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ORR Consultation on the financial framework for PR18 – April 2017

1. The Associated Society of Locomotive Engineers and Firemen (ASLEF) is the UK's largest train driver's union representing approximately 20,000 members in train operating companies and freight companies as well as London Underground and light rail systems.

2. ASLEF welcomed the decision to bring Network Rail in to public ownership. Our view was that retaining the infrastructure company as an arm's length not-for-dividend private company was a nothing other than an accounting trick to keep its debt from the public accounts. An expensive consequence of this was that Network Rail had to pay market interest rates on its debt for more than a decade.

3. So while we recognise the reduction to the cost of borrowing at Network Rail we are concerned that it does not acknowledge the problem of the organisation's escalating and ongoing debt. We believe that Network Rail's debt is a subject of considerable importance to the future of the rail industry and that it is a matter which requires urgent clarification, not least, in terms of the financing of future projects.

4. ASLEF has consistently pointed out the one of the major problems of rail franchising is that the public sector finances work and that private companies benefit from it and take credit for it. The consultation points out that train operators are reluctant to make event token investments beyond their contracts because of the limited length of train operator franchises.

5. For this reason, it is very difficult to cite any genuine examples of private sector railway companies introducing innovation or investment which has benefited passengers. The “Rebuilding Rail” report commissioned by ASLEF and the other transport unions in 2012 contains may interviews with rail industry experts who point out that most of the innovation on the railway has been publically funded. Roger Ford, Industry & Technology Editor at Modern Railways stated, “They’re not investing. Nor are they really innovating. Not all that much.”

6. ASLEF does not believe that it possible for the private sector to invest in any meaningful way whilst the franchising system remains in place. For example, the consultation document states that, “East West Rail provides an example of third party participation in the delivery and funding of a railway scheme. The DfT recently announced that “a new East West Rail organisation will deliver the design, construction and operation of a railway link between Oxford and Cambridge. Whilst most of the financing/funding is expected to come from DfT, the East West Rail Consortium (of local authorities and strategic partners) is making a contribution towards the cost of the scheme.”

7. The Transport Secretary, Chris Grayling, has announced that “Network Rail has got a huge number of projects to deliver at the moment … I want it to happen quicker. This is an essential corridor for this country. On that route we are going to bring in private finance, in a form to be decided.” We note that East West Rail is currently undergoing a scoping exercise on the financing of the project and how much private investment is possible. ASLEF takes the view that this cannot be considered a genuine example of third party participation. The union also fundamentally opposes the privatisation of rail infrastructure and believes we must learn from the mistakes of the past and the catastrophic disaster of Railtrack.

8. Furthermore we believe that the pursuit of a profit and the maintenance and improvement of the rail network are inherently incompatible and have led to fatal consequences in the past. Indeed we affirm that fragmentation has led to a reduction in productivity and is a barrier to efficiency, yet we don't support bringing track and train together under private ownership

9. The private sector is unlikely to invest in rail infrastructure without being guaranteed a return so it is therefore important to question at what price and private sector investment will come.

10. ASLEF has doubts over alternative sources of investment beyond the private sector and we believe that the dramatic cuts to local authority budgets mean that they are unlikely to have the financing to do this. Therefore plans that rely on this devolvement of funding are in danger of actually plans to devolve cuts.

11. ASLEF believes that the best way to create sustainable investment is to end the fragmentation of rail which itself creates inefficiency and also by preventing profit from leaving the industry. In 2014-15 £222 million left the industry through dividends. This is despite a public subsidy of £3.5 billion. Network Rail only receives £1.4bn from the track access and other charges from private operators but gets £4.2 billion from net government grants. How can it make financial sense to allow profit to leave the industry when the industry is still so reliant on public financing?

12. ASLEF believes that its time we stopped tinkering with a broken system. There are of course certain measures which can help increase efficiency when undertaking infrastructure work on our network, such as bringing Network Rail back into public ownership to reduce its borrowing costs. There is no question that the entire structure of the rail network requires change. Until we have a single unified network were profits are reinvested

into the network rather than handed out as dividends we will never achieve the efficiency the railway needs to grow in capacity, reliability and value.

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Cumbria County Council and Cumbria LEP Consultation Response

ORR Consultation on Consultation on the financial framework for PR18

Introduction

1. Cumbria is critical to the future prosperity of the Northern Powerhouse. This is reflected in the level of investments coming into Cumbria over the next decade, approximately £25 billion in total with 5 of the 8 largest investment projects in the North West. This will bring benefits pivotal to the delivery of Government's Industrial Strategy and the growth of the UK economy.

2. The Cumbria Infrastructure Plan identifies rail improvements as a top priority in supporting the delivery of major nationally significant infrastructure projects and the movement of freight and passengers to, from and within the County.

3. Of particular importance in this respect is the Cumbrian Coast Line. Within North, West and South Cumbria this Line provides essential connectivity between key settlements, large employment sites, ports at Workington and Barrow and the West Coast Mainline.

4. This connectivity represents a critical component of the Cumbrian economy; already the County has two-thirds of the UK's nuclear installations and a cutting edge advanced manufacturing sector. By linking many of key locations the Cumbria Coast Line can play a significant role in the development and growth of these sectors; helping to improve access to local and national markets, increasing travel-to-work areas and in carrying the goods and material needed to support the construction and operation of major projects including the Moorside Power Station.

5. For the line to achieve this potential there is an immediate requirement to deliver a significant increase in train path availability and private sector developers are working collaboratively with Cumbria LEP, Cumbria County Council, Network Rail and Transport for the North to progress scheme development through the Coastal Railway Programme Board chaired by Cumbria LEP.

6. On behalf of the Coastal Railway Programme Board, Cumbria County Council and Cumbria LEP wish to see enhancements to this line referenced within the HLOS and moving forward to CP6. Indeed many of the challenges and

opportunities discussed within the PR18 consultation reflect those on this line and the private/public funding model we are promoting represents a dynamic, innovative and deliverable approach which sits comfortably with the thrust of this document.

7. Although the most pressing, the Cumbrian Coast Line is not the only priority within Cumbria. Other enhancements are required to the Tyne Valley Line, Furness Line and West Coast Main Line. These are discussed in more detail within our response to the ORR consultation in September 2016.

Questions - Section 3

Do you have any views on the ways that enhancement projects should be financed/funded in CP6?

8. We recognise that the funding picture for CP6 is challenging and therefore welcome the drive towards new and more innovative approaches that can realise best value.

9. We particularly welcome the statement in paragraph 3.18 that there may be more opportunities for private sector businesses to participate in railway development in CP6 such as contributing financially to a rail enhancement that will bring an economic benefit. This is the approach that is being considered in order to deliver the necessary improvements to the Cumbrian Coast Line.

10. Much of the major investment pipeline in Cumbria (worth in excess of £25bn.) is in West Cumbria. These include the Moorside Nuclear Power Station and West Cumbria Mining with the delivery and operation of these having a significant reliance on rail connections provided by the Cumbrian Coast Line.

11. The level of freight required to support these development is significant and would not be feasible to transport by road. Nonetheless, without improvement the railway will not be able to provide the number of train paths required to enable all of the proposed developments while continuing to serve existing users. In particular early assessment has highlighted a need for new sections of line and passing loops, new signalling and line speed enhancements.

12. Given links to development there is clear scope to use developer contributions to help unlock delivery and there is ongoing dialogue with the development industry through the Coastal Railway Programme Board.

13. Whilst developer contributions can play a role, it is inescapable that critical infrastructure will be required in advance of growth or development – before essential developer contributions can be secured. To overcome this challenge we consider that PR18 should be strengthened to introduce support

for innovative mechanisms whereby infrastructure enhancements can be front funded with a proportion of costs subsequently clawed back through developer or other contributions. Once clawed back it would be possible to reinvest the funding in new schemes – potentially complementing more flexible funding opportunities discussed within the report.

Connecting Opportunities - Coastal Railway Line

Within North, West and South Cumbria the Cumbrian Coast Line provides essential connectivity between key settlements, large employment sites, ports at Workington and Barrow and the West Coast Mainline.

This connectivity represents a critical component of the Cumbrian economy; already the County has two-thirds of the UK's nuclear installations and a cutting edge advanced manufacturing sector. By linking many of key locations the line can play a significant role in the development and growth of these sectors; helping to improve access to local and national markets, increasing travel-to-work areas and in carrying the material needed to support the construction and operation of major projects including the Moorside Power Station.

For the line to achieve this potential there is a requirement to deliver a significant increase in train path availability and local authorities, Cumbria LEP, private sector and Government are progressing scheme development and proactively develop new models for delivery of rail infrastructure enhancements.

Have we identified all of the possibilities for private sector partnerships and financing/funding arrangements that might arise?

14. Although this document has identified a range of potential funding sources we would advise that it should be more explicit about the potential role of private sector developers to directly contribute to the delivery of enhancements that can support businesses or investment and in turn drive longer term economic growth.

15. Linked to this we would advise that further consideration be given to opportunities to integrate improvements with maintenance programmes, wider upgrade programmes or activity needed to address historic under investment. This flexibility would enable Network Rail derive greater efficiency and for available funding to go further.

Do you agree with the reasons we have given for the continuation of the five year control period and the building block approach for calculating Network Rail's revenue requirement?

16. We would agree that the five year control periods arrangements represents the most appropriate means to plan the delivery of essential infrastructure requirements. However, there needs to be an indication of a future pipeline of investments to allow for longer term strategic planning a process that can be integrated with Network Rail own longer term planning together with that undertaken by sub-national authorities like Transport for the North.

<u>Questions – Section 7</u>

Have we identified the key limitations and possible improvements for financial performance assessment in CP6?

17. We are satisfied that some opportunities to improve financial performance have been identified. However, there remain concerns, particularly within the private sector, about Network Rail's ability to deliver timely and cost effective improvements to the rail network.

18. In particular we consider that there are significant benefits to be derived from delivering comprehensive solutions to lines as opposed to incremental upgrades. Comprehensive solutions to rail network enhancement should allow for:

- Minimum disruption to services created by uncoordinated or unplanned enhancements;
- Reduced procurement and project management costs; and
- Opportunity to generate increased running and revenue charges.

End.

Response to ORR's first consultation on the financial framework for the 2018 periodic review of Network Rail (PR18)

This pro-forma is available to those that wish to use it to respond to our consultation. Other forms of response (e.g. letter format) are equally welcome.

Please send your response to pr18@orr.gsi.gov.uk by 13 April 2017.

Full name	Chris MacRae
Job title	Head of Policy – Rail Freight & Scotland
Organisation	Freight Transport Association
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*This information will not be published on our website.

Chapter 1: Network Rail's business structure and funding

We invite stakeholders to comment on the questions set out at the end of the chapter and/or provide any other comments they consider relevant.

- Do you have any views on our proposed use of a building block approach to calculate Network Rail's revenue requirement at route level for CP6?

What is important is that sufficient funding is available for freight enhancement schemes in CP6.

Chapter 2: Financial policy issues

We invite stakeholders to comment on the questions set out at the end of the chapter and/or provide any other comments they consider relevant.

- Have we identified all the important financial issues that need to be addressed in PR18?

  Broadly yes.

Chapter 3: Enhancement funding, a five year control period, the building block approach, and the cost of capital for CP6

We invite stakeholders to comment on the questions set out at the end of the chapter and/or provide any other comments they consider relevant.

- Do you have any views on the ways that enhancement projects should be financed/funded in CP6?
- Have we identified all of the possibilities for private sector partnerships and financing/funding arrangements that might arise?
- Which aspects of the financial framework do you think might be relevant to third party/private sector financial participation?
- What do you consider should be done to address cross-border funding/benefit mismatches with respect to enhancements?
- Do you agree with the reasons we have given for the continuation of the five year control period and the building block approach for calculating Network Rail's revenue requirement?
- Which cost of capital approach do you think should be used for Network Rail in CP6?
- Have we identified all of the issues relevant to the choice of cost of capital approach?

It is important that freight specific scheme funding continues to be available and managed through dedicated funds with oversight Boards / Steering Groups as currently in Scotland and also England & Wales.

Chapter 4: Other financial issues for CP6

We invite stakeholders to comment on the questions set out at the end of the chapter and/or provide any other comments they consider relevant.

- Do you think we should change our approach to the calculation of amortisation allowances in light of:
  - Network Rail's reclassification and the likelihood of a fixed borrowing limit in CP6?
  - the possible developments to enhancement financing/funding set out in chapter 3?
  - financial sustainability requirements?
- Do you think we should include an 'early start' mechanism in the PR18 process?
- Do you consider we should make any changes to our PR13 policies on inflation?
- Do you have any views on the corporation tax and VAT issues we have set out?
- Do you have any views on how we should treat the proceeds from disposals that
  - are made in the normal course of business?
  - are made in response to the Hendy report?
- Do you think we should make any changes to the treatment of traction electricity, industry costs and rates that we applied at PR13?
- Do you have any views on the use of any outperformance amounts that arise during CP6?
- Do you have any other views on the financial issues set out in this chapter?
- Do you think there are any other financial policy issues we should be considering for CP6?

It is important that any sales of identified surplus freight land via the current process result in the proceeds of these sales going back towards freight enhancement schemes.

Chapter 5: Financial sustainability and risk management under a route level determination

We invite stakeholders to comment on the questions set out at the end of the chapter and/or provide any other comments they consider relevant.

- Do you think we have identified the important financial risks applicable to Network Rail in CP6 and that the main risk relates to expenditure levels?
- Do you agree with the approaches we have identified for managing expenditure level risks?
- What protocols do you think might be necessary to govern the reallocation of financial resources between routes during CP6?
- Do you think that the level of Network Rail's debt is a financial sustainability concern?
- Do you consider that any changes will be needed to financial licence conditions or re-opener provisions?

It is important that NR achieve cost efficiencies that can be passed on to FOCs and their end customers to bring down the cost of rail freight to the end customer i.e the shipper or sender of goods. Road freight is continually improving its efficiency and reducing cost to the end customer so it is vital that rail freight does likewise not just to seek new or additional traffic but to retain existing traffic.

Chapter 6: Financial incentives for CP6

We invite stakeholders to comment on the questions set out at the end of the chapter and/or provide any other comments they consider relevant.

- Should we retain the RAB roll forward incentive mechanism for CP6 – could it be improved?
- Could we develop incentives linked to Network Rail's route scorecards?
- Should we develop the spend to save mechanism for CP6?
- Are there any other financial incentives you think we should consider?

Yes to all above.

Chapter 7: Financial performance assessment for CP6

We invite stakeholders to comment on the questions set out at the end of the chapter and/or provide any other comments they consider relevant.

- Have we identified the key limitations and possible improvements for financial performance assessment in CP6?
- If the RAB roll forward incentive mechanism is retained, should we continue to apply the 25% adjustment to FPM?
- Have we identified the key principles that should apply to the assessment of Network Rail's financial performance?
- Should financial performance measures be treated as a regulated outputs or indicators in CP6?
- Should we introduce mechanisms to update efficiency assumptions during the control period?
- How could we develop our FPM reporting to reflect our move to route level regulation?
- Would it be helpful to provide more context for Network Rail's financial performance in our annual reporting, by comparing the performance of the wider railway industry to the assumptions in the governments' SOFAs?

Are there any other approaches we should consider so that we can effectively assess Network Rail's financial performance and hold it to account?

It is important that performance measurement at a geographic route level is also taking account of cross-route operations of FNPO route.

Any other points that you would like to make

With route devolution to geographical routes it is vital that cross route operations such as freight are catered for. This is of course why the FNPO Route has been set up. It is important that dedicated freight enhancement funds continue under the HLOSs and SOFAs for Scotland and England & Wales and equally that there is correct financial project interface between freight fund schemes and route-based schemes.

Thank you for taking the time to respond.

Consultation on the financial framework for CP6

INTRODUCTION

This is the response of Freightliner Group Limited encompassing its subsidiaries Freightliner Limited and Freightliner Heavy Haul Limited to the Office of Rail and Road's (ORR) consultation on the financial Framework for CP6

PERIODIC REVIEW PRIORITIES

Freightliner's priorities for the Periodic Review 2018 are:

- A continued emphasis on improving safety
- A stable, national and simple charging and incentives framework, which does not increase the overall level of charges paid by freight operators
- Reducing overall industry unit costs and delivering efficiency
- A greater focus on optimisation of capacity and careful balancing of passenger and freight needs by the System Operator
- Delivery of value for money outputs through a long term programme of infrastructure
- A customer focused ethic throughout Network Rail and a supplier who wants our business to be successful

Freightliner is aware that this is a very important consultation regarding the funding and measuring the outputsof Network Rail. As a freight operator our response to this consultation concentrates on areas that would impact on our business rather than offering views on elements of the consultation that has no direct impact on our business. We feel that many of the choices in this area are for the Department for Transport, the Office of Rail and Road and for Network Rail to agree on the best solutions.

Chapter 1 – Network Rail's Business Structure and Financing

We welcome the clarity that the building block approach will provide and support this methodology. It is not clear in the consultation how the Freight and National Passenger Operator (FNPO) Route and how the System Operator (SO) will be funded. Whilst neither own railway assets we understand that both will be separately regulated. We note in this regards that freight access charges are shown as an income stream for the geographic routes. It would be helpful if there were clarification how the FNPO Route and the SO fit into the whole.

Chapter 3 – Enhancement financing/funding, a five year control period, the building block approach and the cost of capital for CP6

Freightliner supports a minimum of a five-year funding cycle. Given the long-term nature of its assets and the desire to encourage Network Rail to maintain assets in an efficient whole life cycle funding Network Rail in 5-year cycles is an absolute minimum appropriate funding cycle and we would be supportive of a longer control period up to 10 years going forward.

A longer control period would also support stability in access charges which would be strongly welcomed given the long term nature of freight operators, ports, terminal operators and our customers' assets. There is a perception that charges to access the road network (fuel duty) are stable and are unlikely to change in the new future (fuel duty has been frozen in absolute terms since 2011).

We recognise the revised approach to enhancements included in the DfT/NR Memorandum of Understanding and the implications on the control of expenditure. However, it is still important that there is reasonable transparency of decision making within this framework, particularly where money is transferred across schemes within a portfolio and/or outputs change. We suggest this should be via the Network Rail Delivery Plan.

It is also necessary to consider how a framework for enhancements will support certainty in the supply chain. In order to achieve overall best value for money in the long term the ideal is a steady pipeline of works. A pipeline of schemes would support the supply chain in providing the required skills and available workforce as well as enabling businesses to invest in apprenticeships and training, innovation and capital equipment, (which tends to have a long asset life in the rail industry). Policies that support long term planning by businesses will result in stable and efficient prices being offered by Network Rail's supply chain.

Strategic Freight Network (SFN)

We strongly support the continuation of funds for delivering smaller scale enhancements. The Strategic Freight Network fund has offered value for money of over 4:1 and has enabled freight outputs to be identified and prioritised. The governance structure encourages the best value for money solutions to be identified and was highlighted by the Bowe report as being good practice. We are of course aware that not all schemes have been delivered in the timescales originally set out but note that there are schemes that will enable a step change due to be completed around the end of Control Period 5 (Felixstowe branch and Southampton train lengthening). A continuation of a SFN fund into CP6 would continue to offer high value for money for funders.

Freight investment

Rail freight operators have collectively made investments of more than £2bn in locomotives, wagons and other capital equipment since privatisation[1]. Ports, terminals and other customers have also made significant investments in assets and infrastructure, including rail-connected facilities. In this regard it is important to note that there is already considerable third-party investment in the railway, and related infrastructure.

In some cases this off-network investment has been linked to a contribution to infrastructure enhancements on the rail network. For instance Associated British Ports contributed funds to the Network Rail project to gauge clear to W10 the line between Southampton and Nuneaton, and DP World have contributed to the upgrade of the branch line to their port at London Gateway. There has been inconsistency however in the contributions sought from different ports, both in size and methodology, mainly linked to such matters being dealt with by local planning authorities. Where such contributions to rail network enhancements are requested it is important that the funding requirements are consistent with equivalent schemes on the road network, and seen to be fair and consistently applied to competing ports around the country. One solution may be for Network Rail to take a lead in these matters, enabling a national consistent picture.

Barriers to investment

The 2015 Rail Delivery Group (RDG) Freight Britain report discussed the issue of investment in the railway. It highlighted that there is a 'virtuous circle of investment' and the existence of a symbiotic partnership between government and the private sector investment[2]. While separate, the investments are interdependent and the report highlighted that continued investment in the rail freight network by Government is crucial to facilitate other third-party investments, including in off-network facilities and rolling stock. Therefore when considering third-party funding it is important to understand how public funding can act as a catalyst for private sector investments.

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[1] Freight Britain, Rail Delivery Group, 2015
[2] Freight Britain, Rail Delivery Group, 2015

Stable and affordable charging regime

The RDG report[3] highlighted the importance of a stable and positive environment to promote investment. Key to providing stability is certainty in the long-term charging and regulatory regimes. As we enter the periodic review process for Control Period 6 this remains a concern and uncertainty over the level of charges in the next control period creates significant risks. This risk impacts on confidence and undermines the viability of private sector investment. Certainty over the level and structure of charges is absolutely fundamental for the ability of freight operators, customers and ports/terminal owners to make investments in assets or in off-network locations.

The five year regulatory cycle and uncertainty about future regulatory policy is a barrier to private sector investment in the rail network itself. Typical large infrastructure schemes take several years of planning and several years to implement and therefore do not fit neatly within the regulatory periodic settlement. It would be a major challenge for an investor to be subject to changing rules of engagement in a new regulatory cycle; any investor will be seeking certainty of outcomes throughout the period of investment and post the investment being finalised.

Off network investments

Freightliner has considerable experience in making investments in off-network terminals and facilities, to support efficiency and deliver growth. This includes 100% privately funded investments in maintenance facilities at Crewe and Guide Bridge during 2016/17.

In order to enable the private sector to have the confidence to be able to make investments in off-network locations Network Rail needs an organisation that enables it to be responsive, including across Route boundaries. There is a challenge for Network Rail to match the agility of private sector organisations that often have business cases dependent upon delivery within a very specific timeframe. The attractiveness of making investments is undermined when the timeframes do not align, as this creates risks and leads to inefficiencies.

There is an important role for Network Rail's property teams in supporting the efficient delivery of private investments. Greater alignment between the property teams and the Freight and National Passenger Operators route (FNPO) and geographic Routes would help ensure a more consistent approach.

Contractual framework

It is beneficial that Network Rail introduced template agreements in 2006 to encourage more private investment by reducing the barriers to entry. The establishment of a clear contractual framework helps to ensure a more efficient process. There are however, a number of Network Rail services that are 'non-contestable'. These include asset protection, asset information and booking of possessions, engineering safety management and certain necessary consents.

There are good reasons to retain these as 'non-contestable' services in order to preserve the safety and integrity of the rail network and ensure that the interests of all railway users are considered, for instance in the area of network access. However, given that these services are not open to competition, it is important to ensure that the costs of providing them are transparent and efficient. In our experience, the costs of asset protection can vary tremendously across Routes. Where services are non-contestable it would support third party investment if there was increased transparency and consistency on the level of charges in order to ensure that the costs are appropriate and proportionate.

