

Working paper 5: Enhancements framework responses contents list

| Industry Stakeholder | Pack Page number |
|--------------------------------------|------------------|
| D^] æq ^} ó[!Á/ia} •] [!oÁÖ~VD | 2 |
| D:æÁ[, ^!Šã ã^å | 9 |
| Freight Transport Association | 11 |
| Go-Ahead Group | 12 |
| Merseytravel | 14 |
| Network Rail | 16 |
| North Wales Economic Ambition Board | 24 |
| Rail Delivery Group | 26 |
| Rail North (Transport for the North) | 32 |
| Transport for London | 38 |
| Transport Scotland | 39 |
| Welsh Government | 45 |



Department for Transport

James Dunshea
Office of Rail and Road
1 Kemble Street
London
WC2B 4AN

Brian Etheridge
Director, Rail Network Services
Department for Transport
33 Horseferry Road
London
SW1P 4DR

Department for Transport

Web Site: www.dft.gov.uk
14 October 2016

By e-mail

Dear James

Thank you for the opportunity to respond to *Working Paper 5: Options for the Treatment of Enhancements in PR18*. This Working Paper represents a useful means of focussing the discussion on this subject, at a time when it is crucial that it is given full consideration. Our experiences of enhancements in Control Period 5 (CP5) has demonstrated the need for significant changes in this area. The Bowe Report¹ produced recommendations for planning and delivering enhancements more effectively. These are significant recommendations, based on lessons learned from the experiences of the last few years. We have already begun putting new arrangements into place, including through our new Memorandum of Understanding with Network Rail (NR)², which illustrates how a new, more direct relationship between Government and NR will work in respect of enhancements.

We are also working with NR and ORR to establish the assurance processes that will be used for enhancements over the remainder of CP5. We see this as critical to ensuring that we properly act on the lessons of the Bowe Report.

That said, despite the progress we have made since the publication of the Bowe Report, we are clear that there is still considerable work to be undertaken to establish the arrangements that will be used for the planning, funding, design and delivery and assurance of enhancements in Control Period 6 (CP6). Critical lessons have been learned from the experiences of CP5, but fully implementing a response to them may take some time to work through fully. However, this Working Paper presents a useful juncture at which to present our current views and share them with both the Regulator and industry to inform the regulatory approach.

¹ https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/479560/bowe-review.pdf

² https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/509545/mou-dft-network-rail-rail-enhancements.pdf

Some of the points we wish to make in this response were previously made in our response to the PR18 Initial Consultation³. This response provides more detail and clarity on the points raised in that Initial Consultation response.

Our objectives for enhancements in PR18

We are clear that the processes that were used for the planning and delivery of enhancements during CP5 were not effective. To ensure that past mistakes are not repeated, and that we best enable the delivery of the Government's funding priorities, we have established some key objectives that will underpin our approach to enhancements during the PR18 process.

- We wish to see a more flexible approach towards the planning of enhancements. In previous Control Periods, we have used the High Level Outputs Statement (HLOS) as our primary means of committing our priorities. For CP6, while we may continue to commit to purchase certain outputs via the HLOS, we are very likely to wish to use more flexible processes for other enhancements, ensuring that there is an effective planning process whereby we do not commit funds until the case for and the costs of a scheme are well understood. These processes will need to align with those set out in our Memorandum of Understanding with NR.
- We wish to fund a programme of enhancements which better represents the needs of end-users. For CP5, our emphasis was largely on identifying specific schemes we wished to see delivered. For CP6, our intention is to focus on outputs, but to allow industry to work together, with close involvement of NR's devolved routes and, where appropriate, end-user representatives, to determine how best to deliver those outputs. Before committing funding to infrastructure schemes, we will wish to see evidence that other options, such as timetable changes and rolling stock solutions, have been fully explored to maximise value for money.
- We wish to see more opportunities for third party funding of enhancements, particularly by the private sector. Achieving this may require radical thinking around how enhancements are planned, financed and regulated.

Key considerations for PR18

Paragraph 15 of the Working Paper sets out some of your key questions and considerations regarding the treatment of enhancements in PR18. We do not propose to respond to each of the twelve points raised at this stage, though we recognise that all of them will need to be addressed over the course of the PR18 process. We do, however, think that it would be useful to present some of our thinking to date, structured around the three themes you identify; planning and reporting, regulatory treatment and financial.

Planning and reporting – high level structure

As set out above, it is our intention to decouple much of our enhancements planning from the Periodic Review process. For CP5, we used the HLOS to identify a very significant list

³ https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/541399/dft-response-to-orr-initial-consultation-response.pdf

of enhancement projects we wished to see delivered. Committing to enhancement schemes at an early stage, before their costs and benefits have been properly understood, has not facilitated delivery or provided any certainty for industry. Nor has it proven possible to identify, often as much as seven years in advance, where infrastructure interventions might be required.

We have therefore concluded that we will seek to plan the majority of new enhancements via a more flexible approach, only committing to schemes as they reach the appropriate point in the pipeline approach described in our Memorandum of Understanding with NR. The current intention is to distinguish separately proposals that are considered by Ministers to be worth developing, from those that have been developed to a stage worth designing in detail, and from those that are worth delivering. There will then a further test as to whether those worth delivering are also capable of being delivered and are timetabled to have regard to other factors such as the state of the supply chain and the impact of disruption on the network. This should provide industry with a good balance of transparency and certainty, which we recognise to be important, and enable activities to be planned around a realistic timetable for enhancements.

It is likely therefore that we will seek to use the Investment Framework as a vehicle for planning and funding a significantly larger proportion of enhancements than has been the case. The present Investment Framework has not been updated for some time. As part of the PR18 process, we would welcome the opportunity to work with the ORR, NR and wider industry on an update to the Investment Framework, to ensure that it is fit for our purposes, and also that the Third Party Investment Framework properly supports our ambition to see a greater degree of private sector investment in rail infrastructure.

It is, however, also likely that we will continue to specify some enhancements via the HLOS. In particular, as set out in our response to the Initial Consultation, we may seek to specify the following in this way:

- projects deferred from CP5;
- schemes required to support the delivery of major projects such as Crossrail; and
- projects that are deemed critical to prevent serious deterioration disruption to passenger or freight services.

We are also considering whether, in parallel with, or at least in proximity to, the publication of the HLOS and SoFA, we could make a non-binding policy statement regarding the overall scope of our ambitions for investment over the course of CP6 to further aid transparency for industry.

We recognise that these changes to the planning of enhancements will emphasise the need for robust change control processes, to allow regulated outputs to respond to any changes in the enhancements funding pipeline.

Planning and reporting – output specification

Our intention for setting out our requirements for the railway in the future is to focus on specifying our desired outputs, rather than on the purchase of specific inputs. We are likely, therefore, to articulate our ambitions in terms of issues such as the capacity we

wish to be available on a particular route, on a performance trajectory we wish to see delivered or an environmental objective we wish to see met.

We would then expect to see NR, working at both central and route level and with the full participation of both train operators and, where appropriate, end-user representatives, to develop options for meeting our objectives. In particular, we would wish to see evidence that options involving timetable recasts (or other operational changes) and rolling stock interventions had been considered before committing funding to an infrastructure enhancement.

We recognise that this more flexible approach to enhancements will, by necessity, impact upon other aspects of the regulatory regime, such as the performance metrics monitored via route scorecards. We are engaging on these issues with ORR, NR and industry via work underway on the Outputs Framework. As indicated in our response to Working Paper 4, we welcome engagement with ORR on interrelationships with franchising that might be required in order to properly align industry incentives to support our new approach.

Planning and reporting – Enhancements Delivery Plan

We have not yet reached a firm view on the case for and potential shape of any CP6 Enhancements Delivery Plan. Our current thinking, however, is that we can see a case for an Enhancements Delivery Plan, or a similar document, which covers at least those works that are a direct response to our HLOS. We can also see some benefits to an annually-refreshed Enhancements Delivery Plan, which could be used to provide transparency to industry over the progress of schemes through the “commit to develop, design, deliver” process, helping the supply chain to plan with a meaningful degree of certainty.

Regulatory treatment – monitoring and assurance

Through our work to develop processes for the treatment of enhancements over the remainder of CP5, we have established a clearer understanding of Government’s governance and assurance requirements. We are working directly with NR to put appropriate processes in place. At the same time, we recognise that the ORR has its own assurance requirements. To some degree, these are the same as ours. There are, however, areas in which our needs diverge. For instance, Government will typically need to be assured that a project represents value for money and remains aligned to its strategic objectives. The ORR, on the other hand, will be more concerned with establishing whether the project’s costs are efficient (particularly where its costs are to be added to the RAB) and will not unreasonably disadvantage third parties.

In respect of CP5 enhancements, NR is developing an assurance process which seeks to satisfy the needs of both Government and the ORR, thus reducing the need for duplication and the potential for unclear boundaries of responsibility. We would suggest that it would be appropriate to continue this arrangement for CP6.

Regulatory treatment – grant and loan funding

We are still in the process of determining how we intend to balance our funding of enhancements for CP6 between grant funding and loan funding. We expect this process to continue for some time. Moreover, we are clear that with our intention being to fund enhancements more flexibly across the course of a Control Period, we may not adopt the same approach in each case and that our approach may vary over the course of the Control Period. We would therefore encourage ORR to ensure that its plans for the incorporation of enhancements into the regulatory settlement are sufficiently flexible to adapt to a range of possible outcomes.

We would agree that where required, a similar process to that used for schemes funded through the Investment Framework might be suitable for incorporating enhancements funded outside of the HLOS into the regulatory settlement. That said, as noted above, we believe it will be necessary to review and update the Investment Framework as part of the PR18 process.

Financial

The Working Paper raises a number of issues around the financing of enhancements. These are clearly very important issues, but our view is that these are best addressed through ongoing work on the Financial Framework. In particular, we would anticipate providing more information in this area in response to the upcoming consultation on the Financial Framework.

Principles for the ORR's role of enhancements

Paragraph 18 of the Working Paper presents a useful structure for considering the ORR's role in respect of enhancements. We would agree with the broad principles set out here, though would also like to offer some of our detailed observations.

(i) To protect users in respect of the charges they pay

This is clearly a key function of any economic regulator. Our own recent review of the ORR, carried out in early 2016, identified extremely strong support from the industry for the ORR's function in protecting users of the network from monopoly power. We would agree that, given the implications of the RAB for access charges, the ORR has a legitimate role in assuring itself that any additions to the RAB are made on the basis of efficient cost.

