

Jon Clyne
Head of Financial Economics
Office of Rail Regulation
1 Waterhouse Square
138 – 142 Holborn
LONDON
EC1N 2TQ

Please reply to:
Dave Beynon
Sewta Rail Working Group
c/o Transportation and Engineering
Morien House
Bennett Street
BRIDGEND
CF31 3SH

Our Ref: T7001/HT/DHB Your Ref:

25 April 2005

Dear Jon

Policy Framework For Investments – An Initial Consultation

I am writing to you on behalf of the South East Wales Transport Alliance (Sewta), a body of ten local authorities, working with industry partners and user group representatives to deliver better co-ordinated and more effective transport for people and businesses in the region and beyond. Sewta recognises the valuable role played by its partners in the delivery of its objectives but in this instance, is making this response solely on behalf of its constituent local authorities.

Sewta recognises that if rail services are to develop to better meet the needs of users, it is essential that there is an effective framework for delivering infrastructure enhancements. As an external body actively involved in funding such schemes, Sewta hopes that the Office of Rail Regulation will be able to provide clear and effective processes for agreeing enhancements by breaking down some of the barriers to delivery and then ensuring that they can implemented on time and to budget.

Sewta therefore welcomes the opportunity to comment on the Policy Framework For Investments Consultation document and trust that these comments are of use to you.

Yours sincerely,



**For and on behalf of Justin Cooper
Chair, Sewta Rail Working Group**

SEWTA Response to the Office of Rail Regulation's Policy Framework for Investments: An Initial Consultation.

1. This consultation revolves around the role of Network Rail in performing its licence obligations and how it deals with reasonable requests to enhance the rail network. Whilst the focus on enhancements is welcome, the document largely concerns itself with industry driven enhancements (from clients), and only one section deals with requests from external sources, such as local authorities, which it defines as customers. As Sewta is a partnership of ten local authorities, seeking to work with the rail industry and user group representatives, to deliver better co-ordinated and more effective transport for people and businesses in south east Wales, this response is mainly restricted to those elements that affect this group of funders.
2. Network Rail is charged with delivering improvements in an efficient and timely manner. However, promoters and funders of schemes have expressed concerns over three issues: -
 - a lack of clarity over Network Rail's obligations and the complexity of the industry processes,
 - a culture of risk aversion,
 - a perception of high charges levied by Network Rail for providing services.
3. The Office of Rail Regulation (ORR) consultation sets out a proposed policy framework for investment, which has been discussed by the Department for Transport's Investment Working Group. However, it is noted that the Welsh Assembly Government is not a member of this group. Given that the Railways Act 2005 will transfer the responsibility for funding, specifying and setting of the strategic direction for services within and bordering Wales to the Assembly, this omission is of particular concern.
4. In examining Network Rail's approach to dealing with the identified barriers, the ORR consultation is endeavouring to ensure that Network Rail meet their obligations. Unfortunately, contrary to the statement in the consultation, there does not appear to have been any discussion between Network Rail and Sewta or its individual constituent authorities on the proposals.
5. The Network Rail approach is to allocate risks to the party best able to manage and mitigate them. This aversion to risk has tended to hold up projects and in order to address these issues, it proposes that liabilities are capped and that two new funds are created: -

- i) A Network Fee Fund: - this would be a ring-fenced fund where payments from scheme promoters to cover Network Rail's own costs and liabilities are put into the fund. The fund would be drawn on as necessary by Network Rail and would be added to by any surplus derived from their charges to customers. In addition, Network Rail proposes to contribute £10 million to top up the fund to ensure that it has the incentive to manage liabilities that may arise. This would only be used if contributions from customers were exhausted.
 - ii) An Industry Risk Fund: - funded by customers' contributions based on a proportion of the scheme costs to cover low-probability, high-impact industry risks. This fund would also be used by Network Rail if the Fee Fund was exhausted or if the liability caps had been breached.
6. The suggested contribution from customers is 2% of the cost of the scheme. In addition, the customer would share the liabilities - up to a capped limit - arising from industry risk. This would act as an incentive to manage industry risks where possible.
7. The operation of these funds will be accompanied by a set of template agreements, with model terms and conditions to be approved by ORR under Part G of the Network Code. The agreements will provide customers with transparency on: -
 - Risk allocation
 - Payments to Network Rail
 - Network Rail's obligations and accountability
8. Caps would be set to reflect a reasonable balance of protection both for Network Rail and its customers and would seek to act as an incentive for all parties to meet their contractual obligations. However if the liability caps are breached and both funds are exhausted, Network Rail has stated it would fund the over- spend on such schemes by including them as part of its Regulatory Asset Base. This mechanism would allow Network Rail to fund the investment shortfall on the basis of expected revenue from franchised operators.
9. However, for works funded by third parties, the requirement to sign up to the one sided Network Rail model agreements presents local authorities with a problem, as is shown below.
10. The document considers two approaches to dealing with risks, either through the application of differential rates of return to the risks associated with a scheme or through the application of a contingency allowance for unquantified and unidentified risk. In consideration of these risks, reference is made to outputs from previous schemes and from comparative businesses.

