INVESTMENT FRAMEWORK CONSOLIDATED GUIDELINES

DRAFT FOR CONSULTATION

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Contents

1. Introduction

Background

1.1 In England and Wales, investment to enhance the rail network is funded primarily through Government's Rail Network Enhancements Pipeline (RNEP), with some major schemes such as High Speed 2 being funded via bespoke arrangements. This has created a rolling programme of investment that focuses on outcomes that deliver benefits for passengers, freight users and the economy. This has moved government investment in rail enhancements away from the five-year funding cycle (that is, aligned to Control Periods) that was previously in place.

1.2 In Scotland, the pipeline of enhancement projects and associated funding is managed through the Team Scotland Execution Plan (TSEP). This sets out defined roles, responsibilities and lines of accountability relating to the ownership of programmes, projects and cost estimates to ensure that they are delivered as effectively and efficiently as possible.

1.3 However, it is also recognised that stakeholders may want to invest in the rail network outside of these processes, whereby stakeholders wish to address an opportunity not necessarily identified or prioritised by Government. Investors may include (but are not limited to):

- train operators;
- ports;
- freight operators;
- local authorities;
- financial investors; and
- consortiums of such parties.

1.4 Stakeholders may require a way of funding investment in the rail network outside of Government processes. It is for these investments that we have developed our Investment Framework.

1.5 The Investment Framework is a set of policies and guidelines describing how this type of investment should be treated. It primarily covers:

- the process for investment;
- what the different parties to an investment are obliged to do; and
- an outline of the template agreements available to investors.

1.6 To ensure the Framework is accessible, accurate, and relevant to investors we have consolidated our previous guidance on investment into the Framework. This consolidated guidance is much shorter than the sum of all the previous documents because we have removed material where the policy or guideline has been superseded (because it was a proposal which has since been concluded, or because our policy has moved on). We have also removed the explanatory text describing how we arrived at our conclusions. Hence this consolidated document describes what our investment policy and guidelines are – not the process for deciding them. This consolidation has been undertaken on the basis that we are not changing policy but simply describing it more clearly.

1.7 This consolidation of policy and guidance does not include the mechanism under section 16A of the Railways Act 1993 that allows us to direct the improvement or construction of a railway facility. That mechanism exists outside the Investment Framework, and given the mechanisms and remedies in place under the Framework, we envisage the section 16A provisions would be used only in exceptional circumstances. We have a code of practice for applicants under section 16A, see https://www.orr.gov.uk/sites/default/files/om/309.pdf.

Structure

1.8 This document is structured as follows:

- **Chapter 1** – Introduction
- **Chapter 2** – Process overview, which outlines the process for investing in the rail network.
- **Chapter 3** – Sets out Network Rail's role and obligations to its customers and describes what it is expected to do to facilitate investment. This includes the choice of contractual mechanisms for managing projects, and how Network Rail is held to account for delivery.
- **Chapter 4** – Approval of changes to the Network.
- **Chapter 5** – Monitoring the Investment Framework, which outlines how we monitor the use of the Investment Framework and projects promoted using it.
- **Chapter 6** – Investing at stations and depots.
- **Chapter 7** – Investing elsewhere on the network, including on the track.
- **Chapter 8** – Sale of land or rights to land. The last chapter covers the treatment of land and rights to land, which is often relevant to the funding of investment schemes.

1.9 Network Rail has also published a code of practice incorporating guidance on its investment process, available on its website: https://www.networkrail.co.uk/industry-and-commercial/third-party-investors/

1.10 We can also provide advice and help. Contact details are available on the 'Investing in the industry' page of our website: https://www.orr.gov.uk/monitoring-regulation/rail/investing-rail-network/investment-framework

1.11 Our website also includes a glossary defining industry terminology.

2. Process Overview

2.1 This chapter describes the main steps in the investment process, and how the governance and contractual agreement templates relate to the enhancement project lifecycle.

2.2 This section illustrates the Investment Framework process in the context of:

- the project lifecycle from inception, business case development and design through to commissioning and acceptance into use;
- Network Rail's PACE (Project Acceleration in a Controlled Environment) process for managing investment schemes; and
- the means by which outputs are secured, that is, whether the customer signs a contract for the delivery of its required outputs by Network Rail.

