Responses to the update letter on PR18 Financial Framework

John Larkinson
Director, Railway Markets and Economics
One Kemble Street
London
WC2B 4AN

19th January 2018

Dear John

Re: Update on the financial framework for PR18

It is helpful that the reclassification of Network Rail as a public sector arm's length body coupled with DfT arrangements detailed in DfT's statement of funding available (SoFA) have the potential to simply the financial framework for Network Rail in CP6. However, the revised financial environment that Network Rail will be required to work in has the potential to have a material impact on Network Rail's ability to deliver its Operating, Maintenance and Renewal (OMR) outputs efficiently. It is therefore important that the arrangements that ORR put in place addresses this concern.

In particular, as Network Rail will be unable to borrow in CP6 to support its OMR activities, it is important that the ORR's determination should include mechanisms to allow Network Rail to address situations where costs are higher than expected. It can be envisaged that such a situation could occur for a wide variety of reasons including:

- Supply chain cost trends being higher than expected
- Inflation levels are not as forecast at the time of the determination
- Significant incidents affecting the railway network.

In CP5, it has been evident that the requirement to successively defer and reprogram maintenance and renewal work packages has resulted in higher unit costs, increased planning costs, reduced delivery efficiency and significant disruption to users of the rail network.

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To address this, it is essential that financial framework provides Network Rail with the flexibility to move funding between years in the Control Period so that the execution of maintenance and renewal activity can be undertaken in the most efficient manner and with the minimum of disruption to users of the rail network. Additional flexibility for Network Rail to move funding between its business units (including between Routes) would also assist. However, suitable controls will need to accompany these flexibilities to ensure that the delivery of the outputs that specific customers depend upon is protected.

Experience in delivering renewals has shown that the delivery of renewal schemes provides as cost effective opportunity to ensure that the configuration of the rail network keeps pace with the development of the traffic using the rail network. For example, when renewing a turn out, it is appropriate that the speed limit across the renewed infrastructure should reflect the speeds that trains operating over that turn out or likely to be operating over that turn out during the life span of the renewed turnout are capable of achieving. This approach has sometimes been termed "renewals plus". As the use of the rail network increases, such as approach is necessary to ensure that the overall capability of the rail network is sustained rather than progressively eroded. On occasion it has been wrongly suggested that a "renewals plus" approach is in appropriate as it blurs the boundary between renewals and enhancement and has been seen as a cause of reduced renewals efficiency. On the contrary, given that a "renewals plus" approach provides the most cost effective means by which overall network capability can be sustained, Network Rail should be encouraged to incorporate it in its renewals programme to the maximum extent possible. The financial framework of the determination should support Network Rail in this area.

A significant aspect of the rail industry's plans for CP6 relates to increasing the role that 3rd parties can play in investing in the enhancement of the rail network. It is therefore important that the financial framework established for Network Rail in CP6 by ORR should enable the unlocking of this opportunity. In particular, it needs to be clear how 3rd party investors in the rail network will be rewarded for the risks they are taking in making that investment.

Yours sincerely,

Richard McClean
Managing Director
Grand Central
on behalf of Arriva

By Appointment to Her Majesty The Queen
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Doncaster

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18 January 2018

UPDATE ON THE FINANCIAL FRAMEWORK FOR PR18

This letter contains the comments of DB Cargo (UK) Limited ("**DB Cargo**") concerning the matters included in the "*Update on the financial framework for PR18*" issued by the Office of Rail and Road ("**ORR**") on 14 December 2017 ("**the update**").

Other single till income

Although not specifically mentioned in the update, DB Cargo understands that Network Rail is proposing to sell its profitable and successful commercial estate business. In the factsheet published to provide more information about the sale, Network Rail states that the proposed sale will not impact on the rail network, train operating companies, freight operating companies and other operational partners. However, DB Cargo believes that the rental income from Network Rail's property businesses, forms part of the 'other single till income' and is deducted from ORR's assessment of efficient costs to reduce the revenue requirement Network Rail requires for the Control Period in question.