We welcome the ORR's recognition of the need to be flexible regarding how this assurance is reached. To avoid repeating the mistakes of CP5, we should seek to avoid duplication of activity and blurring of boundaries. Where possible, we believe the ORR should take its assurance from processes put in place bilaterally between funders and NR. We are in the process of engaging with the ORR and NR to establish how this might occur for enhancements over the remainder of CP5. We believe it would be appropriate to extend these arrangements for CP6.

We recognise that for enhancements which are grant funded and not added to the RAB, the ORR's interest will not be so extensive, but that there will still be a need for it to account for the consequent implications of enhancements for maintenance and renewals

costs, as well as any potentially adverse impacts for third parties. We will continue to engage with ORR to develop processes that could be used to account for this.

(ii) To hold Network Rail to account for the delivery of all outputs

We agree that the ORR will continue to have a role in this area in respect of enhancements that are committed to via the HLOS. However, we would note that Government is developing a more direct commercial relationship with NR to manage the delivery of these projects. We would therefore expect the role of the ORR to be somewhat reduced in this respect and likely limited to the assurance of efficient cost described above.

We would note that other funders may wish to see a greater role for the ORR in respect of their own enhancements. We view this as a matter between ORR and those funders and would not wish to prevent any sensible arrangements from being put in place.

(iii) To protect network condition for the benefit of current and future users

There is clearly a continuing role for the ORR in this area and we agree that the ORR will require sufficient information regarding NR's enhancements portfolio to enable it to continue this activity.

(iv) To hold Network Rail to account for how the network expands

We are clear that the overall strategy for the expansion of the rail network is a matter for funders. However, we recognise that there is a continued role for ORR in ensuring that third parties are not unduly disadvantaged by Network Rail's approach to delivering funders' requirements. We would encourage the ORR to clearly articulate its role in those terms and to focus on those consequential impacts, rather than risking any blurring of the line between funders and ORR in terms of setting strategic direction.

(v) To publically report on Network Rail's delivery and cost performance

There may be a continued role for the ORR in this area in respect of those enhancements that are specified via the HLOS. We would, however, encourage the ORR to work with Government and NR to ensure that there is no duplication of activity in this area. We recognise the need for publications on delivery to provide as much certainty as possible to investors regarding progress. We intend to be mindful of this in the development of assurances processes, given our particular interest in securing value for money.

(vi) To support further devolution and encourage third party funding and financing including from the private sector

The Government wishes to see a greater role for private investment in the delivery of rail enhancements. It is important that the regulatory regime supports and promotes this. We would encourage the ORR to review the third party investment framework to ensure it is properly supporting this objective.

We agree that transparent and impartial oversight of the investment process may help to attract greater private sector investment in the network, by giving private investors additional confidence that initiatives will be appraised fairly and transparently.

End users

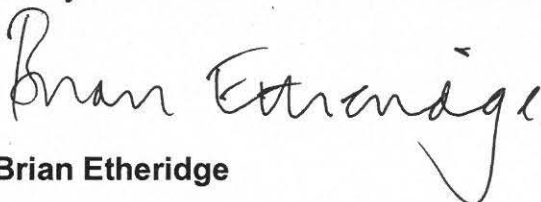
In addition to the principles set out in the Working Paper, we would emphasise that we can see an important role for the ORR in ensuring that end user interests are properly represented in respect of enhancements, in so far as they are covered by the regulatory framework.

Transport Focus is in the process of developing tools that may assist in this area and we would encourage the ORR to engage with Transport Focus as it develops its approach.

Next steps

We are continuing to work across Government, with industry and with the ORR to establish the details of how enhancements will be planned and delivered during CP6. We would expect that some of these discussions will continue for some time. We would therefore urge the ORR to retain sufficient flexibility in its approach at this point so as to be able to respond to a broad range of possible outcomes.

Once again, we would like to thank the ORR for the opportunity to respond to this Working Paper. We have found the sequence of summer Working Papers to be extremely helpful. They have provided a transparent, objective and informative way for Government to engage with the regulatory process and have spurred useful discussions with the industry. We are also grateful to the RDG for the workshops it has organised and run around the various workstreams highlighted by the Working Papers, which have provided a very constructive forum for discussions.



Brian Etheridge

ORR PR18 Working Paper 5:

Options for the treatment of enhancements in PR 18

Response date: 14 October 2016

Drax Power Limited (“Drax”) is the operating subsidiary of Drax Group plc and the owner and operator of Drax Power Station in North Yorkshire. The 4,000MW station consists of six separate units, which together can produce around 7-8% of UK generation. Two of these units have been converted to run on high density wood pellets (biomass) and a third unit is expected to convert in 2016. Drax is a predominantly renewable generator, having completed the largest, single site decarbonisation project in the EU.

Drax is heavily committed to rail and to optimising its use of the national infrastructure to deliver its business objectives. It welcomes the opportunity to contribute to the consultation on the Options for the Treatment of Enhancements in PR 18.

We note that the proposals are at an early stage of consideration and would like to offer some general, high level comments.

1. The enhancements process needs to work for freight and the creation of a virtual Freight Route should help in this regard. Nevertheless, freight schemes will need to be protected where delivery is dependent on the geographic Routes. Any risk of these Routes giving higher priority to ‘their’ passenger schemes over freight schemes will have to be closely managed by ORR. Accordingly, the accessibility and accountability of the Freight Route and the various geographical Routes needs to be clearly delineated.
2. The Strategic Freight Network fund has been successful in delivering small enhancement schemes for freight. Any revised process should give freight the required profile and resources.
3. ORR must ensure that any new process should deliver schemes on the basis of the long term beneficial return to the industry/UK. Schemes that are proposed outside of the periodic review process should be added to a pipeline of supplementary schemes. Where the benefit: cost ratio exceeds those in the PR and funds are or can be identified then these projects should be advanced. This should ensure that a scheme is not delayed to the next periodic review period and that it does not necessarily divert funds from schemes which are in the periodic review process.
4. Enhancements which are committed subsequent to a periodic review must not affect the deliverability of an existing programme. Potential and actual investors in rail terminals and equipment require certainty and confidence in rail as a logistics solution for their business. It is vital therefore that funds for freight related enhancements are ring fenced, schemes are committed to, and timescales are adhered to. Slippage of schemes from one Control Period to another does not engender the confidence which is required if modal transfer is going to be delivered.
5. Holding Network Rail accountable for delivery of its enhancement projects must not lead to Network Rail selecting schemes or setting timescales on the basis of conservative views of its delivery.
6. Enhancements should not lead to higher charges being payable by individual traffic flows, thus deterring the freight they were intended for and creating stranded assets. Freight charging needs to recognise the Government strategy of achieving modal shift, adding to the social

strength of the UK economy whilst delivering the environmental benefits of rail in support of the UK air quality and carbon reduction targets.

7. PR 18 and CP6 covers a period when we will see an unprecedented increase in demand for land transportation capacity. The growth of consumer demand and internet shopping will place enormous demands on couriers, road hauliers and an already congested road network. The environmental issues arising from the projected rise in road transport in terms of road safety, respiratory health and noise will be huge unless action is taken. Similarly the UK will struggle to meet its commitments to emissions reduction under the Fifth Carbon Budget. The potential demand for modal shift from road to rail over the coming years is enormous, but it is clear that at present the rail network would struggle to cope with this increased demand.
8. We consider that a key issue will become the facilitation of modal transfer from an already congested road network to an enhanced rail infrastructure. The new position of ORR as Regulator of rail and road provides it with a fresh opportunity to take a view of infrastructure investment decisions across the Highways and Rail networks. Whilst this will involve a different way of working with Government, the HLOS for rail should be received in conjunction with similar for the road network.

To conclude, Drax would urge the ORR to ensure that the treatment of Enhancements in PR18 should:

- be clear and transparent, engendering confidence in private investors in rail and rail related facilities;
- promote and protect freight related schemes;
- facilitate the modal shift that will be required in the coming years;
- demand greater collaboration between passenger and freight operators is part of any decision involving upgrades to existing or the development of new capacity in order to make the best use of same;
- take the lead in promoting the environmental benefits of rail in support of the UK air quality and carbon reduction targets.

Freight Transport Association response to the ORR's Enhancements Working Paper 5

Further to Working Paper 5 http://orr.gov.uk/_data/assets/pdf_file/0004/21964/pr18-working-paper-5-options-for-the-funding-of-enhancements-in-control-period-6.pdf our comments are as follows:

We clearly recognise the need for better treatment of enhancements in the future and the learning of the lessons from the Hendy and Bowe Reviews. Our interest obviously concerns freight and the funding of freight capacity and capability enhancements via the Strategic Freight Network Fund for England & Wales and its Scottish equivalent. FTA is a member of the Strategic Freight Network Fund Steering Group and the Scotland Freight Joint Board.

What is important for FTA is that for the development of the network for freight is set out and articulated on the clear principles of what outputs are being bought and what will be the practical deliverables of those over a route / corridor / traffic flow basis. This is clearly important for all stakeholders but also for funders. Further this needs arguably to be done on a longer term basis than being constrained into discrete 5 year plans to align with Control Periods / HLOSs / SoFAs given the longer term vision and pipeline of projects required, albeit it can be presented and packaged in five year phases etc. While shorter term financial control is of course vital it is equally important that that longer term vision and outputs of projects are not artificially constrained into shorter periods. What is important to deliver is a wholistic network of capacity and capability enhanced routes for freight on the network that are predicated on market and customer led demand.

Please feel free to contact me if you wish elaboration on any points.

The Freight Transport Association represents the transport interests of companies moving goods by rail, road, sea and air. Its members consign over 90 per cent of the freight moved by rail and over 70 per cent of sea and air freight. They also operate over 220,000 goods vehicles on road – almost half the UK fleet. The main rail freight operating companies belong to FTA as do the major global logistics service providers operating in the European and UK market.

FTA's Rail Freight Council includes all parties to the rail freight supply chain, including rail freight operating companies, Network Rail, wagon builders, logistics service providers and bulk, intermodal and retail shipper customers.

James Dunshea
Office of Rail and Road
One Kemble Street
London
WC2B 4AN

14 October 2016

Dear James,

PR18 Working Paper 5: Options for the treatment of enhancements in PR18

Thank you for the opportunity to respond to the ORR's PR18 consultation on the treatment of enhancements in CP6.

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 extensive experience running complex and challenging rail operations. Govia currently runs three major rail franchises: Govia Thameslink Railway (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 your 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. We will continue to participate in industry discussions as work progresses to further develop the detail of the options outlined in the Working Paper.