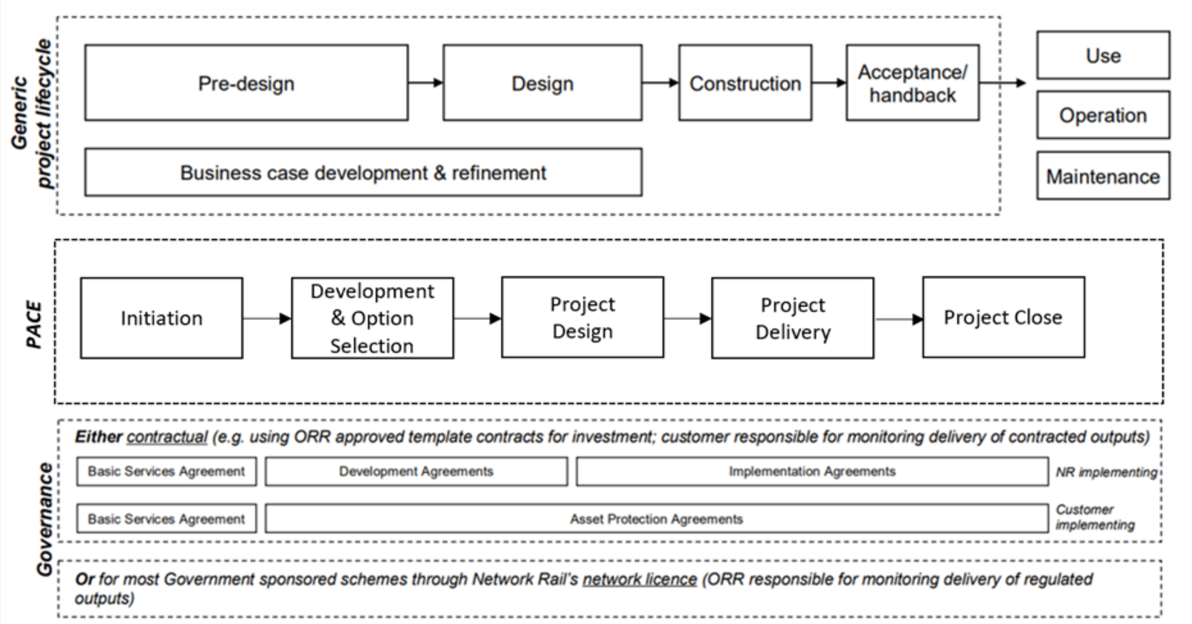

Figure 1: Investment framework process overview

2.3 More detail on the governance choices outlined in Figure 1 can be found in Chapter 3 of this document, where we describe the role of Network Rail.

2.4 The Investment Framework approvals process for enhancements on the rail network varies according to the following factors:

- **Who is promoting the enhancement** - investment schemes can be sponsored by third parties (that is anyone besides Network Rail or Government), franchised train operators (a special case of third party because of their franchise agreement with Government), or by Government itself.

- **What is being enhanced** - a station, the track or lineside infrastructure, or a depot.

- **How the work is funded** - where a scheme has multiple funders, we will support Network Rail in determining what governance arrangements should apply on a case-by-case basis.

3. Network Rail's Role

Network Rail's duty to facilitate investment

3.1 Network Rail is the principal point of contact for investors in the rail network. It has a dedicated information section on its website: https://www.networkrail.co.uk/industry-and-commercial/third-party-investors/

3.2 Network Rail's role in relation to enhancement schemes is underpinned by its obligations as network operator. Network Rail's Licence Condition 1.1 states that it must secure "the improvement, enhancement and development of the network … in accordance with best practice and in a timely, efficient and economical manner so as to satisfy … the reasonable requirements of persons providing services relating to railways and funders, including potential providers or potential funders".

3.3 The Investment Framework and Network Rail's own processes and guidance for investment, have been developed to fulfil this objective.

3.4 Network Rail's role in Investment Framework projects is to:

- Identify, promote and deliver network investment schemes over and above those sponsored by Government using objective, transparent appraisal criteria;
- Facilitate development of, and where appropriate deliver, schemes proposed by operators, other third parties, or Government;
- As part of that facilitation provide the services that only Network Rail can perform ("non-contestable services") for investors; and
- Prioritise between these different activities in accordance with its standard investment appraisal criteria.

