1. Purpose of the paper

1.1 To present to directors three documents for review and approval for formal consultation, including review of two recent changes in the draft Constitution Agreement proposed.

2. Documents for approval and consultation

2.1 Following extensive consultation amongst the subcommittee and the responses to the two sets of stakeholder consultation, the following documents are being presented to directors for approval.

2.1.1 Draft Constitution Agreement (CA) to commence 1.4.2014

2.1.2 Draft Strategic Business Plan (SBP) for 1.4.2014 to 31.3.2019

2.1.3 Draft member funded budget for year 1.4.2014 to 31.3.2015

2.2 The draft CA is designed to support the company in achieving the objectives set out for the Strategic Review in July 2012 and the key changes are summarised in Annex A. It is subject to member consultation, final approval by the board, members approval at a general meeting and then ORR approval. There are two amendments to the draft CA that the board has not been consulted upon before and these are as follows

2.2.1 In the revised Clause 2 (Primary Objective, Principles of Operation, Functions etc.) a number of the ORR duties were deleted from the principle of operation at an early stage. Following further consideration the subcommittee is recommending the re-instatement of two of these principles in Clause 2.2.1 (a):

- to protect the interests of users of railway services;
- to promote efficiency and economy on the part of persons providing railway services

2.2.2 As a consequence of the legal review our lawyers have suggested a new sub clause be added to the ‘May’ functions which would cover, amongst other things, the recent board decision to enter into an MOU with Network Rail Consulting. Within the draft the sub clause appears at 2.3 (b) (ix):
subject to the passing of a Reserved Resolution, the carrying on of activities other than its Primary Objective for the purpose of making additional income available and/or broadening the Company’s knowledge, skills or expertise if, in the opinion of the Directors, the carrying on of such other activities:

(A) is of benefit to; and

(B) does not in any material way prejudice;

the carrying on of the Primary Objective

2.3 The draft SBP is a high level document which sets out high level objectives for the company in CP5 and provides more detail as to how the company will operate through CP5 in accordance with the amended governance arrangements in the new CA. Key changes from the draft which was consulted are summarised in Annex B. Although it could technically be approved by directors as a reserved resolution, in light of 2.2 it is proposed that this is consulted with members alongside the CA.

2.4 The draft member funding budget is set out at Annex C and tabled under the existing CA. Directors are asked to approve it subject to the following:

2.4.1 The approved budget will be used to determine members’ levies for 2014/15 using the mechanism set out in the current CA and invoices will be generated in the normal way to collect the levies for that year.

2.4.2 Provided the new CA comes into effect on 1.4.2014 the members levies established and invoiced through the mechanism in the current CA will be used to populate the schedule of levies that members are subject to in year one and thereafter used to calculate the annual adjustment.

2.4.3 The budget for 2014/15 will be subject to consultation because it will determine members’ levies. Note that subsequent annual expenditure budgets will be subject to unanimous directors’ approval only, as members’ levies will have been determined by the new CA and the application of the price variation formula.

2.4.4 At the last board meeting directors agreed to support an ‘RPI-1’ formula for the five year funding provided the new chief executive undertakes a review in the first year to determine whether there are any further opportunities for efficiency. This is recorded in the board minutes and the mechanism to enable the funding arrangements to be potentially reopened is provided in the draft CA under clause 6.1.3.

2.4.5 Directors discussed contingency and the ability to deal with shocks at the last meeting. In discussion with members of the subcommittee and the audit committee a consensus has emerged about building a contingency reserve of up to £1.5m through an addition of £250k pa to membership levies (see Annex C) and that directors should be able to reopen the membership levies in the event of a positive or negative variance of more than £1.5m in any year as set out in clause 6.1.3 of the draft CA.
AGENDA ITEM: 02

2.5 Future of the board:

With the many changes and developments in the RSSB Constitution, Business Plan, board membership, the new chief executive from March 2014, the various governance groups and the industry generally over the last 12 months it may now be appropriate for the RSSB board to begin to review its own functioning going forward.

