
# Network Rail’s detailed response to ORR’s PR23 draft determination

31 August 2023

# Contents

# Executive summary

This document sets out our detailed response to ORR's 2023 Periodic Review (PR23) draft determination for England & Wales, and its draft decisions on key policy areas (which apply across Great Britain), published on 15 June 2023. It is part of a suite of documents.

We are pleased that ORR has accepted in its draft determination much of what we set out in our SBP but there are areas where we have significant concerns on the regulators proposals. In some areas we have made constructive progress in our discussions with ORR since it published its draft determination but there remain a number of issues where we are asking ORR to review and alter its proposals ahead of its final determination. Our separate 'key messages for England & Wales and GB policy' document sets out these areas, and the key messages are summarised at a high level, below.

The remainder of this document provides further detail on each of these points, as well as other areas of consideration for our draft determination response.

# Key draft determination response messages

1. Given the challenges and uncertainties we face in CP7, it is essential that ORR is flexible and pragmatic in its approach to regulating Network Rail, recognising the high level of anticipated change as PR23 is concluded, and the challenges we face during CP7.
2. We accept almost all of ORR's proposed £550m increase in core asset renewal expenditure in CP7, albeit comprising a different mix of assets across our regions.
3. To fund the increases in core asset renewals and the other funding pressures, we have identified a range of specific savings (and income stretch) within region and function plans and included the remainder as an overlay of c.£600m (2.1%) in regional plans.
4. We accept ORR's move to our 'risk adjusted' plan for England & Wales and have moved c.£1.5bn of 'contingent' funding in region plans to the 'cash risk' fund.
5. There is uncertainty around inflation and input price estimates in CP7. While we consider that our latest input prices assumptions are robust, we have held c.£1bn of our £1.7bn input price inflation in our cash risk funding.
6. Once adjustments have been made for the latest view of inflation and input prices, our total CP7 cash risk fund is c.£1.5bn. We continue to face significant uncertainty in CP7, including from inflation, input price estimates and wider risks, and if these materialise at a significant scale they will exhaust the available cash risk funding.
7. We have raised with ORR our significant concerns around its proposed approach to setting CP7 train performance trajectories. Recent discussions with ORR to find an alternative, more appropriate, approach to setting the CP7 regulatory baselines for train performance (the '2+3' approach) are a constructive step forward. However it is essential that targets for years 1 and 2 of CP7 are realistic and underpinned by credible assumptions and evidence.

8. We welcome that ORR has accepted our overall efficiency target of £3.2bn for the risk adjusted plan. Delivering these efficiencies will be extremely challenging not least given the nature of the approach it has been necessary to take to asset renewals.
9. We will deliver a safe plan in CP7 to support our vision to get 'everyone home safe everyday' and remain strongly committed to the safety outcomes set out in our SBP. We have developed a bow tie risk assessment framework which we will use to demonstrate our understanding of the change in risk profile as a result of conducting fewer renewals in CP7 (due to renewing at less than steady-state levels and through the shift to the risk adjusted plan, discussed below), including assessing the level of alignment between our maintenance and renewals plans, and how we will manage this.
10. We do not support ORR's decision to now not fully implement its original proposals for c.75% (average) lower Network Rail Schedule 8 Payment Rates at the start of CP7.

# 1. Introduction to our detailed response to ORR's PR23 draft determination

### Key response point covered in this chapter

**Key response point 1:** Given the challenges and uncertainties we face in CP7, it is essential that ORR is flexible and pragmatic in its approach to regulating Network Rail, recognising the high level of anticipated change as PR23 is concluded, and the challenges we face during CP7.

## Purpose

The purpose of this document is to set out our detailed response to ORR's 2023 Periodic Review (PR23) draft determination for England & Wales, and its draft decisions on key policy areas (which apply across Great Britain), published on 15 June 2023.

Alongside our key messages, our detailed response is underpinned by individual responses from our regions, System Operator and national functions. We have also responded to ORR's draft determination for Scotland's Railway. We have submitted responses to ORR's consultations on drafting changes to access contracts, and open access airport services, both of which were issued following the draft determination.

We do not consider any of this detailed response document to be confidential. However, there may be other aspects of our overall submission (including supporting documents and evidence) which we consider to be commercially sensitive. We would like to discuss these with ORR on a document-by-document basis prior to any publication.