3.5 For many Investment Framework schemes, Network Rail will act as delivery agent. We expect Network Rail to put in place efficient delivery arrangements for all schemes it is required to deliver, and to take on those risks which it is in the best position to manage, including design and construction risks where appropriate.

Facilitation of schemes delivered by third parties

3.6 Network Rail should facilitate schemes promoted and delivered by third parties, such as station improvements, by providing services on fair and reasonable terms.

3.7 Being fair and reasonable means Network Rail must only recover its additional efficient costs when it is taking a facilitative role (for example when it is providing non-contestable services relating to its role as network operator).

3.8 In many cases the third party will also want Network Rail to design, develop and deliver schemes, whether or not the enhanced assets will then be owned by the third party or transferred to Network Rail following completion. However, in other cases the third party may wish to seek a price from other suppliers for the provision of contestable services, for example design and delivery services. This competition can drive efficiency and create additional capacity in the market for scheme delivery.

3.9 Network Rail should not use its monopoly position to require third party investors to buy contestable services from it. Nor should it offer preferential treatment to customers who depend on its delivery of non-contestable services.

Monitoring, Change Control and Governance

3.10 There are two broad models of project governance for investment schemes:

- Through Network Rail's network licence, which should be used for most projects sponsored by Government which are not funded via the RNEP; or
- Through contracts – for third party sponsored schemes, contractual mechanisms will be put in place for each scheme, for example through template agreements approved by us under Part G of the Network Code.

3.11 In the former the responsibility for monitoring progress on the project rests primarily with us, unless bespoke arrangements are put in place.

3.12 In the latter, it is the scheme investor who should monitor progress with Network Rail providing the necessary information to do this. Network Rail should also ensure that the process for changes to the specification of a project are set out in advance, and that responsibility for the financial consequences of any changes are identified as part of the risk allocation.

Template terms for investment

3.13 Network Rail has developed, and we have approved, a set of template contracts that investors may choose to use as the basis for contracts to deliver enhancements. These templates and accompanying guidance can be found on Network Rail's website. They are provided to reduce transaction time and cost for investors compared to negotiating a contract from scratch with Network Rail, and are designed to offer a fair balance of risk between Network Rail and investors.

3.14 There are four main types of template:

- **Basic Services Agreement**: A simple agreement, aimed at quickly putting in place a contractual relationship to cover pre-feasibility works to scope the scheme and develop the business case.
- **Development Services Agreement**: For development and design work undertaken by Network Rail on behalf of the investor.

- **Implementation Agreement**: With Network Rail acting as a construction manager for enhancement work on or about the controlled railway infrastructure, this is an agreement to provide detailed design and implementation of the investor's scheme. The contracting strategy is to be agreed between Network Rail and the investor.

- **Asset Protection Agreement**: An agreement for investor-led works on the controlled railway infrastructure, where Network Rail facilitates the investor's enhancement scheme interface with the operations, maintenance and renewals business.

3.15 There are two options for the implementation agreement, either fixed price or emerging cost. There are also basic versions of the asset protection and implementation agreements for simpler schemes.

3.16 Customers may have particular concerns and individual projects may have particular risks. We expect both parties to be open to negotiation of alternative provisions that suit individual circumstances, while acknowledging that they must control or manage the risks they take on.

3.17 The template contracts set out the terms for engaging with Network Rail on an enhancement project; there are almost always subsequent contractual processes necessary in order to deliver the enhancement. These include changes to leases; station, depot or network changes; and asset purchase agreements.

3.18 The full range of template agreements available to investors can be found on Network Rail's website: https://www.networkrail.co.uk/industry-and-commercial/third-party-investors/.

Risk Funds

3.19 At each periodic review Network Rail is funded for its costs and risks arising from the outputs required in the review. It is not funded for third party enhancements that arise between periodic reviews, or for the cost of risks associated with them. In order to provide it with funding for the risks associated with investment using the template agreements, risk funds have been established.

3.20 Investors pay into two funds to cover Network Rail's potential liabilities arising from investment using the template agreements, and to cover specific industry cost risks:

- **Network Rail Fee Fund (NRFF):** intended to cover Network Rail's potential liabilities arising from the template agreements.

- **Industry Risk Fund (IRF):** intended to cover low-probability, high-impact industry risks, such as the impact of an operational emergency elsewhere on the network, on a scheme.

