Office of Rail Regulation

Periodic Review 2013

Civil Engineering Contractors Association response

This document has been prepared by the Civil Engineering Contractors Association (CECA) in response to the First Consultation launched by the Office of Rail Regulation as part of its Periodic Review 2013 process.

CECA is the representative body for contractors working in the £40 billion UK civil engineering industry. Our membership of more than 300 companies deliver an estimated 70-80 per cent of the total civil engineering work carried out nationwide. This includes both maintenance and improvements to the country's transportation, power, water, communications and waste infrastructure.

CECA's activities in the rail sector are co-ordinated through the CECA Rail Forum. This grouping, which meets four times a year, allows members to discuss developing rail sector policies and initiatives whilst also affording members of the opportunity to engage with rail clients and other industry stakeholders. As with the wider association, the membership of the CECA Rail Forum represents the majority of major construction contractors working in the rail sector, ensuring that the Forum is well placed to provide feedback and guidance on relevant industry issues.

The preparation of this consultation response involved the production of a draft by CECA staff. This draft was then circulated to all members of the CECA Rail Forum over the summer for comments. Once all comments were received these were used to prepare this final submission.

We trust that the information provided in this response will prove useful to the Office of Rail Regulation as it continues its work on the Periodic Review. We have welcomed the ORR's continuing engagement with industry, both during and prior to the Review, and we would be happy to provide any additional support or feedback from industry as required.

First Consultation

The First Consultation document (http://www.rail-reg.gov.uk/pr13/PDF/PR13-first-consultation-document.pdf) is a broad-ranging overview of the whole Periodic Review. The 68 page document covers issues including outputs, incentives, charges and the structure of the review itself. Respondents are asked to give views on 32 separate questions.

Clearly some of these questions, particularly those around access charges, will have little relevance to civil engineering contractors. As such, we have attempted to draw out only those questions where CECA can reasonably comment.

Q1 - Do you agree with our proposed objective for the review? If not, what issues would you add or subtract?

The consultation document First Consultation defines the objective of the Review to be: *"to protect the interests of customers and taxpayers by ensuring our determination enables Network Rail and its industry partners to deliver or exceed all the specified outcome and output requirements, safely and sustainably, at the most efficient levels possible comparable with the best railways in the world by the end of the control period."*

CECA can offer its full endorsement to this objective statement. We believe that the UK rail sector plays a vital role in protecting and promoting the economic well-being of the UK economy, while also supporting one of the most popular forms of transport used day-to-day by the population.

Given this important position role, it is understandable that the UK should aspire to reestablish itself as a global exemplar of rail best practice. While we believe that the Review cannot achieve this on its own, we think that the objective will help focus the whole industry and its stakeholders to work towards this objective.

We also commend the focus on a safe, sustainable railway. We believe that many of the problems faced by the UK rail sector have their roots in short-cuts and short-termism, building up problems that now require major investment to rectify. The Review must point the industry in a direction that leads to a step-by-step reduction in the costs of the railway, not through squeezing the supply chain, but through the delivery of more sustainable solutions that remove the need for costly interventions later.

Finally, we must recognize that the current economic circumstances mean that funding for the rail sector may be more constrained in previous years. For this reason we believe it is essential that all expenditure is justified, and therefore welcome the inclusion of efficiency as a key point in the statement of objectives.

Q2 - Do you have any views on our proposed timetable for the review? Do you need further information to plan your involvement with PR13?

We broadly welcome the clarity that the Office of Rail Regulation has provided around the timetable for the Review. This clarity has enabled CECA to plan its engagement with members, which will help us to provide informed feedback now and throughout the remainder of the Review.

The current Control Period was set on the same basis as that planned for CP5. The final plans were only settled in March 2009 for the 5 years commencing April 2009. This has led to a very irregular pattern of spend during CP4 – the first two years having lots of expenditure on development & design and the final two years having a massive ramp up of expenditure on construction. This seems to have been as a direct result of an inadequate level of development ahead of the start of the Control Period and the inefficiencies identified by the McNulty review. This issue was raised as a concern in 2008 / 2009 but was rejected on the grounds that the review needed to run to the 11^{th} hour in order to "get it right". This was, however, not achieved since following this settlement, plans for national electrification were added, changing the pattern of investment.

We recommend that:

- Projects are developed, for CP5, during CP4 – there are funds set aside for this
- The CP5 settlement and business plan is in place at least 6 months ahead of the start of the period, in order that the work level can be spread more evenly throughout the 5 years.

Q6 - Is the current approach to defining obligations in terms of outputs the best approach? What outputs should be defined? Should there be a move to more use of outcome based obligations? Would another approach be appropriate such as specifying inputs or intermediate measures?

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Q8 - Should we make more use of 'whole system' outputs over which Network Rail does not have full control, or focus on more narrowly defined outputs which the company is fully responsible for?