This, therefore, implies that the sale of Network Rail's commercial estate business will reduce Network Rail's rental income which, in turn, would reduce the value of the 'other single till income' meaning that more revenue is required from Government grant or track access charges. Consequently, DB Cargo is concerned that the sale of Network Rail's commercial estate business may lead to an increase in track access charges which would have a material adverse impact on freight operating companies (including DB Cargo). DB Cargo considers that this issue should be addressed as part of ORR's PR18 financial framework assessment for Control Period 6 ("**CP6**").

Budgetary flexibility during CP6

A key element of Network Rail's current financial framework is that it has flexibility to adjust budgets between years of the Control Period and between expenditure categories. This reflects the complexity of planning expenditure for the railway. It is important that Network Rail has sufficient flexibility to enable it to respond to risks and opportunities during the control period in support of the efficient delivery of outputs for customers.

As has been acknowledged by ORR, in Control Period 5 the need for Network Rail to re-plan renewals projects to stay within spending limits has led to "*a downward spiral of deferred work and higher costs for the work done*". Reducing Network Rail's ability to flex annual budgets within the control period increases the likelihood that costly deferrals and re-planning will need to take place, to the detriment of taxpayers and railway users.

ORR's letter states that the Governments are presently considering the degree of flexibility Network Rail should have in terms of moving money between financial years and between resource and capital spending in support of business efficiency and effective risk management. ORR is the independent regulator responsible for establishing the financial framework within which Network Rail operates. As such, and recognising that this is not fully within the control of the ORR, DB Cargo believes that ORR should clearly set out its views on the optimal level of flexibility to facilitate efficient delivery in CP6. It will then be clear to decision makers that the implementation of an insufficiently flexible framework is likely to have an adverse impact upon delivery.

Managing Risk

DB Cargo believes that ORR must include in its settlement an allowance for risk and uncertainty. This is particularly important for CP6, given that Network Rail's budgetary constraints will be more stringent than has been the case in the past. During CP6, it is likely that unforeseen changes and events will occur that could lead Network Rail to incur additional costs. Ensuring that Network Rail receives appropriate funding for risk and uncertainty will help to reduce the likelihood that such unforeseen changes will require disruptive re-planning, which may in turn be detrimental to its ability to deliver its work plans in as efficient way as possible.

Should the revenue requirement determined by the ORR, including an allowance for risk, be insufficient to deliver the HLOS, the logical solution would be an increase of the funding available or a reduction of the outputs expected to be delivered in CP6. In these circumstances, DB Cargo believes that it is for ORR to make this case to the Governments.

Given the financial constraints that Network Rail will be operating under in CP6, it is of increased importance that the ORR's efficiency assumptions are credible and achievable in this new environment.

Funding of enhancements

The update notes that, in CP6, enhancements will be funded by capital grants which will be separate from the SoFAs and ORR's determination of Network Rail's revenue requirements. As enhancement projects will not generally be part of the periodic review settlement and instead will be subject to separate funding arrangements, it is important that ORR makes clear that the funding allowed under the CP6 settlement cannot be moved to fund increases in the costs of enhancement projects.

...

Yours sincerely,

Nigel Oatway
Access Manager

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[redacted]

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24 January 2018

Dear John,

UPDATE ON THE FINANCIAL FRAMEWORK FOR PR18

I am writing in response to ORR's update letter on the financial framework for PR18, which was published on 14 December 2017. I hope that you find our response helpful as you continue to develop the CP6 financial framework.

In this response, we highlight specific comments we have about the issues raised in your letter. However, first we provide some background about the key changes to our funding arrangements for CP6 that affect the financial framework, and therefore, how we have responded to your letter.

Changes since previous ORR financial framework consultation

Since ORR's previous CP6 financial framework consultation in January 2017, DfT published its CP6 Statement of Funds Available (SoFA) for England and Wales in October 2017. Therefore, we now have a better understanding of our funding arrangements for CP6.

We welcome DfT's CP6 SoFA as it provides a funding envelope for all five years of CP6 and is based on a significant increase in operations, maintenance and renewals expenditure, compared to CP5. This increase in funding is needed because the network is bigger, the number of people using it has grown and we have been unable to do as much work as originally planned in CP5.