[3] Freight Britain, Rail Delivery Group, 2015

Compatibility with overall strategy

It is crucial that third-party investments in the network should align to the overall strategy of the route, and their implications on the capability and capacity of the network should be understood. This is particularly important when developers fund new stations. The stations themselves are usually relatively low-cost, however, other enhancements to the rail network are often required to support the train service, and to ensure the impact on network capacity is not detrimentally affected.

A good example of this is the third-party investment that funded the development of the new station at Kenilworth. Kenilworth is located on a strategic freight corridor linking Southampton to the West Midlands and beyond, and therefore it's important that the network-wide impacts are fully understood. In this instance, it is highly likely that without the addition of a freight loop this development, and the proposed train service that supports it, would detrimentally affect freight capacity over the line. It also risks jeopardising part of the on-going investment along that corridor that is being funded by the Strategic Freight Network fund to enable longer and heavier freight trains to operate to and from Southampton port, as the two schemes have been separately planned and managed. This in turn risks the delivery of the outputs from the investment already made by government in the Southampton to West Midlands train lengthening scheme, commenced in Control Period 4 and is due for completion by the end of Control Period 5.

Third-party investment should be consistent with the schemes identified through Network Rail's Long Term Planning Process, to ensure compatibility with wider network strategy. These documents (which include the Route Studies), and the schemes that are identified in them, undergo full public consultation and so any third-party funders have the opportunity to provide detailed comments.

In the context of the investment in the station at Kenilworth, it is vital that the full package of supporting infrastructure schemes is also funded to mitigate any detrimental impact. The Route Study[4] identifies the other "associated infrastructure improvements" necessary to provide a train service between Coventry, Kenilworth and Leamington Spa.

Consistency and Flexibility

It is recognised that it is difficult for Network Rail to both plan the network holistically, and be able to react quickly on a local basis to the private sector, but ideally this should be the aim. This may be even more challenging in future control periods as government has indicated that major enhancements in the rail network will be planned outside of the Control Period cycle. To ensure that enhancements in the pipeline remain consistent and aligned with the wider network strategy, it is suggested that the suite of studies, produced as part of Network Rail's Long Term Planning Process, are more regularly updated than currently. This could be considered as the planning, resourcing and funding of the National System Operator is developed.

Role of the National System Operator

Network Rail's National System Operator (NSO) function has a crucial role in supporting third-party investments by clearly establishing the outputs of investment schemes, particularly what train service output is supported. Investments in schemes on and off the network are essentially supporting a train service output. For funders to invest in infrastructure schemes they require clarity on the train service outputs enabled by the investment. This is a complex area, as it is not

[4] West Midlands and Chiltern Route Study, Network Rail, 2016

uncommon for investments in one route to be contingent on train paths being identified across other routes.

In order to provide support to more 3rd party funded schemes Network Rail's Capacity Planning function may need to be expanded in order to be sufficiently resourced to perform the detailed timetable work necessary. With the current focus on the NSO, and the development of the regulatory framework to monitor and support the function, there is an opportunity to invest in the capacity of the NSO into the next control period. Investments in people and systems could allow the NSO to better support third-party investments, by establishing clearly for funders what the train service outputs are.

Once the outputs have been clearly identified there is a challenge to secure those train paths. Between the investment being scoped and it being delivered, timetable changes and additional services on the network may preclude the outputs being delivered. Mechanisms to lock in the outputs of investments should be considered. This may involve the use of access options or could include strengthening the protection of strategic paths.

East-West Railway

We note the new proposed model for the enhancement of the East – West Railway. We recognise that it is early days but it is not clear whether this railway will be charged for in the same way as the remainder of the Network Rail Network. Higher access charges would be likely to exclude the use of this route by freight operators. Network Rail have previously suggested freight could be routed on East West to avoid the West Midlands conurbation, and there is also likely to be demand for construction traffic in support of the economic development along that corridor.

Charging a premium to use new infrastructure will not necessarily consider the wider benefits of such investments and the holistic nature of the rail network. For example, the real benefit of a new flyover may be to increase the capacity of the railway line under the flyover, as a result of a reduction in conflicting moves. Therefore, to levy an additional charge on the users of the new flyover, would fail to understand the benefits of the scheme, and the need to consider the network holistically.

We can appreciate that levying such a charge may look like an attractive means of promoting third-party investment, but this should be balanced against the benefits of having a national charging regime. Freight operators have consistently highlighted the importance of a national charging framework. Any differentiated charges, based on which party funded the infrastructure, risks making rail freight less competitive.

A more complex and expensive charging regime would make rail freight less attractive, and would be likely to lead to modal shift to road. The charging regime for road is in effect fuel duty, which is very simple and has been frozen since 2011. Careful consideration of the impacts would be needed and how this compares to the charging for road before any proposals for charging a levy to train operators were made. The benefits of moving freight by rail instead of road, which have been calculated as £1.6 billion a year[5], fall outside of the railway balance sheet, and these benefits will be eroded if business is lost to road.

Management of cross-route projects

We note the issues around cross – border enhancements; most freight projects by their very nature are cross route. It is vital that the project sponsors are responsible for ensuring the delivery of the outputs of the scheme, rather than just the physical works in their local routes. Network Rail have

[5] Freight Britain, Rail Delivery Group, 2016

already recognised that responsibility of delivering outputs is a gap in the way that they currently deliver projects and we understand that they are intending to make some changes in this regard.

However, any framework for managing costs and benefits must also ensure that the outcomes are delivered. The role of the NSO is also vital here, particularly in ensuring that capacity outcomes are delivered, and the NSO should be responsible to the project sponsor in this regard.

Chapter 4 – Other Financial Issues for CP6

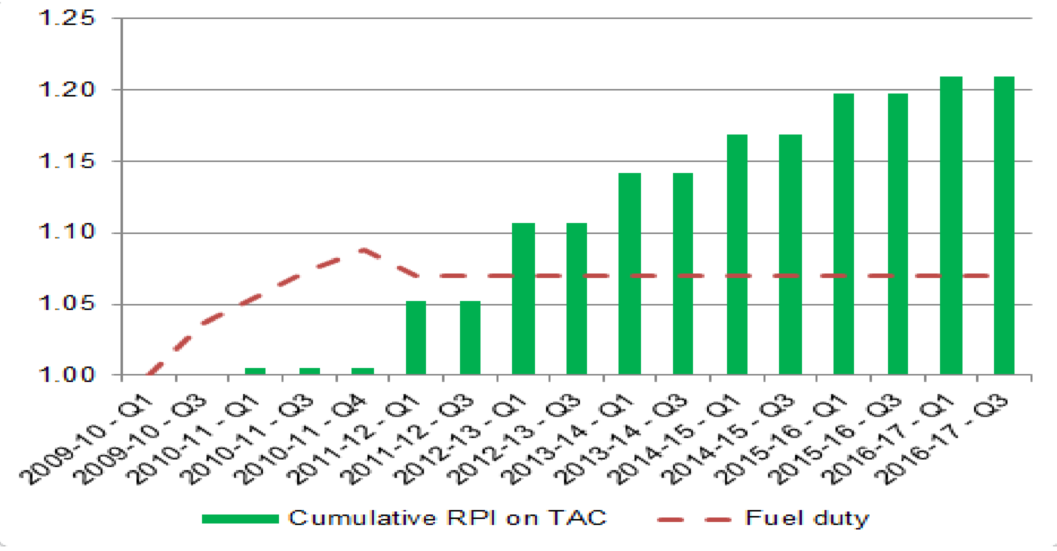
Indexation

The application of CPI or CPIH reflects a more realistic measure of price inflation than RPI, primarily reflecting the structural differences in calculation methodology. We understand that a CPI type measure is the normal indices across most European countries. This is consistent with the UK Governments stated policy to use CPI for the indexation of benefits, tax credits and public service pensions. Since 2003 the Bank of England's Inflation target has also been for CPI of 2% pa (previously RPI of 2.5% pa).

More recently, this was supported in a letter of 9 March 2016 from John Pullinger, National Statistician to the Chair of the UK Statistics Authority[6] in which he provided the following clarification on the future of RPI: *"Put simply, I believe that the RPI is not a good measure of inflation and does not realistically have the potential to become one. I strongly discourage the use of RPI for as a measure of inflation there are superior alternatives".*

Access charges are inflated by RPI every year but for freight operators it is very challenging to pass on a full RPI increase to customers as RPI is largely seen as a thing of the past by industry. We would support a move to CPI, which more closely reflects the consumer nature of today's rail freight markets.

Even out-with the periodic review process it should be noted that fuel duty has been frozen in real terms since 2011, whilst access charges paid to Network Rail increase by the Retail Prices Index (RPI) every year, and over 15% in total since 2011. See below graph:



6 https://www.statisticsauthority.gov.uk/wp-content/uploads/2016/03/Letter-from-John-Pullinger-to-Sir-Andrew-Dilnot-090316.pdf

Land Disposal

We understand that Network Rail need to manage their portfolio of land efficiently and seek value where they are able to or dispose of unused assets to raise capital. We are very keen to engage more in the process for selecting sites and also on how freeholds with current freight tenants may be managed in future. Freight operators have supported Network Rail already by releasing a number of sites protected by the 1994 agreement. We would welcome increased transparency about other sites that are being discussed, and are concerned that the first opportunity we will have to comment is likely to be via the ORR section 7 process.

Once sites are disposed of they are very unlikely to be used by rail freight ever again and the sector will not be able to grow if there are not suitable sites in the future.

We urge the ORR to ensure that an appropriate and balanced framework is put in place that considers the long term interests, not just the short term need to raise capital.

We have no particular view or expertise to comment on the financial treatment of asset disposal income.

Chapter 5 – Financial Sustainability and Risk Management under a route level determination

We seek clarification how the framework for the FNPO Route and the NSO will be set up.

We support the approach of allocating risk to the party who can best bear it. However we note that the scale and financial position of freight operators means that they are unable to bear any greater degree of financial risk. Generally operators will be less able to bear risk than Network Rail. As such proposals that transfer risk to operators should be avoided.

Given the importance of access charge stability to freight operators and customers, we do not support an ability to re-open levels of access charges during the Control Period.

Chapter 6 - Financial Incentives for CP6

We agree that there should be an appropriate link between staff incentives, and the scorecard and Strategic Business Plan objectives. Any such link should incentivise cross route outcomes as well as local measures.

Chapter 7 – Financial Performance Assessment for CP6

Network Rail should as a base line maintain the network in a proper condition for the movement of freight, including maintaining capability (route availability, gauge, length and speed). Any variances should be consulted through the Network Change process. The Network Change process could be improved by including financial information on the options that have been considered. This would help Network Rail in seeking support for any changes that can be justified.

Network Rail should identify opportunities to make cost savings and effiencies, working closely with the freight operators. Network Rail and the freight operators have previously developed ideas for a Freight Efficiency Benefit Sharing (FEBS) scheme, which could replace the CP5 Route Efficiency Benefit Sharing scheme, that has been opted out of by all freight operators. The FEBS scheme is more targeted and identifies specific areas where savings could be jointly identifies.

The efficiency assumptions that are set by ORR play a critical role in the level of track access charges paid by freight operators, and have to be considered alongside the inflationary index.

The ORR monitor indicates that Network Rail is unlikely to achieve the efficiency target set for CP5, and we are concerned about the impact this could have on future access charges, which will directly impact on the future viability of rail freight. It would improve transparency and provide focus if Network Rail's Strategic Business Plans included clearer and more specific plans for delivering effiencies for CP6.

We do not support a re-opener on the efficiency measures during the control period if that fed through into access charges. The need for a stable framework to support investment would be undermined by such an approach.

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Response to ORR's first consultation on the financial framework for the 2018 periodic review of Network Rail (PR18)

This pro-forma is available to those that wish to use it to respond to our consultation. Other forms of response (e.g. letter format) are equally welcome.

Please send your response to pr18@orr.gsi.gov.uk by 13 April 2017.

Full name	Charlie Hodgson
Job title	Managing Director, Rail Development
Organisation	Go Ahead Group
Email*	
Telephone number*	

*This information will not be published on our website.

Govia is one of the leading rail operators in the UK and is a joint venture between the Go-Ahead Group (65%) and Keolis (35%). Govia has experience running complex and challenging rail operations; currently running three major rail franchises: GTR, Southeastern and London Midland. Govia is the UK's busiest rail operator, currently providing around 35% of all passenger journeys. As a key provider of rail services, we welcome the opportunity to respond to the ORR's consultation regarding the 2018 periodic review.

This response represents the views of the three Govia-owned Train Operating Companies as well as Go-Ahead Group plc. Go-Ahead has contributed to the industry response prepared by RDG and this is intended to supplement that response.

Chapter 1: Network Rail's business structure and funding We invite stakeholders to comment on the questions set out at the end of the chapter and/or provide any other comments they consider relevant.
■ Do you have any views on our proposed use of a building block approach to calculate Network Rail's revenue requirement at route level for CP6? We support the approach to a building block approach to calculating the revenue requirement. The move towards more autonomy for routes through devolution provides operators with a greater degree of partnership working through our alliances and the enablement of decisions at a local level. The revenue requirement for routes and the national system operator supports the local agenda and motivates local discussion on Network Rail's performance against the funding received to either hold Network Rail to account or work with Network Rail on alternative solutions.

Chapter 2: Financial policy issues We invite stakeholders to comment on the questions set out at the end of the chapter and/or provide any other comments they consider relevant.
■ Have we identified all the important financial issues that need to be addressed in PR18? We consider the right elements have been incorporated for review in PR18.It is important to learn the lessons from CP5 specifically around increasing costs and underperformance related to deferral of renewals with the need to assure financial sustainability. The associated risks which have historically been managed by the curtailment of activities.

Chapter 3: Enhancement funding, a five year control period, the building block approach, and the cost of capital for CP6 We invite stakeholders to comment on the questions set out at the end of the chapter and/or provide any other comments they consider relevant.
■ Do you have any views on the ways that enhancement projects should be financed/funded in CP6? The approach to enhancements funding is supported with the encouragement of third party investments, funding by train operators as well as the direct funding by Governments. This provides for a more flexible approach though funding by train operators, however consideration would need to be given to residual value issues to enable alignment with asset lives and

franchise terms.

- Have we identified all of the possibilities for private sector partnerships and financing/funding arrangements that might arise?

Headroom in the loan agreement would be an option which could be solely secured for enhancements.

- What do you consider should be done to address cross-border funding/benefit mismatches with respect to enhancements?

The benefits received by operators from cross border enhancements should be taken into consideration for any future reviews of charging arrangements. This would seem to be the most appropriate mechanism given the benefit received by other operators of such an investment.

- Do you agree with the reasons we have given for the continuation of the five year control period and the building block approach for calculating Network Rail's revenue requirement?

The structure of five year control periods is one we support as it provides certainty over a duration of time for operators in terms of access charging arrangements as well as the basis for the funding of operations, maintenance and renewal. This allows Network Rail and operators through its alliances to work towards performance improvements as well as the certainty of funding for enhancements through Network Rail debt and the associated RAB additions. It also provides for the single till approach which considers Network Rail's full range of activities during the calculation of its regulatory settlement.

- Which cost of capital approach do you think should be used for Network Rail in CP6?

It would appear that the choice of cost of capital approach would have no overall effect on government borrowing. However the approach we deem to be most appropriate is the ring fenced fund approach. This provides certainty for ring fenced revenue for delivering specified HLOS outputs. This allows operators to plan with Network Rail on the delivery of those outputs and allowing joint decision making on the deferral of those outputs should there be cost shocks during the control period.

- Have we identified all of the issues relevant to the choice of cost of capital approach?

It is not clear how this would work for schemes that are specified outside of the HLOS/after the start of CP6.

Chapter 4: Other financial issues for CP6

We invite stakeholders to comment on the questions set out at the end of the chapter and/or provide any other comments they consider relevant.

- Do you think we should change our approach to the calculation of amortisation allowances in light of:
  - Network Rail's reclassification and the likelihood of a fixed borrowing limit in CP6?
  - the possible developments to enhancement financing/funding set out in chapter 3?
  - financial sustainability requirements?

We can only comment on the existing approach which would include an incremental uplift for financial sustainability purposes. We would need to understand more on the proposal for increasing amortisation allowances to reflect some enhancements are used up over a finite period or using a fixed asset life assumption to calculate allowances.

Either of these proposals it would seem mean that Network Rail's borrowing would reduce though the revenue requirement would increase by an equivalent amount. This would appear to be largely a decision for the government to decide on the affect on cash outflows.

- Do you think we should include an 'early start' mechanism in the PR18 process?

An 'early start' mechanism should be retained for CP6 allowing schemes to go ahead of the determination particularly where renewals and enhancements provide an overall benefit in terms of performance and capacity early on.

- Do you consider we should make any changes to our PR13 policies on inflation?

Consideration should be given to the alignment of inflation and indexation timings between track access agreements, franchise agreements and regulated fares.

- Do you have any views on the corporation tax and VAT issues we have set out?

We note the approach to corporation tax and VAT issues to remain the same as PR13, should an alternative method be considered we would need to review at that point.

- Do you have any views on how we should treat the proceeds from disposals that
  - are made in the normal course of business?
  - are made in response to the Hendy report?

The proceeds from asset disposals should be treated as Other Single Till Income as Network Rail retains some of the benefit of additional income, therefore it should be deducted from the revenue requirement.

- Do you think we should make any changes to the treatment of traction electricity, industry

- costs and rates that we applied at PR13?

The approach used in CP5 is appropriate and the adjustments made for those costs that are not controllable. However, if a different approach is adopted we would want our operators to be held harmless to such an affect through our Franchise arrangements.

- Do you have any views on the use of any outperformance amounts that arise during CP6?

Financial outperformance by Network Rail should be utilised by funding investments that will reduce costs and provide a benefit for passengers.

Chapter 5: Financial sustainability and risk management under a route level determination

We invite stakeholders to comment on the questions set out at the end of the chapter and/or provide any other comments they consider relevant.

- Do you think we have identified the important financial risks applicable to Network Rail in CP6 and that the main risk relates to expenditure levels?

We agree that Network Rail should be exposed to variances in traction electricity, industry and costs and rates which are controllable by Network Rail. Reopeners for exceptional risk that could not have been realised at the point of the determination should be considered though the materiality of such a scenario would need to be prescribed further so that the reopener provisions are clear.

- Do you agree with the approaches we have identified for managing expenditure level risks?

The approach to managing financial risk through risk modelling to understand ranges of expenditure and the consideration of financial reserves seem sensible, though this is mainly a question of funding. From an operator perspective we would be more interested on the proposals around developing incentives and financial performance assessment mechanisms so that issues are identified earlier and there is a challenge on performance. This supports the plans for devolution of Network Rail and motivates accountability at route level which is more localised to operators.

- What protocols do you think might be necessary to govern the reallocation of financial resources between routes during CP6?

Devolution provides autonomy to the routes and is welcome by operators specifically the approach to calculate the revenue requirement from route level upwards. This provides the route the ability to manage the risk for their business. This could be hampered by the proposal for routes using a centralised business support service to manage aspects of budgetary risk control. The consideration as described of a strategic reserve seems a more pragmatic approach reducing the potential requirement for reallocations between routes.

- Do you think that the level of Network Rail's debt is a financial sustainability concern?

Network Rail's long term financial stability is a concern and should be reflected in the PR18 determination as a road to improvement. However, this does need to be supported by Network Rail by more effective forecasting and a realistic view of what needs to be achieved in the 5 year control period and the supporting finance required. The encouragement and mechanisms to support third party investment can go some way to be reducing the debt, however controls need to be rigorous in managing all aspects of the operation. We therefore welcome the proposal for financial performance assessment mechanisms as this allows further scrutiny from an industry perspective.

- Do you consider that any changes will be needed to financial licence conditions or re-opener provisions?

We do not consider than any changes will be needed to financial licence conditions or re-opener provisions.

Chapter 6: Financial incentives for CP6

We invite stakeholders to comment on the questions set out at the end of the chapter and/or provide any other comments they consider relevant.

- Should we retain the RAB roll forward incentive mechanism for CP6 – could it be improved?

We do not have a strong view on the RAB roll forward incentive mechanism. The consultation describes this as a mechanism which is complex and not understood widely. This suggests that this does not influence the managers responsible for operational and expenditure decisions. The objective of the mechanism is also weakened by the financial structure of Network Rail.

- Could we develop incentives linked to Network Rail's route scorecards?

The linkage to staff remuneration we believe incentivises Network Rail to achieve the targets it has agreed with us. It is unclear on the proposal to link this to financial incentives for Network Rail and how scorecard outcomes would directly be taken into account for implementation of such a proposal.

- Should we develop the spend to save mechanism for CP6?

It would seem appropriate to develop the spend to save mechanism for a company the size of Network Rail. The parameters would need to be understood to see how this incentivises Network Rail especially during the approach to a new control period where Network Rail may invest more than it can save within the timeframe of control periods.

Chapter 7: Financial performance assessment for CP6

We invite stakeholders to comment on the questions set out at the end of the chapter and/or provide any other comments they consider relevant.

- Have we identified the key limitations and possible improvements for financial performance assessment in CP6?

We would want to see a more simpler and transparent approach in CP6 which operators can understand around the adjustments to take account of output and expenditure timing as well as the deferral/acceleration of programmes. This is particularly important with route level regulation and localised plans.

- If the RAB roll forward incentive mechanism is retained, should we continue to apply the 25% adjustment to FPM?

There is no evidence presented to suggest that the 25% adjustment is proportionate or has had an impact on efficiencies of delivery. As per our previous response we do not have a strong view to retain the mechanism.

- Have we identified the key principles that should apply to the assessment of Network Rail's financial performance?

We agree with the principles described in 7.29 of the consultation on the 'principles for assessing financial performance'. We would also include the element of route scorecards and Network Rail's performance against REBs as this provides clarity around localised performance which impacts on operators.

- Should financial performance measures be treated as a regulated outputs or indicators in CP6?

We would support financial performance measures treated as regulatory outputs as opposed to indicators in CP6. This holds Network Rail more to account as it does currently in operational performance. However we would want to understand more on the development on the incentive/motivational effect that could be achieved as well as how outputs could be set and potentially enforced at route level.

- Should we introduce mechanisms to update efficiency assumptions during the control period?

It would be appropriate to update efficiency assumptions using actual outturn information for 2018-2019 as opposed to the forecast position to be used for the October 2018 determination. This provides a more accurate mechanism for setting efficiency benchmarks for CP6. Given that the proposal suggests this does not affect the Network Rail revenue requirement there appears to be no reason to object to this proposal.

- How could we develop our FPM reporting to reflect our move to route level regulation?

The Annual Efficiency and Finance Assessment which is published by ORR should be disaggregated by route. This allows operators to compare route financial performance in a more meaningful way. Should a mechanism such as REBs or similar be retained the information will support how operators and Network Rail work together.

- Would it be helpful to provide more context for Network Rail's financial performance in our annual reporting, by comparing the performance of the wider railway industry to the assumptions in the governments' SOFAs?