## Context

As set out in our CP7 Strategic Business Plan (SBP), the last few years have been incredibly challenging for the railway. Since March 2020, Covid-19 and the associated lockdowns and restrictions have resulted in radical changes in the ways that passengers use rail, and a significant reduction in industry revenue. Covid-19 has exacerbated already challenging economic circumstances in the UK, adding to the pressures on public finances and the availability of funding for rail. We have been, and will continue to be, impacted by the effects of the recent surge in inflation. Based on the latest August 2023 Bank of England inflation forecast, the value of our CP7 funding has been eroded by c.£1.5bn, since the SoFA was published. While industrial action impacting Network Rail's activities came to an end in early 2023, over the last year train service performance has been severely impacted and continues to be impacted by the industrial relations disputes across the industry, as well as issues around train crew availability. There is no obvious end in sight to this. We also continue to experience more frequent extreme weather events across the network associated with climate change, which our assets have generally not been designed to cope with.

Despite these challenges we have remained on a firm financial footing in control period 6 (CP6) and we are on target to make a further £500m of savings on top of our original £3.5bn five-year efficiency programme – exceeding the efficiency targets set by ORR for the first time in our history.

We welcome the engagement we have had with ORR, Government, passenger and freight operators and other stakeholders during the course of PR23 on the wide range of topics that are critical for Network Rail and for the success of the railway in CP7. This engagement is important to us, both at a company level and through our regions and functions, and will continue as we develop our delivery plan and move into CP7.

Since submitting our SBP to ORR in February 2023, we have continued to engage extensively with ORR through focused meetings and the provision of further information to support the development of its draft determination. This included supplementary material provided in March and April 2023, although we note that ORR was not able to factor all of this information (notably the supplementary information provided on maintenance at the end of April), nor the impact of the Bank of England's May 2023 CPI forecasts, into its draft determination. In light of this, a number of areas of our CP7 plan have continued to evolve since our SBP, as well as since ORR published its draft determination – representative of the fact that both milestones reflected our CP7 plans at points in time. We have set out these changes in our draft determination response.

We know that our plans will continue to evolve as we work towards the CP7 delivery plan and during CP7. In particular, we expect we may need to use ORR's managing change process as we work through the impacts of the overlays currently held in regions' plans ahead of the CP7 delivery plan (discussed in chapter 3 of this document), which may require changes to the outcomes set out in ORR's final determination.

Given the challenges and continued uncertainties we face in closing out PR23 and during CP7, it is essential that ORR's final determination is evidence-based, flexible and pragmatic. Overall, we expect ORR's approach – particularly around setting CP7 targets and its approach to managing change and the overall regulatory framework in CP7 – to be consistent with Government's principles for economic regulation originally set out in 2011 and reinforced by its 2022 economic regulation policy paper, including adaptability, coherence and predictability.

In applying these principles ORR must recognise Network Rail's specific characteristics (in particular that we do not have as many mechanisms to vary our funding during a control period as other regulated companies) and that some of ORR's performance targets cover the whole industry so ORR need to take into account how train operators' own performance targets are set with funders – discussed further in chapter 5. ORR's final determination decisions should provide a clear line of sight to its statutory duties, which are defined in and limited in statute, and include acting in a manner which ORR considers will not make it unduly difficult for holders of network licences to finance any activities or proposed activities where ORR has functions. ORR's approach should also provide clarity on how it has sought to balance its duties in a way best calculated to promote the public interest.

Throughout this document we stress the need for flexibility in how we manage our activities and cost base during CP7, as well as the need for flexibility in how ORR defines and monitors our outcomes being an essential part of its final determination. ORR's managing change policy is key in this regard and must minimise regulatory burden so we can respond efficiently to the high level of anticipated change both prior to the start of and during CP7. This is critical for Network Rail and the industry being set up for success in CP7.

## Key assumptions

Subject to working through the impacts of the overlay in regions' plans, as discussed above, our CP7 plan is deliverable if a number of critical assumptions hold. These include that:

- There will be no material changes to existing legislation.
- That ORR will reflect the c.75% reduction in Schedule 8 Network Rail payment rates in years 3 to 5 of CP7.
- That there will be no significant interventions by ORR in respect of safety that require material changes to working practices and the outcomes we can deliver in CP7.
- That inflation will not materially diverge from current forecasts.

These assumptions are important because the amount of risk funding in our CP7 plan, for managing normal business risks, would not be sufficient to absorb significant changes in inflation or other cost or revenue shocks. If these assumptions are incorrect, this will impact our ability to deliver our CP7 outcomes within the funding available, requiring us to initiate the managing change process.

