

Rail Delivery Group

Response to:

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

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Organisation: Rail Delivery Group
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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.