Theoretically we agree that at a high level the effect of Network Rail's expenditure decisions should be realised industry wide therefore a comparison would be feasible. However we would want to understand the proposal fully.

Heathrow Southern Railway Ltd

Heathrow Southern Railway is a private sector project to construct 12.5 kms of new rail infrastructure linking the network owned by Heathrow Airport Ltd at the west end of Terminal 5 station with Network Rail infrastructure at two points, north of Chertsey on the Weybridge - Virginia Water line and between Staines and Wraysbury on the Staines – Windsor line.

The HSR infrastructure will allow operation of new train services, particularly but not exclusively:

- Basingstoke/Guildford – Woking – Heathrow - Paddington, and
- Waterloo – Clapham junction – Richmond - Staines – Heathrow.

In addition to providing southern rail access to Heathrow, the services via Woking would provide an attractive alternative route from Woking and beyond to central London, relieving overcrowding on the South Western Main Line, and potentially providing a “one stop” interchange with HS2 at Old Oak Common.

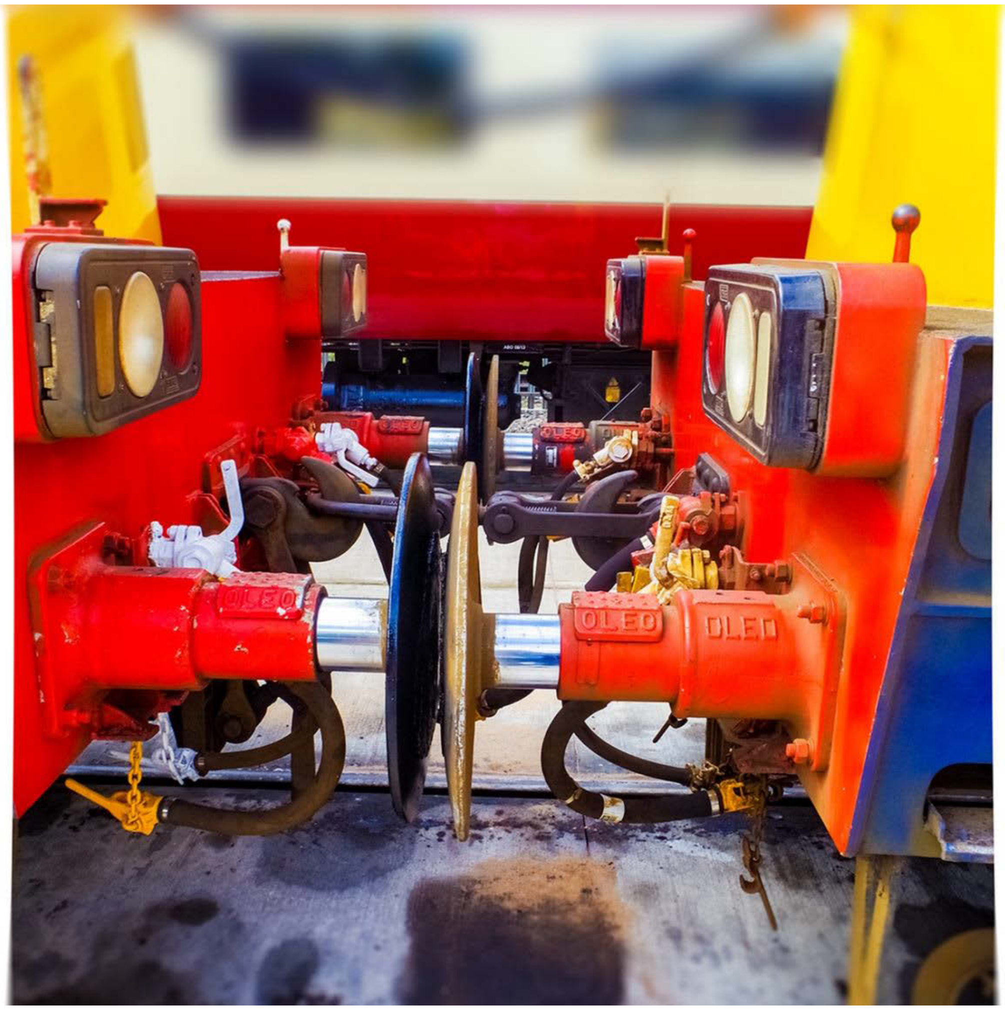
HSR Ltd is now actively taking this project forward, with significant engagement with the Department for Transport and Network Rail. We envisage that HSR will retain ownership of the new infrastructure, and contract out maintenance and renewal. However, HSR will be operated as an integral part of the national network, and would therefore be signalled and controlled by Network Rail.

In taking this project forward, HSR Ltd needs a regulatory framework for Network Rail which delivers:

- Certainty in terms of costs and timescales for all necessary Network Rail works to deliver the scheme (eg the junctions with the Network Rail routes and integration of signalling control and electrification systems).
- Cost-effective delivery of all work carried out by Network Rail.
- Regulated, efficient cost for control and operation of the HSR network when competed.
- Positive facilitation of this and other third party investment projects.
- Transparent and proactive relationships with Network Rail.

Consultation on the financial framework for PR18

IOSH response to the Office of Rail and Road consultation



Submission

10.04.17

iosh

Introduction

The Institution of Occupational Safety and Health (IOSH), the Chartered body for health and safety professionals, registered charity and international NGO, welcomes this opportunity to comment on this important consultation on the financial framework for PR18 by the Office for Road and Rail (ORR).

The content for our submission has been provided by members from the IOSH Railway Group committee. This Group is made up of over 1,500 professionals with a common interest of rail as a specialist area. The Group offers a range of networking and professional development opportunities.

In brief, the aims of the IOSH Railway Group include:

- supporting UK and international members in developing and sharing professional competences relating to rail industry matters
- providing technical support to IOSH
- working closely with IOSH Branches, Groups and Forums, industry regulators, representative bodies and relevant professional bodies

Specifically, its activities include:

- holding and supporting networking and industry events
- reviewing and commenting on key issues
- promoting best practices

In the response that follows, we provide general comments, a supporting reference section and further information about IOSH.

IOSH response

Following our input to the PR18 Consultation on Strategic Business Plans and ORR's acceptance of our views on reasonable practicability, we would like to offer further advice on how health and safety can best be handled in the PR18 process in the context of the financial framework.

The ORR, in common with the Department for Transport (DfT), as an employer, is a duty holder under the Health and Safety at Work etc. Act 1974. In Section 3 of the Act it states, "*It shall be the duty of every employer to conduct his undertaking in such a way as to ensure, so far as is reasonably practicable, that persons not in his employment who may be affected thereby are not thereby exposed to risks to their health or safety*."[1]

The structure of the financial framework, the incentives and criteria ORR use to make investment decisions are part of the way it conducts its undertaking. The decisions ORR makes could affect the health and safety of those not in its employment. This is recognised in the consultation document, "*Choices around the financial framework for PR18 matter because, taken together, they will impinge* *on the: …effective renewal of rail infrastructure and its impact on asset performance and safety…*"[2] We agree with this and advise that decisions about the financial framework cannot be taken in isolation, however, we judge that the potential impact on health and safety is not fully addressed in the financial framework proposals.

In our professional view, we consider it reasonably practicable for ORR to take a holistic view of the totality of the impact of PR18 on Network Rail performance and to use system safety, alongside capability and efficiency, as criteria for judging the design of the financial framework.

In this context, we offer the following professional advice.

1. The PR18 process is analogous to an employer securing products and services from an outside supplier. In this case, the expectation is that the host body (ORR and DfT), would have an 'intelligent customer capability'[3] to assure itself that the health and safety aspects of the proposals are satisfactory. In those cases where the hazards and risks are significant, this would require a structured process of analysis and assessment by competent persons. This capability may be available within the ORR regulator though this may need careful management. Suitable checks and balances to avoid conflicts of interest may be necessary, as both the economic and safety regulator report in the same management line to the same government department.

2. The design of financial incentives, (e.g. to make savings on capital expenditure) should be considered in the context of the whole management process to ensure they are suitable and avoid negative or perverse incentives for health and safety.

3. The availability of funds (or affordability) within 'statement of funds available' (SoFA) is not a relevant component of making reasonably practicable decisions.[4]

4. Submissions by various 'routes' or parts of Network Rail should be seen together to avoid decisions impacting adversely on health and safety issues of other routes.

5. The complex nature of the interactivity between different types of activity is acknowledged, and the potential impact of deferrals on maintenance requirements is recognised, (paragraph 2.2 refers). However, the implications of reliability engineering, (and the 'bath tub curve'), suggest that assets near the end of their useful life usually display increasing failure rates and greater diversity in failure types. In this case, increasing maintenance activity may not always control the risk to the same standard achieved by the original assets.

In conclusion, we recommend that further thought be given to clarifying the 'intelligent customer capability' so that it is transparent to all parties how the ORR will discharge its duties under Section 3 of the Health and Safety at Work etc. Act 1974.[1]

References

1. *Health and Safety at Work etc. Act 1974 (c.37)*. Available at: www.legislation.gov.uk/ukpga/1974/37/contents (Accessed 10 April 2017)
2. ORR. *Consultation on the financial framework for PR18*. London: ORR, 2017. http://orr.gov.uk/__data/assets/pdf_file/0020/23960/pr18-consultation-on-the-financial-framework-2017-01-26.pdf
3. Health and Safety Executive. *Human factors: Intelligent customer capability* web page. HSE, 2017. www.hse.gov.uk/humanfactors/topics/customers.htm (Accessed 10 April 2017)
4. ORR. *RSD Internal Guidance: Assessing whether risks on Britain's railways have been reduced SFAIRP (RIG-2009-05)*. London: ORR, 2017 (Dealing with costs and affordability, p.3). http://orr.gov.uk/__data/assets/pdf_file/0007/2140/rig-2009-05-assessing-whether-risks-on-britains-railways-have-been-reduced-sfairp.pdf (Accessed 10 April 2017)

About IOSH

Founded in 1945, the Institution of Occupational Safety and Health (IOSH) is the largest body for health and safety professionals in the world, with around 47,000 members in over 130 countries, including over 13,000 Chartered Safety and Health Practitioners. Incorporated by Royal Charter, IOSH is a registered charity, and an ILO international NGO. The IOSH vision is:

"A world of work which is safe, healthy and sustainable"

The Institution steers the profession, providing impartial, authoritative, free guidance. Regularly consulted by Government and other bodies, IOSH is the founding member to UK, European and International professional body networks. IOSH has an active research and development fund and programme, helping develop the evidence-base for health and safety policy and practice. Summary and full reports are freely accessible from our website. IOSH publishes an international peer-reviewed journal of academic papers twice a year titled *Policy and practice in health and safety*. We have also developed a unique UK resource providing free access to a health and safety research database, as well other free on-line tools and guides, including resources for business start-ups; an occupational health toolkit; and a risk management tool for small firms.

IOSH has 41 Branches worldwide, including the Caribbean, Hong Kong, Isle of Man, Oman, Qatar, the Republic of Ireland, Singapore and UAE, 17 special interest groups covering aviation and aerospace; broadcasting and telecommunications; construction; consultancy; education; environment; financial services; fire risk management; food and drink; hazardous industries; health and social care; offshore; public services; railways; retail and distribution; rural industries; and sports grounds and events. IOSH members work at both strategic and operational levels across all employment sectors. IOSH accredited trainers deliver health and safety awareness training to all levels of the workforce from shop floor to managers and directors, through a professional training network of more than 2,000 organisations. We issue around 180,000 certificates per year.

For more about IOSH, our members and our work please visit our website at www.iosh.co.uk.

Please direct enquiries about this response to:

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John Larkinson
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Office of Rail and Road
One Kemble Street
London
WC2B 4AN

13 April 2017

Dear John,

cc. Stephen Glaister, Joanna Whittington, Richard Carter (DfT), Nick Joyce (DfT), Emma Fraser (HMT)

CONSULTATION ON THE FINANCIAL FRAMEWORK FOR PR18

I am writing in response to ORR's consultation on the financial framework for the 2018 Periodic Review (PR18), which was published on 27th January 2017. I hope that you find our response helpful in informing the development of the CP6 financial framework.

Setting Network Rail's financial framework is an important part of the periodic review process. The financial framework needs to give Network Rail both the stability and flexibility to efficiently run its business to deliver for its customers and to enable it to attract third party investment, without investors automatically seeking explicit government guarantees.

Since ORR's last periodic review in 2013, there have been fundamental changes to how the industry is funded and governed. This started with the company's reclassification to the public sector as an arm's-length body in September 2014. In July 2016, we published our Transformation Plan, which set out how we intend to look and behave like a private sector business in the context of these recent changes. We want to be relentlessly customer focused, be cost competitive and efficient, attract third party investment, and modernise the culture within the company.

A key challenge for CP6, which is identified in our Transformation Plan, is how we continue to invest in the GB railway to meet the needs of our customers. This is likely to be more difficult than it has been in the past, due to constraints on public finances. Therefore, we also need to make use of private capital to improve our infrastructure. This means finding commercial mechanisms to reward investors and also attracting funding from others that benefit directly from improved transport links, such as property developers. The CP6 financial framework can play a key role in addressing this challenge.

Our priority for the CP6 financial framework is that it supports the delivery of our Transformation Plan by:

- providing stability, through the five-year control period;
- enabling third-party financing and funding;
- supporting route devolution;
- enabling the company to manage financial risk or, where appropriate, transfer it to parties better able to manage that risk;
- taking a more flexible approach to the specification and delivery of outputs;

- supporting changes in funding and financing arrangements for future enhancements; and
- allowing for a balance sheet restructure of some, or all, of DfT's current loan so that our financing costs and financial structure are more in line with other regulated utilities.

We welcome ORR's support, in its consultation document, for a number of our priorities for the CP6 financial framework.

ORR is clear that the **five-year funding settlement**, and the certainty and stability that it provides, remains important for CP6. We agree that without a long-term settlement, we are likely to have to take decisions that do not represent longer-term value for money. For example, stable workbanks allow our suppliers to plan their own schedules, with a reasonable degree of certainty, avoiding peaks and troughs in their work, which can lead to higher costs. Equally important to Network Rail is the flexibility to move spend between years within the control period to minimise costs and allow routes to manage their businesses without unnecessary interference from the centre.

ORR's consultation also provides support for our **route-based business model** and our efforts to seek **greater third party financing and funding** in CP6. Consistent with this, we welcome that ORR has kept open a range of options for calculating **Network Rail's cost of capital** for CP6. We think that ORR should consider adopting a similar funding approach to that used in CP4 to allow Network Rail sufficient funding to provide a return to third party investors during CP6.

We support ORR's view that Network Rail needs flexibility to allocate financial resources between routes to manage risk and exploit opportunities. If Network Rail is not able to **manage risk as a single company** and instead, for example, has ring-fenced risk allowances for each route, then this is likely to increase industry costs compared to pooling risk across the business. A significant financial risk for the company is general **inflation** in its cost base. We agree with ORR's emerging view that it would not be appropriate to index our revenues by CPI in CP6. We think that RPI is a more appropriate measure of inflation for the company as a significant proportion of our cost are linked more closely to RPI, including staff costs and financing costs on our index-linked debt.

We agree that it is important for ORR to consider the **long-term financial sustainability** of Network Rail as part of PR18. Network Rail's debt and financing costs will reach what could be considered to be disproportionate levels in CP6 without changes to its future funding and financing structure. Whilst this is largely an issue for our funders, we would welcome ORR's support for changes to look more like a normal private sector regulated utility (e.g. through a **capital restructure**) to improve our ability to attract greater third party investment.

We do not agree that our **financial performance** should be classified as a regulated output in CP6. Our route customer-focused scorecards will form the basis by which we will monitor and report on our financial performance for CP6. We do not think that a change to the status of financial monitoring measures for CP6 will further increase their importance.

We consider that there are two important issues that ORR has not sufficiently addressed in its consultation. We would welcome further discussion with ORR on these issues during PR18:

- Network Rail needs to be profitable in CP6 to improve its attractiveness to external investors (e.g. so third-party investors do not automatically seek government guarantees) and to prospective employees. ORR's consultation document refers to

profitability in relation to corporation tax but it does not address the issue more generally.

- Network Rail's exposure to **interest rate risk in CP6** could be a significant issue. For example, if interest rates increase by one percentage point then our CP6 financing costs could increase by c.£1.5bn over CP6. However, these money flows are largely circular as the majority of our debt is owed to DfT so higher interest payments flow back to government.

We have set out the key points of our response above. The annex to this letter provides Network Rail's comments on each of ORR's detailed consultation questions.

My team and I are keen to continue working with ORR throughout the periodic review process to develop an appropriate financial framework for Network Rail.

Yours sincerely,

Jeremy Westlake
Chief Financial Officer

ANNEX: NETWORK RAIL RESPONSE TO ORR'S DETAILED PR18 FINANCIAL FRAMEWORK CONSULTATION QUESTIONS

In this annex, we have set out our responses to the specific questions that ORR asked in its consultation document. The key points from our response below have been reflected in our covering letter.

Chapter 1	**Network Rail's business structure and financing**
1.1	Do you have any views on our proposed use of a building block approach to calculate Network Rail's revenue requirement at route-level for CP6?
	We agree that route revenue requirements should be based on the building block approach. This will require ORR to determine a wide range of income, expenditure and financial assumptions at a route-level. This includes the allocation to routes of centrally incurred costs, including financing costs, as well as any allowances for risk and uncertainty that Network Rail will face in CP6. It is also important to consider how the approaches to calculating CP6 funding for the Network System Operator (NSO) and Freight and National Passenger Operator (FNPO) route interact with the revenue requirements of the geographic routes. We will continue to work with ORR to develop the approaches to funding in CP6 for NSO and FNPO.
Chapter 2	**Financial policy issues**
2.1	Have we identified all the important financial issues that need to be addressed in PR18?
	ORR discusses a wide range of financial policy issues in its consultation. However, we think that it could give more attention to the following issues as part of PR18: <u>Profitability</u> We think that the CP6 regulatory settlement should provide a reasonable expectation of profitability for Network Rail during the control period. Network Rail is an arm's-length body and a separate legal entity so it is important that we retain the commercial and operational freedom to manage GB rail infrastructure within regulatory and control frameworks. Therefore, from an external perspective (e.g. investors, media and employees) we need to look and act like other private sector regulated utility businesses, which includes being profitable. Network Rail needs to be profitable in CP6 to improve our attractiveness to external investors and to prospective employees. Although ORR refers to profitability when discussing corporation tax, it does not adequately address this issue. <u>Financial sustainability</u> ORR asks whether the level of Network Rail's debt is a financial sustainability issue but it does not appear to be supportive of the significant changes (e.g. capital restructure) that we consider will improve our financial sustainability and, therefore, improve our ability to attract greater third party financing and funding. A balance sheet restructure of some (or all) of DfT's current loan to Network Rail is a realistic way to strengthen our balance sheet and reduce our financing costs (and revenue requirement). Alternatively, to enable Network Rail to pay down existing debt over time without a restructure, we would need to generate billions of pounds of surpluses / profits each year (c.£3bn p.a.), above our day-to-day expenditure. Alternatively, receiving more money through direct grant payments from government rather than through loans could also help to address the size of our debt. At 31 March 2017, c.£20bn (increasing to c.£31bn by CP5 close) of Network Rail's debt is made up of loans from DfT. These are in effect 'inter-company' loans as they cancel out when Network Rail's assets and liabilities are consolidated as part of the whole of government accounts. Therefore, we plan to work with government to explore the option of carrying out a debt-to-equity conversion of our DfT loan to reduce our debt to a more sustainable level. Any change in

	Network Rail's debt is likely to be accompanied by an adjustment in Network Rail's RAB, meaning that there should be limited costs for government. Interest rate risk exposure Network Rail's exposure to interest rate risk in CP6 is discussed briefly in ORR's consultation but this could be a significant issue for us in CP6. Network Rail's cash financing costs are a significant proportion of the company's total cost base (£1.4bn, or 13% of total expenditure, in 2015-16). Therefore, any change in interest rates or the level of our debt can have a significant impact on Network Rail's profitability and financial position. The main elements of financing costs risk, in addition to inflation risk, are: • **interest rate risk**: the risk that the interest rate on Network Rail's loans vary from the rates assumed by ORR in its determination; • **volume risk**: the risk that Network Rail needs to borrow more money than ORR assumed in its determination; and • **timing risk**: the risk that the timing of Network Rail's borrowing differs from ORR's determination assumptions. The least controllable of these three risks for Network Rail is interest rate risk. Prior to reclassification, Network Rail was able to manage interest rate risk by entering into derivatives (forward-starting interest rate swaps) with banks to fix (or 'hedge') the interest rate the company would pay on that part of its borrowing. However, Network Rail's Framework Agreement and Loan Agreement prohibit the company from entering into new derivatives unless DfT consent (in practice, HM Treasury consent would also be required). If we do not have sufficient funding to cover interest rate risk in CP6 then, to the extent that we cannot manage within any available headroom, an increase in interest costs could impact on the operational railway as may have to cut operational spending. For example, if interest rates increase by one percentage point then our CP6 financing costs could increase by c.£1.5bn over CP6. However, interest payments to DfT are circular, as higher interest payments flow back to government and so are broadly neutral from a funding perspective (although we note that this is not necessarily the case for Transport Scotland). During PR18, we are working with ORR and DfT to explore the treatment of interest rate risk in ORR's PR18 determination and during CP6. Some of the options we are exploring relate to the terms of Network Rail's loan agreement, whereas others relate to the CP6 financial framework. For example, in CP6, DfT could choose to provide us with a pre-determined fixed borrowing rate for CP6. This would significantly reduce the volatility of our financing costs by transferring the risk to government, which is better placed to manage it. Alternatively, ORR's determination could provide a mechanism that allows Network Rail's allowed revenues (and therefore charges/grant) to vary to reflect material changes in forecast financing costs during the control period. PR18 determination as a package ORR's determination of Network Rail's outputs and funding is a package. It is important that the elements of this package are considered together and not in isolation because decisions made in one part of the determination (e.g. financial framework) can have significant impacts on other parts of the determination (e.g. outputs framework). We would like to understand how ORR will assess the overall impact of its PR18 determination. Freight and National Passenger Operator (FNPO) / Network System Operator (NSO) ORR's approach to calculating funding for the FNPO route and NSO is an important part of the financial framework. We understand that ORR will issue a route regulation consultation