## Approach to responding to ORR's draft determination

ORR's draft determination comprises 21 documents (and supporting documentation) running to over 1000 pages. In the formal 11 week consultation period, noting that we have also had ongoing engagement with ORR on various topics, we have taken a focused approach to developing our response. As agreed with ORR, we have prioritised responding to the consolidated set of actions issued as part of the draft determination.

Recognising the limited time available to update, assure and consolidate CP7 plans in this timeframe, we have undertaken a targeted update of key aspects of our CP7 plans to reflect both the evolving context described above, and consideration of ORR's draft determination proposals. Specifically, regions and functions have focused on refining their risk adjusted plans, with a continued emphasis on protecting safety and train performance while retaining 'right-sized' strategic priorities for the longer-term benefit of the network. Most notably, we have had to reflect the significant impact of the Bank of England's May 2023 inflation forecast on our plan that ORR did not reflect, or comment on, in its draft determination – and which necessarily has a material bearing on our plan and our response to ORR.

In developing our response, we have had regular engagement with our Executive and Board, specifically with the Board and Executive PR23 sub-committees. These have been established over the last two years to provide governance, guidance and challenge to our input to PR23.

Our draft determination response provides updated CP7 financial projections (where appropriate) and these are expressed in 2023/24 prices (using the May 2023 Bank of England CPI forecast). We have also considered the impact of the August 2023 forecasts.

We continue to consider that our England & Wales CP7 plans align with the Secretary of State's (SoS) expectations for the railway in England & Wales, as set out in the December 2022 High Level Output Specification (HLOS). On this basis, we have not sought to separately respond to ORR's assessment of the affordability of the HLOS within the Statement of Funds Available (SoFA), but respond to a few specific points within this document.

## Structure of this document

The remainder of this document comprises the following parts:

**Part A** sets out the adjustments we have made to our England & Wales CP7 plans to respond to ORR's draft determination, as well as to account for wider changes to our plans since the submission of our SBP to ORR in February 2023. It also responds to ORR's proposals for our CP7 outcomes, with a focus on train performance. Our response is focused on our CP7 success measures rather than our strategic themes.

**Part B** provides an overview of key improvements to our plans for CP7, following the publication of our SBP and Scotland's interim SBP. These focus on areas that ORR has identified needed further development in its draft determination. We set out in this section which aspects are applicable to both England & Wales and Scotland, and which aspects are specific to England & Wales. We have not undertaken a full plan update to respond to ORR's draft determination due to the short timescales for responding.

**Part C** responds to the key GB-wide proposals in ORR's draft determination policy documents on managing change, the financial framework, incentives and access charges.

**Part D** outlines our GB-wide next steps following our response to ORR's PR23 draft determination.

We have also provided several supporting documents as part of our response to ORR's draft determination to support our detailed response, including a response to each of ORR's 39 actions set out in ORR's draft determination – Consolidated list of decisions, proposals and actions document.

# PART A – Key adjustments we have made to our England & Wales CP7 plans to respond to ORR's draft determination, as well as to respond to ORR's proposals for our CP7 outcomes

# 2. Core asset expenditure and wider funding pressures

### Key response point covered in this chapter

**Key response point 2:** We accept almost all of ORR's proposed £550m increase in core asset renewal expenditure in CP7, albeit comprising a different mix of assets across our regions.

## Introduction

ORR's PR23 draft determination proposed that we should reallocate £550m of expenditure to fund additional core asset renewals across our England & Wales regions. This was largely consistent with our Technical Authority CP7 SBP assurance of our risk adjusted plan. However, ORR also proposed additional spend in other areas not highlighted by our Technical Authority's assurance, for example £50m on operational property (including London Victoria station roof).

In this chapter, we set out our response to ORR's PR23 draft determination proposals to increase our core asset expenditure as well as summarising the other expenditure and income pressures in our CP7 plans.

## Overall funding pressures in our CP7 plan

Table 2.1 summarises the additional expenditure that we have included in our CP7 plan through our latest high level plan updates. These are explained in the rest of this chapter.

