

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

Summary of responses and close out report

Date of publication: 16 June 2017

Summary

The 2018 periodic review (PR18) will determine Network Rail's outputs and funding in Control Period 6 (CP6), which we expect to run from 2019 to 2024. This will feed through into the service passengers and freight customers receive and, together with taxpayers, ultimately pay for. As such, PR18 is a key means by which we will protect the interests of rail users.

In connection with our initial consultation on PR18 in May 2016, we issued five working papers seeking stakeholders' views on more detailed issues. [Working paper 5](#) (WP5), published in August 2016, set out options for the treatment of enhancements in CP6. It described the current context, including the developments and issues that have challenged the framework in CP5 and sought stakeholders' views on a range of options for improving the framework for funding and delivering enhancements in CP6

The consultation process has now completed and this report summarises the responses received, setting out how we will work with Network Rail and funders going forwards. Some of the issues raised are not directly relevant to the periodic review.

We received twelve responses from stakeholders (listed below and published on our website) which all discussed the issues in detail. A number of key themes were evident across all the submissions and we have set these out below as well our response and next steps.

The need for alternative, more sustainable forms of funding, include private investment was raised in the majority of responses.

There were calls for greater devolution of funding and client responsibilities, particularly from the national governments and devolved bodies, whilst Network Rail set out the steps it is taking to devolve responsibilities and accountabilities to its operating routes.

The majority of industry stakeholders wanted transparency over the total envelope of enhancements funding available in CP6 and a clear indication of the outputs government is seeking to purchase. At the time of their responses the Department for Transport (DfT)

and Transport Scotland had not yet decided whether the total amount of funds available for enhancements would be made clear or whether they will specify any new enhancements within their respective high-level output specification (HLOS).

Ring-fenced funds were regarded positively by industry stakeholders. In previous control periods these funds have provided passenger, freight operators and Network Rail with the opportunity to target investment at specific industry priorities, for example in relation to the closure of level crossings, improving flexibility or performance for freight or in carrying out research and development for the railway. Many stakeholders advocated the continuation of these funds.

List of respondents

The table below sets out the stakeholders that responded to WP5. The responses are available on our [website](#).

Respondents
Department for Transport (DfT)
Drax Power Station
Freight Transport Association
Merseytravel
Network Rail
North Wales Economic Ambition Board
Rail Delivery Group (RDG)
Go-Ahead Group
Transport for London
Transport for the North and Rail North
Transport Scotland
Welsh Government

We would like to thank all stakeholders who responded to the working paper.

1. Enhancements separated from the periodic review process

Respondents' views

1. The partial or total removal of enhancements planning and funding from the periodic review process was a key theme raised by all respondents. Stakeholders recognised that the move is in line with the DfT and Network Rail [Memorandum of Understanding](#), noting that enhancements do not necessarily sit easily within the confines of a five-year planning process. In particular this is due to the development and delivery of bespoke engineering solutions, complex, evolving business cases and the non-cyclical nature of enhancements (as opposed to routine maintenance and renewal activities).
2. Both DfT and Transport Scotland intend to move towards a continuous planning process which will provide them with a greater degree of visibility, control and flexibility over project funding and progression. This involves fully committing to funding when a viable business case is in place, a robust cost estimate has been developed, affordability has been demonstrated and all relevant parties are satisfied that it will deliver the necessary outputs. Other potential funders, including third parties and devolved bodies, welcomed this move as enabling them greater flexibility, and time to plan and develop outputs, rather than having to commit to funding enhancements without a sufficient idea of cost and benefit.
3. Network Rail noted that the pipeline would allow them to devote the necessary feasibility and development resources to projects in a planned and controlled manner rather than simultaneously across the portfolio, as has been the case in CP5 and earlier. There was strong support from the Go-Ahead group for this move as it should improve alignment between enhancements outputs and franchising decisions, consequently providing a clearer link between enhancements and the end user.
4. A number of correspondents, including Network Rail and the RDG raised issues with the move away from the periodic review process that the industry will need to address. The main concern was the need to retain the benefits of managing as a portfolio, co-ordinating specialist resources, outputs and access arrangements centrally to ensure the optimal outcome in each case, whilst minimising overheads and duplication of work. Similarly funders and Network Rail will need to be aware of the implications that new schemes delivered via the pipeline would have on existing enhancement commitments as well as Network Rail's maintenance, renewals and operations activities.
5. In the scenario that most or all enhancements were to be removed from the periodic review, many responses articulated the need for clarity over the funds available and the outputs that Governments would be specifying. The DfT stated that it is

considering making a non-binding policy statement regarding the overall scope of its ambitions for enhancements investment in CP6. Alongside this, there was strong support from industry, including operators, RDG and Network Rail, for the retention and improvement of the Enhancements Delivery Plan (EDP) in CP6¹.