	document later in the year. It is important that the discussions relating to the approach to FNPO and NSO are joined-up with wider financial framework policy development so that decisions across the framework are consistent. <u>Other Single Till Income</u> In PR13, Other Single Till Income (OSTI) includes income from freight and open access train operators, as well as station charging income. We think that ORR should review the categories of income included in OSTI to consider whether it is still appropriate to include regulated access charges. Our understanding of OSTI is that it should reflect income that is received from 'non-regulated' activities. Therefore, we propose removing regulated access charges, set as part of the periodic review, from OSTI and including these in the net revenue requirement.
Chapter 3	**Enhancement financing/funding, a five year control period, the building block approach, and the cost of capital for CP6**
3.1	Do you have any views on the ways that enhancement projects should be financed / funded in CP6?
	The terms funding and financing are often used interchangeably within the rail industry. For the avoidance of doubt, we use the following definitions: • *Funding*: is the way in which the initial construction costs and any associated financing costs (i.e. interest costs and equity return) are recovered from users or funders. Funders and customers are paying to receive a service or specific outputs, rather than getting their money back. • *Financing*: is the source of initial money used to deliver an enhancement project (i.e. investors that want their money back with a return on their investment). Currently most enhancements to the network are financed through Network Rail borrowing. Prior to reclassification, Network Rail borrowed from the capital markets but since reclassification, Network Rail borrows only from DfT under the terms of its loan agreement. Historically, Network Rail's revenue requirement has not covered funding to pay down the debt that it has incurred to pay for enhancements. Total debt at the end of CP5 is forecast to be c.£54bn. The revenue requirement only covers the interest costs on the debt. This means that, without changes to our funding approach, our debt levels will continue to increase as we undertake further enhancements for our funders. Most enhancement projects that we deliver have positive business cases but a large proportion of these benefits accrue to parties outside of the railway, i.e. they do not generate additional income for the railway through fares but instead they produce outputs which deliver wider societal benefits. For example, enhancements may improve connectivity between towns and cities or reduce journey times, which could support regeneration. With a significant proportion of the benefits of enhancements being societal, as our debt increases we will become increasingly reliant on grant income from governments to cover our costs (including increasing interest costs). To address this issue we think that new enhancements that primarily deliver societal benefits should be funded on a cash basis by both DfT and Transport Scotland. As a company, we are also seeking to recover greater cash contributions from the third parties that benefit from enhancement schemes. For example, this could include property developers, local authorities and train operators paying towards these costs, commensurate with the benefits they get from the scheme. The process that allows third parties to contribute to schemes that they benefit from is well-established but we are pursuing this more pro-actively than before as part of our route devolution plans. In CP6, we expect there to be a more incremental approach to specifying and funding

	enhancements. Therefore, decisions about the size and terms of any loan agreement and the assessment of the affordability of the HLOSs need to recognise that it is likely that there will be additional enhancement spend during CP6 that is not included in the determination. Network Rail needs to have access to sufficient funding or financing during the control period to deliver enhancements under an incremental approach. This could be achieved either through making an allowance within the borrowing limit for future schemes to draw down upon as they are developed, or by making adjustments to the borrowing limit as new schemes are agreed (the terms of the current loan agreement allow for such adjustments). These options are not mutually exclusive and both mechanisms could be used during CP6. ORR should be mindful when setting the CP6 financial framework that a more incremental approach to funding and specifying enhancements may affect the ability for Network Rail to develop a fully integrated control period delivery plan. This could increase Network Rail's costs and create additional risks for project delivery in CP6.
3.2	Have we identified all of the possibilities for private sector partnerships and financing/funding arrangements that might arise?
	ORR's consultation document refers to enhancement partnerships and equity investment. However, DfT has asked Network Rail to consider the potential for private financing for all proposed future enhancements. Therefore, the regulatory framework should also support third-party debt financed schemes. For example, government-specified schemes could be delivered as project finance schemes where private sector companies finance, deliver and possibly operate and maintain the new infrastructure.
3.3	Which aspects of the financial framework do you think might be relevant to third party/private sector financial participation?
	We consider the following aspects of the financial framework to be relevant to third party financial participation: • Investment Framework – RDG is carrying out a review of the existing Investment Framework. RDG's initial review of the Investment Framework has identified a number of issues that it considers should be reviewed before the start of CP6. These include the potential to improve the existing documentation and also the need to better understand the status of template agreements. • Network Rail's financial sustainability – in discussions with potential investors, they have made it clear that they look to invest (e.g. through joint ventures and project finance initiatives) where companies have long-term capital structures that are appropriate for the business risk that those companies face. Our advisors have also said that whilst there could be significant demand for investment in rail infrastructure, the 'investment proposition' needs to be commercially attractive and sustainable. This includes having debt and RAB levels consistent with current operations and long-term, sustainable, solutions to how the societal elements of rail enhancements are funded. We discuss this issue in more detail in our response to Question 5.4. • Cost of capital – the size of expected return on their investment and risk of this return is a key issue that third parties will consider when reviewing an investment opportunity. • Development funding – in order to secure third party financing and funding, we will need to invest upfront to contribute to scheme development. The framework, and CP6 funding settlement needs to recognise the need for development funding. • Risk transfer – to deliver value for money for customers, funders, and taxpayers, there would need to be sufficient risk transferred to third party investors as part of any project.

3.4	What do you consider should be done to address cross-border funding/benefit mismatches with respect to enhancements?	
	We recognise that there are examples of potential enhancement projects where the direct financial benefits flow to parties that are not funding / financing the project. However, we consider this to be an issue for only a relatively small number of potential projects. We think that the solutions to this issue should be addressed by funders on a case-by-case basis. It is also important to recognise that a significant proportion of the benefits of rail enhancements accrue to parties outside of the railway (i.e. they deliver wider societal benefits). Therefore, when considering cross-border funding issues, the location of non-railway benefits of a scheme should also be taken into account.	
3.5	Do you agree with the reasons we have given for the continuation of the five year control period and the building block approach for calculating Network Rail's revenue requirement?	
	We think that it is critically important that we retain the stability of the five-year funding settlement. We agree with the reasons that ORR has set out in its consultation document for the importance of the five-year control period. Notably, a long-term funding settlement is important for Network Rail, even in the context of reclassification and an incremental approach to specifying and funding enhancements. In our view, a five-year settlement provides certainty for us to manage and improve the network. It allows us to make decisions that are best for the GB railway over the longer-term rather than focusing on short-term financial targets that are reset each year. Network Rail should be incentivised to make operating and investment decisions on a whole-life cost basis. To do this, Network Rail needs to be able to develop its plans with some degree of certainty about of the availability of funding and an understanding of the outputs it is expected to deliver. Our suppliers need certainty of workbanks so that they can plan their own schedules and avoid peaks and troughs in their work, which can lead to higher costs. Without a long-term settlement, we are likely to have to take decisions that do not represent longer-term value for money. A five-year control period also provides greater certainty and stability for stakeholders. It fixes the charges that train operators pay to use the network, which allows them to plan and invest in their own businesses with a reasonable degree of certainty, and it identifies the outputs that Network Rail is expected to deliver over that period. The stability of a five-year settlement is important for attracting third party financing and funding. Investors value stability and are likely to demand higher financial returns if they consider that there are significant risks to their investments from short-term planning, budgeting and decision making. The longer period of time that the regulator and funders agree to fix the level of funding and overall framework, the less risk there is for investors. In considering the importance of a long-term funding settlement, we have reviewed DfT's 'Case for creation of a new public body in place of the Highways Agency'[1], which set out DfT's view on the importance of a long-term settlement. It is clear that the move to a longer-term funding arrangement for Highways England was meant to provide it with stability so that it could operate more like a commercial organisation, within the strategic direction of government. We have provided two quotes from DfT's report to illustrate this view: • "… a consequence of strengthening the strategic plan for roads will be restricting the flexibility of ministers within the circa five-year cycles. Once the Highways Agency is replaced by an arm's-length company, it will be harder for ministers to micromanage delivery and the relationships of the company with stakeholders, in order to serve	

[1] Available at: https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/315772/ha-reform-business_case.pdf

	changing priorities." • "… the key to achieving this is to create an arm's-length body that has its own legal identity, so that it can operate and contract in its own right with a funding stream that is insulated from short-term change, while leaving government responsible for the overall strategic direction." A key aspect of the five-year control period is that Network Rail has flexibility to adjust its plans within the control period to respond to changing events. It is important that the flexibility of the current regulatory and funding framework is maintained so that Network Rail is not forced to make financial decisions to manage to annual budget limits, where these would not be value for money. This flexibility is also important for the success of route devolution. Routes need some flexibility in their plans so that they can get on with the day-to-day running of their business, without the need to liaise and deal with the demands of Network Rail's centre and governments.
3.6	Which cost of capital approach do you think should be used for Network Rail in CP6?
	To attract third party investors to take part in joint ventures, project finance initiatives or even route concessions, we need to be able to provide them with a reasonable return on their investments. The standard regulatory approach to providing investors a return on their investment is to allow the regulated company to recover a 'full cost of capital' through access charges. For example, in Control Period 4 (CP4), Network Rail was allowed to recover an estimate of its full cost of capital through its revenue requirement. However, in calculating the CP4 revenue requirement, ORR assumed that the 'equity surplus' was used, largely, to pay for capital expenditure during the control period. This effectively cash funded approximately one third of Network Rail's forecast enhancements expenditure in CP4. We think that ORR should consider whether it could move away from the CP5 'adjusted WACC' approach and adopt a similar funding approach to that used in CP4. This would provide Network Rail with sufficient funding to provide a return to third party investors during CP6. This approach is similar to Network Rail receiving Network Grant to pay for enhancements rather than using loans to finance them. ORR should provide a view in PR18 of whether the funding approach it takes for CP6 is likely to continue into future control periods. This would help to provide assurance to third parties that there will be sufficient funding to provide a reasonable return over the life of an investment. It should be noted that for a given level of activity, Network Rail will still need, broadly, the same amount of cash from Government to spend on the GB railway as any cash surplus / realised profit could be offset by a lower borrowing requirement and re-invested in the railway. However, the cost of capital approach will impact Network Rail's profitability, and, therefore, our corporation tax liabilities so we would need sufficient funding to cover this additional cost too.
3.7	Have we identified all of the issues relevant to the choice of cost of capital approach?
	We do not think that ORR has sufficiently considered the issue of profitability in CP6 to absorb risk and improve our attractiveness to external investors and prospective staff. We think that the CP6 regulatory settlement (e.g. through the allowed return) should provide a reasonable expectation of profitability for Network Rail during the control period. From an external perspective (e.g. investors, media and staff) we need to look and act like other private sector businesses, which includes being profitable.

Chapter 4	Other financial issues for CP6
4.1	Do you think we should change our approach to the calculation of amortisation allowances in light of: • Network Rail's reclassification and the likelihood of a fixed borrowing limit in CP6? • The possible developments to enhancement financing/funding set out in chapter 3? • Financial sustainability requirements?
	We think that ORR's current approach to amortisation, which is largely based on Network Rail's long-run renewals, is still appropriate in light of reclassification. However, the amortisation allowance needs to reflect a realistic view of the expected long-term renewals costs for Network Rail. It is important that Network Rail has sufficient funding to deliver the volumes of renewals activity to maintain or improve train performance and reliability levels. However, we do not think that it is necessarily appropriate to adjust for shortfalls in the allowed return, e.g. under an adjusted WACC approach, by increasing amortisation as this reduces the RAB and worsens our financial ratios. We think that it is more appropriate to adjust the allowed return, rather than the amortisation allowance, so that Network Rail receives an appropriate return to cover its financing costs and an allowance for risk in CP6. ORR should consider its determination as package and so its approach to amortisation should take account of decisions that are taken in other parts of the regulatory settlement. It is important that the elements of this package are considered together and not in isolation because decisions made in one part of the determination (e.g. financial framework) can have significant impacts on other parts of the determination (e.g. outputs framework). Where enhancements that are agreed outside of the periodic review process have a material impact on Network Rail's ongoing operating and capital expenditure, we would expect funders to address this during the control period, e.g. by increasing the size of Network Rail's loan agreement, so that Network Rail has sufficient funding for any additional spend that is required before the next periodic review.
4.2	Do you think we should include an 'early start' mechanism in the PR18 process?
	We agree with the principle of an early start mechanism for PR18. However, Network Rail's current funding constraints mean that it is unlikely that there will be any significant capital expenditure before the start of CP6 that would require this type of mechanism.
4.3	Do you consider we should make any changes to our PR13 policies on inflation?
	One of the most significant financial risks to Network Rail is general inflation in its cost base. For example, if outturn inflation in CP6 is one percentage point higher in each year of the control period than assumed in ORR's determination, this would represent c.£1.4bn of additional cash costs for Network Rail over the control period. This is due to the scale of Network Rail's spending and the cumulative impact of inflation over five years. There will also be c.£1bn of additional non-cash financing costs in this scenario from higher accretion on index-linked debt. In CP5, ORR allowed Network Rail's charges, grants and RAB to increase by general price inflation (based on the Retail Price Index (RPI)). ORR's approach reflected the fact that Network Rail cannot control general inflation risk but that it can influence input price changes. In PR13, ORR made no adjustments to our efficiency assumptions for input price inflation but did make an adjustment to reflect its view that Network Rail could do more to manage inflation risk on Network Rail's costs. We continue to think that Network Rail is like any other company and is unable to manage general inflation risk, without the ability to change our prices, and so our CP6 financial framework needs to reflect this.

	The inflation index that ORR uses for CP6 needs to reflect the price inflation that Network Rail faces, consistent with our existing contractual commitments. We think that RPI is the most appropriate index for CP6 as it most closely reflects increases in our costs. For example, we still have significant (currently c.£18bn) RPI inflation-linked debt outstanding. RPI is also the inflation measure that is used by other parts of the industry (e.g. fares increases) and any change in approach to indexation would need to consider the impact on the wider rail industry.
4.4	Do you have any views on the corporation tax and VAT issues we have set out?
	Network Rail is subject to Corporation Tax just like any other UK company. Therefore, ORR must take account of Network Rail's Corporation Tax expense during CP6 as this estimate feeds directly into the building blocks for Network Rail's revenue requirement. In previous control periods, Network Rail has been able to mitigate its corporation cash tax liability through the use of historic losses. However, proposed legislative restrictions to the availability of historic losses and changes to the deductibility of other previously qualifying expenses, announced in Budget 2016, may lead to an increase in Network Rail's corporation cash tax costs in CP6. As a public sector body, Network Rail is subject to restrictions in regards to tax planning that extend beyond those of a typical UK corporate. It is therefore important that ORR allows Network Rail to recover sufficient revenues to fund cash tax costs in CP6 to cover the potential increases.
4.5	Do you have any views on how we should treat the proceeds from disposals that • are made in the normal course of business? • are made in response to the Hendy report?
	ORR's consultation primarily refers to asset disposals included in the Hendy report[2]. Additionally, and not in scope for CP5, Network Rail is currently exploring new, innovative ways to fund investment in the railway in the years ahead, which could include disposing of core parts of the railway. We think that there are two main parts of the financial framework relevant to the treatment of proceeds from disposals: • *Adjustment of the RAB*. We think that disposals of assets that are not core to running the railway should be treated in the same way as they are for CP5 (i.e. recognise this income as OSTI) without adjustments to Network Rail's RAB. However, we do expect that any disposals in relation to core railway assets would require an adjustment to our RAB. • *Financial Performance*. The approach to the treatment of proceeds from asset disposals in CP6 will depend on whether Network Rail's financial performance is measured against the company's business plan or against the PR18 determination. Network Rail's business plan will include a forecast of proceeds from disposals, whereas ORR's determination may not, unless they were known at the time of the periodic review. Where the business plan is the basis for calculating financial performance, adjustments to any performance measure is less likely to be required because the forecast value of proceeds should be included in the baseline.
4.6	Do you think we should make any changes to the treatment of traction electricity, industry costs and rates that we applied at PR13?
	In PR13, ORR's review of the treatment of industry costs and rates was largely about how ORR treated underspend and overspend for financial performance measurement purposes. This was because there was an expectation that any overspend could be absorbed by the borrowing headroom in our debt-to-RAB limit.

[2] Available at: http://www.networkrail.co.uk/wp-content/uploads/2015/11/hendy-report.pdf

	However, given that we may again face a fixed borrowing limit in CP6, an important consideration is whether we have access to sufficient funds in CP6 to pay for any increases in these costs, above ORR's determination assumptions. <u>BTP and RSSB costs</u> Network Rail does not consider that it was appropriate for ORR to expose it to variances in BT Police and RSSB costs in CP5 and, therefore, strongly believes that it should not be exposed to variances in these costs in CP6. Our limited ability to influence these costs means that ORR's decision to expose us to them has negligible incentive properties and increases our exposure to what is largely an uncontrollable cost. We consider that these costs are very different from controllable support costs and thus should be treated differently. We strongly consider that a better and more equitable approach would be to treat them in the same way that ORR proposes treating the ORR licence fee and safety levy. Network Rail would still use its influence over the level of costs and it would still need to manage the financial consequences of any variations. <u>Licence Fee and Safety Levy</u> These costs are not controllable by Network Rail and thus any variance between forecast and outturn costs should be logged up/down in the next control period. We believe that BT Police and RSSB costs should be treated in the same way. We think that there is a case for reviewing whether it is appropriate to retain the role of the independent reporter in CP6. We propose that the desirability (or otherwise) or retaining independent reporters in the next control period is considered as part of a wider review of Network Rail's network licence. Should the independent reporters be retained, we think that these costs should be treated in the same way as the licence fee and safety levy because we do not think that we have sufficient control over the level of expenditure in this area. <u>Business Rates</u> Network Rail supports ORR's CP5 approach not to expose it to variations in business rates, subject to Network Rail being able to show that it has negotiated efficiently with the Valuation Office Agency. We are currently exposed to approximately £65m of additional cumulo rates costs in CP5 following the revaluation and it is important that in CP6, this risk, and cost risk associated with the other elements of industry costs and rates, is considered as part of any funding allowance for risk.
4.7	Do you have any views on the use of any outperformance amounts that might arise during CP6?
	We consider that any financial outperformance should be reflected in route management incentive plans. It should also be reflected in routes' regulatory accounts so that it is recognised in future periodic reviews and route control period revenue requirements. However, we think that a relatively cautious approach is needed to using outperformance at both a route and company level. There is a risk that outperformance in one period may be offset by higher costs in future period. We need to make sure that outperformance is not confirmed too early as this funding might be needed at a later date. Outperformance by Network Rail, as a whole, could be used to fund additional renewals or enhancements, to pay down debt, or be rebated back to government. We would welcome a discussion with ORR and funders about the use of outperformance in CP6. We think that underperformance should initially be managed within each route. Where the route cannot manage any underperformance (or overspend) within the route, it would need to seek to use Network Rail's central risk allowance or central borrowing facility. In extremis, it may be necessary to make adjustments to route budgets such that any shortfalls in individual route budgets can be managed within Network Rail's overall framework. A transparent process for reporting 'over' and 'under' spend at the route-level will be necessary. This would also include

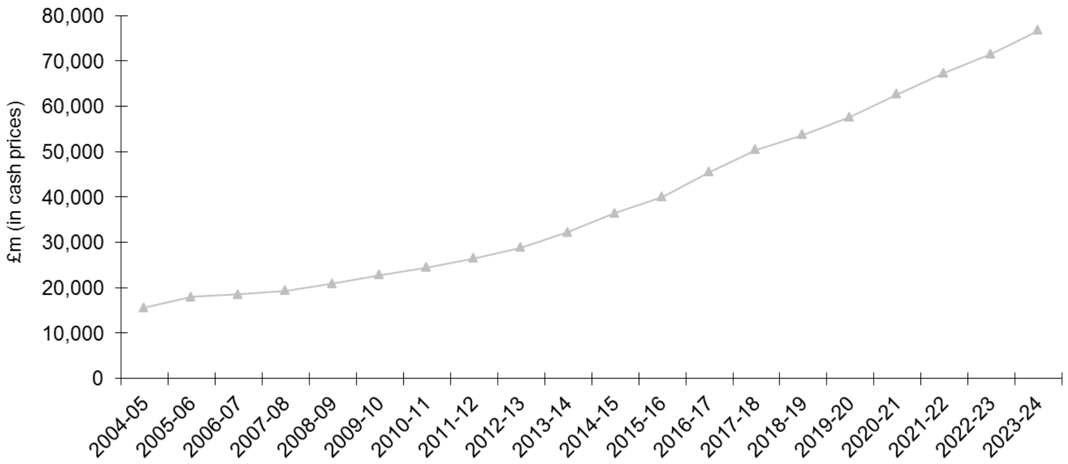
	recording routes' financial performance in their route regulatory accounts and in their RABs.
4.8	Do you have any other views on the financial issues set out in this chapter?
	We do not have any additional views to raise that are not already covered in our responses to the other questions in Chapter 4.
4.9	Do you think there are any other financial policy issues we should be considering for CP6?
	We have already identified other financial policy issues that we think ORR should consider for CP6 in our response to Question 2.1.
Chapter 5	**Financial sustainability and risk management under a route level determination**
5.1	Do you think we have identified the important financial risks applicable to Network Rail in CP6 and that the main risk relates to expenditure levels?
	We agree that you have identified many of the important financial risks applicable to Network Rail. However, as set out in our response to Question 2.1, Network Rail's exposure to interest rate risk in CP6 is discussed briefly but this could be a significant issue in CP6. Network Rail's cash financing costs are a significant proportion of the company's total cost base (£1.4bn, or 13% of total expenditure, in 2015-16). Although the interest rates on existing borrowing are fixed, significant differences between the interest rate assumptions used by ORR to determine our funding as part of PR18 and outturn rates during the control period could have a significant impact on our profitability and financial position in CP6. ORR also refers to poor operational performance, which could lead to higher levels of payments in CP6. However, it is important to recognise that Schedule 8 payments could be even higher in CP6 if Network Rail's Schedule 8 benchmarks are not set at an achievable level. This could be a significant cost in CP6. Additionally, whilst the reliability of our assets has improved, the delay that each incident causes has increased, partly because of the growth in traffic on the network. The Capacity Charge currently attempts to mitigate this risk but we are aware that ORR is considering whether to remove this charge for CP6, which could increase our exposure to Schedule 8 risk.
5.2	Do you agree with the approaches we have identified for managing expenditure level risks?
	We support ORR's view that it needs to allocate financial risks to Network Rail that it is best able to manage. The approach to allowing Network Rail, as a single company, to manage financial risk and uncertainty for CP6 and beyond is a key priority for Network Rail. If Network Rail is not able to manage risk as a single company and instead, for example, has ring-fenced risk allowances for each route, then this is likely to increase industry costs compared to pooling risk across the business. The CP6 regulatory framework should allow Network Rail to continue to deliver a safe and sustainable railway even in the event of cost shocks, for example, by ensuring that Network Rail has funds to repair damage to the network caused by severe storms. Without an appropriate framework for dealing with risk and uncertainty, the sustainability of the network may be put at risk during CP6. There are a number of ways that risk can be handled, including explicit buffers built into charges, headroom in borrowing facilities and triggers that lead to reopening parts or all of a price control. In practice, a combination of these approaches could be adopted. It is important that we work together with ORR during PR18 to achieve the right approach to funding and management of risk for CP6.