3. Next Steps

Subject to directors approval, the documents attached to this paper, with an explanatory cover, will be sent to all members and stakeholders for consultation, with responses by Christmas. Subject to satisfactory consultation, the January board meeting should be able to confirm the documents for a members’ general meeting and subsequent ORR approval of the CA. A consequence of the proposed changes to the Constitution Agreement is the need to conform the Articles which will also be subject to members’ agreement, and this conforming will be done in parallel.

4. Recommendations

The board are asked to:

- **APPROVE** the draft Constitution Agreement for consultation and unanimously recommend to members that they support it as presented.

- **APPROVE** the Strategic Business Plan and unanimously recommend to members that they support it as presented

- **APPROVE** the draft budget and unanimously recommend to members that they support it as presented

- **DELEGATE** authority to the executive to finalise the documentation for member consultation including non-material changes to the drafts.

- **NOTE** the next steps

Annex A: Summary of major changes in the CA
Annex B: Summary of changes in the SBP from consultation
Annex C: Members Funding proposal for 2014/15

Attachments:

Draft Constitution Agreement – with Track Changes from current CA
Draft Strategic Business Plan – with track changes from consulted document
Clause 2  Primary Objective, Principles of Operation and Functions

The primary objective has been amended in two ways – to emphasise that RSSB’s role is to support the industry in the achievement of its objectives and the scope has been clarified as including both safety and other business improvement.

The principles of operation have dropped a number of the ORR ‘Section 4 Duties’ and added in principles confirming the relationship between RSSB activity and members and other stakeholders, including RDG.

The functions of RSSB have been updated and include a distinction between certain functions that RSSB shall do (which would require a Constitution change to alter) and those which RSSB may do, which would require board approval to change. It also introduces the concept of products and services, which RSSB provide to the industry to support the primary objective and in fulfilment of the Functions, all of which are governed by the board and the various cross industry groups set up under the authority of the board.

Clause 3  Membership including change of Franchise

Introduces the potential to have associates – subject to the board agreeing relevant terms.

The mechanism for the change of franchises is amended to deal with the new funding mechanism.

Clause 4  Board

There are a few areas where the ORR is no longer required to approve, and the audit committee gets involved. The requirements to dismiss a director are amended to reflect the deletion of the ORR approval.

Clause 6  Funding

Under the present Constitution, the mechanism for funding RSSB is that an agreed budget is developed and the full cost of that budget (less any grant from DfT and other income etc) is set as the aggregate membership fee. It is then allocated across the membership starting with members in the categories of Freight Operating Companies, non Franchised passenger operators, Infrastructure Contractors, ROSCOs and Suppliers, according to a schedule of turnover related fees. This yields less than £1m in total. The balance of the fees are then divided equally between Network Rail (who pay one half) and Franchised Passenger Operators (who pay the other half between them, with each TOCs share being set according to their previous years turnover). This system guarantees RSSB that it will recover all of its costs, but also means that
even in a stable year, individual fees from TOCs or Network Rail could change significantly, in a way that is unrelated to the fee payer’s activity.

The new funding mechanism is based on a five year ‘settlement’ and creates a baseline for the first year – calculated in the same way as under the current Constitution. Once each members’ levy is determined under the current mechanism, it becomes their base levy for year one and is subject only to RPI-1 adjustment for each of the four years that follow. This mechanism enables members to plan for their RSSB levies with a greater degree of certainty, creates an efficiency incentive for RSSB and also means that if RSSB gains or loses voluntary members in the supplier categories within the plan period, its income will change to reflect that – thus creating an incentive to encourage new members and to retain existing ones.