ORR response

6. We recognise the benefits of a more flexible approach to planning and delivering enhancements and welcome responses on this issue.
7. Mechanisms do currently exist to allow for enhancements to be funded or financed and delivered outside of a periodic review; the Investment Framework has been in place since 2007 and many projects, from programmes such as the Edinburgh to Glasgow Improvement Programme and Crossrail to smaller schemes such as TOC-funded stations works, have been funded using this mechanism.
8. In order to provide Network Rail, operators and wider stakeholders with transparency and the necessary information to plan ahead, the ORR currently intends to require Network Rail to publish an Enhancements Delivery Plan. This would set out Network Rail's obligations with regards to Enhancements, detailing the outputs government is purchasing and the Regulated Milestones² Network Rail needs to meet to demonstrate successful delivery. It would again be the key document for publicly holding Network Rail to account and the baseline for all changes to outputs or milestones.

2. Enhancements included in the periodic review process

Respondents' views

9. Alongside the move towards the pipeline approach, DfT and Transport Scotland retain the option to specify enhancements in their High Level output Statements (HLOS) as part of the periodic review process.

¹ This is a document setting out the obligations and outputs Network Rail commits to in line with funding for enhancements; this provides clarity over agreed outputs and timescales and is useful as both a baseline for the portfolio and holding Network Rail to account for delivery and performance.

² The ORR has typically held Network Rail to account for two milestones on each enhancement. These are at the end of Option Selection (by which point Network Rail has selected a solution to deliver the output) and at the point at which Infrastructure is ready for passenger services to begin (when the construction and authorisation processes have completed)

10. The DfT stated it is likely they will continue to use the HLOS to specify a specific set of enhancements, potentially including projects deferred from CP5, schemes required to support the delivery of major programmes such as Crossrail, and projects that are deemed critical to prevent serious deterioration disruption to passenger and freight services.

ORR response

11. While the previous section covered the issue of removing enhancements from the periodic review there remains the option for funders to include some if required. In this scenario efficient costs need to be determined as these feed into the calculation of access charges. For CP4 this was done by ORR at the time of the review. For CP5 the Efficient Cost Adjustment Mechanism (ECAM) was set up to do this progressively as there were so many projects at an early stage of development. ECAM has been discontinued in England & Wales but remains in use in Scotland for the rest of CP5.
12. The ORR will discuss with funders how efficient costs will be determined in CP6. The issue of which organisation is responsible for determining efficient cost, the suitable point in the project lifecycle for reviewing costs and the most effective method for doing so needs to be clarified in advance of the Final Determination. This will ensure Network Rail is properly incentivised, track access charges remain proportionate and taxpayers receive value for money from enhancements to the rail network.
13. As part of a broader review of Network Rail's maintenance and renewals activities we will carry out a review of any specified enhancement schemes to provide assurance on whether Network Rail's processes for assessing deliverability and affordability are robust.

3. The Investment Framework

Respondents' views

14. Alongside support for a more flexible approach to enhancements delivery and the need for greater third-party investment, the majority of respondents requested an update to the Investment Framework, which has been developed over time to enable investment outside of the five year funding cycle, notably from third-parties as well as the governments.
15. The reasons given for a requested update to the framework were that it has not been refreshed for a number of years and a review would determine areas that had worked successfully in previous control periods and particular aspects that could be improved, particularly in relation to simplifying and incentivising private investment on the network.

ORR response

16. Work is already underway to identify barriers to investment and explore new models for funding and delivering projects. Network Rail recently commissioned the Hansford Review, an independent assessment of all potential barriers preventing alternative project delivery models. It is due to report in spring 2017 and its recommendations may have a significant impact on any updates to the Investment Framework. Cambridge Economic Policy Associates has also been commissioned by RDG to explore alternative methods of delivery and financing in the rail industry, in particular identifying what it is private investors will require prior to investing in schemes. Its work is also being reviewed in light of calls to update the Investment Framework.
17. The ORR has been working closely with Network Rail, the DfT and industry through the RDG's Enhancements Working Group, to undertake a review of the Investment Framework. This work has identified that there is not a systemic failing with the whole Investment Framework; the suite of documents has been found to be sufficiently clear and flexible to accommodate a broad range of funders and schemes. Instead the weaknesses that have been identified include ambiguity over the purpose and utilisation of the framework's template contracts; the role of project sponsors in progressing privately funded schemes; guidance on the use of the Investment Framework and; a lack of transparency and governance over the Network Rail Fee Fund and Industry Risk Fund, both of which are designed to cover Network Rail's contingent liabilities arising from third-party investment. As well as the template contracts, investors have the option of using bespoke contracts if these are better suited to their requirements.
18. The Enhancements Working Group has agreed that its review of the Investment Framework will focus on addressing these four areas rather than existing wholesale rework of the framework. Network Rail will identify means of managing the use of the Framework internally, via organisational and cultural change aimed at making the company more open to private investment and actively seeking to encourage it. Network Rail will also review its template contracts to ensure they remain fit for purpose, are used in the correct manner by funders and sponsors and are not overly prescriptive.
19. The ORR will review the Investment Framework Risk Funds outlined above. This will determine whether they are in fact barriers to investment and how they can be improved or replaced to reflect the need for greater private investment in the network. We would also review any proposed changes Network Rail makes to its template contracts following the completion of its review. In this case we will assess whether they are clear, provide strong incentives for Network Rail and represent a logical balance of risk between Network Rail and the investor.