DfT's SoFA confirmed that, in CP6, we will not borrow to fund the outputs in the High Level Outputs Statement (HLOS). This means that, where we do not receive third-party financing or funding, government grants will pay for expenditure that would have previously been covered by borrowing, e.g. enhancements costs and the repayment of maturing debt.

Unlike previous periodic reviews, funding for enhancements, financing costs, corporation tax and British Transport Police costs will sit outside of ORR's Final Determination. Some enhancement funding was included in the SoFA but the use of this money will be agreed with governments through a 'pipeline' approach during the control period. We need to agree how this 'pipeline' will operate before the start of CP6.

DfT's SoFA also signalled a change in our budgetary controls for CP6. We are working with governments to agree these controls but it seems likely that we will have less flexibility to adjust our budgets between different categories of spend and across each year of CP6, compared to previous control periods. It is important, however, that we retain sufficient flexibility to manage the rail network efficiently.

Feedback on points raised in ORR's consultation

CP6 funding and budgetary flexibility

We support Government's move to increased **grant funding** in CP6 as it will address a key concern about the size and continued growth in our debt. However, we do not agree with ORR that our CP6 funding arrangements will not affect our underlying financial position. For example, the use of grant funding to repay existing debt will significantly reduce our debt and, if this is by way of revenue grants, could significantly increase our profits, leading to significantly higher corporation tax charges. This can be addressed by converting debt to capital.

A crucial element of our current financial framework is that we have appropriate **flexibility to adjust budgets** between years of the control period, and between expenditure categories and routes. This reflects the inherent complexity of planning expenditure for the railway. Therefore, we agree with ORR that we need flexibility in CP6 so that routes and central functions can respond to risks and opportunities during the control period to support the efficient delivery of outputs for customers. We are continuing to work with Government to develop the financial controls framework (i.e. the "AME / DEL" question) for CP6.

We recognise the importance of explaining any changes to our plans during CP6, including the consequence of those changes, to our customers and funders. Any changes we make during the control period will be made transparently with the implications of material changes made clear to our customers, funders and ORR.

In CP6, we will continue to report a wide range of information about our operational and financial performance. This **reporting will be increasingly presented at a route level** and, therefore, this should give confidence to ORR and funders that flexibility in our plan within CP6 will not lead to inefficiency. Therefore, we do not think that it is necessary for ORR to introduce additional processes or require ORR approval for changes to our plans during the control period, which could increase the regulatory burden and generate additional cost.

Separate funding for enhancements

We welcome the governments' continued commitment to investing in the GB railway to increase capacity, improve journey times and deliver greater reliability in CP6. We understand the reasons for taking decisions about enhancements out of the periodic review process. However, we are not yet clear about **how the cost of projects will be determined or how funding will be provided for specific schemes** during the control period in both England & Wales and Scotland. For example, we do not know whether there will be an efficiency test, which is distinct from agreeing the funding envelope, particularly if schemes are grant funded. We would welcome further clarity from ORR about its role in the overall pipeline process.

Enhancement schemes can have an incremental impact on our operations, maintenance and renewals costs. Schemes can also have an impact on train performance. We agree with ORR that governments should consider the **incremental impact of delivering enhancements schemes on our costs and on train performance** when agreeing to new work, as these costs will need to be funded. These issues are equally important for third-party promotors or funders of schemes.

Other non-SoFA costs

In its SoFA, DfT committed to making adequate funding available to meet our **costs that are not included in the CP6 funding envelope**. These costs include our financing costs (including

FIM fee) and British Transport Police costs. We are continuing to work with Government to agree the detailed processes and timings for how we notify / forecast amounts covered by those expenditure categories and how we receive these amounts from DfT. In particular, as security is a key aspect of the railway, we are seeking clarity on the quantum and control we have of this budget.

Determining revenue requirements

Network Rail continues to be a corporate entity. Therefore, whilst our funding arrangements will change for CP6, we think that it is important to **keep the key elements of the regulatory framework** to maintain transparency of our performance and to retain flexibility for the future. This includes keeping the building blocks approach to calculating our CP6 revenue requirements.