Go-Ahead has previously responded to the ORR's other Working Papers on route level regulation, the system operator function and outputs, and this response should be read in conjunction with those.

We agree that following the problems experienced in Control Period 5 (CP5), the approach to the planning and delivery of enhancements needs to change for PR18 taking into account the lessons learned from previous years. Enhancement plans must be deliverable, outcome focused and aligned with franchise commitments. They must reflect the needs of end-users and incentives need to be in place to drive the right behaviours.

It is clear that in CP5 projects were not sufficiently mature at the point they were committed which imported significant risks. We agree with the approach set out in the DfT's response which advocates only committing to schemes as they reach the appropriate stage and making the distinction between (a) proposals worth developing, (b) proposals worth designing in detail and (c) proposals worth delivering. Following this three stage approach and only committing at the appropriate point is vital in preventing a reoccurrence of the problems we have experienced previously.

We also support the move away from a five yearly specification of enhancements and the adoption of a pipeline approach, with the decision to commit to specific enhancements being taken at a variety of decision points. This flexibility will allow for the greater alignment of major enhancements and franchising decisions.

The programme of enhancements should better reflect the needs of end-users, focus on outcomes and only commit to infrastructure changes once all other avenues, such as timetable recasts and rolling stock options, have been explored. Similarly, in terms of measuring the successful delivery of the enhancement projects, this must be based on the outcome.

As we have raised previously in PR18 consultations, when projects have failed to deliver the planned benefits, it has presented little risk to Network Rail, particularly in comparison to the reputational impact experienced by Operators if the commissioning of the project is linked to the introduction of a new

service for example, and the consequential impact is that the new service is delayed with commitments having already been made to stakeholders, shareholders and passengers.

It is important that there is a clear process to document other schemes which are outside of the periodic review but which may impact on Network Rail's ability to deliver due to constraints on resources or access, for example. We would support Network Rail's continuation of a portfolio approach to the delivery of all enhancements in CP6 regardless of whether they are included in the periodic review.

In terms of planning and reporting, we strongly support the retention of ring-fenced funds and we would advocate the publication of the enhancements delivery plan once projects are committed, in the interest of transparency and giving the supply chain an opportunity to plan.

With regards to regulatory treatment, we agree that the way in which projects are funded should affect how they are monitored. We also agree that previously there has been a lack of clarity among the Off, Network Rail and the ORR regarding their roles in terms of planning and monitoring CP5 enhancements, and this must be addressed.

Clearly, it is important there is no ambiguity over the responsibilities of the ORR and funders in holding Network Rail to account for delivery of enhancements. We support the ORR's move towards a new, more direct relationship with Network Rail and improved focus on planning and overseeing rail enhancements, with greater governance and clearer accountability. The Department is now better placed to take ownership of the planning and monitoring of enhancements which it funds outside of the periodic review.

We agree with the roles of the ORR set out in the paper in terms of enhancements, in particular that it plays an important part in protecting users in respect to charges, holding Network Rail to account for delivery of agreed outputs, protecting the network condition and publically reporting on Network Rail's delivery and cost performance. We also agree that the ORR must continue to ensure that any additions to the RAB are appropriate and cost efficient. Where enhancements are outside of the periodic review and not RAB funded, the ORR's involvement might only be to consider the implications on Network Rail's portfolio and its ability to deliver its regulatory outputs.

It is crucial that enhancement business cases consider the wider impacts on Network Rail's programme of maintenance and renewals, not just to achieve efficiencies through alignment but also to ensure Network Rail's ability to deliver the 'day job' is not compromised. We therefore agree that one of the ORR's key focuses should be on Network Rail's ability to balance being ambitious and avoiding over-committing, as well as ensuring the deliverability of the entire portfolio or work is reassessed as part of any enhancement business case.

Clearly, a change control mechanism will be needed to alter targets as and when outcomes of enhancements materialize and to allow regulated outputs to respond to changes in the enhancements pipeline. A strong and effective enforcement regime will continue to be required to ensure Network Rail's delivery of enhancements is robustly assured.

If you would like to discuss this response in further detail please contact Chantal Pagram, Head of Rail Policy.

Yours sincerely,



Charlie Hodgson
Managing Director, Rail Development

ORR Treatment of Enhancements in PR18

Consultation Response from Merseytravel

Introduction

Merseytravel appreciates the opportunity to respond to the ORR's thoughts on the future treatment of enhancements.

Our response does not cover all the issues raised but focuses on those issues which are a particular concern to Merseytravel.

Merseytravel is the Local Transport Authority for the Liverpool City Region and sees the development of the railway as a key plank in the economic development of the City Region. We are currently working with Network Rail on the delivery of three major rail projects funded by the City Region and thus have an interest on how the issue of enhancements will be taken forward in the future.

Planning and Reporting

Network Rail obviously plays a key role in the development and delivery of rail projects. As a public body, once projects are committed, Network Rail should clearly identify the projects it intends to deliver and the timescales expected for delivery. The government needs to know exactly what it is purchasing and how and when this will impact on the delivery of rail services both current and in the future.

This is of particular interest to external bodies such as the City Regions who see rail as a key driver of economic development within the Region and who may wish to invest in the railway. Understanding what Network Rail intends to deliver plays a role in identifying gaps which the City Region may wish to fill through the use of their own funding.

Regulatory Treatment

Network Rail's delivery of enhancement projects needs to be monitored. It is important that such projects are delivered to time and in budget. It is not important how the project is funded it is merely good practice to ensure that what has been planned and committed to is actually delivered or if not, why not.

The existing investment framework allows projects to be delivered outside of the Periodic Review process. As indicated above rail projects play a key role in economic development. The ability to take forward rail projects outside of the periodic review is important, particularly for third parties.

The paper raises the issue of how projects are funded. For DfT specified projects this should be a matter for the DfT to identify the most efficient method of funding projects and the maximum available funding for enhancements. A mechanism currently exists for third party enhancements which should remain in place.

Fundamentally the DfT needs to be clear how much it wants to spend and the outputs that Network Rail would then be required to deliver.

Funding for enhancements promoted by organisations other than the DfT

There is a current method of assessment which is used by the DfT and third parties for the assessment of value of potential projects through the Major Projects process. There is a need to balance the economic value of a project against its cost and affordability. This method was used for devolved Major Projects such as Newton-le-Willows improvements, Maghull North new station and Halton Curve re-instatement - all projects being taken forward within the Liverpool City Region.

With respect to delivering projects within a specific control period. While this may be relevant for maintenance and renewals works it is hard to see its relevance when projects take longer to deliver than one control period or if a project would straddle two control periods. In most cases this is likely to be the case and it is suggested that enhancements should be separated out from the 5 year periodic review process and dealt with as a specific workstream. However, where practicable, synergies should be sought between Network Rail and funders/clients of enhancement schemes to bring together renewal/maintenance needs and enhancements to try and achieve savings for a scheme, and therefore, savings to the public purse. If Network Rail was able to indicate (at a high level) a rolling programme of renewal and maintenance activities (e.g. over 2 or 3 control periods), it would provide an opportunity for third parties to identify opportunities for synergies which could be beneficial to all parties. Project development timescales are such that 5 years' notice (at most) of potential synergy opportunities is not enough time to sufficiently develop schemes to an appropriate level of detail for those opportunities to be identified and progressed.

We would not expect Network Rail to finalise or guarantee a 15 year maintenance and renewals programme for each asset discipline, but the identification (at a high level) of critical opportunities (such as major re-signalling, track layout amendments, electrification works etc.) over a longer period of time could permit better synergies and savings for all affected parties. If this process was to begin soon, it could become a rolling process such that once a 5 year period had passed, the next 10 years would already be planned, with a further 5 years brought into scope for consideration. Network Rail could also benefit from such a planning cycle internally across different asset disciplines, which would not only provide savings for schemes but also potentially reduce periods of disruption to train operators, passengers, freight customers and the public, which would have substantial benefits for the rail industry as a whole and would also reduce the detrimental economic impact of rail network closures.

Network Rail's response to the ORR's PR18 working paper 5: Options for the treatment of enhancements in PR18

14 October 2016

KEY POINTS

Network Rail is pleased to respond to the ORR's working paper on options for the treatment of enhancements in the 2018 Periodic Review (PR18). The key points are summarised below.

- Funders require flexibility as to their preferred approach to funding enhancements, either through the periodic review process or the investment framework. Both approaches need to be reviewed to make sure they are fit for purpose and address the key points set out below.
- A more flexible approach is required to the funding framework for enhancements to facilitate the incremental 'pipeline' approach to the development and delivery of enhancements set out in the MoU between Network Rail and DfT.
- The enhancements framework must support the introduction of third party financing and funding.
- There needs to be a change control process that facilitates incremental commitments as enhancements progress through the agreed joint decision points, that facilitates the incorporation of additional enhancements funded outwith the periodic review and that can adjust Network Rail's existing commitments and funding as necessary as a consequence of these additional enhancements.
- There needs to be a clear understanding of the respective roles of funders and ORR in determining the efficient cost and value for money of individual enhancements and in the overall framework for holding Network Rail to account.
- The SoFA must provide certainty of funding for the enhancements specified in the HLOS for delivery in CP6. The SoFA should also make an appropriate allowance to manage scope and cost changes as the portfolio develops as well as funding for development of other enhancements in the pipeline.
- In order to plan efficiently and to address deliverability and affordability of the enhancements programme, it would be helpful to have an understanding of the potential overall funding envelope for CP6 and a view of further development priorities in preparing our CP6 Plans. We recognise this is an evolving picture which will require continuous dialogue between Network Rail and funders.

The remainder of this response follows the structure of the consultation paper.

1. INTRODUCTION AND CONTEXT

Context

As set out in our response to the ORR's initial consultation on PR18, the review coincides with a significant period of change in the industry. The approach and outcomes of PR18 must support the rail industry in meeting the challenges and opportunities ahead in delivering benefits for passengers and freight users. This will be of particular importance for the treatment of enhancements in PR18.

Network Rail's reclassification as a public sector organisation in September 2014 has led to a number of changes that are relevant to enhancements. In particular, reclassification has removed the benefits of the company's previous funding and financing structure. Network Rail must now borrow directly from the UK government and there is a binding borrowing limit in place for CP5. In respect of enhancements, our reclassification means that we can no longer raise additional debt to manage the risk of overspend, for example, in response to project costs increasing or requests to deliver additional benefits.