4. Funding and funding decisions

Respondents' views

20. There was an acknowledgement from both the DfT and Transport Scotland over the issue of investment sustainability in future control periods. There was consensus that all options for delivering an output need to be explored in advance of committing to funding; for example where timetable, or rolling-stock changes may deliver the same journey time, operational resilience or capacity improvements, and be more cost-effective, sustainable, and less disruptive, than an infrastructure intervention.
21. DfT and Transport Scotland both addressed the issue of enhancement priorities and funding commitment and set out some potential guidelines for prioritising and developing projects. This correlates with requests from operators for greater inclusion in investment decisions. There was agreement that this would assist in delivering clarity over what is being purchased in terms of outputs and deliverables and the ultimate benefits of a project.
22. Network Rail and the Rail Delivery Group proposed a change in funding arrangements for future enhancements. In order to avoid continued accumulation of RAB debt, Network Rail should put forward potential solutions including grant funding of the proportion of new enhancements that deliver socioeconomic benefits (as opposed to rail-related or financial benefits) and better sharing of the costs of investment between the beneficiaries (including operators or local businesses).
23. Whilst DfT and Transport Scotland stated they were open-minded regarding the retention of the ring-fenced funds into CP6, whether debt-financed or grant-funded, there was evidence of strong-support for their continuation from industry groups, operators and Network Rail.

ORR response

24. The historic growth in Network Rail's debt reflects the increase in use of the rail network and the investment required to facilitate it. We recognise that a broader range of funding and financing options would greatly benefit investment in enhancements, increasing the capital available to the railway and potentially driving improved methods of delivery. We have held discussions with a number of third party investors over the last year in support of this and we welcome further such approaches.

5. Devolution and cross-border issues

Respondents' views

25. The Scottish and Welsh governments and other devolved authorities expressed support for additional devolution of Network Rail's operations. Much of this is in line with the DfT and Network Rail MoU and industry review findings that recommend greater devolution to Network Rail's routes, to support route-orientated investment and alignment of outputs with operations and regional growth.
26. Both Transport Scotland and the North Welsh Economic Ambition Board responses raised the particular issue of cross-border enhancements, whereby the investment and delivery occur in one route whilst the benefits accrue to another or across multiple routes, with the examples of Carstairs Junction and Halton Curve mentioned. In previous periodic reviews schemes have been removed from scope due to complications over the share of funding and benefits and it is important this does not occur in future where there are real benefits to be delivered.

ORR response

27. As set out in our wider consultation documents the key focus for the ORR in PR18 is the move towards route-based regulation to reflect and drive the increasing operational devolution to each of Network Rail's eight geographic routes, Freight and National Passenger Operator route (FNPO), and National System Operator (NSO).
28. For enhancements a major new development is the identification of the NSO function within Network Rail. The structure of this organisation is still developing but it is anticipated that alongside timetabling and capacity planning type functions, one aspect will be to co-ordinate the activities of the route-based project sponsors, overseeing network-wide issues including affordability, deliverability, operational impact and change control across the portfolio to support the Pipeline³.

Next steps

29. In summary:
 - (a) we will work with the governments and Network Rail to understand how the regulatory framework fits in with the pipeline processes they are developing, with an emphasis on ensuring that accountability and transparency are built into the governance arrangements; and

³ The Network Rail Monitor is the biannual report produced by the ORR setting out how we think Network Rail is doing in delivering its obligations to its customers and funders and highlighting any areas of concern. This includes reporting on enhancements progress.

- (b) we will lead a review of the Investment Framework Risk Funds to determine whether they are barriers to investment and how they can be improved or replaced. We will also review any changes to Network Rail's Template Contracts.
30. Should you wish to engage with us further regarding the regulatory framework relating to enhancements, please contact our policy lead James Dunshea (James.Dunshea@orr.gsi.gov.uk / 020 7282 2064).



© Crown copyright 2017

This publication is licensed under the terms of the Open Government Licence v3.0 except where otherwise stated. To view this licence, visit nationalarchives.gov.uk/doc/open-government-licence/version/3 or write to the Information Policy Team, The National Archives, Kew, London TW9 4DU, or email: psi@nationalarchives.gsi.gov.uk.

Where we have identified any third party copyright information you will need to obtain permission from the copyright holders concerned.

This publication is available at orr.gov.uk

Any enquiries regarding this publication should be sent to us at orr.gov.uk