply to Network Rail's ultimate customers, the travelling public and train customers, as well as its main stakeholders.

Network Rail can engage the public through shared ownership

Network Rail is a complex business and an enormous logistical and financial undertaking. To be able to engage ordinary people in such a large enterprise, it is essential to foster a kind of ownership that enables citizens to feel that institutions in which they have a stake are run on their behalf, and not for someone else's vested interest.

Over 150 years ago, progressive thinkers invented mutual structures – membership organisations that were committed to the members they served, often very large sections of the population. Many of these mutuals, like the Co-operative Group and the major Building Societies, continue to thrive today, playing a distinct role in society.

In a modern context, this very structure is ideally suited for the provision of many public enterprises. Modern community mutuals can include all stakeholders, including Government, by making management accountable to a board comprising employee, customer and Government representatives, along with other stakeholders. Of course managers must have the freedom to make tough decisions, but this structure of accountability ensures that these decisions are made with the right interests in mind.

These models provide many benefits in their own right, such as local community control, a constitutional role for employees, the encouragement of citizenship and the promotion of long-term thinking in the interests of the community. They achieve the basic objectives of efficiency and flexibility, but they also connect with their stakeholders far more effectively.

This begs the question of whether people really care about these things. The public can be offered all the opportunities in the world to participate, but these opportunities are worthless if people can't be bothered to use them.

The honest answer to the question is 'sometimes.' It is fair to say that if things are running smoothly there is a natural tendency to leave well alone. However, when things go wrong everybody has a view on how to fix it, or at least an interest in berating those charged with sorting out the problems – ask any commuter. Once a crisis passes, interest decreases. Consequently, few people want to engage with any issue all of the time, but they value the right so to do.

But one of the main causes of things going wrong or becoming unpopular is that providers are out of touch with their users. Keeping in touch with a cross-section of these important people, and hopefully not always the same ones, should be a good idea in principle.

Network Rail will build trust by acting transparently

In any venture, trust will often follow from an open and transparent relationship between stakeholders. In practical terms, this means that information sharing and discussion are entered into by decision makers and prized by their recipients. It is a mutual process that is driven by the human desire for honesty and open-ness.

Mutual structures provide a framework for seeking to achieve this level of trust. It has been shown that customers of mutual businesses, for example, do in fact believe them to be inherently more trustworthy than their proprietary counterparts.

Trust Rewards, an independent report from Cambridge University and the University of London, surveyed members of mutual societies to establish how they rated various aspects of performance, and how these contributed to overall trust levels. The results gave an overwhelming endorsement of mutuality as an organisational form.

Customers agreed that the organisational structure of mutuals – in which the members are also the owners – contributes to their performance:

- Mutual society members were four times more likely to trust their mutual than a plc.
- 72% of co-operative society members felt that the Co-operative acts more in members' interests because it is not answerable to 'Big City' investors, with 90% agreeing with the statement 'The Co-op is trustworthy'.

These findings were supported in a parallel survey of the general public, which found that people were more likely to trust a building society than a bank and twice as likely to invest with one in the future.[18]

A 2007 opinion poll conducted by YouGov for the Co-operative Party uncovered even stronger links between public trust and ownership. It stated:

- **81% of regular users of public transport felt that they did not have enough of a say in how it is run.**
- **90% suggested that they trusted customer owned businesses 'to some extent' or 'a great deal,' to deal fairly with their customers**
- **32% felt the same way about government run companies**
- **20% felt the same about shareholder owned businesses.[19]**

Fundamentally, people in the UK trust co-operatives/mutuals far more than either government-run or private companies to deal fairly with their customers.

This is stark – for a company such as Network Rail, which was established to serve the interests of the public, it seems that there is a greater thirst for public engagement than currently exists.

Railway travel, especially for regular commuters, is an emotive issue. Not knowing at weekends and public holidays whether your train will run or you will have to take a bus, whether you can reserve a seat, especially for those with children, luggage or mobility problems, can be very worrying for passengers who now link this uncertainty with Network Rail's failures over the New Year period.

So, if this argument is accepted, the next problem to solve is that of finding a mechanism or structure for achieving this stream of communication.

American independence fighters famously wanted representation in return for their taxes. They didn't all want to be MPs, but they needed the opportunity to be consulted through their representatives, with the sanction of changing them if they felt the need. It is the same today with any public endeavour.

