

# ORR Investment Policy Framework - Consultation

3rd Party Templates

26 September 2007

# Discussion points

- Background
- Proposal process - update
- Key issues
- Treatment
- Next steps

# Background

- Templates in place for 18 months. Number of 3<sup>rd</sup> Party schemes continues to grow.
- Templates, along with organisation capability, aimed at providing customers a consistent and improving experience.
- Network Rail recognise that the arrangements will require refining continuously.
- Recognising the need for consistency, changes to templates to address project specific circumstances & customer policies are often accommodated.
- It is Network Rail's hope that confidence in the arrangements & relationships will continue to grow, & that the arrangements will become increasingly stable with further benefit for all parties.

# Network Rail internal review

- Aimed at:
  - adapting the way we work to better meet customers' needs
  - making it easier to do business with Network Rail
  - providing greater certainty to customers that their project will be developed & implemented in accordance with the risk approach they have chosen (fixed price/ emerging cost / facilitation)
- By:
  - identifying the key principles & making the necessary changes to the template clause
  - clarifying wording used in template agreements, including better linkage & explanations of processes
  - further demonstrating that Network Rail is incentivised to deliver in order to meet its customer requirements
  - reviewing obligations of parties - Network Rail take on further obligations where appropriate to provide customer with greater certainty in their business case
  - making template agreements more simple

# Proposal process - update

- Network Rail was previously undertaking a review of template terms & conditions
- ORR held workshop in April 2007 & received consultation responses from stakeholders in May 2007
- To reinforce Network Rail's assessment of the template terms and conditions we:
  - reviewed consultation responses
  - identified generic issues & assessed against Network Rail review.
  - undertook initial discussions with ORR
  - Undertook a further review & released our proposals to address consultation responses
  - held further meetings to discuss our proposals (including with ORR)
  - clarified / adjusted proposals to take into account residual issues raised

# Customer relationship management

- Any template updates are made within a framework of:
  - how & why the template agreements are structured as they are, along with how they link into the overall customer service proposition Network Rail is offering
  - better account management by Network Rail in identifying with the customer their project requirements, as well as other improvements to relationship related issues
  - end to end project timescale performance improvement with change & simplification of Network Rail internal processes
  - fast track feasibility development process to allow customers to make rapid choice on moving projects forward
  - simpler scheme interface & greater certainty & assurance that scope & timescales risks will be managed through engineering safety management processes for well managed projects

# Key issues (1)

- Demonstrable Network Rail incentives in agreements
  - linked to obligations on managing & ‘standing behind’ procured contractors / consultants
  - liquidated damage increases for delay
- Risk funds
  - fee level reductions
  - Removing uncertainty in overall customer project costs
  - Assessing IRF contribution
- Liability
  - Network Rail liability – explaining & increasing
  - Customer cap – reducing development cap
- Asset protection
  - Approvals – better understanding of process
  - Early involvement of Network Rail
- Early stage development
  - fix the price
  - fast track development



# Key issues (2)

- Development
  - Cap the price for development stage (recover later or write off as appropriate) or fix price
  - Lighter touch governance
- Design risk
  - Network Rail taking on design risk at the appropriate stage through implementation linked to template type
- Consents
  - industry consents – cap on costs for non-industry customer
  - OMR – link into process for industry consent agreements
- Other obligations of the parties – simplification / review risk allocation
- Larger projects – increased participation options
- Escalation as an option to resolve matters in a timely manner
- Guidance note update



# Treatment of key issues - Demonstrable Network Rail incentives in agreements (1)

“Demonstrable Network Rail incentives in agreements - linked to obligations on managing & ‘standing in front of’ procured contractors / consultants”

## **Concern –**

- Network Rail incentive in the management of contractors / consultants
- Customer can be exposed to cost risk from losses due to contractors' / consultants' default
- Customer at risk if not recovered by Network Rail & not otherwise recoverable through collateral warranties.

## **Proposed Solution -**

- *Applies to where Network Rail are developing and/or delivering a scheme for a customer.*
- *This will be achieved through Network Rail being liable for the costs of the contractors' / consultants' default in these circumstances up to the Network Rail Cap (NR Cap).*



# Treatment of key issues - Demonstrable Network Rail incentives in agreements (2)

“Demonstrable Network Rail incentives in agreements - timescale liquidated damage (LD) increases”

## **Concern**

- Timescale incentives through the liquidated damages regime do not provide sufficient incentive for Network Rail to manage to timescales.
- This may be from time delay due to Network Rail when delivering a scheme, or facilitating scheme (asset protection) against an approved customer works programme, leading to increases in customer costs.