Table 2.1: Summary of additional funding pressures, pre-efficient

| £m, 2023/24 prices | Costs (£m) |
|---|---|
| Core asset expenditure | 541 |
| Income shortfall | 101 |
| High output capabilities | 150 |
| Performance improvement and innovation fund (PIIF) | 20 |
| **Total** | **811** |

## Increase in core asset expenditure

The development of our CP7 plans from the start of PR23 has been informed by guidance and assurance activity undertaken by our Technical Authority. This has included an assessment of regional asset strategies and maintenance and renewals plans, focusing on a number of key questions (e.g. the extent to which proposals for each asset are in line with Asset Policy guidance and minimum levels of activity advised by the Technical Authority). Our minimum levels of activity (i.e. our red lines) are based on an assessment by our Technical Authority of the required levels of asset renewals to maintain a safe railway during CP7 and judged to be at a sufficient level to not require an undeliverable step up in activities in CP8 and beyond to continue to deliver safe asset performance. Our assurance is supported by counterfactual 'modelled' assessments of renewals and maintenance demand in CP7 (and beyond), and a view on the level of required renewals activity by region and asset type in CP7 and in future control periods.

We have reviewed ORR's proposed increase in core asset renewals expenditure in CP7, as set out in its draft determination. Whilst both our SBP assurance, and ORR's draft determination were largely aligned on the key areas of additional core asset expenditure required in CP7 (albeit there were a few items of ORR's proposed increase in core asset renewals expenditure which we consider ORR has not fully justified the need for) – they reflect a point in time. Since the submission of our SBP to ORR, we have continued to refine our risk adjusted plans for CP7, which has included updating our view of the level of renewals activity required in CP7 based on the latest information – including the CP6 year 5 position on deferred renewals. For example, some of our renewals activity initially proposed to be delivered within CP6 will be rephased or reassessed and this activity will form part of the planned activity within CP7. Our CP7 delivery plan will account for any deferred renewals from CP6 to CP7 and the impact of these on our plans.

Based on our targeted plan updates and latest assurance activity, we have identified different assets which require additional expenditure in order to be above our Technical Authority's 'red lines' from a safety and performance perspective. Therefore, whilst we accept almost all of ORR's proposed £550m increase in core asset renewal expenditure in CP7, our planned additional activity includes a different mix of assets compared to ORR's draft determination. We have set out in table 2.2, below, our proposed increases in core asset renewals expenditure by region and asset type as well as the rationale to support our view. We will also provide an updated Technical Authority assurance report to support our draft determination response.

More broadly, we expect, given the level of core asset renewals in CP7 (including the £541m we have added to our CP7 plan), there will be a projected reduction of 2.5% in the Composite Sustainability Index (CSI), which is one of ORR's key metrics for CP7 – and measures the long-term sustainability of the infrastructure. Our current view is that long-run core asset renewals demand would require expenditure of around £19bn in CP8 and £20bn in CP9 (compared with around £15bn of core asset renewals expenditure in CP7, noting that this does not include other capital expenditure), to achieve a more sustainable position in respect of asset condition in CP9 onwards.

Table 2.2: Overview of increase in pre-efficient core asset renewals expenditure in CP7 (£m, 2023/24 prices)

| Region | Asset type | ORR proposal | Network Rail proposal | Network Rail rationale |
|---|---|---|---|---|
| Eastern | Earthworks | 30 | 30 | Eastern recognises the risk profile associated with earthworks identified by ORR in its draft determination, with this funding being targeted to areas of higher risk, particularly soil and rock cuttings with North & East holding more of the at-risk assets. The additional £30m has been incorporated into Eastern's plan, covering works across embankments, soil cutting and rock cutting activity. The Technical Authority (TA) agree that this additional expenditure is required in order to bring earthworks renewals volumes to above minimum levels from a safety perspective. |
| | Track | 0 | 55 | Based on the latest CSI projections and the poor track condition in the East Coast and Anglia routes relative to other parts of the wider network, Eastern identified the need to increase the level of expenditure on track renewals in CP7 to mitigate the significant impact of broken rail incidents on high speed lines (noting that ORR did not identify this as an area that required additional expenditure in its draft determination). In particular, Eastern recorded over 36% of the entire network's broken rails over the past seven years with the East Coast Main Line (ECML) being the worst performing main line due to the age of its rail. In addition, c.12% of all broken rails occurred on the ECML, which only represents 3% of the network mileage.<br><br>The TA are supportive of the need to increase track renewals volumes in CP7 in Eastern region, based on further understanding and reflection of the risk presented by Eastern following the SBP. |
| | Structures | 0 | 30 | In consideration of the latest CSI projections and to support improving the risk profile of the structure's portfolio, Eastern has invested a further £30m in this asset class. This investment will also support achievement of our freight growth targets.<br><br>The TA support Eastern's proposals and agree that there is a need to address under-strengthened bridges across the region in CP7, which this funding will enable. |
| | Signalling | 0 | 30 | The North London Line re-control and life extension project is a critical life extension project which involves closing the mechanical boxes and centralising the interlockings which enables future re-signalling works in the wider north London area. The scope of this activity was removed within the risk |