Reclassification has also necessitated a closer working relationship with the Department for Transport (DfT). The terms of this relationship are set out in the [Memorandum of Understanding](#) which has been agreed between the DfT and Network Rail.

The Memorandum of Understanding was agreed in response to the recommendations of the [Bowe Review](#) into the planning of Network Rail's enhancements programme for CP5. The review concluded that in CP5 many decisions to fund projects through PR13 were taken whilst projects were immature and without adequate understanding of the risk and uncertainty for cost or delivery that this entailed.

The Memorandum of Understanding describes a different approach to planning and funding projects than was followed in PR13. It supports a continuous planning approach and moves away from a rigid five-year cycle for enhancement planning linked to control periods. It establishes a lifecycle for enhancements with joint decision points covering development, design and delivery. These are formal gateways to proceed to the next stage of work, supported by joint commitments to fund and deliver work, and informed by the Treasury's business case guidance. Joint decision points can only be passed when there are sufficiently mature cost, benefit and risk estimates, and will ensure there is a clear line of sight between funding, outputs, outcomes and benefits. The framework for enhancements in PR18 should support the principles of this approach.

2. DRIVERS FOR CHANGE

Network Rail recognises the drivers for change described in the ORR's working paper. The lack of maturity in the development of a number of projects specified by the DfT and Transport Scotland in their 2012 HLOSs at the time of Network Rail's 2013 Strategic Business Plan (SBP) submission was a key reason for the challenges experienced in delivering the enhancements portfolio for CP5.

While the enhancements cost adjustment mechanism (ECAM) process mitigated this to some extent, it required Network Rail to develop a large volume of complex, high value projects simultaneously. A shift to a "pipeline" of projects would allow Network Rail to devote the necessary feasibility and development resources in a planned and controlled manner. This would result in projects that are initiated as the need is identified, and committed to in alignment with decisions on franchises or other key interfaces.

An additional driver for change in the treatment of enhancements in PR18 is Network Rail's view that financial sustainability should be a key priority for PR18. In respect of enhancements, this should include limiting the future increases in debt, increasing the proportion of enhancements which are grant funded and improving the railway's attractiveness to third party investors.

3. KEY CONSIDERATIONS FOR PR18

Planning and Reporting

We agree that it is for the DfT and Transport Scotland to decide to what extent the commitment to fund enhancements is made through the periodic review. However there should be certainty of funding for the projects to which Network Rail and funders have committed, whether this is as part of PR18 or otherwise.

The framework used by funders should also facilitate the principles described in the Memorandum of Understanding between Network Rail and the DfT, in particular the development of a continuous planning approach to enhancements in which funding is only committed to projects once they are sufficiently developed.

An advantage of including enhancements within the periodic review is that it allows detailed planning of the delivery of enhancements projects to be integrated with plans for renewals and other areas of Network Rail's business. This is particularly important on major programmes of enhancements with complex timetable changes. Commitment to enhancements through the periodic review also provides certainty to the supply chain, allowing suppliers to plan their businesses efficiently, and to operators that outputs will be delivered and that they will be able to make changes to their operations accordingly.

In order to mitigate the uncertainty potentially created by a progressive approach to committing to enhancements, Network Rail and funders will need a shared understanding of the potential overall portfolio of projects to be delivered and scale of funds likely to be available. Recognising this may change over time, this will require a process of continuous dialogue with funders on the overall pipeline of projects in development and delivery as we develop and deliver our overall plans for CP6. This will allow Network Rail to plan with a reasonable degree of certainty to deliver enhancements efficiently alongside renewals and maintenance and to manage our resources and access effectively.

If funders choose to make significant commitments to enhancements outside the periodic review it is essential that there is a clear process to capture the impacts upon other areas of Network Rail's business.

In our response to the ORR's working paper on the outputs framework we set out that our routes and the System Operator will work with customers and funders to agree our core priorities for CP6, which will form the basis of our scorecards. These will enable our businesses to set, track and achieve their objectives.

Our response proposed that the regulated status of each measure on the scorecard will be made clear and its forecast will be updated through the control period, rather than having a hard target set at the start of CP6. This will allow the impacts of progressively announced investments in enhancements to be flexibly taken into account and appropriate adjustments made. Planning for

delivery of renewals and maintenance works could also be affected and there will need to be a clear process for updating plans to take account of the impact of new enhancements in agreement with relevant customers.

Network Rail is 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. This means of funding is flexible and allows relatively small investments to be made to improve outputs efficiently by directing them through the industry party best able to deliver the benefit. A further benefit is that funds can provide a means of leveraging small scale third party investment into the rail industry that would not otherwise be realised.

Network Rail believes that the Enhancements Delivery Plan is a useful way of providing transparency to funders, customers and stakeholders of the outputs which Network Rail has committed to deliver. We would need to agree what the scope and purpose of this document, including with funders, as it may not be appropriate to include all enhancements in this document.

The structure of the plan will be reviewed to best align with the principles of the Memorandum of Understanding and the funding and regulatory arrangements for CP6, including the potential for increased third party funding of enhancements.

Regulatory Treatment

The decision to fund projects outside of PR18 must be accompanied by an assessment of the impact of developing and delivering the project on Network Rail's business as a whole. Where funders wish to purchase enhancements which impact other outputs there will need to be a transparent process for making changes to these outputs involving consultation with customers and the ORR.

We agree on the need for clarity around RAB additions in PR18. Network Rail must have confidence about when and how it will be reimbursed for the cost of enhancements projects to which it commits. The process for determining RAB additions and the efficient cost of projects should be aligned to the project lifecycle and the decision points established in the Memorandum of Understanding. It is our view that the efficient cost of a project should be agreed at the final decision point, the commitment to deliver. Network Rail is continuing to develop this process and will use this work to inform the ongoing development of the periodic review.

It will be essential to have a clear framework to fund projects outside PR18 and the current investment framework should be reviewed to determine whether it is fit for purpose. Its ability to support third party funding and financing of enhancements, and to provide a mechanism to incorporate projects committed to outside PR18 into the regulatory framework, will be key factors in determining the current investment framework's suitability.

Financial

It is critical that the borrowing limit and HLOS affordability assessment take account of the potential to commit to projects outside the periodic review so that Network Rail can be given certainty of funding when these projects are committed to. 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 committed to. These options are not mutually exclusive and both mechanisms could be used during CP6.

As discussed, above, long-term financial sustainability is a key priority for Network Rail in PR18. We propose a change in the funding arrangements for future enhancements to avoid the continuing accumulation of debt and impact on Network Rail's balance sheet. 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 (potentially including Train Operating Companies and local businesses). Currently projects that have major socioeconomic benefit are mainly funded by Network Rail through increased debt. Such projects could be funded by stakeholders who will benefit from the socioeconomic changes and therefore could realistically contribute to the expenditure.

Network Rail will shortly write to the ORR to set out our views on key aspects of the CP6 financial framework, which will include changes in the financial arrangements for future enhancements.

4. PRINCIPLES OF ORR'S ROLE IN ENHANCEMENTS

It is important that there is no ambiguity over the roles and responsibilities of ORR, funders and Network Rail. In particular it must be clear who is holding Network Rail to account for the delivery of agreed outputs. This is in accordance with the principles described in the Memorandum of Understanding and the findings of the Bowe review. The future agreement of Memoranda of Understanding between Network Rail and Transport Scotland, and between the DfT and the ORR should further clarify roles and responsibilities.

We would welcome the ORR playing a role which supports further political devolution and encourages third-party funding and financing, including from the private sector.

5. POTENTIAL APPROACHES FOR REGULATORY TREATMENT OF DFT AND TRANSPORT SCOTLAND PROMOTED ENHANCEMENTS

Criteria for an overall approach

Network Rail agrees with the criteria set out in the working paper. In addition it is essential that the approach supports the principles of the Memorandum of Understanding and gives certainty of funding for committed projects.

Options for the DfT and Transport Scotland

Network Rail agrees that the three options described in the working paper are all viable and are not mutually exclusive. A fourth option could also be explored of enhancements being grant funded through the periodic review. This would support our ambition to improve our long-term financial sustainability through PR18 which we have discussed in sections 2 and 3, above.

Network Rail is committed to implementing the principles of the Memorandum of Understanding with all funders to allow the most effective management of projects and the minimisation of risk across Network Rail's entire portfolio. The Memorandum of Understanding describes joint investment decisions between the funder and Network Rail, rather than decisions solely by the funder as

described in the working paper. These principles should be implemented regardless of the funder and the funding mechanism that is employed.

Commitment to schemes through the periodic review allows links between enhancements and other areas of Network Rail's business to be considered at the time of the periodic review and gives increased certainty to the supply chain and other industry parties. However it is essential that schemes committed to through the periodic review process are adequately developed to avoid the risk that Network Rail and funders are required to commit to projects without sufficient certainty of outputs and costs.

Commitment to schemes separately from the periodic review by funders allows Network Rail to develop a pipeline of schemes which are only committed for delivery when they are sufficiently developed and their costs and outputs are well understood. However it means that these schemes cannot be considered alongside other areas of Network Rail's business at the periodic review and potentially it reduces visibility for the supply chain and other industry parties. In order to mitigate these impacts it will be essential for the overall regulatory framework to include a mechanism so that the impact on other outputs of new commitments to enhancements can be taken into account.

If schemes are committed to separately to the periodic review and are debt funded there will need to be a mechanism to increase the borrowing limit, if it has been fixed in PR18. Alternatively headroom could be assigned in the borrowing limit set at PR18. As the costs of enhancements projects will not be well understood at this time this would need to take the form of an allowance without specific outputs attached which would be drawn upon until it was fully utilised.

In all options there would need to be clarity about the allocation of risk between Network Rail and the funder. Allowances would need to be made in Network Rail's funding for additional risk to enhancements delivery and other areas of the business created by commitments made to deliver additional enhancements.

Areas that may be impacted by the options selected

In PR18 Network Rail supports moving away from having outputs specified by the ORR and instead publishing scorecards that we can update, with clear statements of the regulatory status of each measure. Additional commitments to enhancements projects outside the periodic review and their effects on other measures would be reflected in updates to these scorecards. This approach was described in our response to the ORR's working paper on the outputs framework.

As has been described, visibility of the forward enhancements pipeline and the priority projects for CP6 would allow Network Rail's renewals and maintenance works to be planned efficiently. The impact of new commitments on the core business and the deliverability of the existing enhancements portfolio will be a key consideration for Network Rail at joint investment decision points for enhancements.

