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Rail

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Andrew Haines
Chief Executive
Network Rail

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By e-mail

Dear Andrew

Network Rail Funding in Control Period 6

We have spoken previously about Network Rail funding for Control Period 6.

Dealing with the impact of Covid-19 is one of the greatest challenges our railway and society has faced. So first of all, I want to take this opportunity to recognise and thank Network Rail for the way it has worked with Transport Scotland and our partners, at all levels, to respond to the crisis. The Scottish Government greatly appreciates the role that your organisation has played in ensuring that we can get key workers to and from their workplaces safely. And as we start to emerge from the Covid-19 restrictions, Network Rail will have a critical role to play in supporting Scotland's economic recovery and resilience. I know that you will be up for that challenge.

As we have discussed in the past, I have long held concerns about our collective ability as an industry to deploy limited public resources for rail in a way which delivers best value for investment. Even before Covid-19, and the consequent reduction in activities, trends were starting to emerge which suggested that Network Rail in Scotland may not be in a position to deliver its challenging work-programme for Control Period 6 in full, whereas we had a franchise which was in considerable financial distress and where long-term investment was at risk.

Turning first of all to the improvements budget for Control Period 6. As you will be aware, unlike the UK Government, we included a notional funding allocation for new railway improvements in Control Period 6 in our Statement of Funds Available. At the time, we took the decision that this funding should not be included in the regulatory settlement.

Rather, that managing the funding through the Team Scotland approach would be far more effective, and indeed will be key if we are to deliver our ambition to decarbonise our railways by 2035. I am therefore confident that we have sufficient levers in place to deploy the improvements budget with the flexibility necessary to take a whole rail system approach.

Turning to the regulatory settlement for Control Period 6 and the Network Grant from the Scottish Ministers, we have now had the opportunity to test the new financial arrangements for more than a year. I think that the process put in place by Network Rail and Transport Scotland, with support from the ORR, to monitor the financial position has improved financial oversight. The new approach identifies issues of importance much earlier than in previous Control Periods, which in many instances, emerged too late to be resolved satisfactorily.

Network Rail was already reporting a significant underspend against Network Grant, for Financial Year 2020/21 prior to the implementation of the Covid-19 restrictions on activities. This followed an underspend in 2019/20. Clearly, as Network Rail in Scotland has been for a period limited to undertaking safety critical works, the levels of underspend will have increased further.

A key question, which our teams have discussed, is whether Network Rail can recover fully its works programme by the end of the Control Period. For recovery to be possible, the back-loading of works towards the end of the Control Period 6 would be needed, which was already an increasing feature of the work programme pre-Covid. This places considerable pressures on the supply chain and internal Network Rail resources.

There is not a positive track record in previous Control Periods of delivering back-loaded works. It leads to inefficiency and we would not want to see protracted periods of railway closure towards the end of Control Period 6. Added to this, our ability to move funding between financial years and away from the profile originally given to HM Treasury, is limited. All of this would suggest that it is unlikely that the Control Period 6 programme will be fully delivered and the more likely scenario is that we will see some works move into the early part of Control Period 7.

In summary, I am of the view that we are facing a position where Network Rail is unlikely to be able to deliver efficiently its full work programme for Control Period 6. I appreciate the point that this may affect Network Rail's ability to deliver final outputs, though we have noted in discussion that the correlation between expenditure and quality of output is not inevitable. However, there is now the strong likelihood that Network Rail is now over-funded for the remainder of Control Period and this is not a defensible position, particularly given the increasing pressures on public finances.

I am therefore asking that Network Rail approach the ORR at this time to seek permission to reduce the overall revenue requirements in Control Period 6 by at least £67m. This is based on the projected Network Grant requirements for FY 2020/21 (£462m) set against the Scottish Government budget (£529m). I would state that the £67m figure is conservative, as it does not account for the full impact of Covid-19. We would look to continue to review this as we progress through the financial year and as we better understand the impact of the restrictions on rail works in Scotland.

I would also ask that our organisations work together to be flexible and pragmatic in how we would treat such a reduction in revenue requirements, seeking support from the ORR in doing so. It may be that a reduction in Network Grant is the simplest way forward, once a quantum is agreed. However, it will be in our shared interests to explore all other available options under the current ORR policies on financial rebates.

One other thing to reflect is that we have been working with the Network Rail and the ORR to understand fully the extent to which the outputs for Scotland for Control Period 5 have been delivered and the final financial outturn for the Scottish Government investments. As I hope you agree, it is vitally important that, collectively, we are able to demonstrate clearly what was delivered in Control Period 5 and at what cost to public finances. Otherwise, it may become increasingly difficult to secure public investment in rail.

It may be useful to have an early discussion on these matters.

Yours sincerely

A handwritten signature in blue ink, appearing to read 'Bill Reeve', followed by a period.

BILL REEVE
Director of Rail