Rail Delivery Group

Response to

ORR's update on the financial framework for PR18

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ORR’s update on the financial framework for PR18

Organisation: Rail Delivery Group

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Business representative organisation

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

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

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

Budgetary flexibility during CP6

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

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

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

Managing financial risk

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

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

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

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

[1] http://orr.gov.uk/__data/assets/pdf_file/0012/25221/pr18-improving-network-rail-renewals-efficiency-consultation-july-2017.pdf
[2] https://www.raildeliverygroup.com/about-us/publications.html?task=file.download&id=469773307

Third-party Investment

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

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

Funding of enhancements

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