## **Proposed Solution:**

- *Strengthen the arrangements around the time obligations in the template agreements*
- *where a scheme is delayed for reasons other than allowed for, the Network Rail staff costs (over the current estimate and programme) will be non-allowable costs after the target completion date. (Note this is already in place for the fixed price templates.)*
- *Identified LD levels in our original proposal. In further discussions with ORR we have proposed to go further with the tiered arrangement linking payment into Industry Risk fund & value of agreement. (see table)*

# Treatment of key issues - Demonstrable Network Rail incentives in agreements (3)

“Demonstrable Network Rail incentives in agreements - timescale liquidated damage increases”

(IRF = Industry Risk Fund)

<b>IRF contribution in £k</b>	£0 to £50k	£50 to £100k	£100 to 500k	£500 to £2,000k	£2,000 to £5,000k	£5,000 to £10,000k	£10,000 to £25,000k	> £25,000 < £50,000k
<b>Liquidated damages per day</b>	£0.5k	£1.0k	£1.0k	£2.0k	2.5k	£3.0k	£4.0k	£5.0k
<b>Cap ( based on contract value)</b>	100%	100%	100%	50%	25%	25%	25%	25%

# Treatment of key issues – Risk Funds (1)

## **Concern**

- the level of fees outweighs the level of exposure to risk at different stages of a scheme.

## **Proposed Solution**

- *have reviewed current levels of fees & level of drawdown on funds*
- *For BSA/DSA/FDA we propose that the NRFF contribution payable under them should be reduced from 10% to 5% of Network Rail Costs.*
- *For other agreements we believe it is too early to judge & propose reviewing in Sept 08 when more projects are complete.*

## **Concern**

- *Contributions to the risk funds (NRFF and IRF) should not be adjusted upwards if costs on an emerging cost basis increase, ie based on estimated cost.*

## **Proposed Solution**

- *where Network Rail has had the opportunity to produce a cost estimate as part of a previous agreement this will be capped, excluding variations*
- *For APAs customers to provide adequate overall project estimates, scope & programme, excluding variations*

# Treatment of key issues – Risk Funds (2)

## **Concern**

- Customers seeking to contract wider terms for the risk fund management arrangements lying behind the template agreements

## ***Proposed Solution***

- *Overarching management arrangements through ORR already in place*
- *Explain better - review Investing in Network / guidance to meet specific customer needs.*

## **Concern**

- Consider (i) the introduction of a cap on fees for larger schemes & (ii) also consider reductions for customers who have paid significant amounts into the funds.

## ***Proposed Solution***

- *(i) for IRF we propose for projects in excess of £5m/ with significant high street environment works, we would undertake a risk assessment with the customer so that an appropriate level of IRF fee can be agreed in line with the risks presented to the operational railway.*
- *(ii) we believe that the revised arrangements being proposed in the sections below for public sector customers & cost estimates should reduce these concerns.*

# Treatment of key issues - Liability

## Concern

- Assumption that liability is biased in favour of Network Rail in that the liability caps are perceived to be imbalanced.

## Proposed solution

- NR Cap for breach (see table), with negligence uncapped (except LDs).*
- in current agreements no NR Cap has been exceeded.*
- Customer Cap for the DSA and design services in FDA reduced to 10% in line with other template agreements.*
- additional Network Rail obligations described in this note will provide further assurance to customers that these arrangements provide an effective governance toolset.*

Agreement Type	Current Fee	Current Cap	Current Total Cap*	New Fee	New Cap	New Total Cap*	Comments
BSA/DSA/FDA	10%	3x Fee	30%	5%	6 x Fee	30%	* = Total Agreement cost ** = as current agreement
APA	10%	3x Fee	30%	10%	4 x Fee	40%	
IA's (EC)	5%	3x Fee	15%	Same**	Same**	Same**	Note additionally includes: (1) Costs recovered from contractors / insurance. (current) (2) NR to stand in front of contractors to NR Cap (new)
IA (FP)	13%	3x Fee (Deliver for Base Price)	15%	Same**	Same**	Same**	



# Treatment of key issues – Asset Protection

## Concern

- Better understanding of the process so that customer business case (cost, time & scope) is achieved, particularly around risks to submissions for approval made by customers' contractors/ consultants which are too often rejected

## Proposal

- *Guidance on process to allow:*
  - *better quality communication between customer & Network Rail*
  - *approvals – better understanding of process for customer & proportionate review by Network Rail*
  - *early involvement / visibility for Network Rail of proposed specification to allow clarification / discussion on the correct specification to be achieved before costs are expended on design*
  - *a detailed works programme to allow Network Rail to plan resource*
  - *risk management skills of customer teams & ongoing management of the customer's contractors/ consultants*



# Treatment of key issues – Development

## **Concern**

- Early stage development & fixing the price to customers to allow planning of the funding requirements.