Access planning is a key constraint for the delivery of rail enhancements. The progressive commitment to enhancements separately from the periodic review could affect Network Rail's ability to plan access efficiently and there will be a trade-off to be managed between the desired flexibility and the stability of the portfolio to plan access and resources in an efficient manner. Commitments to deliver projects separately from PR18 will need to be taken in sufficient time to allow integration into the existing work bank planning.

Network Rail would expect to take a portfolio approach to the management of enhancement projects in CP6, regardless of the option through which funders choose to commit to enhancements. Projects could be added to the portfolio progressively over CP6. If the impact of a new enhancement on the deliverability of the overall portfolio would be likely to be significant then this would need to be assessed as part of the decision to commit to the project. Management of enhancements as a portfolio, rather than these projects having discrete budgets, allows Network Rail to balance over and under spends on projects within the portfolio. As noted in the working paper, the required risk uplift from a group of projects treated as a portfolio is statistically less than the sum of individual project risk so the portfolio approach can offer significant value.

We would expect to treat funding for enhancements as ring-fenced from funding for other purposes, including renewals and maintenance.

We agree that the introduction of new enhancements schemes into the portfolio has an impact on Network Rail's level of risk, both for the delivery of the enhancements portfolio and for other activities. An allowance would need to be made to reflect this increased risk. This means that even for grant funded enhancements an adjustment to the borrowing limit might be required to reflect the risks of delivering the enhancement to Network Rail's wider business.

Incentivisation could be achieved by a number of different mechanisms, depending on the allocation of risk between Network Rail and funders, and further discussion is required to establish the appropriate approach consistent with the overall framework.

6. OPTIONS FOR OTHER FUNDERS OF ENHANCEMENTS

As discussed, above, the ability to support third party funding should be a key consideration in determining the framework for enhancements in PR18. Since reclassification, the allocation of all of Network Rail's financing capacity for enhancements to HLOS projects has meant that there has been no ability to RAB finance third party projects, as was previously done through the investment framework. PR18 should create a framework in CP6 that supports more third party involvement in the funding, financing and delivery of CP6 outputs.

The existing investment framework should be assessed to determine whether it is able to deliver this objective. It is important that this mechanism is understandable and transparent to non-rail industry parties.

Network Rail would welcome an exploration of the proposal for a ring-fenced fund allowance for third party schemes to be explicitly included in the determination and reflected in our loan agreement. Such a fund would be similar to the Stations Commercial Project Facility that was successful in delivering profitable enhancements at stations in CP4 and CP5. However, other options could also be considered as facilitating third party investment in the rail network is a key objective for Network Rail in PR18.



north wales economic ambition board bwrdd uchelgais economaidd gogledd cymru

The North Wales Economic Ambition Board ('the Board') works closely with the Welsh Government representing the 6 North Wales Local Authorities, together with the Chairs of the 3 North Wales Enterprise Zones, representatives from the Mersey Dee Alliance, the academic sector and the Private Sector through the North Wales Business Council. The purpose of the Board is the development of the North Wales economy, and improved connectivity is central to achieving this.

The Board see rail in North Wales as an increasingly important driver of economic growth in the region. To support a growing economy faster services offering reduced journey times and with more capacity are needed. Connectivity to key destinations such as Liverpool, Manchester, and Birmingham along with their respective airports needs to be improved and an enhanced rail infrastructure is paramount to achieving this.

These are the Board's comments regarding some of the thoughts expressed by the ORR in the PR18 working paper 5:

1. The Board concurs with the DfT thinking that there should be more separation between new enhancement schemes and the periodic review process. The current arrangement encouraged a flurry of proposals in an attempt to make sure that they are included in the HLOS, irrespective of their state of maturity. Consequently, Network Rail ran into significant problems one year into the current control period. By separating enhancements from the period review process it allows for a rolling programme of enhancements as and when they are fully designed and developed.
2. The Welsh Government is mentioned as another funder for enhancement investment but it does not have devolved responsibility or separate funding provision for rail investment in the same way that Transport Scotland does. Any rail investment by the Welsh Government can only be at the expense of investment elsewhere so there is no net benefit in Wales from a DfT expectation for the Welsh Government to fund rail enhancements irrespective of whatever the process is. If the ORR believe that sub national transport bodies and local authorities should be funding rail enhancement then there must be devolved funding to cater for this.
3. It is essential that the ORR continue to hold Network Rail to account for delivery of all agreed outputs. The redoubling of the line the line between Saltney Junction to the west of Chester and Rossett to the north of Wrexham is scheduled for handover 2 years later than the date first published in 2014. This is a scheme that has been funded completely by the Welsh Government and the delay means that any benefits arising from the enhancement will be deferred. This is a good example of where an independent body to review Network Rail's performance is needed.
4. The Board support the principle of further devolution but as mentioned above this has to be accompanied by a budget allocation. Private sector funding sounds attractive but is essential that is properly set up and managed learning the lessons from experience elsewhere. If private sector

finance is to be encouraged it has to be accepted that a return on capital will be expected and this represents a cost over and above investment by grant funding. In that respect it's no different from debt added to the Regulatory Asset Base by Network Rail and the Government pays the interest.

5. Considering the two options set out at paras 28 and 29 they both allow flexibility to develop, design and deliver plans at the appropriate time in the project's development, whenever that falls in the control period. This is an advantage as it allows a natural rolling programme of scheme development and takes into account how they fit around Network Rail's core business of maintenance and renewal. The Option at para 29 has more financial flexibility than that at Para 28 because there's no requirement to allocate a capital sum for the whole investment in advance. The downside being that the debt increases and it has to be serviced.

6. Option 30 is similar to the current periodic review but has been tightened up so that only projects that are sufficiently mature are included. While that avoids the problems encountered in the current control period it is much more restrictive so that a project is either in or out at period review cut off.

7. Further thought needs to be given on how 3rd party funding would be shared, where costs and benefits straddle administrative boundaries. An example of this is the Halton Curve, which is in England but the benefits are spread across both sides of the border.

Yours sincerely

Rebecca Maxwell

Rail Delivery Group

Response to:

**ORR'S Working Paper 5: Options for the treatment of
enhancements in PR18**

Rail Delivery Group Response to ORR's Working Paper 5: Options for the treatment of enhancements in 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.

Overview

1. This paper outlines key points from industry in response to the ORR's Working Paper 5 (WP5) – Options for the treatment of enhancements in PR18.
2. The RDG has already provided a full response to the initial PR18 consultation and many of the points made there are relevant to this response on WP5. Our response to this working paper should be read in conjunction with our response to the initial consultation document and also responses on route level regulation (WP1), system operation (WP2 and WP3) and the output framework (WP4).
3. There has also been, and will continue to be, extensive industry engagement and discussion with the ORR through the industry working groups that the RDG has set up for PR18. The RDG values this engagement and we understand the ORR has also found it helpful.
4. The RDG industry groups, such as the Planning Oversight Group and the Contractual and Regulatory Reform Working Group, are a useful means for engagement between Network Rail and train operator owning groups to help set out industry views on the PR18 framework in the longer term including, for example, how scorecards fit into route-level regulation. We envisage that the PR18 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 tone and purpose of the ORR working papers which are intended to facilitate a more dynamic process of industry engagement to support an iterative approach to developing policy.
5. We confirm that we are content for this response to be published on the ORR website.

Overall framework

6. We support the consideration of new approaches to the treatment of enhancements in PR18 in the ORR's working paper. The reclassification of Network Rail in September 2014 has led to a number of changes relevant to enhancements which should be reflected in PR18. In particular, reclassification has removed Network Rail's flexibility to borrow additional funds in response to project cost increases or requests to deliver additional outputs, and has necessitated a much closer working relationship between Network Rail and the Department for Transport (DfT).
7. Network Rail and the DfT agreed a [Memorandum of Understanding](#) in March 2016 which sets out the terms of this relationship. The Memorandum of Understanding supports a continuous planning process, based upon the established and effective industry Long Term Planning Process, which moves away from a rigid 5 year cycle for enhancement planning linked to control periods. This will allow greater alignment between enhancements, franchise specifications and outcomes, and other desired outputs.
8. In CP5 many decisions to fund projects through the periodic review were taken while projects were immature and without adequate understanding of the risk and

uncertainty for cost and delivery that this entailed. This significantly contributed to the challenges encountered in delivering the enhancements portfolio for CP5 which resulted in the Hendy review and the reprogramming of a significant number of projects. To avoid these issues in CP6 the treatment of enhancements in PR18 should support the principles of the Memorandum of Understanding.

9. We support the regulatory framework for PR18 accommodating the funding of enhancements by parties other than the DfT and Transport Scotland. With a greater focus from governments on devolution to sub-national transport bodies and Network Rail's ambition to attract increased private funding to the railways it is essential that the PR18 framework supports contributions from all funders. The process by which third parties can invest in the railway should be as straightforward as possible.
10. Governments should focus on the specification of outcomes, allowing the rail industry to work together, with the close involvement of Network Rail's routes and, where appropriate, end-user representatives, to determine how best to deliver these outcomes. A hierarchy of solutions should be considered beginning with the potential for timetable changes and rolling stock solutions which may be able to deliver outcomes with better value for money than infrastructure schemes. This is consistent with the approach taken in the industry's Long Term Planning Process.
11. A shift by governments to make progressive commitments to enhancements throughout CP6, rather than specifying all enhancements in a High Level Output Statement (HLOS), should be implemented in such a way as to avoid a loss of transparency and certainty for customers, stakeholders and the supply chain.

Potential approaches for regulatory treatment of enhancements

12. It will be for funders to decide to what extent enhancements are specified through PR18. Regardless of the option that is adopted for the specification of enhancements there must be certainty of funding for projects to which Network Rail and funders have already committed. The funding and regulation of projects should also safeguard the core principles of the Memorandum of Understanding.
13. If a large number of enhancements are committed to outside of PR18 it will be helpful to have foreknowledge of the total funding likely to be available in CP6 and the priority projects for development. This will assist planning by the industry, and in particular Network Rail, and give early confidence to the supply market and to customers about the scale and sequencing of enhancements works that are planned.
14. We would expect the priorities for enhancements in CP6 to be informed by the Initial Industry Advice in which the industry sets out desired outcomes and potential interventions to deliver them; this builds on the work of the industry Long Term Planning Process.
15. Commitment of enhancements as part of the periodic review allows detailed planning of the delivery of enhancements projects to be integrated with plans for renewals and

other areas of Network Rail's business, and the planning of franchises. If funders choose to make significant commitments to outcomes or enhancements that require additional investment outside the periodic review it is essential that there is a clear process to capture the impact of these on other areas of Network Rail's business such that they can be accounted for within the wider PR18 settlement and addressed within relevant franchises.