5.3	What protocols do you think might be necessary to govern the reallocation of financial resources between routes during CP6?	
	We welcome ORR's view that Network Rail should have flexibility to reallocate financial resources between routes, if needed. The CP6 financial framework needs to give routes the ability to manage the risks that they face during CP6. Network Rail is a single company and during CP6 may need, from time to time, to allocate scarce resources between its routes to maximise overall outputs and value for money. However, for routes to be able to deliver efficiencies in CP6, they need stable workbanks so that routes can commit to certain volumes of work. Therefore, whilst the flexibility to change route budgets during CP6 will be needed, this is not something Network Rail will seek to do without considering the wider implications for routes. ORR's approach should allow Network Rail to make the best use of resources. Therefore, Network Rail should have the ability to adjust route budgets and consider changes to route boundaries during the control period. However, a clear process for reporting any significant changes to business plans and 'over' and 'under' performance at the route-level will be necessary. This includes recording routes' financial performance in their route regulatory accounts and in their RABs, and reflecting this in route-based management incentive plans and route scorecards. This will provide transparency to the wider industry as well as ORR. Network Rail is currently developing its thinking on its approach to insurable incidents in CP6. We need to agree how routes will manage these types of incidents, given that their budgets will not include significant financial reserves (or access to borrowing headroom). One option is for Network Rail's Centre to hold a central risk allowance, which is funded by 'insurance premiums' paid by routes. The Centre could then cover the costs of any significant incidents that occur in routes during CP6 (with smaller incidents managed within route budgets). We would welcome discussions with ORR about this potential approach for CP6.	
5.4	Do you think that the level of Network Rail's debt is a financial sustainability concern?	
	Network Rail's debt and financing costs will reach what could be considered to be disproportionate levels in CP6 without changes to its future funding and financing structure. Figure 1 shows that our debt is forecast to reach c.£54bn (in cash prices) by the end of CP5. If the CP5 funding approach (i.e. adjusted WACC and 100% debt financing for enhancements, continues into CP6) then net debt could reach £75bn or more (in cash prices) by the end of the next control period[3]. No other regulated utility has these debt levels – our current net debt level is significantly higher than companies such as National Grid (c.£25bn), Severn Trent (c.£5bn) and United Utilities (c.£7bn)[4]. Ranked according to debt quantum, Network Rail would appear in the top-10 FTSE companies (similar debt to BP) and top-25 developed nations (similar debt to New Zealand).	

[3] Modelling is based on operating and capital expenditure at broadly similar levels to current CP5 forecasts, i.e. no significant increase in capital expenditure.

[4] All at 31 March 2016

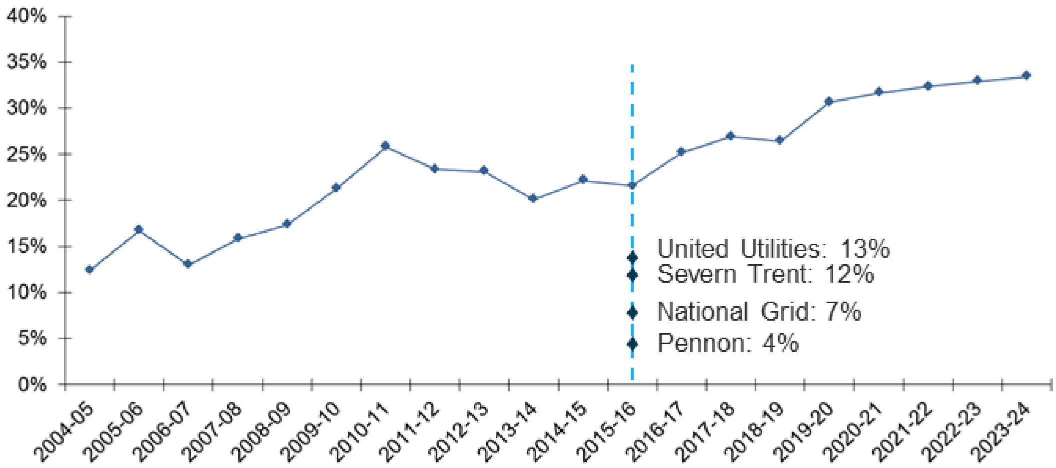
Figure 1: Actuals and forecast of net debt (PR13 approach continues into CP6)



Source: Network Rail analysis based on the adjusted WACC approach for CP6

Although our debt / RAB ratio (70.3% at 31 March 2016) will remain more or less in line with other regulated utilities (e.g. National Grid, 59%; United Utilities, 61%; Anglian Water, 82%[5]), our balance sheet is growing at a much faster rate than our income statement. As the value of our liabilities (debt) increase so does the value of our assets (RAB), but these are equal increases rather than proportional (i.e. £100m of debt-financed enhancements results in £100m increase to both debt and RAB) and therefore our debt/RAB ratio continue to deteriorate under this mechanism.

Figure 2: Actual and forecast of financing costs as a proportion of total income



Source: Network Rail analysis based on the adjusted WACC approach for CP6

Figure 2 shows that our financing costs are an increasing proportion of our revenue. We currently spend over £4m per day (or £1.5bn p.a.) on financing costs. This is out of line compared with other regulated utilities. This is also reflected in financial metrics with low profitability and adjusted interest cover ratio (ICR) of less than one, due to the adjusted WACC approach – a typical investment grade corporate would be expected to have an ICR of at least two.

By the end of CP5, £31bn of our forecast total debt of £54bn is forecast to be loans from DfT. Therefore, a significant proportion of our cash financing costs (forecast 72% (or £1.2bn) in 2018-19) will be paid to DfT. However, the payments we make to DfT are effectively circular money flows because DfT also provides a significant amount of our funding through network grants.

[5] All at 31 March 2016

5.5	Do you consider that any changes will be needed to financial licence conditions or re-opener provisions?
	We think that there should be a wider review of the network licence as part of PR18. We think this is necessary given the changes to the industry since the last periodic review. We set out our views on three parts of the licence, relevant to the financial framework, below: <u>Debt-to-RAB limit</u> Currently, Condition 3 of Network Rail's network licence places restrictions on the company's financial indebtedness. The licence, currently, sets a limit of financial indebtedness at 75% of the value of the RAB. The purpose of this restriction is to incentivise Network Rail to control its costs. At the time of PR13, the licence limit was intended to be the main restriction of Network Rail's indebtedness. However, the loan agreement with DfT placed a fixed limit on Network Rail's borrowing, which set an additional restriction on indebtedness during CP5. Any DfT loan facility may effectively create a fixed borrowing limit, which is below the restriction in the licence. However, we think that the licence limit acts as an additional 'back stop' to constrain Network Rail and funders during the control period and it ensures that Network Rail retains the financial discipline of a normal regulated utility. We also think that it is important to retain standard economic regulatory architecture so that we continue to look like a normal regulated utility and provide flexibility in future to make changes to Network Rail's structure. We think that it is appropriate to keep the licence limit on Network Rail financial indebtedness in CP6 but ORR should review the value of the limit to make sure that it is consistent with the CP6 regulatory settlement. For example it may need to be higher if Network Rail's only access to additional funds for risk in CP6 is through headroom in its loan agreement with DfT. <u>Re-openers</u> In the event of an unexpected material change in circumstances, ORR can re-open the CP5 determination to change Network Rail's allowed revenues for the control period by resetting its access charges. We recognise that making changes to access charges part way through a control period could be unsettling. However, we think that re-openers are an important part of the regulatory framework as the alternative would be to provide Network Rail with sufficient allowed revenues or borrowing headroom to cover all risks. This is unlikely to represent value for money. Also, retaining re-openers ensures the same approach as other regulated utilities. We think that ORR should retain re-openers in CP6 to help Network Rail manage material unforeseen circumstances. <u>Financial ring-fence</u> In CP5, ORR concluded that no changes were required to the financial ring-fence except where the drafting could be improved or simplified. We maintain the view that a fundamental review of Licence Condition 4 should be undertaken, particularly to clarify (and potentially broaden) the scope of Network Rail's Permitted Business. We further consider that a review of the regulatory obligations concerning de minimis, which are prescriptive and difficult to comprehend, should be undertaken.
Chapter 6	**Financial incentives for CP6**
6.1	Should we retain the RAB roll forward incentive mechanism for CP6 – could it be improved?
	We agree that as long as there is no direct link between Network Rail's funding and its RAB, the incentive properties of the RAB roll forward pain/gain share are limited. However, we still think that this mechanism should be retained as it provides some certainty over funding arrangements as well as flexibility for the future changes to Network Rail's funding and financing. The mechanism could be helpful where there is more third party investment as it shares the risk and

	rewards of schemes between customers and funders. The current approach is also understood and has been reported in the regulatory accounts for a number of years.
6.2	Could we develop incentives linked to Network Rail's route scorecards?
	We consider that significant incentives already exist which encourage Network Rail to deliver its route scorecards (i.e. reputational incentives and incentives linked to our company bonus arrangements) so we do not think that it is necessary for ORR to develop further regulatory incentives for the company to deliver its route scorecards.
6.3	Should we develop the spend to save mechanism for CP6?
	We agree that where Network Rail outperforms its determination, the company should not be penalised, through the RAB or FPM, for investing in additional schemes that will reduce industry costs in the longer term. However, we need to ensure that we do not 'use' outperformance too early in the control period, where it may be needed at a later date. We do not think that developing the spend to save mechanism is a priority for PR18, given the likely constraints on funding for CP6. We will need to have a source of funding or financing to pay for the investment, which is likely to be a more significant issue than how this expenditure will be treated for financial performance measurement. An alternative approach would be for ORR and Network Rail to agree the regulatory treatment of any additional spend on a case-by-case basis to provide flexibility to Network Rail and ORR.
6.4	Are there any other financial incentives you think we should consider?
	We do not think that ORR should consider any additional financial incentives for PR18.
Chapter 7	**Financial performance assessment for CP6**
7.1	Have we identified the key limitations and possible improvements for financial performance assessment in CP6?
	ORR has suggested a range of changes to the existing approach, which we comment on in our response to the questions, below. We think that ORR should also consider the following financial performance issues as part of PR18: • how we can have a more dynamic discussion about changing items in renewals baseline to help mitigate perceived issues in this area; • the approach to reporting scope efficiency; and • the approach to identifying the impact of headwinds separately from the percentage value of efficiency, with a separate explanation of the reasons for changes. We have recently started a programme on meetings with ORR to discuss financial performance measurement for CP6. It is a complex area and so whilst we have highlighted some of the main considerations in this response, we will continue to discuss a broad range of issues with ORR through this series of meetings.
7.2	If the RAB roll forward incentive mechanism is retained, should we continue to apply the 25% adjustment to FPM?
	We do not expect the removal of the 25% adjustment to FPM will have a significant impact on incentives. However, removing the adjustment is likely to create bigger movements in FPM in CP6. ORR should set out the implications of this proposal before deciding whether to change its approach. These movements in FPM are likely to be larger if ORR continues to use the final determination assumptions as the baseline for FPM, rather than using Network Rail's business plan.

7.3	Have we identified the key principles that should apply to the assessment of Network Rail's financial performance?
	We agree with the key principles for assessing Network Rail's financial performance. However, we think that ORR should also include some additional principles: • minimise unnecessary administrative burden on Network Rail; • only collect data where this will be used as part of the assessment of performance; and • take a risk-based approach that reflects the role of customer scorecards in incentivising Network Rail.
7.4	Should efficiency and/or financial performance be treated as a regulated output in CP6?
	Financial performance is included in our CP5 scorecards and will continue to be a priority within our CP6 scorecards. We will continue to report financial performance at a route level through our route scorecards. Our scorecards will form the fundamental basis by which we will monitor and report on our financial performance. Network Rail provides a vast amount of information on its financial performance each year – much of this is at a route-level – to allow robust regulatory assessment. We agree with ORR that the publication of reports on our financial performance and efficiency strongly incentivises us to focus on financial performance. Therefore, we think that the regulatory treatment of financial performance should be consistent with our scorecards and that ORR's approach should continue to focus on reporting and monitoring against our forecasted trajectory. This approach will allow us to concentrate on achieving the targets within our customer-focused scorecards. We do not think that a change to the status of financial monitoring measures for CP6 will further increase the importance of these measures as they are already prioritised on our scorecards. There is already significant pressure on Network Rail to address any issues related to its efficiency and we consider that ORR's enforcement action should focus on the service we provide to our customers.
7.5	Should we introduce mechanisms to update efficiency assumptions during the control period?
	We understand ORR's rationale for considering updating efficiency assumptions during the control period. For example, it could improve the alignment of Network Rail and ORR's reporting and so help to improve stakeholder buy-in of our plans. However, we think that the real issues are: • deciding on the most appropriate baseline for measuring Network Rail's performance in CP6 (e.g. reflecting changes between our business plan and the final determination); • recognising that Network Rail can make changes to its plan during CP6; and • the availability of headroom (or a funding allowance for risk) during CP6, given the uncertainty of forecasting costs. If ORR does choose to primarily report against the final determination assumptions during CP6, we think that it could consider making updates to a wider set of determination assumptions during CP6, particularly for those assumptions which are very difficult to forecast.
7.6	How could we develop our FPM reporting to reflect our move to route-level regulation?
	We consider that the implementation of route-level regulation for CP6 will require fundamental reform to the way in which Network Rail reports to and is monitored by ORR. The reporting and monitoring framework currently in place cannot be rolled out across a route-based model without significant implications from a cost, headcount and management distraction perspective. The reporting framework needs to recognise the importance of ongoing customer engagement and a more risk-based approach by ORR. We expect that this would lead to a slimmer, more

	strategic approach to reporting rather than an increase in ORR's reporting and monitoring activity. We think that our customers and funders should have a strengthened role in holding Network Rail to account for our delivery against the customer-focused scorecards. As we set out in our response to ORR's PR18 initial consultation, a regulatory regime that supports this should result in ORR being able to take a more targeted and risk-based approach, allowing it to focus on more strategic issues. We consider that there is scope to reduce the scale of formal reporting (for example the Regulatory Financial Statements and Annual Return). Instead, more data could be provided as supporting material to ORR rather than through formal publications. Regulatory reporting would be focused on the delivery of key outputs which would ease significantly the regulatory reporting burden. ORR's focus should be on the income, costs and outputs that Network Rail has control over. We think that ORR should also consider how it would report on any internal insurance arrangements that seek to provide routes with cover for insurable incidents. We would welcome a discussion with ORR on this issue as part of PR18.
7.7	Would it be helpful to provide more context for Network Rail's financial performance in our annual reporting, by comparing the performance of the wider railway industry to the assumptions in the governments' SOFAs?
	We think that the primary assessment of Network Rail's financial performance should be against Network Rail's own business plan in CP6. However, we think that it could be helpful to set our performance in the context of wider industry performance, and against the governments' original SoFA or ORR's final determination assumptions. This approach could help stakeholders understand the growth in the, overall, GB rail industry and the cash flows that go directly to DfT and Transport Scotland from train operators.
7.8	Are there any other approaches we should consider so that we can effectively assess Network Rail's financial performance and hold it to account?
	We do not think that any additional approaches are required for CP6.

Rail Delivery Group

Response to

ORR's consultation on the financial framework for PR18

Date: 13 April 2017

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Rail Delivery Group response

ORR’s consultation on the financial framework for PR18

Organisation: Rail Delivery Group

Address: 200 Aldersgate Street, London EC1A 4HD

Business representative organisation

Introduction: The Rail Delivery Group (RDG) was established in May 2011. It brings together Network Rail and passenger and freight train operating companies to lead and enable improvements in the railway. The purpose of the RDG is to enable Network Rail and passenger and freight train operating companies to succeed by delivering better services for their customers. Ultimately this benefits taxpayers and the economy. We aim to meet the needs of:

- Our Members, by enabling them to deliver better outcomes for customers and the country;
- Government and regulators, by developing strategy, informing policy and confronting difficult decisions on choices, and
- Rail and non-rail users, by improving customer experience and building public trust

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Introduction

1. This document outlines the key points from industry in response to the ORR's consultation on the financial framework for PR18.

2. There has been, and will continue to be, extensive industry engagement and discussion with the ORR about a range of issues through the industry working groups that the RDG has set up for PR18. We envisage that these working groups will continue to operate throughout the rest of the PR18 process as we believe they provide useful forums to work through the detailed issues. We welcome the constructive tone and purpose of the ORR PR18 consultation documents and working papers which are intended to facilitate a more dynamic process of industry engagement to support an iterative approach to developing policy.

3. We confirm that we are content for this response to be published on the ORR website.

Building block approach to assessing Network Rail's revenue requirement in CP6

Paragraph 1.1 to 1.28 of the consultation.

4. We support the proposed use of a building block approach as it facilitates a route-based regulatory framework with separate settlements for each Route and the national system operator. This supports the work on devolution that the industry is already doing including separate scorecards and better engagement between Network Rail and its customers. As noted in our responses to earlier PR18 consultation documents, the RDG supports route devolution with local ownership of plans and better engagement between Network Rail Routes and operators, and better engagement with passengers and freight users.

Enhancement financing/funding in CP6

Paragraph 3.2 to 3.28 of the consultation.

5. We support a framework that allows a flexible approach to funding enhancements such that private funding and financing is encouraged as well as direct government funding.

6. One option to facilitate this could be to include headroom in the loan agreement which could be ring fenced for financing of third party schemes.

7. We are also strongly supportive of retaining ring-fenced funds funded through PR18 in CP6, provided that there is clarity on the funds' objectives and the appropriate fund governance is in place to allow industry decision making on the allocation of the fund, where required. This means of funding is flexible and allows relatively small investments to be made to improve outcomes efficiently as they can be directed through the industry party best able to deliver the benefit. A further benefit is that funds could provide a means of leveraging small scale third party investment into the rail industry, for example through matched funding of private sector investment, that would not otherwise be realised.

8. An RDG working group recently completed a review of the role that private finance and alternative delivery models have in the rail industry. The conclusions are set out in a report by Cambridge Economic Policy Associates[1]. The report makes several recommendations to bring more private investment into the industry and so is relevant when considering the financial framework for CP6. For example, the report notes that potential investors are seeking several things to encourage them to invest, including: (1) a pipeline of committed projects, (2) leadership from government and the regulator to provide some certainty on the overall approach, and (3) clarity on the revenue stream

[1] http://www.raildeliverygroup.com/about-us/publications.html?task=file.download&id=469772167

that projects could generate.

The importance of a five year control period

Paragraph 3.29 to 3.30 of the consultation.

9. The arrangement for a five year control period is well established and we support the ORR recommendation for its continuation. This is because:

    a. It provides certainty of funding over a reasonable length of time;

    b. It better reflects the long term nature of the industry in terms of asset management, and enhancement and renewal planning. Processes should encourage continuity in planning and avoid disconnects that can occur when there is uncertainty on short-term funding;

    c. It supports stability in access charges;

    d. It supports the drive for securing innovation and efficiency from suppliers.

10. We note that for enhancements, there should be a longer term view for planning purposes so that a pipeline of potential schemes can be developed and then taken forward to match the availability of funding.

Managing financial risks

Paragraph 5.16 to 5.27 of the consultation.

11. The regulatory settlements should be flexible so that they are able to deal with changing circumstances. The framework should recognise the network is a system, with a single Network Rail, with some activities being managed at a route level and others being more efficiently delivered for the benefit of the whole network.

12. We also think it is important that Network Rail has flexibility to move resources from one Route to another to maximise system wide efficiency and make best use of scarce resources. This might include targeting resources where there is the greatest need, e.g in meeting outputs agreed with customers.

13. An effective change control mechanism, including stakeholder endorsement, can provide a means of supporting the flexibility described in the previous points.

Financial sustainability

Paragraph 5.28 to 5.30 of the consultation.

14. We agree that financial sustainability is a concern and believe PR18 should support an improvement in Network Rail's long-term financial stability. We support a change in the funding arrangements for future enhancements, to avoid the continuing accumulation of debt and the deterioration of Network Rail’s balance sheet.

15. Potential solutions include grant funding of the proportion of new enhancements that deliver socioeconomic benefits, and better sharing of the costs of investment between the beneficiaries. At present those projects that have major socioeconomic benefit are mainly financed by Network Rail through increased debt.

Consultation on the Financial Framework for PR18

Response from Rail Freight Group

March 2017

1. Rail Freight Group (RFG) is pleased to respond to the ORR's consultation on the Financial Framework for PR18. No part of this response is confidential.

2. RFG has no comment on the majority of the topics in the consultation. However there are some areas where there are potential impacts on the freight sector, which are covered in this response.

3. Overall, we recognise that the final determination must be fair, proportionate and give sufficient flexibility to enable Network Rail (NR) to undertake its business effectively. In achieving this, we also note that ORR must also take a proportionate approach to the impact on operators, and ensure that they also have a fair and proportionate outcome. This must include stability of charges, and appropriate risk transfer recognising the ability of different sectors to bear such risk.

4. The framework should also recognise the private sector nature of freight customers and operators and the cross modal nature of their businesses and choices.

Chapter 1 – Network Rail's Business Structure and Financing

5. The proposals for setting revenue requirements for each route does not appear to cover the somewhat different requirements for the FNPO route and the NSO, neither of which are asset owning. As we understand that both will be separately regulated, this should be clarified. As freight access charges are shown as an income stream for the geographic routes, the funding of FNPO should also be clarified.

Chapter 3 – Enhancement financing/funding, a five year control period, the building block approach and the cost of capital for CP6

6. We recognise the revised approach to enhancements now enshrined in the DfT/NR MOU and the implications on the control of expenditure. ORR must continue to ensure that there is sufficient transparency of decision making within this framework, particularly where money is transferred across schemes within a portfolio and/or outputs change. This should be via the NR delivery plan, or other successor documents.

7. We strongly support the continuation of funds for delivering smaller scale enhancements. The SFN fund has worked well in enabling freight outputs to be identified and prioritised, albeit that individual schemes have been impacted by the wider issues with NR's delivery programme. We would strongly support continuation of an SFN fund into CP6. We are already aware of some 'carry

over' issues for SFN schemes which we understand are being progressed.

8. We note the various mechanisms for private sector investment. For some SFN (and other) schemes, a direct contribution from a freight customer or regional body has been secured, and an appropriate mechanism should be provided to enable this to continue.

9. Freight customers may also wish to fund new freight connections (for example, the new rail connected quarry at Arcow, new SRFI at iPort etc). Customers will fund the project in full, and pay an annual connection charge. Any mechanism for third party funding must enable these schemes to progress as quickly and cost effectively as possible.

10. We understand DfT and Transport Scotland's desire to move to a pipeline of enhancements. Any measures to prioritise supply chain in accordance with the pipeline must not hinder or delay the delivery of these third party projects.

11. On East – West Rail we are concerned to ensure that the resulting railway can be used by freight at the same access charges as the rest of the network. NR have previously suggested freight could be routed on East West to avoid the West Midlands conurbation, and there is also likely to be demand for construction traffic in support of the economic development along that corridor.

12. We note the issues around cross – border enhancements. Several SFN projects are exposed to this risk. The principle concern is ensuring that the outputs of the project are protected within each route, particularly where the project has several elements all of which are necessary to deliver the benefits. Any framework for managing costs and benefits must also consider ways of safeguarding outcomes, particularly capacity, during the development and construction phases as well as on completion.

13. We support the retention of a five year (or longer) control period, to give NR sufficient certainty to plan its business, and enable it to give certainty to its suppliers. This is critical to enable efficiency and investment.