Consultation without rights is just a favour – which can be withdrawn as easily as it is given. The public must feel that they have the right to demand to be heard. The only way to guarantee this for Network Rail is to establish The People's Rail.

18 Cook J, Deakin S, Michie J, Nash D (2002), Trust Rewards: Realising the Mutual Advantage
19 http://www.yougov.com/archives/pdf/Topline%20Coop.pdf

Turn Network Rail into a consumer mutual

The case for a Network Rail that is accountable to rail consumers is compelling. The number of rail passengers continues to grow, with 2.75 million people using the rail network each day. Thus the impact of infrastructure failures on both individual citizens and businesses is keenly felt.

The Network Rail monopoly, a technicality verging on the abstract for most people, becomes immediately problematic once the signals turn to red and journeys are interrupted.

Thus the corporate structure of Network Rail certainly matters to passengers when things go wrong. Consumers expect to receive the service for which they have paid, and reasonable answers when it is not forthcoming. Allied with the view that is prevalent, that passengers are not sufficiently involved in decisions affecting their transport, the case for a Network Rail that is accountable to rail consumers is compelling.

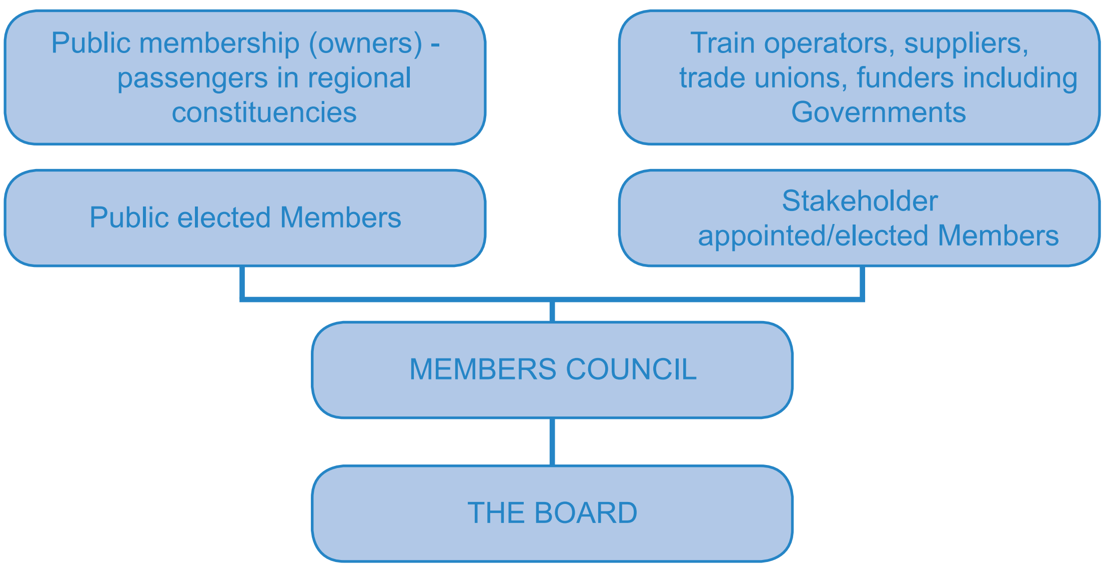
The corporate status of Network Rail need not be altered from its current form. This means that it can continue as a company limited by guarantee, with the same relationships to The Office of Rail Regulation and funding stream from governments.