11. This equates to contingencies of between a low of 8% and a high of 43% depending on the type of scheme. Sewta's recent experience with Network Rail suggests that 25% is the current norm. Even this does not appear to give Network Rail a sufficient incentive to provide customers' with robust and reliable cost estimates.
12. Network Rail has also proposed a schedule of fees for the services that it provides to third parties. These are being assessed for reasonableness by ORR against market tested schemes elsewhere. Proposed mark-ups on these cost-based fees will be paid into the Network Rail Fee Fund to cover liabilities or cost overruns that are attributed to Network Rail. As a third party, Sewta is grateful for the project management support that it receives from Network Rail but this proposal does nothing to address their one sided view toward risk sharing.
13. It is hoped that the measures proposed will provide a means of taking those schemes forward, which presently are stalled due to issues of cost and risk allocation. Unfortunately, this is unlikely to be the case as they do not appear to address fully the enhancements by third parties, such as local authorities, or as in the case of Sewta, combinations of local authorities. The remainder of this response therefore deals with the funding issues being faced by local authorities or regional groupings of local authorities, as they seek to take forward rail enhancement schemes.
14. Over the past few years, moving such projects forward has proved extremely difficult. Together with the form of agreements used by Network Rail, the issues surrounding the apportionment of risk have been the major problems in the process. These problems are not new. Aversion to risk was endemic in Railtrack and continues to be so within Network Rail. Both organisations have signally failed to take account of how local authorities are funded and have perpetuated a situation where public money is being demanded to protect public money from risk.
15. In Wales, rail schemes are funded through the Welsh Assembly Government's Transport Grant programme. This means that the scope of the scheme and a reasonably accurate cost estimate has to be submitted within a bid for funding. Under the Network Rail proposals, an agreed percentage will have to be added to these estimates, for payment into the funds to cover risk.
16. When local authorities expend public money, they are expected to deliver the projects within the level of their grant funding and need to limit cost overruns. Thus in the past, negotiations have revolved around investigating the way in which this could be addressed. Unfortunately, throughout the transition from Railtrack to Network Rail, the requests have not been resolved nor has the suggestion that a different set of agreements is needed for local authority funded schemes, been accepted.

17. Allied to this is the total lack of understanding shown by Network Rail of how the local authority driven enhancement schemes are funded and the different conditions which govern the grant mechanism. Past experience has seen that a number of such schemes throughout Wales have been lost because of the failure of Railtrack to react to the spending deadlines associated with the grant funding. There is nothing currently to suggest that the Network Rail proposals will address these issues.
18. From the document it appears that whatever happens during the course of a project, Network Rail is protected against financial loss. The same does not appear to be true of any local authority investment. The concerns that have been expressed repeatedly about local authorities being presented with one-sided agreements remain unresolved.
19. However, it is pleasing to note that under Condition 7 of Network Rail's Network Licence, there is a requirement to improve, enhance and develop the network "so as to satisfy the reasonable requirements of persons providing services relating to railways and funders in respect of the quality and capability of the network".
20. These requirements have long been restricted just to maintaining the network and the requirement to enhance and improve, is a positive change which is long overdue. Too often the local authorities and regional consortia such as Sewta have been told when promoting schemes - even those with full funding - that there is nothing in it for Network Rail.
21. Hopefully, this revised condition will mean that greater consideration will have to be given to local authority schemes, especially those that are able to be piggy-backed onto Network Rail renewal schemes. This may mean that Network Rail needs to engage on a more formal basis with local authorities to ensure that complementary schemes are identified at an early stage.
22. Reference is made in the consultation document to the discussions which have taken place over the past year on the proposed changes between Network Rail and its customers. Unfortunately, there is no such evidence of any approach having been made either to the individual local authorities that make up Sewta, nor to any discussions with Sewta in its own right. Similar enquiries both to the Welsh Assembly Government and those other local authorities throughout Wales that are currently engaged in rail enhancement schemes has also identified that none of them has been subject of any such consultation.
23. This causes concern, especially given the amounts of funding that are being pumped into enhancing the railways in Wales by local authorities through the regional consortia. For example, the value of the rail enhancement schemes, currently being progressed through the feasibility and implementation stages within the Sewta region alone, amounts to £70 million. What is lacking from Network Rail is the realisation that the local authorities are on the same side and are actually working with them as partners to develop the railway..

24. If progress is to continue to be made on third party enhancement schemes, the proposed Network Rail funds and template agreements is not the way forward. In place of the proposed agreements, Sewta would therefore suggest the creation of a "catch-all" agreement between Network Rail and the Government and its regional assemblies, which underwrites projects funded by local authority sponsors. In Sewta, where individual Transport Grant schemes costing up to £50 million are programmed, this is essential in order to move forward.
25. In the absence of such an agreement, separate negotiations have had to take place in order to progress works because the terms used by Network Rail are not appropriate to local authority accounting rules. Therefore, assurance has had to be obtained from the Welsh Assembly Government to ensure that any cost over-runs will be underwritten. This method removes the one sided imposition of risk from the local authority sponsor.

END