14. The five year control period is also critical for setting access charges, giving at least some level of stability. ORR should also consider whether there should be a longer period of certainty for access charges, given the need to provide investment certainty to operators and customers. This would also reduce the regulatory burden of the access review process on businesses.

Chapter 4 – Other Financial Issues for CP6

15. As access charges are also inflated by RPI we would support a move to CPI, which more closely reflects the consumer nature of today's rail freight markets.

16. ORR should consider how inflation is applied to road user charges in considering the approach to rail freight.

17. Although we have no particular view on the treatment of asset disposal income, we remain highly concerned over the potential disposal of the freight estate, and the long term implications of the sector. It is particularly concerning if NR seek to pursue a freehold disposal, which is at odds with our understanding of the so called '1994 agreement'.

18. The freight estate is vital to enable rail freight to operate, and for freight customers to undertake their rail linked business. We cannot imagine DfT or NR suggesting an unprotected freehold disposal of passenger stations. ORR must ensure that any asset disposal, however valuable, is only undertaken where the long term interests of network users are protected.

19. Rail freight operators and NR have already reviewed and released a number of sites with no realistic possibility of future use.

Chapter 5 – Financial Sustainability and Risk Management under a route level determination

20. As outlined earlier, the framework for FNPO and NSO may vary and should be explicitly considered.

21. We support the approach of allocating risk to the party who can best bear it. However we note that the scale and financial position of freight operators means that they are unable to bear any greater degree of financial risk. Generally operators will be less able to bear risk that NR. As such proposals which transfer risk to operators should be avoided. This includes the review of schedules 4 and 8.

22. Given the importance of access charge stability to freight operators and customers, any potential re-opener of access charges should only be possible in the most exceptional circumstances.

Chapter 6 - Financial Incentives for CP6

23. We agree that there should be an appropriate link between staff incentives, and scorecard and SBP objectives. Any such link should incentivise cross route outcomes as well as local measures.

Chapter 7 – Financial Performance Assessment for CP6

24. At its most basic, NR must ensure that it is maintaining the network in a proper condition for the movement of freight, including maintaining capability (route availability, gauge and so on).

25. The efficiency assumptions which ORR set on NR are a critical part of the process for establishing freight access charges. We are concerned to ensure that a fair, long term deal is established for freight, recognising and rewarding the measures which the sector has taken to enable NR to become more efficient. This could use a similar process to the long term efficiency deal which was used

in CP4.

26. We do not support a re-opener on the efficiency measures during the control period if that fed through into access charges. The need for a stable framework to support investment would be undermined by such an approach.

National Union of Rail Maritime and Transport Workers

RMT

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Office of Road and Rail

22 March 2017

Dear colleagues

I am writing in response to the PR18 *consultation on the Financial Framework for PR18.*

RMT is concerned that the PR18 determination will be set at a route and NSO level because we believe that this will hinder the transfer of financial resources amongst routes and the NSO and subsequently undermine the economies of scale which Network Rail, as a national organisation, achieves. RMT believes that such an approach will not allow Network Rail to efficiently manage risks and exploit opportunities across its business as a whole. RMT believes that the ORR proposal in the consultation document is contradictory and in itself recognises the huge shortcomings of the devolution agenda.

It is unclear as to how such a rigid approach to Network Rail's finances can be introduced when "the routes are not separate companies", and should the ORR continue its long standing approach of not interfering in the internal workings of Network Rail following the determination. RMT believes that Network Rail should continue to be treated as a single company with a single determination, and that the additional tiers of bureaucracy that the proposed fragmentation has already introduced into the PR18 process should be a stark warning against their introduction into the management of Britain's rail infrastructure.

These concerns are underlined by the consultation document which states that "as sub-divisions of Network Rail's business, the route's capacity to manage risk will be lower than for the company as a whole" and that "routes will be dependent on centralised business support services for some aspects of budgetary risk control".

RMT is also concerned that an accounting mechanism, such as the amortisation allowance, may be used to determine the extent to which safety critical renewals work is carried out.

RMT is disappointed that much of the discussion surrounding the financing of a safe efficient railway is focussed on potential perceptions of public expenditure and which accounting mechanisms (such as those proposed for the cost of capital) should be used to facilitate particular perceptions. RMT believes that the ORR should resist

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attempts by the government to impose an ideological framework on its role as the economic and safety regulator of the railway. We have consistently opposed such interference in the work of the independent regulator including, for example, when the government dictated that the ORR must consider so-called "value for money" in its safety role.

RMT welcomes the fact that the ORR's view is not to move away from RPI, as recommended by the Johnson review and we agree that CPI is not an appropriate measure to be used for CP6.

RMT considers the following statement in the consultation to be highly suspect: "Other forms of taxation (including PAYE associated with labour costs) are considered to be parts of the costs of the activity to which they relate".

This statement is unclear. Due to the wide variance in employment practice between maintenance, renewals and enhancements the question must be asked as to whether the ORR is implying that bogus self-employment, or the culture of subcontracting, is a means of reducing the cost of activities and subsequently is the ORR advocating a move away from genuine employment through a public body (and consequently rejecting the return of PAYE tax to the exchequer) as a means of achieving so-called value for money?

Has the ORR conducted any assessment of the cost to the exchequer of the changes in employment practices over the previous control periods and in particular the amount of PAYE tax returned?

RMT notes these where alternative forms of engagement are prevalent, such as amongst the renewals labour force, targets have been consistently missed and inefficiencies have grown. In fact during CP5 efficiency on renewals fell by 20.5%, not including the additional determination target for it to increase by 11.6%. OMS became 5.4% more efficient because the work was undertaken in house[1]. Network Rail's efficiency deficit of around 8% was mainly due to renewals, and RMT believes this is as a direct result of employment practices not conducive to either an efficient or a safe railway.

It should also be noted that the demands of train operating companies being prioritised over completing necessary renewals works has led to a situation where the fragmentation and privatisation of rail operations has also significantly contributed to inefficiencies in renewals work.

RMT believes that enhancements should continue to be funded through the determination in order to ensure a constant work stream for the workforce and also to prevent unnecessary, and potentially wasteful, additional contracting.

We are very concerned that further asset disposals and third party/private sector funding are being advocated as a means of addressing any "cost shocks" during

[1] See Figure 1.3 in ORR's 2015-16 Efficiency and finance assessment of Network Rail

CP6. RMT believes a mechanism should be available whereby such shocks can be addressed through accessing public financial reserves and should certainly not be used to allow further fragmentation or privatisation of Network Rail. The role the private sector has played in creating additional costs to Network Rail, and the wider rail industry, is well documented and creating financial reliance on the private sector (especially during emergency or unprecedented circumstances) can only increase costs due to the short term avarice of private interests.

Furthermore, RMT believes that a predetermined fixed rate should be used regarding interest rates applicable to the DfT loan facility.

RMT welcomes the recognition in the document that "Network Rail could be exposed to additional counterparty risk if it enters into more commercial partnerships during CP6" and believes that that alone is reason enough for the ORR to cease advocating private sector involvement during CP6.

Finally, we wish to reiterate our belief that the funding cycle should be extended to beyond a five year period under a long term planning process, to ensure that it does not fall foul of either the temporary interests of elected representatives or the short term avarice of the private sector.

We look forward to responding to the further consultation on the financial framework for PR18 in September 2017.

Yours sincerely

Mick Cash

Mick Cash
General Secretary

Response to ORR's first consultation on the financial framework for the 2018 periodic review of Network Rail (PR18)

This pro-forma is available to those that wish to use it to respond to our consultation. Other forms of response (e.g. letter format) are equally welcome.

Please send your response to pr18@orr.gsi.gov.uk by 13 April 2017.

Full name	David Hoggarth
Job title	Rail North Director
Organisation	Rail North / Transport for the North
Email*	
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*This information will not be published on our website.

Chapter 1: Network Rail's business structure and funding

We invite stakeholders to comment on the questions set out at the end of the chapter and/or provide any other comments they consider relevant.

- Do you have any views on our proposed use of a building block approach to calculate Network Rail's revenue requirement at route level for CP6?

The strict distinction between operating and capital expenditure can distort incentives in a way that skews management decisions away from the most efficient use of resources. We would like to see a move towards a more flexible system that explicitly recognises the interaction between some forms of operating expenditure and capital expenditure. One idea might be to take into account the capex savings that result from a given stream of operating expenditure (for example, due to reduced depreciation or higher value being derived from the existing infrastructure – effectively analogous to an increase in the RAB). We feel that it would be helpful for the ORR to produce some concrete worked examples of the interaction between capex and opex.

The monitoring of Network Rail's costs and outputs at route-level is not disaggregate enough to scrutinise and challenge its efficiency in a meaningful way. A more in-depth understanding of cost drivers, necessarily at a more disaggregate spatial scale, is essential to arrive at more reliable efficiency targets and to monitor these as time goes on. We would therefore like to see the building blocks approach implemented at a more detailed spatial scale. As Transport for the North becomes a statutory sub-national transport body and Rail North is integrated within it, we need to be able to understand the costs and revenue of the rail network at the geography we operate. This will require greater disaggregation than route level, as recognised in the Shaw Report into the future shape and financing of Network Rail.

Chapter 2: Financial policy issues

We invite stakeholders to comment on the questions set out at the end of the chapter and/or provide any other comments they consider relevant.

- Have we identified all the important financial issues that need to be addressed in PR18?

Although the consultation document acknowledges the potentially growing role of third party funders, it largely overlooks the already significant and growing role of transport authorities at both the local (e.g.: Combined Authorities) and regional/sub-national (e.g.: Rail North/Transport for the North and West Midlands Rail) level. Unlike ad-hoc third party funders (e.g.: developers) or, to a large extent, TOCs these bodies are relatively permanent and have a vested interest in both the long-term success of the railways (including its financial sustainability) and in ensuring that the railways contribute to wider social and economic outcomes. They also have a degree of knowledge of local rail infrastructure, operations, and, in some cases, cost drivers that is generally not available to national bodies. As such, these organisations can potentially play a vital complementary role to the DfT and ORR in holding Network Rail to account. This should be recognised explicitly as part of PR18. The Government has signalled its intention to establish Transport for the North as the first Statutory Sub-National Transport Body in 2017 and at that point, Rail North will be integrated within it. Rail North is already a service specifier and with statutory status, Transport for the North expects to play a role in output specification for the North, including holding the industry to account, as well as potentially being a funder in its own right.

Turning more specifically to financial issues, there are three areas where the regulatory framework could go further to take greater advantage of what these organisations have to offer.

***Firstly**, it could require Network Rail to release cost and output information at a much greater level of disaggregation, for example at sub-national transport body geography. This would enable sub-national bodies to play a much more active and effective role in scrutinising and challenging NR‟s performance. At present, the financial framework reinforces the asymmetry of information between NR and its stakeholders by requiring information to be disclosed only at very high level. It could be argued that there is a cost involved in making this information available. We would argue that it can actually be more costly to aggregate raw data up to an arbitrary level set by the regulator than to simply open up disaggregate data that should in any case be available to management.*

***Secondly**, it could expose NR to greater level of financial risk when delivering third-party funded enhancements. The current „emerging cost‟ approach fails to meet the ORR‟s principle that NR should bear those risks that it is best able to bear. In practice, this* *means that NR is neither exposed to the effect of its own actions nor accountable to those who are paying for enhancements in any way. This state of affairs cannot incentivise efficient behaviour and it also prevents local stakeholders from challenging NR costs. It also acts as a barrier to "contestability" in rail and discourages third party funders as we have said in our response to Network Rail"s "Hansford Review". Another way in which NR is protected from the impact of its actions is by not being required to compensate users of the network or their funders for failing to deliver planned work on which operating plans are predicated. One example is where delays to electrification make some rolling stock idle and may force to operators to lease additional vehicles. It could be argued that the effect of exposing NR to greater risk would be to push up its revenue requirement. This may be true but would it not also create more effective incentives towards efficient behaviour?*

***Thirdly**, some of the funding that is currently routed through the DfT could instead flow to NR through these organisations. Whilst we appreciate that this is a decision for the DfT rather than the ORR, we would be interested to have the ORR"s thoughts on how this could be accommodate within the financial framework for PR18.*

On a separate point, we would observe that the consultation document concentrates more on monitoring symptoms than addressing causes. Yes, it is the role of the ORR to set an efficient revenue requirement and to monitor NR"s progress towards greater efficiency. During CP5, the ORR was able to show that NR did not achieve the level of efficiency it had been set. But we are still not convinced that we know how this could have been avoided. So we would query whether the industry (and, by extension, the ORR) has the right level of skills and the right information to determine efficiency ex-ante and to challenge emerging information. We believe that this deserves some consideration in designing the financial framework for PR18. As we argue earlier, greater disaggregation of financial information (well below route-level as currently proposed) would be a step in the right direction.

Another issue that the consultation document should consider at greater length is the potential role of alternative delivery mechanisms (i.e.: where third parties deliver network enhancements) in determining appropriate efficiency targets. Some of our members have experience of directly delivering or contracting rail infrastructure works outside mainstream NR channels. This type of information could perhaps provide useful benchmarks to measure NR"s performance against.

Chapter 3: Enhancement funding, a five year control period, the building block approach, and the cost of capital for CP6

We invite stakeholders to comment on the questions set out at the end of the chapter and/or provide any other comments they consider relevant.

- Do you have any views on the ways that enhancement projects should be financed/funded in CP6?

  We would our comments in the context of chapter 2, relating to routing of DfT funding through sub-national and local stakeholders and delivery of rail infrastructure works by organisations other than NR.

- Have we identified all of the possibilities for private sector partnerships and financing/funding arrangements that might arise?

  As we argue under chapter 2, we feel that the consultation document largely overlooks the already significant and growing role of transport authorities at both sub-national and the local level.

- Which aspects of the financial framework do you think might be relevant to third party/private sector financial participation?

  ** No views **

- What do you consider should be done to address cross-border funding/benefit mismatches with respect to enhancements?

  We have no further ideas on this topic but would point out that this issue is of relevance not just in the context of devolved nations but also for local and regional transport bodies. In a North of England context, cross-boundary issues with North Wales are particularly important given the strong links between Transport for the North/Rail North are already working with the Welsh Government on a number of rail issues.

- Do you agree with the reasons we have given for the continuation of the five year control period and the building block approach for calculating Network Rail's revenue requirement?

  Yes.

- Which cost of capital approach do you think should be used for Network Rail in CP6?

  We have no strong views, given the information presented in the consultation paper which suggests that the net impact on public finances would be more or less negligible. However, we recognise the point that different approaches could incentivise different types of behaviour on the part of Network Rail and agree that it would be worth exploring this in more detail before a decision is made.

- Have we identified all of the issues relevant to the choice of cost of capital approach?

  ** No views **

Chapter 4: Other financial issues for CP6

We invite stakeholders to comment on the questions set out at the end of the chapter and/or provide any other comments they consider relevant.

- Do you think we should change our approach to the calculation of amortisation allowances in light of:
  - Network Rail's reclassification and the likelihood of a fixed borrowing limit in CP6?
  - the possible developments to enhancement financing/funding set out in chapter 3?
  - financial sustainability requirements?

  ** No views **Do you think we should include an 'early start' mechanism in the PR18 process?

  Yes, on the basis that this introduces greater flexibility.

- Do you consider we should make any changes to our PR13 policies on inflation?

  ** No views **

- Do you have any views on the corporation tax and VAT issues we have set out?

  ** No views **

- Do you have any views on how we should treat the proceeds from disposals that
  - are made in the normal course of business?
  - are made in response to the Hendy report?

  We have no strong views though it seems to make little sense to leave the RAB unchanged following disposals as this would presumably reward Network Rail for *reducing its asset base.*

- Do you think we should make any changes to the treatment of traction electricity, industry costs and rates that we applied at PR13?

  ** No views **

- Do you have any views on the use of any outperformance amounts that arise during CP6?

  ** No views **

- Do you have any other views on the financial issues set out in this chapter?

  No.

- Do you think there are any other financial policy issues we should be considering for CP6?

  No.

Chapter 5: Financial sustainability and risk management under a route level determination

We invite stakeholders to comment on the questions set out at the end of the chapter and/or provide any other comments they consider relevant.

- Do you think we have identified the important financial risks applicable to Network Rail in CP6 and that the main risk relates to expenditure levels?

The consultation document makes no reference to the possibility that Network Rail could be required to compensate users of the network for delays to the delivery of planned schemes, or output reductions, which could have a knock-on impact on operating costs.

There is also no consideration given to the possibility that the current approach to third party funded enhancements (known as „emerging costs") could be changed so that Network Rail is liable for a greater proportion of over-spends.

- Do you agree with the approaches we have identified for managing expenditure level risks?

The consultation document concentrates on how to respond when risks are realised but gives a relatively superficial treatment to addressing the causes of these risks and tackling those at source. We feel that more emphasis should be given to detailed, bottom-up analysis of NR processes and efficiency at a more disaggregate spatial level. As we argue earlier in our response, more disaggregate cost and output data should be made openly available to a wider range of stakeholders, including transport authorities, who could use their local knowledge to complement and support the work of the ORR.

A few more specific comments:

Para 5.18 "[NR] will need to set out well-founded expenditure assumptions for each of its routes in its business plans" – how does „well-founded" mean and what guidance is being given to NR on this point?

Para 5.19 "[ORR will] use our own risk modelling to better understand possible ranges of expenditure" – what does this consist of? What methods and data are being used? How detailed will the analysis be? Could other stakeholders contribute to this work?

Para 5.20 "NR will need to manage financial risk by using good quality management information to identify costs and output pressures as early as possible" – what is good quality management information? What is ORR"s current assessment of the quality of NR"s management information? What oversight does ORR have of this information?

Para 5.20 "NR will need to manage financial risk by, where appropriate switching from asset renewals to life extension programmes or additional maintenance activity". Agreed, but what concrete incentives is NR being given to choose to do this in practice?

Para 5.20 "NR will need to manage financial risk by optimising advantages from devolving management decisions to routes". We would argue that one of these advantages will be that routes can be more easily held to account by their local stakeholders. However, what tools are they [local stakeholders] being given to perform this role more effectively?

- What protocols do you think might be necessary to govern the reallocation of financial resources between routes during CP6?

  ** No views **

- Do you think that the level of Network Rail's debt is a financial sustainability concern?

  ** No views **

- Do you consider that any changes will be needed to financial licence conditions or re-opener provisions?

  ** No views **

Chapter 6: Financial incentives for CP6

We invite stakeholders to comment on the questions set out at the end of the chapter and/or provide any other comments they consider relevant.

- Should we retain the RAB roll forward incentive mechanism for CP6 – could it be improved?

  It is not clear why NR should only bear 25% of the cost of over-spends, given that it presumably has greater control over these.

  The consultation document claims that this mechanism creates reputational incentives for NR managers but it is unclear whether this is the case. How visible is it in practice and what evidence is there that it influences managers" behaviour?

- Could we develop incentives linked to Network Rail's route scorecards?

  Yes. One useful measure would be the % over-spend on third party funded schemes.

- Should we develop the spend to save mechanism for CP6?

  Yes, it seems to be a sensible mechanism. Rail North/TfN have a strong interest in this, and would welcome the opportunity to discuss this issue with ORR.

- Are there any other financial incentives you think we should consider?

  Yes, NR should have greater exposure on third-party funded enhancements and be required to provide detailed cost data, and other project management information, to funders in a timely manner. The publication of detailed cost data is essential in order to avoid the incentive on Network Rail to over-inflate cost estimates at the outset in order to absorb potential over-spends.

Chapter 7: Financial performance assessment for CP6

We invite stakeholders to comment on the questions set out at the end of the chapter and/or provide any other comments they consider relevant.

- Have we identified the key limitations and possible improvements for financial performance assessment in CP6?

  See earlier responses.

- If the RAB roll forward incentive mechanism is retained, should we continue to apply the 25% adjustment to FPM?

  See response to chapter 6.

- Have we identified the key principles that should apply to the assessment of Network Rail's financial performance?

  See our response to chapter 5, where we query the degree of information which the ORR holds regarding NR costs. See also our earlier points about enabling local stakeholders to complement the scrutiny role of the ORR through greater transparency over NR cost and output information.

- Should financial performance measures be treated as a regulated outputs or indicators in CP6?

  We see little value in treating financial performance measures as regulated outputs, especially as it is not clear at this point what impact, if any, this would have on the behaviour of NR management. We believe that regulatory effort should go towards understanding and challenging cost data in greater detail rather than setting arbitrary outputs that may well be un-realistic from the outset.

- Should we introduce mechanisms to update efficiency assumptions during the control period?

  In principle, yes. But, again, we believe that more regulatory effort should go towards understanding and challenging cost data in greater detail rather than dealing with the fall-out – changing efficiency assumptions may be necessary as a matter or process but does little to solve underlying causes.

- How could we develop our FPM reporting to reflect our move to route level regulation?

  Our default position (see previous responses) is that cost information should be openly available at the most disaggregated level available. The cost is likely to arise in aggregating this information up so as to meet regulatory requirements. If so, then there should be relatively little cost involved in providing more disaggregate information than at present.

- Would it be helpful to provide more context for Network Rail's financial performance in our annual reporting, by comparing the performance of the wider railway industry to the assumptions in the governments' SOFAs?

  ** No views **

Any other points that you would like to make

Thank you for taking the time to respond.

swindonwiltshire
Local Enterprise Partnership

Office of Rail and Road
PR18@orr.gsi.gov.uk

Monkton Park
Chippenham
SN15 1ER

12th April 2017

Dear Sir / Madam

Consultation on the financial framework for PR18

This response is compiled from the perspectives of the Swindon and Wiltshire Local Enterprise Partnership (SWLEP) as a potential third-party infrastructure funder, together with its associated local transport authorities (Swindon Borough Council and Wiltshire Council) that may provide revenue support in the early years of enhanced rail passenger services.

The SWLEP follows a scheme prioritisation process in which rail schemes compete with each other and other transport modes, and with schemes for other areas for limited funding. The comparison framework includes both cost and risk elements. For the SWLEP, a successful financial framework is one in which scheme cost is reduced through efficient working, but also risk to the external funder is minimised.

Responses are provided for two of the consultation questions.

Do you have any views on the ways that enhancement projects should be financed / funded in CP6?

Given that the Government's priorities for the rail industry lead to funding being focused on capacity / performance, it falls to the SWLEP and constituent local authorities to consider public-sector funding for local capacity issues and for enhanced connectivity through new stations and improved / new services. The consultation document seems to consider funding as either central government or private sector, which leads to a number of concerns:-

- Whereas choices for the method of funding enhancements tend to be cost-neutral to the DfT (which would pay one way or another, either via direct grant or indirectly via franchise determinations taking into account access charges), the same is unlikely to be true for other public-sector (or private sector) funders.
- The consultation document notes the principle that the party benefitting ought to pay the costs (3.14). It is rightly acknowledged (3.27) that the difficulty of aligning costs and benefits could deter the development of enhancements, although the document only considers the case of the England/Scotland boundary, whereas local authority and LEP boundaries are also likely to lead to additional challenges in allocating benefits and costs to various scheme partners.
- These are real issues for the SWLEP. Most of its proposed rail schemes feature an element of cross-boundary benefits and costs. In the interests of reaching agreement with other funding partners, there should be a high degree of transparency in cost and benefit allocation where these are within the power of the ORR to secure,

[continues]

Have we identified the key limitations and possible improvements for financial performance assessment in CP6?