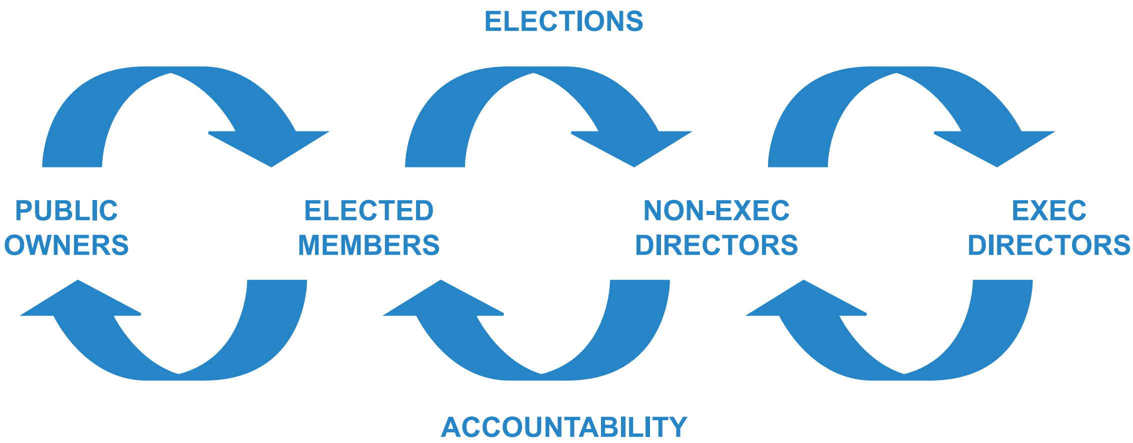
What needs to change is the manner in which the members are recruited. Currently, they are accountable only to themselves. The taxpayers' interests are defended only by the nominated members representing the Department for Transport and the Scottish Executive. With only two out of the current 104 members nominated in this way, this means that the taxpayers are, in effect, disenfranchised from the main decision-making of Network Rail members.

An open membership

For Network Rail's members to be accountable to the public, all citizens must be given the right to become individual members. This might appear a radical solution, but it is merely an extension of the logic that led to the incorporation of Network Rail in the first place.

In practice, this would mean that rail passengers would be invited to become members of Network Rail. Passengers could register for votes when they purchase their season ticket,





or indeed any rail ticket. Membership would be advertised on the company's website, in stations, and in communications between the train operating companies and their customers.

As a genuine mutual venture, Network Rail would then give all of its individual members the right to elect governor representatives to a Members' Council that would replace the role currently fulfilled by Network Rail's existing members.

Stakeholder members of Network Rail should continue to be nominated as at present by their respective interest groups, be they train operating companies or trade unions.

To make the democracy meaningful, electoral constituencies representing the nations and regions of Great Britain should be created, each electing a number of governors to Network Rail.

Governors would be subject to re-election and would no doubt be judged on their performance in the previous period. Satisfaction or dissatisfaction with the Governors would be expressed through the ballot box by consumers.

In this way, the travelling public will achieve ultimate control over the performance of network, having in their hands the sanction of appointment and removal of governors, depending on their performance.

This would certainly focus the minds of governors when considering their role in relation to the network rail board, which would continue as now to run the business.

In order to reduce the numbers involved in the governance to a more manageable level, it is envisaged that there would be significantly fewer governor representatives than there are current members of Network Rail. There would, however, still be a majority of public members on the Council, to ensure that Network Rail acts in the interests of its passengers and the public.

In this way, a chain of accountability is established from the Board through the members to the public, with each responsible for appointing/removing the next level, and therefore accountable directly to it.

In addition to making Network Rail's governance structures more accountable to the public, the new structure would also increase the accountability of the Board to its members. In addition to the membership's current role, the Members' Council would:

- Select and appoint the Chair and non-executive directors through a nominations committee.
- Approve appointment of the Chief Executive.
- Be involved in the development of an annual strategic plan produced by Network Rail.

It would also have powers to:

- Dismiss the Chair and the non-executive directors.
- Determine the board's wage and bonus structure through its remuneration committee.

A Members' Council along these lines would undoubtedly reduce the democratic deficit, without causing a major upset in the railway structure. It would give the public a direct voice in Network Rail's plans for renewals and enhancement, and the all-important need to keep the network open for the use of customers, as well as making its management directly accountable.

The role of members

As a genuine mutual venture, Network Rail would be structured to give its members a voice. The membership would provide a genuine forum for informing and, where appropriate, consulting with citizens. It would provide information to ensure that passengers remain fully informed of its progress in improving the network and be a focus for ensuring that links with passengers remain strong.

As members of Network Rail, citizens would be consulted on issues such as the most convenient ways to plan engineering works around travel schedules; where and when new services should be offered; and the development of services in their stations. Members could also be surveyed to gauge their satisfaction with Network Rail's performance in discharging its duties, which could be used by the remuneration committee as one of the key determinants of performance related bonuses.

All members would also enjoy nomination and voting rights to elect from their number to Network Rail's Members' Council.