## ***Proposed Solution***

- *For projects generally up to £5m, we intend to instigate & roll out a fast track early stage development process to allow customers to make rapid choice on moving projects forward*
- *Dedicated fast track development teams to achieve this*
- *Simple funding letter, generally fixed at £25k*

## **Concern**

- Some customers, particularly in the public sector, wish to have certainty of development cost to align with their funding requirements..

## ***Proposed solution***

- *For projects, generally up to £5m, we propose to agree to cap development cost, with any reasonable overspend being recovered as part of the implementation stages, or fix the price as appropriate.*
- *This will also enable a lighter touch on governance arrangements as we will be taking overspend risk for the development stage*

# Treatment of key issues – Development, design risk

## Concern

- Customers left with the residual design risk, including when Network Rail procures the design & implements the project.

## ***Proposed solution***

- *Network Rail accept design risk when we procure the design & implement the works*
  - *For IA(FP) variants - upon entry into agreement.*
  - *For IA(EC) variants - upon acceptance of the enhanced asset, so long as variations required to deliver the design intent are agreed by the customer.*
- *Customer designed and implemented (APA) - the residual risk will generally remain with the customer.*

# Treatment of key issues – Consents (1)

## **Concern**

- Rail industry consents processes are difficult to understand & leave non-industry customers concerned about their ongoing business case exposure.
- Agreeing Regulated Change with all affected industry parties can be protracted, even though it should be complete by end of GRIP Stage 4, but even when agreed an industry party can potentially re-open a compensation claim.

## **Proposed Solution**

- *Undertaking the process in a pro-active manner & continuing to involve train operators early in the process to help mitigate & manage these concerns.*
- *Network Rail can be more proactive, particularly with non-industry customers who have limited experience of working in the rail industry.*
- *Propose to cap customers' exposure to Regulated Change costs to that estimated by us and agreed with the non-industry customer at the time of implementing a project, as long as Regulated Change has been completed and fully agreed, where we are undertaking the Regulated Change.*
- *As Network Rail does not manage the scheme delivery or the process through asset protection arrangements we do not propose to apply the process here.*

# Treatment of key issues – Consents (2)

## **Concern**

- Current drafting can be construed as potentially conflicting with the network / station change processes.

## ***Proposed solution***

- *This was never the intention and so wording to make clear that the agreement cannot override the network / station change processes will be added.*

## **Concern**

- Additional OMR cost – There is sometimes a concern from customers with respect to adequate assessment of these costs and the open ended nature of their obligations.

## ***Proposed solution***

- *Should be addressed through a maintenance plan, which forms a GRIP stage product.*
- *Close out of OMR costs before implementation - all parties need to continue to work through the scheme development process to establish that OMR costs are funded by the relevant operator or station franchise operator (SFO), transferring to any new franchise as appropriate.*
- *£50,000 “de minimis” OMR costs - understand relevant operator & SFO projects are not eligible in each case. Where there is no financial benefit use of £50,000 “de minimis”.*
- *Trespass & vandalism will be removed from templates where Network Rail implementing.*

# Treatment of key issues – Participation rights & escalation

## **Concern**

- Larger projects - some customers request greater monitoring / control rights over Network Rail's project management due to financial exposure

## **Proposed Solution**

- *Established appropriate participation arrangements that better provide this assurance where the customer wishes to be more involved*

## **Concern**

- Escalation rather than adjudication – escalation only appears in a few templates. Escalation should be the first option for disputes resolution

## **Proposed solution**

- *Escalation to address matters of concern has been particularly successful in helping build relationships*
- *Propose to extend this to all template agreements*

# Treatment of key issues – other obligations of the parties

## Concern

- Reduce customer exposure & provide certainty on future risks
- Complexity of indemnity provisions / unforeseen costs

## ***Proposed solution***

- *See previous risk areas*
- *Guidance note to explain more clearly to customers the risks arising from projects and/or the network & how those risks are shared between the parties to reduce the level of uncertainty for the customer.*
- *Reduce the complexity and any inadvertent duplication on cost recovery routes. As the template agreements were approved at different times, we also intend to review them for consistency.*



# Next Steps

- Following ORR consultations:
  - Agree principles having listened to comments
  - Any further comments before Friday 5 Oct 07
  - Draft into templates
  - Concurrent guidance drafting
  - Comment dependent, aim is to have in place by end Oct 07 (will agree changes to this with ORR)
  - ORR to provide updated template letter