3.21 These contributions to the funds (the Network Rail Fee and the Industry Risk Fee) are calculated as percentages of costs. The percentages and the costs in scope are defined in the template agreements themselves.

Bespoke arrangements for schemes governed via the Network Licence

3.22 For some large schemes Government has asked for bespoke governance arrangements, for example to reflect a risk allocation which differs significantly from the default. For example, this approach has been used in the protocols set up for the Thameslink project. Network Rail can advise investors if it believes their scheme requires a bespoke arrangement.

3.23 A typical protocol would describe the following elements:

- the scheme definition, including the scope of the works required, the outputs to be delivered and the expected timescale for the works and delivery of outputs;

- the funding mechanism(s) for the scheme, explaining how Network Rail will recover its costs;

- risk allocation, and a description of the roles and responsibilities of the stakeholders involved;

- cost control, monitoring and management processes, including the process for approving variations to the scope or cost of the scheme; and

- the dispute resolution processes.

Remedies

3.24 Remedies are available to investors during the contract negotiation stage, and after contracts are signed.

Before contracts are signed

3.25 If an investor is unhappy with Network Rail's approach to negotiating a contract for investment, in the first instance they should escalate the issue within Network Rail.

3.26 If that does not resolve the concern, or is not practical, investors may refer the matter to us. We would raise the issue with Network Rail and if necessary decide if Network Rail was complying with its network management and stakeholder relationships licence conditions, and take enforcement action if necessary.

After contracts are signed

3.27 After contracts are signed, the available remedies depend on the scheme's governance model, i.e. whether it is governed through a contract or through Network Rail's network licence.

3.28 In the case of schemes governed through the network licence, if the investor cannot resolve an issue with Network Rail, it can refer the matter to us. We will raise the matter with Network Rail and escalate it as appropriate, and if necessary take enforcement action.

3.29 In the case of schemes using a contract-based approach, once signed, the template contractual agreements incorporate an escalation and disputes process which either an investor or Network Rail can follow in the event of a dispute.

3.30 Ultimately Network Rail still faces obligations under its network licence. If customers or potential customers consider that Network Rail is acting unreasonably they can refer the matter to us. In accordance with our enforcement policy we can then consider whether Network Rail is complying with its network management and stakeholder relationships licence conditions, and take enforcement action if necessary.

4. Approval of Changes to the Network

4.1 If you are carrying out physical enhancement work it is likely that you will need to use a formal contractual changes process.

4.2 The Network Code provides a procedure by which changes can be made to the network which are likely to have a material effect on its operation. Part G of the code sets out the processes for proposing, consulting on, and implementing a network change. It also details the associated compensation and appeals procedures.

4.3 The Network Code can be found on our website: [The Network Code | Office of Rail and Road (orr.gov.uk)]

4.4 Proposals for network change can be initiated by either Network Rail or a train operator.

4.5 Part 3 of the Independent Station Access conditions (which govern those stations managed by Network Rail) and part C of the National Station Access Conditions (which govern most other stations on the network) outline the process for making a change to the common station services or amenities at a station (set out in Annex 1 of the relevant access conditions). The change procedures in the access conditions apply when the proposed change will materially affect the condition, standard or quantum of the services or amenities that are offered to all users of the station.

4.6 The station facility owner, Network Rail, any other operator at the station or a Station Investor can make a change proposal.

4.7 More information on station access, including the station access conditions can be found on our website. https://www.orr.gov.uk/guidance-compliance/rail/operator-access-network/station-and-depot-access/station.

4.8 Changes to regulated depots are governed by the depot access conditions, guidance on which is also available on our website. https://www.orr.gov.uk/guidance-compliance/rail/operator-access-network/station-and-depot-access/depot.

5. Monitoring the Investment Framework

5.1 We monitor how the Investment Framework is working in terms of:

- How well Network Rail is carrying out its obligations in general;
- Calls on the risk funds, to establish if the fee levels are still appropriate; and
- Use of the variation mechanism included in the template contracts, since the contracts rely on parties to the contracts being reasonable in requiring or objecting to variations.

5.2 We also respond to concerns raised with us by investors.

5.3 We welcome any feedback from investors – positive or negative – on their experience of the use of template agreements or of the Investment Framework more generally, including on Network Rail's responsiveness to investor requirements.

5.4 Where an investor has engaged with Network Rail through a template contract, or through another contract, it is the investor's responsibility to monitor and manage their project through that contract. We do not monitor progress of third-party schemes.