The experience of other consumer mutual organisations suggests that this membership role, combined with direct lines of accountability, would make Network Rail more responsive to the needs of its passengers and more focused on delivering what they want.

An example of this can be seen in the financial sector. Evidence given to the All-Party Parliamentary Group for Building Societies and Financial Mutuals suggests that mutuals are consistently placed higher than plcs in Best Buy tables on a variety of products. The Association of European Co-operative and Mutual Insurers has found that mutual insurers pay out a greater proportion of their turnover as claims (73.1 % against 71.2%).

Financial mutuals also tend to be rooted in the communities that they serve, often providing valuable services and jobs in areas that might not otherwise be served. While 24.9% of bank branches closed between 1995 and 2000, only 2.4% of building society branches did the same. Even though the gap in closure rates narrowed between 2000 and 2004, banks still cut a further 7.2% of their branches, compared with 2.7% for building societies

The same has occurred in the food retail sector. As opposed to the majority of companies, who have moved their services out of communities and into 'out of town' sites, consumer co-operatives have maintained their shops in poor areas, keeping fresh and high quality food within easy reach of those without cars.

In short, open membership systems deliver organisations that act in the consumer interest. If the British public are to get the rail network they deserve, then the People's Rail is the only way forward.

The next stages

If you are:

A member of Network Rail – As the nominal 'owner' of the organisation, you have the power to make the People's Rail happen, without any need for legislation.

The first stage is for you to have an independent review of Network Rail's Articles of Association. A review would be able to clarify who owns Network Rail, establish clearly to whom it is answerable, and consider any changes that may be desirable to ensure greater accountability. You can do this at your AGM or by calling a special EGM.

Once the Review has been undertaken, it is important that this is followed by a real commitment to change the way that Network Rail operates. This is an historic opportunity for you, as the ORR has suggested that if Network Rail does not improve its performance over the medium term, its monopoly could well be on the line.

The ORR – We urge you to use your considerable influence over Network Rail to ensure they are properly accountable. Quite rightly, you in part fulfil this role and you do an excellent job in holding them to account. But it is not the role of the ORR to take on the obligations of the owners, nor is it a role that you can easily fulfil. We urge you to support the campaign, and to do what you can to influence Network Rail.

The Transport Select Committee – If Network Rail refuse to do so themselves, we would like you to launch an investigation into the effectiveness of Network Rail's governance, and how this affects its performance as an organisation.

For everyone else – Public support will be vital to bringing about the People's Rail. If you believe that you deserve better than a rail network run for the convenience of unaccountable managers, and believe the British public should have real power over its rail network, sign the charter and join the campaign at www.peoplesrail.org.uk

About the authors

Robbie Erbmann is the Policy Officer of the Co-operative Party.

Previously Robbie has worked as a public policy researcher for both Mutuo and the Co-operative Party between September 2006 and January of this year. He joined both organisations after completing a degree in Modern History at St. Peter's College, Oxford, where he received first class honours.

In 2007 he was a co-author of '21st Century Pioneers,' a report produced by Mutuo for the Co-operative Group's Constitutional Review, as well as the Mutuality Review of NHS Foundation Trusts undertaken on behalf of the Department of Health.

He has also helped pilot the successful passage of the Building Societies (Funding) and Financial Mutuals (Transfers) Act 2007 through Parliament.

Peter Hunt is the Chief Executive of Mutuo, and former General Secretary of the Co-operative Party.

Peter is particularly interested in mutuality and has sought to engage the UK Co-operative Movement in work to raise the profile of the co-operative and mutual sector. In 1998, he instituted the 'New Mutualism' series of eight policy pamphlets, which inspired a serious debate on the role of mutuals in UK society.

In 1999, he was co-founder and secretary of Supporters Direct, the football supporters' initiative, which has gone on to establish over 100 mutual supporters' trusts at professional football clubs.

In 2001, he established Mutuo (Communicate Mutuality Ltd) as the first cross mutual sector project to promote mutuality to opinion formers and decision makers.

In 2002 and 2003, he led the Parliamentary team which piloted three Private Members Bills through Parliament, updating Industrial and Provident Society law and encouraging democratic employee ownership.

Since 2004, he has advised many public sector organisations on how to engage with communities and stakeholders by harnessing mutuality

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