ORR's letter sets out the **building blocks** that it proposes to include in its calculation of our CP6 route revenue requirements. ORR's list excludes expenditure not covered in DfT's SoFA, such as British Transport Police, financing and corporation tax costs. However, we think that ORR should continue to include these costs in the revenue requirement, even if they are funded outside of the SoFA. This will allow for comparison to previous control periods and also create a clearer picture of Network Rail's overall funding requirement for CP6.

Third-party investment

A key challenge for CP6 is how we continue to invest in the GB railway to meet the needs of our customers. This is a key part of our Transformation Plan[1]. Constraints on public finances mean that **we anticipate that there are benefits to private capital** to make additional improvements to our infrastructure in CP6. To do this, we need to find commercial mechanisms to reward investors and also attract funding from others that benefit directly from improved transport links, such as property developers.

To facilitate third-party financing and funding it is **important that ORR is clear about the role it expects to have in relation to third-party investments** in CP6. We believe that ORR can facilitate third-party investment in CP6 by providing certainty about the regulatory framework for these types of schemes. For example, ORR's updated investment framework guidance should provide clarity about any regulatory requirements for new schemes and provide certainty about the regulated return on investment that third parties can expect. However, many third-party schemes could be considered as commercial arrangements rather than regulated transactions and so would not necessarily require ORR's involvement.

We also ask that ORR provides clarity on how it will adjust our CP6 settlement for asset disposals during the control period.

Financial risk management

Network Rail, like any other company, faces known, quantifiable risks. In addition, we face uncertainty that is highly probable but these risks are often uninsurable. Unlike other companies, we have no normal equity buffers to accommodate such risks. Therefore, it is important that we have sufficient funding to operate, maintain and renew the GB rail network, which includes **funding for risk and uncertainty**.

[1] Our Transformation Plan (and subsequent updates) is available at: https://www.networkrail.co.uk/who-we-are/delivering-for-our-customers/

No explicit allowance for risk was included in DfT's SoFA so, in our Strategic Business Plan, we will progressively release part of the funding envelope so that we have resources to manage cost risks during CP6. This will prevent the reprogramming effect seen in CP5. Ideally, actual results will be in line with our CP6 plan and we will be able to gradually release this funding for risk and uncertainty to the routes to invest it in improving the railway. Its release will depend on successful delivery of routes' plans and robust business cases.

We welcome that ORR has committed to recognising, in its determination, the financial risk and uncertainty we face in CP6. We will set out our proposals for managing risk and uncertainty in our Strategic Business Plan submission.

Inflation

One of the most significant risks we face in CP6 is inflation. The maximum Network Grant in DfT's SoFA is set in cash prices. Therefore, although ORR may continue the current practice of increasing our access charges by inflation during CP6, **we will have to manage the impact of inflation risk** on the majority of our expenditure in CP6[2]. We estimate that the impact of inflation on our cost base would be c.£1.2bn over CP6 per percentage point of inflation above forecast. Given we are in an era of heightened inflation volatility, this is a significant issue for us.

ORR's proposal for the treatment of inflation focuses on how it could present its determination of our funding, rather than addressing the significant inflation risk that we will face in CP6. We ask ORR to consider inflation risk in its assessment of the funding we need for risk and uncertainty in CP6.

We still agree with the view that ORR set out in its January 2017 financial framework consultation that it would **not be appropriate to index our revenues by CPI** in CP6. We think that the inflation index used by ORR should be the one that most closely reflects the inflation we face – we have assessed this to be RPI. The fixed cash settlement in CP6 means that the choice of inflation index, used by ORR to adjust our access charges each year, will not have a financial impact on the rest of the industry. For example, passenger fares will not be influenced by any change to how our access charges are adjusted for inflation by ORR. A move away from RPI would also hinder comparability back to previous control periods. ORR should be assured that, irrespective of the inflation index it chooses to use, we will continue to seek to enter contracts with suppliers, which use the lowest possible inflation index. In CP5, we have made significant progress to move our multi-year contracts to CPI.

My team and I are keen to continue working with ORR throughout the periodic review process to develop the CP6 financial framework. Please note that no part of this response is confidential and we are content for it to be published in full.

Yours sincerely,

Jeremy Westlake
Chief Financial Officer

[2] We note that even if our access charges are allowed to increase by inflation each year, government budgetary controls in CP6 may mean that we do not benefit from the increase in income.