16. Integration between enhancements and renewals can often allow small upgrades to be made to the capability of the railway which have very high value for money. The framework for PR18 should allow enhancements and renewals to continue to be integrated in a flexible way.
17. Network Rail would expect to continue to take a portfolio approach to the delivery of all enhancements in CP6, whether or not they are committed to through PR18.
18. We are 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 can provide a means of leveraging small scale third party investment into the rail industry that would not otherwise be realised.
19. The Enhancements Delivery Plan is a useful way of providing transparency to funders, customers and stakeholders of the deliverables which Network Rail has committed to and the outcomes that they enable. We support Network Rail continuing to publish an Enhancements Delivery Plan for this purpose showing all projects for which commitments have been made. The structure of the plan should be reviewed to best align with the principles of the Memorandum of Understanding and the funding and regulatory arrangements for CP6, including the potential for increased third party funding of enhancements.

Funding of enhancements

20. 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.
21. 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.

22. Network Rail will require clarity at the point at which it commits to an enhancement on how the cost will be reimbursed and how risk is allocated between parties. For enhancements which are debt financed in CP6 there needs to be a clear process for determining additions to the Regulatory Asset Base (RAB) and the efficient cost of projects. This should be aligned to the project lifecycle and the decision points established in the Memorandum of Understanding. The efficient cost of a project would be best agreed at the final decision point, the commitment to deliver, when there is greatest certainty of cost.

Third Party Investment

23. The ability to support third party funding should be a key consideration in determining the framework for enhancements in PR18. Since reclassification the allocation of all of Network Rail's financing capacity for enhancements to HLOS projects has meant that there has been no ability to RAB finance third party projects. PR18 should create a framework in CP6 that supports more third party involvement in the funding, financing and delivery of outputs.
24. One option to achieve this would be to include headroom in the loan agreement which could be ring fenced for financing of third party schemes. The RDG supports the further exploration of this and other options.
25. The RDG has set up a working group to examine the key barriers and enablers to increased third party investment in the railway network.

The role of the ORR

22. It is important that there is no ambiguity over the roles and responsibilities of the ORR and of funders in holding Network Rail to account for delivery of enhancements in CP6. This is in accordance with the principles described in the Memorandum of Understanding and the conclusions of the Bowe review. The agreement of Memorandums of Understanding between Network Rail and Transport Scotland, and between the DfT and the ORR should further clarify roles and responsibilities.
23. We would welcome the ORR playing a role which supports further political devolution and encourages third party funding and financing, including from the private sector.

ORR Consultation Response – Treatment of Enhancements in PR18

Rail North – October 2016

ORR Responsible Officer; James Dunshea

Introduction

This paper is the fifth instalment from the ORR regarding the future of the next periodic review, PR18, effective from April 2019 – March 2024 (also known as CP6). As Rail North, we have prepared previous responses to the initial consultation in August 2016 and subsequent papers too.

This outline and response has been prepared to cover the future treatment of enhancement schemes, and builds on questions raised in the initial consultation (section 4.38, pages 27 & 28). The central themes to be considered by Rail North within this paper relate to **Planning** of works and schemes, **Funding** options, and implications for the industry, and the **Regulatory Treatment** of the scheme being developed and delivered on the other targets, and assessment of Network Rail's performance in line with their licence conditions.

Overview

The crux of the working paper is looking at funding mechanisms for future enhancement schemes, interestingly, with a notion that each scheme be assessed on its merits to achieve the best possible solution given the timing, scale, and wider requirements of the transport bodies sponsoring the outcome. Essentially, there are three broad options being proffered;

1. Commitment to fund an enhancement outside of the existing periodic review process, with the allocation of a funding grant (i.e. upfront funding from the outset for the entirety of the scheme)
2. As part of the existing periodic review process, and forming part of the existing debt funding,
3. Commitment to fund an enhancement outside of the existing periodic review process, and this forming part of the existing debt funding (and therefore being spread over time and several HLOS's).

The timing of the paper is set against a back drop of the change in funding status for Network Rail now, with binding borrowing limits in place for each control period, and the books 'needing to be balanced' irrespective of increasing costs or requests to deliver additional benefits materialising.

In a positive development, there has been an MoU signed between DfT and Network Rail to further clarify roles between the DfT and Network Rail as Client, and Deliverer, and this should provide additional governance, balances and checks for the delivery of large, complex enhancement schemes over multi control period timescales.

Response

The key considerations asked of this consultation response relate to how schemes in the future are developed, the planning and reporting of progress, the regulatory status of these schemes (and their impact on NR's performance and compliance to the network licence accordingly), and the funding mechanism (particularly where this sits across or needs to be considered within multiple HLOS's). Within the submission from Rail North, we should outline to positive and collaborative approach being taken in producing the Northern Route Study between Network Rail and Rail North early in 2017.

Also under review appears to be the future role of the ORR in all of the above, where they have outlined 6 conditions that they feel they are best placed to deliver. This is of particular importance as Rail North / Transport for North is working closely with the DfT to become a sub national transport body, and thereby set the High Level Output Statement (HLOS) and Statement of Funds available (SoFA). Assuming this application will be successful, there are slightly different challenges, and opportunities that this paper presents, and we should prepare our position accordingly.

Planning

1. *What should the role of Network Rail's routes be in the enhancement planning process?*

Rail North and Transport for North have been instrumental in developing a better understanding of issues and opportunities across the North. A mechanism for the development, and management of future enhancements, and smaller scale initiatives has been prepared. Additionally, the IIA submission as part of PR18 has been developed between Rail North and Network Rail.

TfN has submitted its proposal for a Sub-national Transport Body to the Secretary of State for Transport. The proposal recommends that:

'.....TfN is established through regulations, to jointly exercise alongside central government departments, the directing of national delivery agencies; advising the Secretary of State throughout industry planning processes on the strategic transport priorities for the North of England. Such advice will be underpinned by TfN's transport strategy and investment plan and economic analysis.'

As such, we feel that there are a lot of positives in Rail North/TfN taking the lead on the developments of Enhancement schemes in the future. The ability to harness local knowledge of the concerns, bottle necks, future developments (commercial & residential) across the combined authorities, and ability to then align these with sub-national economic analysis (Northern Powerhouse Independent Economic Review) and for example, committed obligations within the franchise agreements, to other opportunities and schemes represents a real opportunity for both the North, and the industry as a whole. A first step in this emerging relationship has been a commitment with NR to co-author the Northern Route Study too. The role and functions Rail North/TfN's proposal seeks to establish, will we believe engender stronger, collaborative working relationships with Network Rail and enable shared development of economic analysis, modelling, etc to ensure the enhancement priorities for the North's network are better aligned with sub-national needs, and a stronger case for investment is presented to government.

2. *Who decides when an enhancement should be committed to, and when?*

Rail North/Transport for North are developing an Integrated Rail Report, and this is due for completion at the end of the year. Rail North, working with its member Authorities are also developing a number of schemes and proposals for CP6 with a view to influencing the funding, allocation and development of future enhancements.

It is the aspiration to secure, and utilise statutory powers as a sub national transport body, to enable it to determine what schemes should be committed to, and when that decision should be made. This would most likely be done as part of a co-decision making body with DfT, and these are already in practice on a number of enhancements already.

Rail North/TfN will be able to take a longer term view on transport investment. Through the Independent Economic Review, the value of longer term economic planning has been demonstrated,

with scenarios developed to 2050. In developing the Strategic Transport Plan, TfN will establish a sequenced prioritised portfolio of transport investment that goes beyond any other strategic planning process, looking at the long term impact and benefits of schemes¹.

We understand DfT is currently reviewing the HLOS / enhancement planning process with a view to developing a 3 stage gateway approach i.e. feasibility – development – delivery. TfN through its STB proposal and engagement with DfT and Network will look to agree the appropriate role to ensure:

- Better links to the North's economic plans;
- Better links to franchise service outputs; and
- Better integration with wider / local multi-modal transport planning.

3. *Once projects are committed, should Network Rail publish all of its commitments in a Delivery plan?*

For the purposes of integration, and deliverability, it would make sound economic sense for all of the commitments to be published in the Network Rail Delivery Plan, with there being a sound case for future or emerging schemes (in early GRIP stage development) to also be tracked this way.

There are a number of considerations to be looked at regarding why information should be published, and some of the core considerations regarding the status of schemes could reasonably include; Access to undertake works (possessions), Deliverability (in terms of supply chain, status of contract awards and complexity), and cost (forecast / baseline)

Rail North/TfN will establish the overall requirement for pan Northern travel – road, rail, commuters, business to business, freight. Transport planning remains focused on modes and can better articulate the relative benefits of modal shift to meet economic outcomes. Through the NTS and emerging studies on freight and international connectivity, Rail North/TfN is already making significant progress in understanding and articulating multi modal choices. Multi modal planning and appraisal undertaken in an integrated approach will provide better value for the taxpayer by developing the right priorities and schemes, regardless of modal basis, thereby eliminating duplication and inconsistencies across modal schemes and driving down costs through more efficient analysis, modelling and commissioning. For Network Rail and the industry, this should mean a smarter client able to drive down costs through more efficient commissioning.

4. *What or how should the change control process be managed for the Network Rail Delivery plan?*

The existing process, and introduction of ECAM has brought more rigour to the management of scope, cost and time for enhancement schemes, but there needs to be significant improvement. With the transfer of Network Rail debt back onto the public books, and a need to fund any variations within the available funding, there is a strong case for greater control to be in place. In order to make this process more robust, there is a reasonable case for the future change control of schemes to be made in an open and transparent way. The establishment of an MOU between Network Rail and DfT will support this objective.

There has been recent agreement between the DfT and Rail North for the use of co-decision making to support the development and management of certain schemes, notably for the Trans Pennine

¹ Transport Scotland *National Transport Strategy*; London Infrastructure Plan 2050; TfGM *Greater Manchester Transport Strategy 2040*

Route Upgrade (TRU). It is our view that the change control process for enhancements could be monitored and managed better where there is more accountability and decision making by the areas affected. At a national level, there could be a role for the national infrastructure commission who would be cognisant of the financial position and relationship with HMT, and able to make recommendations regarding any future changes.

Financial

5. How should any funding decision (inside or outside the existing periodic review process) affect the setting of the borrowing limit and HLOS?

