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10 April 2006

Dear



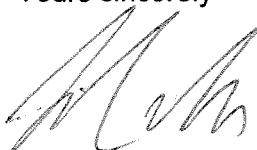
FUNDING ARRANGEMENTS FOR NETWORK RAIL POST 1 APRIL 2006

1. This letter provides further detail of the funding arrangements relating to the Scottish Ministers' new role of funding and specifying the rail network in Scotland that takes effect from 1 April.
2. The document 'ORR's approach to regulation in Scotland: Conclusions' published in December 2005 identified 'Network Grants and other funding' in the Scotland net revenue requirement of £338m/£338m/£324m (¹) for the years 2006/07 to 2008/09. As part of the devolution settlement, the Department for Transport is transferring funding to Transport Scotland to enable it to assume responsibility for funding Network Rail's operation, maintenance and renewal activities in Scotland.
3. In terms of the detail of how Network Rail will receive its net revenue requirement in relation to England & Wales and Scotland going forward, the Deed of Grant Transfer Scheme came into force on 1 April 2006. This transfers the SRA's current obligations to pay Network Grant to the Secretary of State and Scottish Ministers. As a result of this, the SRA Deed of Grant under which the SRA paid Network Grant to Network Rail has been restated as separate Deeds binding the Secretary of State and the Scottish Ministers to pay their apportioned parts of the Network Grant.
4. As you know, ORR has been involved in preparing the Transfer Scheme and the revised Deeds of Grant, as have Network Rail and Transport Scotland. A copy of the transfer scheme, which includes revised Deeds of Grant is attached.

¹ All values in this letter are in 2004/05 prices

5. Transport Scotland will pay annual Network Grants of £212m/£212m/£198m to Network Rail from 2006/07 to 2008/09, with the Department's Network Grant payments being reduced by the same amount. The total amount of Network Grant received by Network Rail therefore remains exactly the same as in the existing SRA Deed of Grant.
6. The remaining element of the funding arrangements will be annual payments of £126m from Transport Scotland to Network Rail made through the Department for Transport. This arrangement is in effect a 'joint procurement' by the Department and Transport Scotland for part of the network outputs in Scotland. It is a transitional measure for the remainder of the current control period only (i.e. to 2008/09), required principally for government accounting reasons. In the forthcoming periodic review of access charges, the Department and Transport Scotland will work with ORR and Network Rail to ensure that, for 2009/10 and beyond, all of Network Rail's Scotland net revenue requirement will be met by Track Access Charges (TACs) paid by Scotrail, or grant payments from Transport Scotland in lieu of TACs agreed with ORR through the periodic review.
7. Network Rail is fully aware of the arrangements and content with them. There is no effect on the total income Network Rail receives from TACs. The £126m will be shown in Network Rail's regulatory accounts as part of its income in relation to Scotland, along with Network Grant paid by Transport Scotland, Scotrail TACs and other single till income.
8. On a related issue, the Deed of Grant Transfer Scheme also makes certain amendments to the Grant Dilution provisions in Part 3 to Schedule 7 of Track Access Agreements to take account of Transport Scotland's new role in paying Network Grants. Train Operating Companies have been informed of these changes.
9. This letter has been discussed and agreed with Transport Scotland, and I am sending a copy to Malcolm Reid. I am also copying to John Armitt at Network Rail.

Yours sincerely



Mike Mitchell
Director General of Rail

Copy: Tom Oscott