The consultation considers that the future may bring wider involvement of third-party funders, most of whom will be less-well placed than the DfT / ORR to evaluate objectively the performance of Network Rail in executing the funders' projects. It might be beneficial for the ORR to monitor performance at a scheme level, perhaps by benchmarking. The overall financial performance assessment should avoid creating perverse incentives that impact upon third-party schemes.

David Phillips
Senior Transport Planner
Wiltshire Council

OFFICE OF RAIL AND ROAD

Response to ORR's first consultation on the financial framework for the 2018 periodic review of Network Rail (PR18)

This pro-forma is available to those that wish to use it to respond to our consultation. Other forms of response (e.g. letter format) are equally welcome.

Please send your response to pr18@orr.gsi.gov.uk by 13 April 2017.

Full name	Richard Tyndall
Job title	Business Consultant
Organisation	Thames Valley Berkshire Local Enterprise Partnership
Email*	
Telephone number*	

*This information will not be published on our website.

Any other points that you would like to make

1. The subject matter covered by your consultation is highly specialised and very complex. Our organisation does not have the depth of understanding or experience to make an informed response to your specific questions. Therefore, I have made no comment in response to the detailed questions you have set out.

2. The Thames Valley Berkshire Strategic Economic Plan (available at http://thamesvalleyberkshire.co.uk/Strategic_Economic_Plan), at page 17 under the heading "Our Connectivity" makes the following points:

    "The biggest single risk to the future economic contribution of TVB concerns our transport and communications infrastructure.

    […]

    "We are encouraged that the importance of our connectivity is recognised by government. In particular:

    > *» We welcome the observation from the Office of the Rail Regulator that £3bn (20% of the national total) will be invested on the Western route between 2014 and 2019. We have made the case consistently for investment in Western Rail Access to Heathrow (WRAtH) and have demonstrated that the short rail link (which needs 4km of new tunnel between Langley and Terminal 5) will deliver economic benefits of over £2 billion and create 42,000 new jobs. This project is crucial to TVB's growth ambitions. Also important is the completion of Reading Station; the provision of semi-fast Crossrail services to and from Reading; […] and the electrification of the Berks & Hants route, at least to Bedwyn."*

3. Since this was published in March 2014 we have experienced the best and the worst of Network Rail's performance.

4. The good news is that the Reading Station project, including the West Reading Flyover, has been a great success, completed ahead of schedule and vastly improving the capacity of the station for both trains and passengers. Similarly, the progress of the

Crossrail investment is on time, and poised to transform the inner suburban services on the Western Route.

5. The bad news is that faltering performance of the Western Mainline Electrification Project has cancelled out the goodwill Network Rail created for themselves with their successes. The bad news for Thames Valley Berkshire has come in dribs and drabs, and seemingly without apology or regard for the consequences on the ground.
6. The first setback was the discovery that the Bourne End and Marlow Branch would not be included in the electrification programme because the new rolling stock was too long for the reversing movement required for trains travelling through Bourne End.
7. The second setback was the indefinite postponement of the electrification of Basingstoke to Southcote Junction announced in the Hendy Review. The consequences for the long-planned new Reading Green Park Railway Station were not considered in the Hendy Report. The delivery of passenger services to the new station within the franchise agreement between the Government and Great Western Railway was dependent on the use of electric-hauled trains. It was left to others to pick up the pieces (and the financial consequences) of Network Rail’s decision.
8. The third setback was ministerial announcement that electrification of the two remaining Thames Valley Branch Lines (Slough-Windsor and Twyford-Henley) was to be deferred indefinitely. It appeared to us that the rescheduling announced in the Hendy Report had been miscalculated, and that further emergency savings were required at short notice.
9. The fourth setback has been the continuing inability of Network Rail to bring forward the Western Rail Link to Heathrow scheme on the previously envisaged timetable. This project has been the number one infrastructure priority of the Thames Valley Berkshire LEP since our creation and we are still at the stage where a Development Consent Application is 12-18 months away from being submitted, let alone approved. The prospect of a start on site is as remote as ever and it is difficult to imagine the first trains running in 2024 as indicated in the latest reworked plan.
10. Another irritation has been the delay of the introduction of the additional services on the North Downs Line announced in the GWR franchise extension due to the impact on level crossings – not disclosed by Network Rail before the announcement.
11. This response therefore asks the ORR, as Network Rail’s regulator, to consider whether or not there will be any mechanisms in the CP6 settlement which will address these gross failures in performance. In particular, there needs to be a focus on the external costs borne by others when Network Rail fails to deliver its projects. We know that at its best Network Rail can do great things (see Reading Station for example); we hope for more good news than bad in CP6.

PR18 Financial Framework consultation response from Mr. Thomas Wheeler

I am responding to your consultation as an individual and occasional rail passenger. As a layman, I am not able to comment on most of these matters but would like to make the following response to some of the questions regarding chapter 3.

There are certainly benefits to the five-year control period approach, as stated. However, this approach is not appropriate for very large enhancement projects (and some very small ones). There are also issues with the 'High-Level Output Specification' sometimes being too low-level. Electrification falls into both these categories.

As has been widely reported, the CP5 electrification schemes have suffered greatly from delays, in part due to the industry lacking the capability/skills/capacity to achieve the goals set. Rather than stating the stretches of route to be electrified within the period (which turned out to be an unrealistic aim), perhaps the specification should have been more high-level. For example, would the objective 'to work towards electrification of all major freight and express-passenger trunk routes and other intensively used sections of the network', together with a statement of funds available for this, have avoided the budget overruns? Perhaps more importantly, would a five year commitment to electrification be sufficient for contractors to invest in building the skilled workforce necessary to complete the work? I do not believe it is, therefore the high-level objective needs to be accompanied by a funding commitment over several control periods, or even outside the control-period structure altogether.

Is it right that we continue to use polluting diesel trains over such a wide part of our network, with the health impacts (air-quality) and wider environmental damage (climate change) that entails? Of course not, that is why a long-term commitment to electrification, through and beyond CP6, is required.

At the other end of the scale, it should be possible to develop and implement small enhancements during a control period which were not envisaged during the periodic review process in the run up to the control period. This is perhaps particularly important since operating franchises may be short and not align well with the control-period process (for example, a five year franchise starting soon after a periodic review would end before the next control period it has a chance to influence begins). In other words, it should be possible to quickly implement small enhancements, without going through a slow-moving process and making passengers wait years for the benefits.

Regards,
Thomas J. Wheeler

Response to ORR's first consultation on the financial framework for the 2018 periodic review of Network Rail (PR18)

This pro-forma is available to those that wish to use it to respond to our consultation. Other forms of response (e.g. letter format) are equally welcome.

Please send your response to pr18@orr.gsi.gov.uk by 13 April 2017.

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*This information will not be published on our website.

Chapter 1: Network Rail's business structure and funding

We invite stakeholders to comment on the questions set out at the end of the chapter and/or provide any other comments they consider relevant.

- *Do you have any views on our proposed use of a building block approach to calculate Network Rail's revenue requirement at route level for CP6?*

ORR proposes to calculate the overall revenue requirement for Network Rail from the route-level upwards, with a building block calculation for each route. In doing so, it says it will challenge Network Rail's plans and determine its own view of efficient expenditure levels.

TfL supports the building block approach in principle but has some concerns over its application in practice, particularly on the quality of data and incentives.

Regional funders, such as TfL, have limited ability to monitor, scrutinise and challenge Network Rail's costs and outputs when they are provided at a route level. Further disaggregated data is required to allow a more in-depth understanding of cost drivers and to determine efficiency targets more reliably. Analysis at a more disaggregated level than the route-level would enable relevant stakeholders to better understand and test Network Rail's costs and assumptions. TfL considers outputs at the Operator and London wide-level would be useful and appropriate.

Stakeholders can then play a more active role in assisting ORR to robustly challenge Network Rail's plans and views of efficient expenditure levels, and to assess whether outputs required by government can be delivered within the SOFA funding. The role of ORR in this process was not exactly clear in CP5, and rephasing and descoping of CP5 works occurred.

Chapter 2: Financial policy issues

We invite stakeholders to comment on the questions set out at the end of the chapter and/or provide any other comments they consider relevant.

- *Have we identified all the important financial issues that need to be addressed in PR18?*

This chapter notes "Network Rail's activities in CP5 have cost more than expected and some of its delivery forecasting has not been sufficiently accurate." As ORR will be aware there is a longstanding concern over several control periods as to outcomes of Network Rail's capital programmes compared to budgeted cost and planned delivery schedule. There is a need for greater scrutiny of Network Rail's planning and cost estimation, as well as consideration of the drivers and incentives which influence both planning and delivery.

As noted in response to Chapter 1, analysis at a deeper level than route-level would allow both the ORR and relevant stakeholders (such as TfL) to better analyse and test Network Rail's plans, costings and assumptions. Views on other specific issues raised in this section are outlined below.

Chapter 3: Enhancement funding, a five year control period, the building block approach, and the cost of capital for CP6

We invite stakeholders to comment on the questions set out at the end of the chapter and/or provide any other comments they consider relevant.

- *Do you have any views on the ways that enhancement projects should be financed/funded in CP6?*
- *Have we identified all of the possibilities for private sector partnerships and financing/funding arrangements that might arise?*
- *Which aspects of the financial framework do you think might be relevant to third party/private sector financial participation?*
- *What do you consider should be done to address cross-border funding/benefit mismatches with respect to enhancements?*
- *Do you agree with the reasons we have given for the continuation of the five year control period and the building block approach for calculating Network Rail's revenue requirement?*
- *Which cost of capital approach do you think should be used for Network Rail in CP6?*
- *Have we identified all of the issues relevant to the choice of cost of capital approach?*

Opportunities for third party investment already exist. As discussed in the consultation document, there is a range of ways in which third party funders, such as TfL, can work with Network Rail to fund and deliver enhancements to the network. However, in a similar way to how more in-depth, disaggregate data is necessary (as discussed earlier), there is a need for greater transparency to enable funders to challenge costs and work programmes.

ORR should consider how Network Rail can be incentivised to engage more closely with third party funders and to ensure it is adequately resourced to complete projects on time and to budget. A greater exposure of Network Rail to financial risk when delivering third-party funded enhancements could be one such mechanism (for example, providing compensation to users of the network or its funders when Network Rail fails to deliver planned work on time).

Greater transparency would be another way to incentivise Network Rail to improve enhancement planning and budgeting. It could also lead to greater appetite from third parties to propose and invest in enhancements to the railway, as they would have greater confidence in Network Rail's ability to deliver such enhancements to budget and schedule.

ORR could consider what mechanisms could have improved the planning and delivery of the Gospel Oak to Barking electrification project, including communication with an enhancement funding partner. TfL, which part-funded the project, was only informed the works would not be completed in the last month of an eight month blockade.

ORR could also consider how Network Rail could be incentivised to proactively seek external funding and alternative delivery mechanisms to upgrade the railway – for example, how development on and around Network Rail sites could help pay for railway enhancements.

The chapter discusses on-going enhancement projects – i.e. those that continue from CP5 into CP6. It is important to ensure ongoing projects are completed.

Chapter 4: Other financial issues for CP6

We invite stakeholders to comment on the questions set out at the end of the chapter and/or provide any other comments they consider relevant.

- *Do you think we should change our approach to the calculation of amortisation allowances in light of:*
  - *Network Rail's reclassification and the likelihood of a fixed borrowing limit in CP6?*
  - *the possible developments to enhancement financing/funding set out in chapter 3?*
  - *financial sustainability requirements?*
- *Do you think we should include an 'early start' mechanism in the PR18 process?*
- *Do you consider we should make any changes to our PR13 policies on inflation?*

- *Do you have any views on the corporation tax and VAT issues we have set out?*
- *Do you have any views on how we should treat the proceeds from disposals that*
  - *are made in the normal course of business?*
  - *are made in response to the Hendy report?*
- *Do you think we should make any changes to the treatment of traction electricity, industry costs and rates that we applied at PR13?*
- *Do you have any views on the use of any outperformance amounts that arise during CP6?*
- *Do you have any other views on the financial issues set out in this chapter?*
- *Do you think there are any other financial policy issues we should be considering for CP6?*

The consultation document suggests continuing to use RPI instead of CPI because rail fares and some of Network Rail's debt are linked to RPI. Given the general shift away from RPI to CPI, as recommended by the Johnson review, the ORR should consider how and when a transition to CPI could be implemented.

TfL supports including an 'early start provision' in the PR18 process.

Chapter 5: Financial sustainability and risk management under a route level determination

We invite stakeholders to comment on the questions set out at the end of the chapter and/or provide any other comments they consider relevant.

- *Do you think we have identified the important financial risks applicable to Network Rail in CP6 and that the main risk relates to expenditure levels?*
- *Do you agree with the approaches we have identified for managing expenditure level risks?*
- *What protocols do you think might be necessary to govern the reallocation of financial resources between routes during CP6?*
- *Do you think that the level of Network Rail's debt is a financial sustainability concern?*
- *Do you consider that any changes will be needed to financial licence conditions or re-opener provisions?*

No comments.

Chapter 6: Financial incentives for CP6

We invite stakeholders to comment on the questions set out at the end of the chapter and/or provide any other comments they consider relevant.

- *Should we retain the RAB roll forward incentive mechanism for CP6 – could it be improved?*
- *Could we develop incentives linked to Network Rail's route scorecards?*
- *Should we develop the spend to save mechanism for CP6?*
- *Are there any other financial incentives you think we should consider?*

TfL supports ORR considering how to incentivise Network Rail to develop ways to reduce its costs and increase its income, for example through the spend to save mechanism. As discussed earlier, Network Rail should also be incentivised to proactively seek alternative funding, for example through development and third-party contributions.

ORR should also consider the effects of the possession compensation regime on the behaviour of Network Rail, funders and operators. In some circumstances, the current regime may lead to excessive possession periods being booked in advance, or dissuade works being undertaken, which are in the long term interests of the railway, due to compensation negatively affecting the economic case. A possession compensation regime should incentivise necessary upgrade works to be undertaken at the right time and in a timely fashion – this could be implemented through recalibration and reintroduction of a free allowance.

No further comment beyond potential financial incentives to improve planning and budgeting discussed earlier.

Chapter 7: Financial performance assessment for CP6

We invite stakeholders to comment on the questions set out at the end of the chapter and/or provide any other comments they consider relevant.

- *Have we identified the key limitations and possible improvements for financial performance assessment in CP6?*
- *If the RAB roll forward incentive mechanism is retained, should we continue to apply the 25% adjustment to FPM?*
- *Have we identified the key principles that should apply to the assessment of Network*

Rail's financial performance?

- *Should financial performance measures be treated as a regulated outputs or indicators in CP6?*
- *Should we introduce mechanisms to update efficiency assumptions during the control period?*
- *How could we develop our FPM reporting to reflect our move to route level regulation?*
- *Would it be helpful to provide more context for Network Rail's financial performance in our annual reporting, by comparing the performance of the wider railway industry to the assumptions in the governments' SOFAs?*
- *Are there any other approaches we should consider so that we can effectively assess Network Rail's financial performance and hold it to account?*

No further comment beyond the need for greater transparency and disaggregation of information to a more local level, as well as the various financial and performance incentives discussed earlier.

Any other points that you would like to make

Thank you for taking the time to respond.

Response to ORR's first consultation on the financial framework for the 2018 periodic review of Network Rail (PR18)

This pro-forma is available to those that wish to use it to respond to our consultation. Other forms of response (e.g. letter format) are equally welcome.

Please send your response to pr18@orr.gsi.gov.uk by 13 April 2017.

Full name	Bryony Chetwode
Job title	Company Secretary
Organisation	TravelWatch SouthWest CIC
Email*	
Telephone number*	

*This information will not be published on our website.

Chapter 1: Network Rail's business structure and funding

We invite stakeholders to comment on the questions set out at the end of the chapter and/or provide any other comments they consider relevant.

- Do you have any views on our proposed use of a building block approach to calculate Network Rail's revenue requirement at route level for CP6?

The new building block approach to route level funding appears to be a sensible way forward and we look forward to seeing this being put into action for the Western and Wessex Routes. Adequate funding, however, for renewals and enhancements is essential no matter what the new approach is.

The need for good quality expenditure forecasts is highlighted as critically important but given recent experience around the Great Western electrification we need reassurance that Network Rail will be able to provide these.

Where are the references to passengers and their interests? What will be the final outcome, for the passenger, of the new financial framework? As one of Network Rail's main aims is to provide the infrastructure for passenger services there should be some recognition of them in the new framework.

Chapter 2: Financial policy issues

We invite stakeholders to comment on the questions set out at the end of the chapter and/or provide any other comments they consider relevant.

- Have we identified all the important financial issues that need to be addressed in PR18?

No comment.

Chapter 3: Enhancement funding, a five year control period, the building block approach, and the cost of capital for CP6

We invite stakeholders to comment on the questions set out at the end of the chapter and/or provide any other comments they consider relevant.

- Do you have any views on the ways that enhancement projects should be financed/funded in CP6?
- Have we identified all of the possibilities for private sector partnerships and financing/funding arrangements that might arise?
- Which aspects of the financial framework do you think might be relevant to third party/private sector financial participation?
- What do you consider should be done to address cross-border funding/benefit mismatches with respect to enhancements?
- Do you agree with the reasons we have given for the continuation of the five year control period and the building block approach for calculating Network Rail's revenue requirement?
- Which cost of capital approach do you think should be used for Network Rail in CP6?
- Have we identified all of the issues relevant to the choice of cost of capital approach?

There are numerous references to opportunities for third party funding. To achieve this Network Rail must make itself more attractive to investors through being committed to improving delivery times, reducing costs and ensuring greater value for money. Providing more robust, accurate and reliable costs estimates from the earliest stages of rail projects will provide investors with greater confidence.

We welcome the ideas around enhanced partnerships and third party funding generating a return or income stream for the investor. We believe such an approach could start to make it more attractive for third party funders to invest.

Retaining the five year control periods (CP) provides a consistent approach but this should not be used as the mechanism to slip schemes from one CP to another to resolve funding and delivery issues. The opportunity to bring in new grant funded schemes outside of the CP programme adds an element of flexibility but this should not be at the cost of undermining the rest of the CP programme. With Network Rail's resources already stretched it will not help if new un-programmed schemes are introduced.

We do not entirely agree with the principle that "the party benefitting ought to pay the costs" as the issue of who benefits can be complex. Capacity/resilience improvements for example that maybe local in nature, can provide benefits over a much wider area. For local authorities meeting the whole cost of schemes in not a great incentive to invest. We note that the ORR has provided some recognition of this issue for the specific case of cross-border schemes involving Scotland, but the methods suggested might be applied more extensively at a regional level.

Chapter 4: Other financial issues for CP6

We invite stakeholders to comment on the questions set out at the end of the chapter and/or provide any other comments they consider relevant.

- Do you think we should change our approach to the calculation of amortisation allowances in light of:
  - Network Rail's reclassification and the likelihood of a fixed borrowing limit in CP6?
  - the possible developments to enhancement financing/funding set out in chapter 3?
  - financial sustainability requirements?
- Do you think we should include an 'early start' mechanism in the PR18 process?
- Do you consider we should make any changes to our PR13 policies on inflation?
- Do you have any views on the corporation tax and VAT issues we have set out?
- Do you have any views on how we should treat the proceeds from disposals that
  - are made in the normal course of business?
  - are made in response to the Hendy report?
- Do you think we should make any changes to the treatment of traction electricity, industry costs and rates that we applied at PR13?
- Do you have any views on the use of any outperformance amounts that arise during CP6?
- Do you have any other views on the financial issues set out in this chapter?
- Do you think there are any other financial policy issues we should be considering for CP6?
-

No comment.

Chapter 5: Financial sustainability and risk management under a route level determination

We invite stakeholders to comment on the questions set out at the end of the chapter and/or provide any other comments they consider relevant.

- Do you think we have identified the important financial risks applicable to Network Rail in CP6 and that the main risk relates to expenditure levels?
- Do you agree with the approaches we have identified for managing expenditure level risks?
- What protocols do you think might be necessary to govern the reallocation of financial resources between routes during CP6?
- Do you think that the level of Network Rail's debt is a financial sustainability concern?
- Do you consider that any changes will be needed to financial licence conditions or re-opener provisions?

We welcome the route approach to funding and believe it will provide greater local accountability and ownership for the Western and Wessex Routes. Retaining an element of flexibility to reallocate funds between routes to manage risks and exploit opportunities as and when they arise is appropriate but not at the cost of raiding successful routes to bail out under performing ones. We believe there should be a strategic central reserve to avoid routes losing out through such reallocations. Reassurance is also sought that any reallocation is done in an open and transparent manner and stakeholder are made aware of the impact.

Chapter 6: Financial incentives for CP6

We invite stakeholders to comment on the questions set out at the end of the chapter and/or provide any other comments they consider relevant.

- Should we retain the RAB roll forward incentive mechanism for CP6 – could it be improved?
- Could we develop incentives linked to Network Rail's route scorecards?
- Should we develop the spend to save mechanism for CP6?
- Are there any other financial incentives you think we should consider?

No comment.

Chapter 7: Financial performance assessment for CP6

We invite stakeholders to comment on the questions set out at the end of the chapter and/or provide any other comments they consider relevant.

- Have we identified the key limitations and possible improvements for financial performance assessment in CP6?
- If the RAB roll forward incentive mechanism is retained, should we continue to apply the 25% adjustment to FPM?
- Have we identified the key principles that should apply to the assessment of Network Rail's financial performance?
- Should financial performance measures be treated as a regulated outputs or indicators in CP6?
- Should we introduce mechanisms to update efficiency assumptions during the control period?
- How could we develop our FPM reporting to reflect our move to route level regulation?
- Would it be helpful to provide more context for Network Rail's financial performance in our annual reporting, by comparing the performance of the wider railway industry to the assumptions in the governments' SOFAs?

Are there any other approaches we should consider so that we can effectively assess Network Rail's financial performance and hold it to account?

No comment.

Any other points that you would like to make

As the consultation document is referring to possible approaches and not firm proposals, it is extremely difficult to figure out the full implications. Whilst we broadly welcome the approach taken we trust that the ORR and Network Rail will be open and transparent with stakeholders in its implementation.

Thank you for taking the time to respond.

Response to ORR's first consultation on the financial framework for the 2018 periodic review of Network Rail (PR18)

This pro-forma is available to those that wish to use it to respond to our consultation. Other forms of response (e.g. letter format) are equally welcome.

Please send your response to pr18@orr.gsi.gov.uk by 13 April 2017.

Full name	Pedro Abrantes
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Organisation	Urban Transport Group
Email*	
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*This information will not be published on our website.

Chapter 1: Network Rail's business structure and funding

We invite stakeholders to comment on the questions set out at the end of the chapter and/or provide any other comments they consider relevant.