This is a crucial point for Rail North and Transport for North. Given the duration of enhancement schemes almost always being over multiple control periods, there is a lot of sense in these being prepared, and costed outside of the periodic review process. The requirement to balance and manage the funding available and setting of a borrowing limit by HMT / DfT in line with an emerging cost being known on an enhancement scheme is pivotal. While this activity may require a lot of work, and scrutiny, it is critical to the future success of delivering multi billion pound schemes in the future.

As an example of this, it is reasonable to state that at some point, an enhancement scheme will work out to be much more expensive and / or later than planned, and this could result in a 'claim' from NR whereby works had been planned but postponed pending the enhancement being delivered. This would be within DfT's gift to assess, resolve and award funding, but this would require a contingency pot to be held centrally.

6. Should schemes be funded via a grant, or debt funding, and as part of the control period process or outside?

There are merits to each of these approaches, and with Rail North /Transport for North looking to set advise the HLOS for CP6, we feel that Rail North / Transport for North are well placed (with any of these options) to specify a broad set of objectives and (following negotiation with DfT / HMT) a total fixed budget.

Funding could then be managed with delegated authority and an industry board being in place to assess, develop, monitor and fund such initiatives. This is very similar to what RN are proposing with the 4Cs approach for schemes in CP6 (this is also very similar to the ring fenced funds methodology used in CP5, and helps move away from having to specify very set scheme outcomes early in the process too). The current issues found with an emerging scope, and how this is priced currently by Network Rail, could be subject to more scrutiny, and potentially being offered to a wider selection of contracting and design teams, with a view to achieving efficiencies, and a more accurate, robust output.

The benefits of undertaking a grant approach is that the scheme is underwritten and funded from the very outset, and takes away future concerns regarding whether a scheme will proceed beyond the immediate 5 year review. This is equally true in the event of a change in personnel, government, strategy or priorities within the HMT too.

Regulatory Treatment

7. How does the monitoring of progress of a project occur if the funding sits outside of the periodic review process?

We understand DfT is currently reviewing the HLOS / enhancement planning process with a view to developing a 3 stage gateway approach i.e. feasibility – development – delivery. TfN through its STB proposal and engagement with DfT and Network will look to agree the appropriate role to ensure:

- Better links to the North's economic plans;
- Better links to franchise service outputs; and
- Better integration with wider / local multi-modal transport planning.

Rail North and Transport for North are supportive of the establishment of a MoU (as NR and DfT have just entered into) and that updates are provided quarterly in a published report. Additionally, monitoring would be undertaken with Programme Delivery Groups, and Programme Boards as is custom and practice on a number of enhancement schemes already in flight.

We will look to ensure Rail North/TfN is a 'smarter client' to ensure strategic transport needs of the north are founded on strong underpinning economic analysis and with the appropriate governance and working arrangements formalised to ensure effective managing and monitoring of progress throughout the feasibility – development – delivery phases

With the adoption of a stringent change control process, that makes consideration of the impact of any changes, on the wider industry - i.e. the ability of Network Rail to achieve their regulated milestones and / or TOCs to achieve their committed obligations within their franchise agreements, it is likely that emerging risks and issues can be more successfully mitigated.

8. How will the costs of an enhancement scheme be aligned to the RAB, and then used to inform (calculate) the charges paid by train operators?

Rail North/Transport for North does not have an explicit view on this point regarding the management of the RAB. As an organisation responsible for managing the Northern and TPE franchises though, we have a strong commercial management interest and knowledge of the commitments. As such, Rail North / TfN would be well placed to assess any impact on the charges to be paid by the train operators.

One area that merits further discussion is the initial pricing mechanism used for the development and control of enhancements as there are inherent problems with the current methodology, that ECAM has only been partially successful in resolving.

9. How will the decision on funding of schemes be assessed against Network Rail's regulated outputs, financial risk, and the forecasting of deliverability?

At the point of approval for a scheme, Rail North / TfN could mandate that such an assessment is undertaken regarding the impact on Network Rail's regulated outputs, and financial risk is completed. This (in effect) would also then form a set of 'requirements or programme assumptions' that the scheme would need to have supported by all parties, and monitored and managed accordingly, with strict adherence to a change control process and use of impact assessments.

Where the forecasting of deliverability is to be undertaken, again, this could be done as part of the mandatory steps when the scheme is being proposed from an operational (access) perspective, but also in terms of the supply chain and selection of a competent contractor (whether this is Network Rail and Infrastructure Projects or an external outfit).

10. What may happen to the existing Investment Framework?

There are elements of the Investment Framework that are of interest to Rail North / Transport for North, particularly in treatment of third parties and would welcome further discussion as to how this might be deployed, and works managed when engaging works and Network Rail across the supply chain.

Transport for London

James Dunshea
Office of Rail and Road,
One Kemble Street,
London,
W2B4AN

Transport for London
Rail and Underground
Palestra
London
SE1 8NJ

14 October 2016

Dear James,

Working Paper 5: Options for the Treatment of Enhancements in PR18

This letter sets out TfL's comments on Working Paper 5. TfL is content for its response to be published and shared with third parties.

We note the increased focus on alternative funders for enhancements and the need to encourage third party investment in rail projects. The PR18 Review should provide an opportunity for review of the Network Rail Fee Fund and its application to projects funded by third parties, especially where these are also public sector organisations such as TfL and London Underground.

Fee Fund contributions are subject to negotiation and we are aware of some cases where terms have been revised. The Review should consider whether such a mark-up is appropriate when a third party is paying Network Rail's project costs and is taking risk. A further area for review is the cashflow impact on the funder of requiring payment at the start of a project.

Yours sincerely,



Carol Smales
Rail Development Manager

James Dunshea
Office of Rail and Road
1 Kemble Street
London
WC2B 4AN

Your ref:

Our ref:
PR18/WP/05

Date:
14 October 2016

By e-mail

Working paper 5: Options for the treatment of enhancements in PR18

Thank you for the opportunity to respond to your *Working Paper 5 (WP5): Options for the Treatment of Enhancements in PR18*. We welcome the ORR's focus on this area, not least given some of the significant challenges that we have seen with Network Rail's recent delivery of the CP5 enhancements programme in Scotland, both in terms of cost increases and potential schedule delay.

You should be aware that Transport Scotland is expecting to consult shortly on our post-2019 rail infrastructure investment strategy. Whilst some clear ideas will be expressed through this consultation (many of which are repeated in this response) on the opportunities that we see available to strengthen the approach to developing, designing and delivering major rail projects, our final position may be influenced by the nature of the stakeholder feedback we receive. Accordingly we would ask that you note that the views and observations set out below reflect our current thinking which may develop further in the light of consultation responses.

Our response has been informed by our general experience and understanding of how the existing enhancements framework has operated in CP5 as well as the findings from the various independent reviews, both in a Scottish and an English and Welsh context, that have examined the circumstances surrounding major enhancement projects in some detail. Taken together, these clearly indicate that previous processes used for the planning and delivery of enhancements were not as effective as they should have been and significant change is therefore required. Such changes would be over and above the strengthened governance arrangements that have already been introduced by Transport Scotland for the funding and delivery of our enhancements portfolio.

An enhancements framework that works for Scotland

Despite recent challenges, Scotland's railways continue to thrive with over 94 million passenger journeys undertaken on the ScotRail passenger network last year. A transformative programme of improvements to the rail infrastructure is building on the strength of the network and services which have already grown significantly since rail powers were devolved to the Scottish Government. The success of which is evidenced by record passenger numbers. In terms of freight, the recent position has been more challenging, although a new strategy has been

introduced to ensure that the sector in Scotland can properly adapt to the loss of key coal markets.

Investment to improve the performance, capability and capacity of our railways will remain a key priority of the Scottish Government. The way in which enhancement projects are specified in Scotland remains a matter for the Scottish Government. We recognise the need to continue our investment to enhance the infrastructure if our railways are to continue to thrive, and indeed Network Rail's '*Scotland Route Study*' and the more recent RDG '*Investing in the Future*' documents helpfully set out some of the investment choices available.

The Scottish Government is clear that our rail investment programme must remain aligned to our strategic priorities. It must also be efficient, sustainable, and affordable, with identified risks from project development to delivery mitigated or minimised. We will seek the best possible outcomes for passengers and freight customers at the most efficient cost. Accordingly, our investment strategy will reflect the investment hierarchy based around the priorities of:

- Maintaining and safely operating the existing railway infrastructure, in a way that is fully integrated with franchise agreements and rolling stock;
- Promoting whole-industry measures that can help make better use of existing railway assets, fully exploiting timetable and rolling stock options before considering infrastructure solutions;
- Making efficient and affordable targeted improvements to expand and improve the capacity and capability of the rail network to support the growth in demand that is projected.

As the principal client and funder of the railway infrastructure in Scotland, it is also vital that the right governance arrangements are put in place for the delivery of enhancement projects, ensuring that Network Rail in Scotland has all the levers available to discharge its responsibilities to full effect, and indeed that they can be fully accountable to the Scottish Government for their delivery. This is a key point we have highlighted in our previous PR18 consultation responses and the Scottish Government will continue to pursue options for full devolution of Network Rail to Scotland. In the absence of this we will continue to press for Network Rail to increase the depth and scale of its decentralisation programme, providing more local accountability and responsibility particularly in terms of the Infrastructure Projects function. In particular, we consider there is scope to reduce the level of central overhead costs allocated to projects; to adopt a better value for money approach to the application of standards in Scottish projects than has been applied remotely; and to build on the efficiency of whole railway system specifications which can be facilitated through the involvement of the Operator through the ScotRail Alliance

A flexible, pipeline based approach

To better align with our needs, we are proposing a flexible but robust process to govern the development, design and delivery of enhancement projects. We understand that this approach is supported by the UK Government and Network Rail, with the ORR also clear that the approach to specifying enhancements need not be constrained by the five-year regulatory cycle

Accordingly, rather than commit to a list of projects at varying stages of development, we are expecting to move to a more flexible, 'pipeline' based approach. Under this model a decision to commit to a specific enhancement project will only be taken when the business case is clear and both price and affordability are certain. We will also require confirmation of the availability of

suitable capabilities and resources in rail industry supply chains to deliver the project – ensuring that we do not repeat the mistakes experienced during CP5.

We expect that this approach would apply to all potential rail projects, including those being promoted by third parties that require Scottish Government investment to support delivery. We will, of course, continue to support promoters as they look to develop their proposals and produce associated business cases for consideration.