6. Investing at Stations and Depots

Introduction

6.1 This chapter covers investment in enhancements at stations and depots.

Third Party and train operator promoted schemes

6.2 Third parties include any scheme investor other than Government and Network Rail. Examples might be a Passenger Transport Executive, a local authority, Transport for London or a train operator.

6.3 The investor provides the funding for the project.

6.4 Train operators can promote schemes in the same way as any other third party.

6.5 Investment by third parties and train operators at stations and depots can be facilitated by Network Rail using the mechanisms detailed in Section 3.

Government-sponsored schemes

6.6 Government-sponsored infrastructure schemes are those which are promoted by DfT, Welsh Government or Transport Scotland. These are not required by their high-level output specifications and are separate from enhancements (and so are not funded via the RNEP or TSEP).

6.7 Government must fund any ongoing operating, maintenance and renewals (OMR) costs on a pay-as-you-go basis until the subsequent periodic review. At the next periodic review the incremental OMR costs of the scheme will be considered together with those of other assets in determining Network Rail’s revenue requirement and charges.

Depot arrangements

6.8 Contractual, operational and charging arrangements at depots are different from those in place at stations. Our role in enhancements at depots is limited to the light maintenance depots owned by Network Rail.

6.9 These depots provide a range of services, dependent on the size and structure of the depot, its technical capabilities, the equipment used, and the type of rolling stock provided for. Therefore, parties negotiate access to a depot depending on their specific circumstances and the services required.

6.10 For this reason we have not published formal guidelines on the process for investing in enhancements at Network Rail-owned light maintenance depots, although Network Rail must comply with its licence condition obligations.

6.11 If stakeholders think that more detailed guidelines from us would be useful in this area, we will consider this once this consolidation of existing investment advice is finalised.

7. Investing elsewhere on the network

Introduction

7.1 This chapter covers the specifics of investment in enhancements to the network outside stations and depots – in other words, on the track.

Third party promoted schemes

7.2 Third parties include any scheme investors other than Government and Network Rail. Examples might be a PTE, a local authority or Transport for London.

7.3 Train operators can promote schemes in the same way as any other third party.

7.4 The investor provides the funding for the project.

7.5 Investment by third parties and train operators on the network (outside of stations and depots) can be facilitated by Network Rail using the mechanisms detailed in Section 3.

7.6 On-going operating, maintenance and renewals (OMR) costs in excess of £50,000 per annum resultant from the enhancement should be paid for by the investor. Where multiple operators benefit from the enhancement, implications for existing track charges need to be considered. This flexibility is necessary to prevent a barrier to investment for parties that do not have access contracts with Network Rail.

Government-sponsored schemes

7.7 Government-sponsored infrastructure schemes are those which are promoted by DfT, Welsh Government or Transport Scotland. These are not required by their high-level output specifications and are separate from enhancements (and so are not funded via the RNEP or TSEP).

7.8 Government must fund any ongoing operating, maintenance and renewals (OMR) costs on a pay-as-you-go basis until the subsequent periodic review. At the next periodic review the incremental OMR costs of the enhancement will be considered together with those of other assets in determining Network Rail's revenue requirement and charges.

Rebate Mechanism

7.9 The rebate mechanism is designed to allow third party investors in large-scale enhancements to recover a fair proportion of the costs incurred in funding an investment scheme where other parties benefit from the use of the enhancement.

7.10 Once an enhancement to the network is operational, any train operator can apply to Network Rail for access to it. If granted, the charge for access is payable to Network Rail, and as a general principle reflects the marginal cost of providing access. Under current arrangements, therefore, a third party funder cannot charge operators directly for access to an enhancement in which it has invested. Consequently, operators may be able to 'free ride' on the investment of others.

7.11 This means that the investor could be at a competitive disadvantage, reducing the incentive to invest and ultimately meaning that beneficial investments may not go ahead.

7.12 Third parties investing in large-scale track infrastructure enhancements to the network can apply to Network Rail for a rebate charge to be put in place. This charge will be levied on operators that access and benefit from the enhancement. Government-funded schemes are outside the scope of this mechanism.