Rail Delivery Group

National Rail

BRITAIN RUNS ON RAIL

Rail Delivery Group

Response to

ORR's update on the financial framework for PR18

Date: 18 January 2018

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www.raildeliverygroup.com 020 7841 8000 Registered in England and Wales No. 08176197

ORR's update 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

For enquiries regarding this consultation response, please contact:

Tom Wood, Senior Regulatory Adviser

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Rail Delivery Group

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1. This document sets out the Rail Delivery Group's views on the ORR's update letter on the financial framework for PR18 dated 14 December. Although the ORR did not specifically request responses to the letter, there are a number of points that we thought it would be helpful to raise at this stage.

Budgetary flexibility during CP6

2. A key element of Network Rail's current financial framework is that it has flexibility to adjust budgets between years of the control period and between expenditure categories. This reflects the inherent complexity of planning expenditure for the railway. It is important that Network Rail has sufficient flexibility in CP6 to enable it to respond to risks and opportunities during the control period in support of the efficient delivery of outputs for customers.

3. As has been acknowledged by the ORR, in CP5, the need for Network Rail to re-plan renewals projects to stay within spending limits has led to "*a downward spiral of deferred work and higher costs for the work done*".[1] We stated in our response to ORR's consultation on improving Network Rail's renewals efficiency that lumpiness and change in the renewal programme makes it harder for suppliers to plan for and respond to the rail industry's demands, which can also contribute towards cost increases.[2] Reducing Network Rail's ability to flex annual budgets within the control period increases the likelihood that costly deferrals and re-planning will need to take place, to the detriment of taxpayers and railway users.

4. The ORR's letter states that the governments are presently considering the degree of flexibility Network Rail should have in terms of moving money between financial years and between resource and capital spending in support of business efficiency and effective risk management. ORR is the independent regulator responsible for establishing the financial framework within which Network Rail operates. As such, we believe that the ORR should clearly set out the optimal level of financial flexibility required to facilitate efficient delivery in CP6.

Managing financial risk

5. It is imperative that ORR includes in its settlement a sufficient allowance for risk and uncertainty. This is particularly important for CP6, given that Network Rail's budgetary constraints will be more stringent than has been the case in the past.

6. During CP6, it is likely that unforeseen changes and events will occur that could lead Network Rail to incur additional costs. Ensuring that Network Rail receives appropriate funding for risk and uncertainty will help to reduce the likelihood that such unforeseen changes will require disruptive re-planning, which may in turn be detrimental to its ability to deliver its work plans in as efficient a way as possible.

7. Should the revenue requirements determined by the ORR to deliver the HLOSs, including an allowance for risk, be greater than the SoFAs, it is then of course for governments to decide whether to increase the funding available or reduce the outputs expected to be delivered in CP6.

8. Given the financial constraints that Network Rail will be operating under in CP6, it is of increased importance that the ORR's determinations incorporate efficiency assumptions which are achievable with a high degree of confidence.

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[1] http://orr.gov.uk/__data/assets/pdf_file/0012/25221/pr18-improving-network-rail-renewals-efficiency-consultation-july-2017.pdf

[2] https://www.raildeliverygroup.com/about-us/publications.html?task=file.download&id=469773307

Third-party Investment

9. The ORR confirms in the letter that it is reviewing the investment framework in order to make sure that it aligns with changes in the industry. We agree that there need to be commercial mechanisms to reward investors and also attract funding from others that benefit directly from improved transport links, such as property developers.

10. It is important that ORR is clear about what it sees its role being in relation to third-party investments in CP6.

Funding of enhancements

11. The update letter notes that, in CP6, enhancements will be funded by capital grants, separate from the SoFAs and ORR's determination of Network Rail's revenue requirements. As enhancement projects will not generally be part of the periodic review settlement and subject to these separate funding arrangements, it is important that ORR makes clear that the funding allowed under the CP6 settlement cannot be moved to fund increases in the costs of enhancement projects.

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	[redacted] Matthew Crawford
Job title	Corporate Finance
Organisation	Transport for London
Email*	[redacted]
Telephone number*	[redacted]

*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 w 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.