In terms of potential prioritisation, the need to safely operate, maintain and renew the existing core network is our primary objective. Beyond this, and once all reasonable service-based opportunities (e.g. changes to timetables, lengthening trains and/or revising stopping patterns) to meet key strategic objectives have been exhausted, we propose a tiered approach to new infrastructure investment, aligned with the potential hierarchy as set out above:

- **Tier 1:** Any enhancement projects that require to be carried over from the CP5 programme for completion in CP6;
- **Tier 2:** Enhancement projects considered essential to maintain a safe, high performing railway as well as supporting social, economic and environmental objectives. Such projects, linked efficiently with planned renewals works, would be expected to provide increased capacity, improved journey times and/or improved performance at key locations where such outcomes are currently constrained;
- **Tier 3:** Enhancement projects to stimulate inclusive economic growth, including potential new routes, alignments and stations;
- **Tier 4:** Enhancement projects to increase capacity on key cross-border routes, with joint-funding arrangements, and appropriate future-proofing for long-term ambitions including integration with High Speed Rail.

We expect this approach, together with the key priorities identified above, to be embedded within a new and separate Memorandum of Understanding between Transport Scotland and Network Rail which will help define a single, integrated way of governing the planning, development, design and delivery of a the rail enhancements portfolio in Scotland, including constituent programmes and projects. Work is on-going between Transport Scotland and Network Rail to confirm and agree this MoU.

Another key issue for the Scottish Government is having certainty on the outputs that are to be delivered from each enhancement project, thus protecting the integrity of the business cases upon which they have been agreed. This is also an issue for enhancement projects that link to the cross-border infrastructure, including on the East Coast Main Line, and is an area that we would welcome further discussion with the ORR.

Certainty of funding

The core funding requirement to enhance - in addition to safely operate, maintain and renew - the railway infrastructure in Scotland will continue to be met by the Scottish Government in line with our devolved responsibilities.

Following reclassification Network Rail's borrowing limits have and will continue to be set by the UK Government. These limits are currently set separately for Network Rail's activities in Scotland and in England & Wales, thus protecting the integrity of the devolution settlement and

the 2005 Railways Act. The financing costs from any borrowing by Network Rail for activities in Scotland continue to be met in full by the Scottish Government.

Irrespective of the final approach taken to specify individual enhancement projects, the Scottish Government expects the funding requirements for such activities, including all necessary borrowing, to be included within the regulatory determination for CP6. The Scottish Ministers' Statement of Funds Available (SoFA) will be published on this basis. Any decision to proceed with individual enhancement projects should be a matter for the Scottish Government alone and not require negotiations on a transaction by transaction basis with the UK Government as might seem to be implied by the current Investment Framework model and expected arrangements regarding access to borrowing. This is a matter we are picking up separately with colleagues at the DfT.

Key considerations for PR18

Your paper highlights a number of key considerations on which it seeks views. We do not feel that we can fully cover each and every point at this stage but some of our initial observations are set out below.

Planning and Reporting

As outlined above, we expect a more flexible approach to specification and delivery based on business cases and affordability. Where individual schemes are not sufficiently developed and priced to be specified, we still expect that the broad strategic outcomes to be delivered by any enhancements, and the quantum of funding available to support their delivery, will be specified in the HLOS and SoFA.

We are open-minded on the question of retaining ring-fenced funds in CP6 and will await the findings of our future rail investment consultation before we adopt a settled position on this. The move to a more flexible approach to enhancement investment overall may, however, reduce the need for separate specification and administration of these individual funds, with investment opportunities being considered instead on a case by case basis. Our final position will, however, be informed by our own consultation exercise and any reviews covering the effectiveness of the existing ring-fenced funds.

We support the principle of transparency of delivery but would look for any reporting arrangements to properly reflect the requirements as set out in the HLOS and any subsequent investment commitments. These should also properly reflect the requirements of Transport Scotland as funder and complement any other governance and monitoring arrangements in place.

Regulatory Treatment

A number of pertinent considerations have been raised by the ORR under this heading, many of which cannot be fully answered at this stage.

In very broad terms we have indicated our intention for a more flexible approach and our intention to secure a MoU with Network Rail which will clearly define roles, responsibilities, governance arrangements and the framework under which potential enhancement schemes will be planned and delivered in Scotland. However, we are equally clear that this framework must continue to operate within a broader regulatory regime that appropriately reflects the broader responsibilities than Network Rail will carry and to which we expect the ORR will continue to hold them to account.

We agree with the need for further clarity around the process underpinning any RAB additions, the Investment Framework to ensure it remains fit for purpose, particularly under reclassification, and any broader issues around links back to the regulatory framework. These are all issues where we would expect further detailed discussion with both the ORR and DfT.

Financial

As indicated above, the Scottish Government will look to protect the integrity of the existing devolution settlement in any new funding arrangement for CP6. This is an absolute priority. Network Rail's ability to safely operate, maintain, renew and enhance the rail infrastructure in Scotland will inevitably depend on sufficient access to borrowing being made available by the UK Government.

Clearly the long-term sustainability of the RAB funding model has been under consideration for some time, even before Network Rail's reclassification. We look forward to continuing discussions with the ORR and UK Government to find a sustainable, affordable funding model that reflects both the needs of and resources available to the Scottish Government under existing legislative arrangements.

Principles for the ORR's role in enhancements

We note the assessment set out by the ORR in relation to its role in respect of enhancement projects and would broadly agree with the six key responsibilities identified.

Clearly the experiences of CP5 has led to significant changes in terms of governance and accountabilities, much of which the ORR has been able to respond to effectively. This need for on-going flexibility will be particularly important to avoid duplication, particularly as any new framework for developing and delivering enhancement projects crystallises.

At this stage we would also wish to note that the nature of the level of accountability of Network Rail to the UK Government is different to that seen in Scotland. Accordingly, our requirements from the ORR in CP6 may also be different. This is an area that has been identified in our review of major projects and is something we will wish to reflect upon with the ORR as the PR18 process progresses.

Cross-Border enhancements

The Scottish Government's is committed to High Speed Rail and working with the UK Government and industry partners to develop options that could help reduce journey times between Scotland and London down to 3 hours or less.

In the short term we want to support early improvements in cross border journey times, both on West Coast and East Coast Mainlines. During CP5 we have funded Network Rail to develop detailed engineering options for investment at Carstairs to add capacity, improve reliability and increase the speed of the line.

You will recall that the issue of how such enhancement projects should be funded was discussed in detail during the PR13 process and there was general agreement on the need to revisit during PR18, particularly to reviewing the regulatory changes that could ensure that there was a fairer distribution of benefits, to make such investment sustainable on this premium line. A mechanism that appropriately identifies and charges the beneficiaries of such enhancements may lead us collectively to a solution for such schemes and we would welcome further

discussions with both the ORR and UK Government on the potential options that may sit within the CP6 financial framework.

Next Steps

As outlined elsewhere in this paper, we will imminently be holding a consultation on our post-2019 rail investment strategy and we will share the findings of this consultation, in so far as they relate to the PR18 process, with the ORR, DfT and other industry colleagues in early 2017.

In the meantime we would like to thank the ORR for providing the opportunity to comment on key issues for PR18 through its series of Working Papers and also the RDG for facilitating the many workshops that have fostered such lively discussions through summer. We look forward to our continued engagement in these discussions as we progress through the PR18 process.

Yours sincerely,

Steven McMahon
Head of Rail Strategy & Funding



Welsh Government Response to the ORR's PR18 Enhancements Working Paper 5

Introduction

The Railways Act 2005 provides the Welsh Ministers with powers to invest in the railway and the Commission on Devolution in Wales recommended devolution of powers to direct Network Rail and funding for rail infrastructure. The Welsh Government is pressing for this recommendation to be implemented and wishes to steps taken towards achieving this.

Although funding has not been devolved, the Welsh Government has since 2011 invested over £200m to enhance the railway. Against this background, the Welsh Government welcomes the opportunity to comment on the proposals for the delivery of enhancements set out by the ORR in PR18 Working Paper 5.

Welsh Government Investment

The future investment framework needs to reflect moves to increase stakeholder input at the route-level. The difficulties encountered by the Welsh Government during the delivery of rail infrastructure projects by Network Rail leads us to conclude that the principal accountability arrangement for third party funders - Condition 1 of Network Rail's licence - is not a satisfactory mechanism for ensuring that Network Rail is held to account for its delivery of schemes, especially those progressed outside of the HLOS process. The regulatory framework for Control Period 6 should enable the ORR to hold Network Rail to account for outputs funded by the Welsh Government in the same way as those funded by the DfT.

We also believe there is scope for improvements to the model framework contracts currently available for funders. The Welsh Government wishes to work with Network Rail and the ORR to develop a suite of Wales-specific model contracts which recognise the unique position of the Welsh Government. This is in line with recommendations made by the Wales Audit Office report into Rail Investment in Wales [Welsh Government Investment in Rail Services and Infrastructure – September 2016](#). Additional value could be added by other public funding investors making use of these contracts, or building upon them. It would also be helpful for the ORR to provide a mechanism for sharing best practice and lessons learnt in the delivery of third party funded projects.

Funding and Delivery of Enhancements

Regardless of how a HLOS for CP6 is framed, in order to support planning and provide certainty to Network Rail and the industry, the SoFA should include the full envelop of available funding for enhancements - as well as OMR.

It is clear from the ORR's rail industry financial information that the Wales Route has not received a fair proportion of enhancements expenditure since 2011. Allocating funding to routes is welcome and requires an approach which delivers a fair share of enhancement funding to the Wales Route to support the move towards devolution in

this area as recommended by the Commission on Devolution in Wales. This would also better enable integration of enhancement works with renewals projects.

We agree with the principle of ring fenced funds, and the added flexibility they provide to fund schemes within control periods. However, the Wales Route has not seen a fair level of investment from these funds. We would like to see a ring-fenced fund for Wales established which adequately reflects the Welsh Government's developing role in the rail arena.

In the light of the emerging focus on developing a pipeline of enhancements, ensuring that sufficient development funding is available becomes even more crucial. The process and criteria for applying for and allocating funding needs to be clear and transparent, with appropriate governance and stakeholder representation.

Roles and Responsibilities

The new framework will need to be work for the Welsh Government which is in a unique position as a (future) franchising authority without control of, or funding for infrastructure. We welcome the engagement that has taken place so far, and would like to see this strengthened. This is particularly required around how the enhancements – and wider regulatory framework – will impact upon our plans for developing Metro-style systems in North and South Wales.