We understand that the outputs that Network Rail will be required to deliver during CP5 will not be set until after the publication of the High Level Output Specification in July 2012. From our attendance at recent consultation events, and the consultation document, we understand that the debate in this area revolves around whether the obligations on Network Rail should come in the form of outcomes, outputs, inputs or intermediate measures; and if it is a mix of these factors, what the split should be.

We believe that the debate on how obligations should be defined will, at least in part, be controlled by the success or failure of attempts to align objectives between all parts of the rail sector.
If the whole sector is aligned towards the delivery of common goals, then it seems reasonable to set outcome-based targets. This is because, while delivery of these targets would be outside Network Rail's control, there should be mutual interest in delivery across all players. The benefit of this approach would be that outcome-based targets focus on the high-level objectives for the rail network as a whole.
However to have entirely outcome-based targets would put undue pressure on Network Rail, should the hoped-for alignment of the rail sector fail to materialize, shifting responsibility for achieving targets to Network Rail when it is not within its gift to do so.
For this reason we think that output-based targets should continue to be used, while outcome targets can be used as an additional monitor to ensure that – where outputs are being delivered – they are indeed securing the expected results for passengers and other stakeholders.
We recognize that a focus solely on output-based targets might contribute to self-preservation behaviours within Network Rail, causing it to act to meet its own targets, even if in doing so has negative impacts for others within the industry.

Q11 - Should Network Rail's output obligations include a specific safety requirement, different from its legal obligations?

Given the safety requirements that already exist elsewhere within the rail sector, we understand why there is an argument in favour of removing the safety requirement from the ORR obligations.

As with all other players in the rail sector, we feel that health and safety should remain of paramount importance. Given the human impact of poor safety performance, the issue should never be allowed to become subordinate to other considerations.

However we believe that over-regulation on safety carries its own risks. Where regulation compliance and bureaucracy takes the place of genuine initiatives to improve safety behaviour, it is clear that regulation is failing. As such, we believe that inclusion of a safety-related output should be agreed only if there is broad agreement from industry stakeholders that such a target did indeed contribute to improved safety performance within CP4. This may need to be an area of additional consultation during the Periodic Review.

Q20 - What are your views on the duration of the control period?

CECA has for many years campaigned for greater clarity over the forward investment pipeline for infrastructure. We recognize that by providing the supply chain with greater understanding of the forward outlook for work, companies can respond, investing in improved skills, products and processes.

For this reason we welcome the fact that the current control period model provides considerable security to the rail civil engineering sector, offering certainty about the likely size of the market in the medium-long term. This encourages better planning and investment, which has the consequential effect of delivering work on the network more efficiently.

With this in mind we would have concerns about the impact on the rail supply chain of any effort to reduce the length of control periods. Were this to happen, the supply chain would lose confidence in its ability to invest. We would hope that, were this situation to arise, additional measures would be put in place to allow some clarity of investment pipeline between control periods.

The alternative scenario would be to introduce longer control periods. This could produce significant benefits in terms of providing the supply chain with even greater forward visibility, but it does raise concerns about the flexibility of the overall plan. As we have seen with the recent economic downturn, it is difficult to provide long-term forecasting for the levels of demand on the UK rail network. As such, longer control period might run the risk of acting as a straitjacket on the network, if future demand failed to reflect the expectations at the time of the Periodic Review. For these reasons, we would continue a support in the five year cycle for Control Periods.

Q23 - Network Rail faces a number or risks. At this stage, do you have any views on how general inflation risk and input price risk should be addressed?

The issue of input cost inflation is one that has commonly been reported by Civil Engineering Contractors Association members in recent years. These concerns relate not solely to rail civil engineering but to the whole infrastructure sector and are driven by volatility in some of the key resources used by the industry, namely fuels and hydrocarbon products, metals (mainly steel and copper) and concrete/aggregates.

For these reasons CECA has carried out considerable work to look at how best this volatility can be restrained, through the use of indexation; hedging; options; or improved purchase planning. We would be happy to discuss our work in this area with the Office of Rail Regulation at greater length if required.

However one point underlying the whole debate relates to the consequences of passing inflation risk into the supply chain.

While suppliers can take this risk (and indeed in some cases may be best positioned to do so) it should not be perceived that this is always the most effective method of dealing with this issue.

If inflation risk is passed to the supply chain, firms will understandably seek to adjust their pricing to reflect this. If a project requires resources with significant cost volatility then the ‘inflation risk weighting’ attached to the price of the project may outweigh any efficiencies that have been achieved elsewhere, particularly if the anticipated volatility does not arise.

For this reason, we continue to work with others in the rail sector to develop appropriate forms of inflation risk management, and will seek to develop this in the run-up to CP5.

A common series of indices, used at the Network Rail / Government and Network Rail / Contractor interface would allow contractors to focus on efficiency and innovation led savings.

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