7.13 Investors will only be eligible for the rebate mechanism if they can demonstrate to Network Rail (and us) that they satisfy one of two criteria:

(a) The funder is a private sector third party funder and:

(i) there is a stand-alone business case for the investment in the absence of the rebate and free riding; and

(ii) there is a real likelihood of free riding on the investment by competitors, which would mean that the project could not be undertaken without the prospect of such higher charges.

Or

(b) The funder is a public sector third party funder, e.g. TfL, PTEs and:

(i) the scheme represents value for money in the absence of the rebate;

(ii) funding constraints mean that the scheme could not proceed, or would be delayed with significant adverse effects, without the prospect of recovering higher charges via the rebate, due to a lack of available funding; and

(iii) the prospect of recovering higher charges via the rebate would ease the funding constraint.

7.14 In either case, the project should not be being funded through other mechanisms, such as franchise arrangements, grants or innovation funds; and the funder should have explored thoroughly the possibility of joint-funding arrangements before applying for the rebate mechanism.

The rebate charge

7.15 The rebate charge will be an (index-linked) tariff levied per benefiting path, and will be payable to Network Rail as a premium to the access charge. Network Rail will then have responsibility for distributing the tariff received to the appropriate investing party(/ies), the rights to which will be set out in the relevant access contract or access option.

7.16 The level of the charge should be calculated by Network Rail and be based on the average annual cost of the investment per relevant path available. The charge will be applicable only for the ex ante payback period of the investment, as set out in the access rights or options of the investing entity. If the original investor loses its access rights with respect to the enhancement, the mechanism for paying a rebate charge to the investor will survive, unless the investor has been appropriately compensated for its investment.

7.17 The mechanism will be implemented through applications under section 17 to 22A of the Railways Act 1993. The level of the rebate charge and the expiry date of the charge should be set out in schedule 7 of the track access contract.

8. Sale of Land or Rights to Land

Introduction

8.1 This chapter deals with two types of land-related transaction that sometimes accompany an Investment Framework enhancement:

- changes to the value of land as a result of access to the land granted by another party ('shared value'); and
- the potential for Network Rail to take an asset, or work done to enhance an asset, in lieu of a cash payment for land ('hypothecated gains').

Shared Value

Background

8.2 Shared value is the term used where a landowner seeks a share of the increase in value created when it grants property rights in respect of its own land, to a developer, and this increases the value of the developer's land.

8.3 For example, a developer owns a piece of land to which access is difficult because of intervening land (e.g. a railway). If the owner of the intervening land grants access rights to the developer's site over its land, then the value of the developer's site will rise. The landowner would then normally seek a share of this increase.

8.4 The principle behind seeking a share of any valuation uplift as a result of granting such rights is part of established property valuation practice.

Guidelines

8.5 Network Rail can seek to share in the benefit of an increase in land value where that increase has been unlocked by providing developers with access to its own land or over its land. In doing so Network Rail must comply with relevant legislation. We would expect Network Rail to be mindful of relevant precedents, and not to frustrate developments from going ahead or significantly delay their implementation by adopting an unreasonable position. Where proposed developments have either direct or indirect rail-related benefits, we would expect Network Rail to have regard to this when negotiating with developers.

8.6 While there may be circumstances in which competition concerns might be raised, it should be noted that our role in enforcing the Competition Act 1998 only applies to services relating to the railways. It is likely therefore that competition issues relating to non-railway developments will fall outside the scope of our powers.

8.7 With these points in mind, it is a matter for the parties concerned to agree between them whether, in particular circumstances, shared value principles apply and if so, the appropriate level of shared value.

8.8 If a developer thinks that Network Rail is unreasonably frustrating developments from proceeding, it can take its case to the Lands Tribunal but Network Rail offers other options in order to resolve disputes, including mediation. Network Rail has also confirmed that it is willing to discuss other possible dispute resolution mechanisms with investors.

Hypothecated Gains

8.9 'Hypothecated gains' are assets taken (by Network Rail in this case) in lieu of cash. They occur where a developer offers to carry out an enhancement in return for, for instance, acquiring Network Rail land for development.

8.10 If Network Rail accepted cash from a developer, it would benefit directly from those receipts, whereas the value of enhanced assets taken instead of cash typically falls to other parties such as TOCs, passengers and funders. Network Rail may take hypothecated gains instead of cash in those scenarios where developers can offer an asset whose value exceeds any cash payment they are prepared to make.

8.11 Network Rail must set out details of expected hypothecated gains in its annual plans, to inform customers and funders.`

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