Because the new mechanism effectively sets the funding stream for RSSB for five years, there is a need for a mechanism to enable the company to deal with a financial shock – whether it is positive or negative, and a mechanism is provided whereby if the directors wish to produce a budget with a loss or profit forecast of £1.5m or more, then they can re-open the membership levies and adjust them. This is set out in Clause 6.1.3. In addition, under the 2014/5 budget proposal, RSSB will begin to accumulate a modest contingency reserve to enable it to manage below the £1.5m threshold with a degree of flexibility.

Apart from the re-opener described above, each year the directors will review the company budget and priorities and adjust/approve it, but as membership levies will not change as a result, there will be no member wide consultation. Each category of member is represented by at least one director, and the resolution to approve the budget has to be a unanimous one.

Clause 7 Annual Report and Accounts

This section is simplified to reflect current practice, and permit members to request information.

Clause 8 Deletion of all reference to the Advisory Committee which was abolished in 2011.

Clause 10 Deletion of section on failure to achieve a majority at a general meeting as it does not include any powers.

Clause 13 Insurance

This section is much simplified as a number of provisions designed for the first years of RSSB operation are no longer valid. It now simply states the obligation of the directors to secure insurance that meets legal requirements and such other insurance as they deem appropriate.
Annex B  
Summary of changes in the SBP from consultation

The version of the SBP that is attached is a track changed version of the one consulted with members and stakeholders in the summer of 2013. It has been updated and amended to reflect consultation responses. The significant changes that have been made are as follows:

1. There is an additional objective to expand membership.
2. The first year member funded budget is included within the Plan.
3. The mechanism for the board to review and agree the budget each year is described.
4. Some respondents wanted more detail about specific activities and resources. This will be provided in the detailed plans for each year that will be approved by the board each March and placed on the RSSB website.
Annex C  Member Funding Budget proposal for 2014/15 – Year one of the proposed five year settlement

It was agreed by directors at the July and September board meetings that the 2014/15 budget for core member funding would a) become the baseline for the five year funding and b) be based on the outturn for 2013/14, together with known/agreed changes.

The outturn forecast for 2013/14 as at October 2013 is for expenditure on member funded activity of £19.6m which is in line with the approved budget.

The two variances that it was agreed in principle to make to this figure to arrive at the proposed members’ levy budget for 2014/15 are:

I. The application of RPI-1. RPI in July 2013 was 3.1% and therefore the adjustment is by +2.1%
II. The sub committee has recommended that RSSB seek to accumulate a small contingency fund of £1.25m over the life of the five year funding settlement and this will be achieved by the addition of £250,000 to the baseline figure for members levies (but not included in the expenditure budget)

<table>
<thead>
<tr>
<th>Outturn for 2013/14</th>
<th>£19.60m</th>
</tr>
</thead>
<tbody>
<tr>
<td>Plus RPI-1 = 2.1%</td>
<td>£20.01m</td>
</tr>
<tr>
<td>Plus contingency (£250k)</td>
<td>£20.26m</td>
</tr>
</tbody>
</table>

So the Expenditure Budget for 2014/15 would be based on income of £20.01m and Members Fees for the base year (2014/15) would be based on £20.26m.

Further agreed adjustments, which will be dealt with bilaterally with the companies concerned are:

I. The proposed arrangement with Network Rail, whereby they will pay for the RSSB work undertaken in the ERTMS project through an addition to their membership fee. This has been agreed in principle but will not be factored into the calculation of members’ levies. When and if agreed the adjustment will be inserted into the schedule of levies and treated as part of the NR levy for subsequent price adjustment.
II. The introduction of the new rolling stock system (R2) during 2014, whereby members who are users/funders of the RSL and RAVERS systems will stop paying their fees to ATOS and will instead pay (lower) figures to RSSB. When these are introduced the relevant R2 charge will be added to the schedule of levies for each particular member and treated as part of the levy for subsequent price adjustment. Members who are not bound to RSSB by licence condition will also be asked to sign an agreement to continue paying RSSB in the event of their ceasing to be members.