- Do you have any views on our proposed use of a building block approach to calculate Network Rail's revenue requirement at route level for CP6?

  The strict distinction between operating and capital expenditure can distort incentives in a way that skews management decisions away from the most efficient use of resources.

  We would like to see a move towards a more flexible system that explicitly recognises the interaction between some forms of operating expenditure and capital expenditure. One idea might be to take into account the capex savings that result from a given stream of operating expenditure (for example, due to reduced depreciation or higher value being derived from the existing infrastructure – effectively analogous to an increase in the RAB). We feel that it would be helpful for the ORR to produce some concrete worked examples of the interaction between capex and opex.

  We have argued throughout PR13 that the monitoring of Network Rail's costs and outputs at route-level is not disaggregate enough to scrutinise and challenge its efficiency in a meaningful way. A more in-depth understanding of cost drivers, necessarily at a more disaggregate spatial scale, is essential to arrive at more reliable efficiency targets and to monitor these as time goes on. We would therefore like to see the building blocks approach implemented at a more detailed spatial scale.

Chapter 2: Financial policy issues

We invite stakeholders to comment on the questions set out at the end of the chapter and/or provide any other comments they consider relevant.

- Have we identified all the important financial issues that need to be addressed in PR18?

Although the consultation document acknowledges the potentially growing role of third party funders, it largely overlooks the already significant and growing role of transport authorities at both the local (e.g.: Combined Authorities) and regional/sub-national (e.g.: Rail North/Transport for the North and West Midlands Rail) level. Unlike ad-hoc third party funders (e.g.: developers) or, to a large extent, TOCs these bodies are relatively permanent and have a vested interest in both the long-term success of the railways (including its financial sustainability) and in ensuring that the railways contribute to wider social and economic outcomes. They also have a degree of knowledge of local rail infrastructure, operations and, in some cases, cost drivers, that is generally not available to national bodies. As such, these organisations can potentially play a vital complementary role to the DfT and ORR in holding Network Rail to account. This should be recognised explicitly as part of PR18.

Turning more specifically to financial issues, there are three areas where the regulatory framework could go further to take greater advantage of what these organisations have to offer.

Firstly*, it could require Network Rail to release cost and output information at a much greater level of disaggregation. This would enable local stakeholders to play a much more active and effective role in scrutinising and challenging NR's performance. At present, the financial framework reinforces the asymmetry of information between NR and its stakeholders by requiring information to be disclosed only at very high level. It could be argued that there is a cost involved in making this information available. We would argue that it can actually be more costly to aggregate raw data up to an arbitrary level set by the regulator than to simply open up disaggregate data that should in any case be available to management.*

Secondly*, it could expose NR to greater level of financial risk when delivering third-party funded enhancements. The current 'emerging cost' approach fails to meet the ORR's principle that NR should bear those risks that it is best able to bear. In practice, this means that NR is neither exposed to the effect of its own actions nor accountable to those who are paying for enhancements in any way. This state of affairs cannot incentivise efficient behaviour and it also prevents local stakeholders from challenging NR costs. Another way in which NR is protected from the impact of its actions is by not being required to compensate users of the network or their funders for failing to deliver planned work on which operating plans are predicated. One example is where delays to electrification make some rolling stock idle and may force operators to lease additional* *vehicles or renege on franchise commitements. It could be argued that the effect of exposing NR to greater risk would be to push up its revenue requirement. This may be true but would it not also create more effective incentives towards efficient behaviour?*

***Thirdly**, some of the funding that is currently routed through the DfT could instead flow to NR through these organisations. Whilst we appreciate that this is a decision for the DfT rather than the ORR, we would be interested to have the ORR's thoughts on how this could be accommodate within the financial framework for PR18.*

On a separate point, we would observe that the consultation document concentrates more on monitoring symptoms than addressing causes. Yes, it is the role of the ORR to set an efficient revenue requirement and to monitor NR's progress towards greater efficiency. During CP5, the ORR was able to show that NR did not achieve the level of efficiency it had been set. But we are still not convinced that we know how this could have been avoided. So we would query whether the industry (and, by extension, the ORR) has the right level of skills and the right information to determine efficiency ex-ante and to challenge emerging information. We believe that this deserves some consideration in designing the financial framework for PR18. As we argue earlier, greater disaggregation of financial information (well below route-level as currently proposed) would be a step in the right direction. Other ideas could include further international benchmarking.

Another issue that the consultation document should consider at greater length is the potential role of alternative delivery mechanisms (i.e.: where third parties deliver network enhancements) in determining appropriate efficiency targets. Some of our members have experience of directly delivering or contracting rail infrastructure works outside mainstream NR channels. This type of information could perhaps provide useful benchmarks to measure NR's performance against.

Chapter 3: Enhancement funding, a five year control period, the building block approach, and the cost of capital for CP6

We invite stakeholders to comment on the questions set out at the end of the chapter and/or provide any other comments they consider relevant.

- Do you have any views on the ways that enhancement projects should be financed/funded in CP6?

  We would refer to our comments in the context of chapter 2, relating to routing of DfT funding through local stakeholders and delivery of rail infrastructure works by organisations other than NR.

More generally, we feel it would be beneficial to align enhancement funding to route study outcomes and to develop a longer term (i.e.: longer than the current 5 year cycles) pipeline process of schemes to deliver capacity and journey time improvements. Within the pipeline, schemes would run through the development, design, business case, funding and implementation stages. The delivery programme of both enhancements and renewals could then need also be aligned to maximise efficiency and minimise disruption to the travelling public.

- Have we identified all of the possibilities for private sector partnerships and financing/funding arrangements that might arise?

  As we argue under chapter 2, we feel that the consultation document largely overlooks the already significant and growing role of transport authorities at both the local and regional/sub-national level.

- Which aspects of the financial framework do you think might be relevant to third party/private sector financial participation?

  ** No views **

- What do you consider should be done to address cross-border funding/benefit mismatches with respect to enhancements?

  We have no further ideas on this topic but would point out that this issue is of relevance not just in the context of devolved nations but also for local and regional transport bodies.

- Do you agree with the reasons we have given for the continuation of the five year control period and the building block approach for calculating Network Rail's revenue requirement?

  Yes.

- Which cost of capital approach do you think should be used for Network Rail in CP6?

  We have no strong views, given the information presented in the consultation paper which suggests that the net impact on public finances would be more or less negligible. However, we recognise the point that different approaches could incentivise different types of behaviour on the part of Network Rail and agree that it would be worth exploring this in more detail before a decision is made.

- Have we identified all of the issues relevant to the choice of cost of capital approach?

  ** No views **

Chapter 4: Other financial issues for CP6

We invite stakeholders to comment on the questions set out at the end of the chapter and/or provide any other comments they consider relevant.

- Do you think we should change our approach to the calculation of amortisation allowances in light of:
  - Network Rail's reclassification and the likelihood of a fixed borrowing limit in CP6?
  - the possible developments to enhancement financing/funding set out in chapter 3?
  - financial sustainability requirements?

  ** No views **

- Do you think we should include an 'early start' mechanism in the PR18 process?

  Yes, on the basis that this introduces greater flexibility.

- Do you consider we should make any changes to our PR13 policies on inflation?

  ** No views **

- Do you have any views on the corporation tax and VAT issues we have set out?

  ** No views **

- Do you have any views on how we should treat the proceeds from disposals that
  - are made in the normal course of business?
  - are made in response to the Hendy report?

  We have no strong views though it seems to make little sense to leave the RAB unchanged following disposals as this would presumably reward Network Rail for reducing its asset base.

- Do you think we should make any changes to the treatment of traction electricity, industry costs and rates that we applied at PR13?

** No views **

- Do you have any views on the use of any outperformance amounts that arise during CP6?

  ** No views **

- Do you have any other views on the financial issues set out in this chapter?

  No.

- Do you think there are any other financial policy issues we should be considering for CP6?

  No.

Chapter 5: Financial sustainability and risk management under a route level determination

We invite stakeholders to comment on the questions set out at the end of the chapter and/or provide any other comments they consider relevant.

- Do you think we have identified the important financial risks applicable to Network Rail in CP6 and that the main risk relates to expenditure levels?

The consultation document makes no reference to the possibility that Network Rail could be required to compensate users of the network for delays to the delivery of planned schemes, or output reductions, which could have a knock-on impact on operating costs.

There is also no consideration given to the possibility that the current approach to third party funded enhancements (known as 'emerging costs') could be changed so that Network Rail is liable for a greater proportion of over-spends.

- Do you agree with the approaches we have identified for managing expenditure level risks?

The consultation document concentrates on how to respond when risks are realised but gives a relatively superficial treatment to addressing the causes of these risks and tackling those at source. We feel that more emphasis should be given to detailed, bottom-up analysis of NR processes and efficiency at a more disaggregate spatial level to understand how much different activities ought to cost. As we argue earlier in our response, more disaggregate cost and output data should be made openly available to a wider range of stakeholders, including transport authorities, who could use their local knowledge to complement and support the work of the ORR.

A few more specific comments:

Para 5.18 "[NR] will need to set out well-founded expenditure assumptions for each of its routes in its business plans" – how does 'well-founded' mean and what guidance is being given to NR on this point?

Para 5.19 "[ORR will] use our own risk modelling to better understand possible ranges of expenditure" – what does this consist of? What methods and data are being used? How detailed will the analysis be? Could other stakeholders contribute to this work?

Para 5.20 "NR will need to manage financial risk by using good quality management information to identify costs and output pressures as early as possible" – what is good quality management information? What is ORR's current assessment of the quality of NR's management information? What oversight does ORR have of this information?

Para 5.20 "NR will need to manage financial risk by, where appropriate switching from asset renewals to life extension programmes or additional maintenance activity". Agreed, but what concrete incentives is NR being given to choose to do this in practice?

Para 5.20 "NR will need to manage financial risk by optimising advantages from devolving management decisions to routes". We would argue that one of these advantages will be that routes can be more easily held to account by their local stakeholders. However, what tools are they [local stakeholders] being given to perform this role more effectively?

- What protocols do you think might be necessary to govern the reallocation of financial resources between routes during CP6?

  ** No views **

- Do you think that the level of Network Rail's debt is a financial sustainability concern?

  ** No views **

- Do you consider that any changes will be needed to financial licence conditions or re-opener provisions?

  ** No views **

Chapter 6: Financial incentives for CP6

We invite stakeholders to comment on the questions set out at the end of the chapter and/or provide any other comments they consider relevant.

- Should we retain the RAB roll forward incentive mechanism for CP6 – could it be improved?

  It is not clear why NR should only bear 25% of the cost of over-spends, given that it presumably has greater control over these.

  The consultation document claims that this mechanism creates reputational incentives for NR managers but it is unclear whether this is the case. How visible is it in practice and what evidence is there that it influences managers' behaviour?

- Could we develop incentives linked to Network Rail's route scorecards?

  Yes. One useful measure would be the % over-spend on third party funded schemes.

- Should we develop the spend to save mechanism for CP6?

  Yes, it seems to be a sensible mechanism.

- Are there any other financial incentives you think we should consider?

  Yes, NR should have greater exposure on third-party funded enhancements and be required to provide detailed cost data, and other project management information, to funders in a timely manner. The publication of detailed cost data is essential in order to avoid the incentive on Network Rail to over-inflate cost estimates at the outset in order to absorb potential over-spends.

Chapter 7: Financial performance assessment for CP6

We invite stakeholders to comment on the questions set out at the end of the chapter and/or provide any other comments they consider relevant.

- Have we identified the key limitations and possible improvements for financial performance assessment in CP6?

  See earlier responses.

- If the RAB roll forward incentive mechanism is retained, should we continue to apply the 25% adjustment to FPM?

  See response to chapter 6.

- Have we identified the key principles that should apply to the assessment of Network Rail's financial performance?

  See our response to chapter 5, where we query the degree of information which the ORR holds regarding NR costs.See also our earlier points about enabling local stakeholders to complement the scrutiny role of the ORR through greater transparency over NR cost and output information.

- Should financial performance measures be treated as a regulated outputs or indicators in CP6?

  We see little value in treating financial performance measures as regulated outputs, especially as it is not clear at this point what impact, if any, this would have on the behaviour of NR management. We believe that regulatory effort should go towards understanding and challenging cost data in greater detail rather than setting arbitrary outputs that may well be un-realistic from the outset.

- Should we introduce mechanisms to update efficiency assumptions during the control period?

  In principle, yes. But, again, we believe that more regulatory effort should go towards understanding and challenging cost data in greater detail rather than dealing with the fall-out – changing efficiency assumptions may be necessary as a matter or process but does little to solve underlying causes.

- How could we develop our FPM reporting to reflect our move to route level regulation?

  Our default position (see previous responses) is that cost information should be openly available at the most disaggregated level available. The cost is likely to arise in aggregating this information up so as to meet regulatory requirements. If so, then there should be relatively little cost involved in providing more disaggregate information than at present.

- Would it be helpful to provide more context for Network Rail's financial performance in our annual reporting, by comparing the performance of the wider railway industry to the assumptions in the governments' SOFAs?

  ** No views **

Any other points that you would like to make

Thank you for taking the time to respond.

Ken Skates AC/AM
Ysgrifennydd y Cabinet dros yr Economi a'r Seilwaith
Cabinet Secretary for Economy and Infrastructure

Llywodraeth Cymru
Welsh Government

Stephen Glaister
Chair
Office of Rail and Road
One Kemble Street
London
WC2B 4AN

21 April 2017

Dear Stephen,

I welcome the opportunity to respond to the consultation on the financial framework as part the Office for Rail and Road's (ORR) Periodic Review 2018 (PR18).

Devolution, both in terms of more responsibility to the Network Rail routes and more generally in terms of establishing devolved authorities' roles, should be at the centre of thinking in respect of the future funding framework and I expect the ORR to have due regard to our unique position when developing proposals for charges and incentives in PR18.

Enhancements

Although rail infrastructure is not devolved, Welsh Government has historically invested significantly in improving rail infrastructure and an ambitious programme of improvements continues to be developed and delivered across Wales, including future plans for Metro systems for both North and South Wales.

However, the planning and financing of rail schemes would be simpler, more efficient, and easier to manage with more assurance around delivery timescales, costs and outputs. Condition 1 of Network Rail's licence, currently the principal accountability arrangement for third party funders, including Welsh Government, is not a satisfactory mechanism for ensuring Network Rail is held to account for the delivery of these non-regulated schemes. The regulatory framework for PR18 should enable the ORR to effectively hold Network Rail to account for outputs funded by the Welsh Government in the same way as those funded by the DfT through the HLOS.

I want the ORR to work with Network Rail to develop a suite of Wales-specific model contracts for PR18, in line with the Wales Audit Office recommendations, which recognise the unique position of the Welsh Government. I would also like consideration given to how funding arrangements could enable third party funders to make fixed cost contributions to enhancements to rail infrastructure so that they are not liable, beyond an agreed level of development, for indefinite construction cost increases after budgets have been agreed and funding committed.

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This could be facilitated by the adaption and upgrading of the existing industry risk fund, with appropriately robust governance arrangements. In addition, the efficient delivery by Network Rail of third party enhancements should be further incentivised through regular monitoring and reporting of third party scheme delivery in route balanced scorecards.

The most appropriate funding mechanism for new UK Government funded enhancements is a matter for the Department for Transport and the Treasury. However, in order to provide greater clarity and certainty for Network Rail and its supply chain, an appropriate funding envelope for enhancements in Control Period 6 should be identified in the SOFA. Certainty would also be improved through the inclusion as regulated outputs of on-going and committed enhancements from Control Period 5 into Control Period 6 in the HLOS.

Notwithstanding the funding mechanism, the process for scheme development and delivery needs to be clear and transparent with appropriate levels of governance around decision-making and the allocation of funding at each stage. ORR should also continue their regulatory role over the delivery of enhancements under all future financing arrangements.

Maintenance and Renewals
The methodology used for the development of route-level business plans, and the subsequent allocation of funding to routes needs to take account of current route performance and existing levels of reliability. This would ensure that routes where performance is currently below the national average can improve their operations relative to better performing areas and I expect ORR to consider existing relative route performance when assessing Network Rail's route business plans for Control Period 6.

Efficiency targets for the delivery of maintenance and renewals schemes need to be considered in the context of Network Rail's performance during the current control period. Planned step-changes in Network Rail's performance and delivery need to be accompanied by a strong justification and coherent rationale as to how any planned and budgeted efficiencies would be achieved.

In order to continue to deliver planned enhancements during Control Period 5, Network Rail have deferred a number of planned renewal schemes. In order to preserve the long-term sustainability of the rail network and supporting infrastructure, these schemes should be integral to Network Rail's business plans for Control Period 6 with a clear timetable for delivery and a costed budget. In future control periods, the deferral of planned renewal and maintenance schemes should not be possible without a strong justification as to how any benefits lost will be delivered, a revised programme, and budget identified for their delivery.

Route Devolution and Funding
The current level of Network Rail's debt is a concern as the cost of servicing this debt potentially puts at risk the delivery of crucial renewals and enhancements required over future control periods.

Welsh Government welcome the greater route devolution proposed in the next control period. However, if route devolution is to be effective in delivering the expected benefits of improved customer engagement and local decision making, the routes need to have sufficient autonomy to develop their business plans, infrastructure renewal and maintenance requirements and necessary levels of funding. The protocol for transferring funds between routes within a control period needs to be developed including the identification of all material impacts, the decision-making process and parties, and mitigation measures.

I appreciate the engagement that ORR has undertaken so far for PR18 and I would like my officials to continue to be kept regularly updated on progress on the issues identified above and also the wider work being undertaken to inform PR18.

Yours ever,

Ken

Ken Skates AC/AM
Ysgrifennydd y Cabinet dros yr Economi a'r Seilwaith
Cabinet Secretary for Economy and Infrastructure

Office of Rail and Road
By email

12 April 2017

Dear Sir/Madam

West of England response to ORR's first consultation on the financial framework for the 2018 periodic review of Network Rail (PR18), January 2017

Thank you for the opportunity to respond to the consultation on the financial framework for the 2018 periodic review of Network Rail (PR18). This response represents the views of the West of England which is made up of the four local authorities of Bath & North East Somerset, Bristol City, North Somerset and South Gloucestershire and the Local Enterprise Partnership. The response has been drawn up with input from officers from the four councils and the Local Enterprise Partnership.

Many of the questions asked as part of the consultation are not relevant to or appropriate for the West of England to answer. Where possible our responses are still based around the Chapter headings in the consultation report.

Chapter 1: Network Rail's business structure and funding

The building block approach to route level funding looks sensible but we do wish to highlight the need to adequately fund capital expenditure for renewals and enhancements. We note good quality expenditure forecasts are flagged up as critically important but we are not confident given recent experience around the Great Western electrification and our MetroWest Phase 1 scheme that Network Rail are yet in a position to be able to provide these.

It is curious that the importance of the passenger is almost entirely absent from the report. Yet along with providing for the freight operating companies, Network Rail's purpose is to provide the infrastructure to enable passenger train services. New forms of capital and budgetary calculation and control are all very well but will it actually deliver improvements to the passenger? What is the final outcome, for the passenger, of the new financial framework?

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Chapter 3: Enhancement funding, a five year control period, the building block approach, and the cost of capital for CP6

We note the various references to opportunities for third party funding. We respectfully refer you back to the West of England's previous responses of 10 January 2017 to the ORR's Strategic Business Plan consultation and of 11 July 2016 to the initial consultation on the 2018 periodic review on the need for Network Rail to make itself more attractive to third party funders. We believe it is worth restating them.

Increasing the role of local funders is evidently a key aim of the new financial framework but to achieve this Network Rail has to be more attractive to investors through being committed to improving delivery times, reducing costs and ensuring greater value for money. More robust, accurate and reliable costs estimates from the earliest stages of rail projects will provide investors with greater confidence that costs can be managed and delivered on budget.

As part of the West of England's response to the National Infrastructure Commission's Call for Evidence in October 2016 a new mechanism for sharing the costs and risks of third party rail schemes between the third party and Network Rail funding schemes was proposed:

GRIP 1-2 is funded 100% by and all the risks are owned by the third party funder.

GRIP 3 & 4 is funded jointly by the third party (67%) and Network Rail (33%) and risks shared third party (80%) and Network Rail (20%).

GRIP 5 is funded jointly and risks shared by the third party (67%) and Network Rail (33%).

All non-GRIP costs funded 100% by the third party.

GRIP 6-8 implementation costs jointly funded by the third party (67%) and Network Rail (33%) with all risks owned by Network Rail. GRIP 5 cost estimates will fix the contribution of the third party to the construction and implementation of the scheme.

We believe this will create an equal risk and reward framework that will encourage more third party investment in the rail network.

We welcome the ideas around enhanced partnerships and third party funding generating a return or income stream for the investor. We believe such an approach could also start to make it more attractive for third party funders to invest.

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We agree with retaining the five year control periods (CP) but we do need more certainty regarding the delivery of schemes and the avoidance of simply slipping one CP scheme to the next to resolve funding and timescale issues. The ability to bring in new grant funded schemes outside of those in the CP programme will benefit projects such as MetroWest once funding is confirmed and approvals in place. MetroWest is a longstanding scheme with an established programme but our concern is that new schemes will undermine the CP programme and cause schemes to be deferred to the following CP. Network Rail's resources for delivery are already stretched and this will not be helped if new un-programmed schemes are introduced. We acknowledge there will need to be an element of programme flexibility around unforeseen and urgent schemes.

We do not agree with the principle that "the party benefitting ought to pay the costs" as the issue of who benefits can be complex. We refer you to our response of 10 January 2017 to the ORR's Strategic Business Plan consultation on recognising that third party investors are contributing towards the betterment of the rail network. This should be taken into account in setting Network Rail's financial framework. As an example, MetroWest Phase 1 will see freight trains on the Portbury line benefiting from higher running speeds, deferred maintenance requirements, the removal of two level crossings, modern signalling and greater capacity as a result of the upgrading to carry passenger trains. Yet as things stand these enhancements are to be entirely funded by the West of England local authorities together with all the delivery risk. Bearing the whole cost is not an incentive to invest.

Our recent experience with the MetroBus project has demonstrated how Network Rail has exported cost to other public transport and publicly funded projects. This reiterates the need for Network Rail to ensure greater value for money, deliver on time and on budget with more robust, accurate and reliable costs estimates from the earliest stages of projects.

Chapter 5 Financial sustainability and risk management under a route-level determination

We welcome the route approach to funding and believe it will provide greater local accountability and ownership. Network Rail should retain an element of flexibility to reallocate funds between routes to manage risks and exploit opportunities as and when they arise but this should not be at the cost of raiding successful routes to bail out under performing ones. To this end we argue there should be a strategic central reserve to avoid routes losing out through reallocations. We also seek reassurance that any reallocation is done in an open and transparent manner and stakeholder are made aware of the impact.

Chapters 2, 4, 6 and 7.

We have no comments to make on these chapters.

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We trust you will find our response of use.

Yours Faithfully

James White
Transport and Rail Coordinator

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