| Region | Asset type | ORR proposal | Network Rail proposal | Network Rail rationale |
|---|---|---|---|---|
| | | | | adjusted plan due to funding constraints but has been re-prioritised based on it being a significant driver of overall performance for Anglia and Eastern region.<br>At this stage, TA support the overall proposed increase in core renewals expenditure in Eastern region and recognise that further work is required to develop the scope. |
| | E&P | 0 | 20 | Eastern has identified that further expenditure is needed to enable continuity for investment in OLE renewals that commenced in CP6 but are required to conclude in CP7 across the Essex Thameside route of Anglia. Part of the justification for increasing expenditure in this area is to retain the required skills in supply chain to deliver these activities in CP7 and beyond.<br>The TA are supportive of the need to increase E&P renewals volumes in CP7 in Eastern region. Similar to the justification around track renewals, prior to this point in the planning process. This reflects Eastern's review of previous mitigations, including minor works and, in light of recent experiences agree that there is a need for a greater volume of E&P renewals activity in CP7. |
| Southern | Track | 50 | 0 | Southern region has not included additional track renewals in its CP7 plans as proposed within ORR's draft determination. The volumes that were removed as part of the move to our risk adjusted plans relate to planned strategic volumes in years 4 and 5. As such they were intended to manage the overall asset age profile and were not targeted at specific problem statements or identified safety risk.<br>The TA support Southern's decision to not include additional track volumes in its CP7 plan, on the basis that it expects Southern to be undertaking more track maintenance in CP7. We note that as part of the TA's assurance of our SBP, it did not identify a gap in track renewals volumes within the Southern SBP. |
| | Structures | 50 | 32 | Southern has considered further the profile of risk from structures and has identified £32m of additional renewals expenditure on structures assets in CP7 (including £11m for HAW which will be targeted at refurbishment of metallic structures across the portfolio rather than discrete renewals). The TA has undertaken a detailed assessment of structures volumes in Southern's CP7 plans, and supports the inclusion of c. £30m in additional structures renewals activity in CP7 (rather than ORR's proposed £50m). TA noted that ORR's proposed increase to £50m is much higher than what is required to bring structures volumes above minimum required levels. |

| Region | Asset type | ORR proposal | Network Rail proposal | Network Rail rationale |
| --- | --- | --- | --- | --- |
| | Earthworks | 80 | 122 | Southern has increased its earthworks renewals activity by 22% since its SBP, investing a further £122m over CP7. The additional Earthworks investment will deliver a further 115 additional effective volume units of renewals with an understanding that re-prioritisation will occur should emergency interventions be required. This increase is based on Southern's latest understanding of asset condition, which has been informed by further inspections and identification of developing risks.<br><br>The TA are supportive of Southern's inclusion of an additional £122m of earthworks renewals in its CP7 plans. This is c. £40m higher than ORR's proposal. This is largely due to the scope of Southern's earthworks volumes being broader than other regions, resulting in a higher overall cost. The TA are content that the proposed £122m increase covers the required additional volumes but will work with regions in CP7 to review and align the scope of earthworks renewals. |
| | Ops property / buildings | 50 | 0 | Southern has not included additional funding for Operational Property as it does not agree that reincorporating the renewal of Victoria station roof into the workbank offers value for money in a constrained funding scenario. Instead, Southern plans to use different interventions to manage the condition of the station roof during CP7. This has been discussed with ORR who have been supportive of this alternative approach. TA are also supportive of Southern region's rationale for not including funding for Victoria Station roof renewal in CP7. |
| | Signalling | 0 | 37 | Southern has included £37m of additional signalling renewals activity in CP7. Our TA fully support the additional £37m in signalling renewals to correct an error in our modelling. This was not a widespread issue, and related to a specific model that estimates the cost of signalling renewals in CP7 which is only used by two regions. The impact did not materially affect the other region. |
| Wales & Western | Track | 50 | 31 | Based on the latest asset information, Wales & Western have increased their track renewals expenditure by £31m which delivers a 4% increase in volumes overall, including 20 additional S&C units planned for intervention. Whilst this is lower than ORR's proposed £50m, Wales & Western consider that the £31m brings the level of activity above TA red lines, addressing ORR's feedback and that this is reflective of wider network prioritisation. |

| Region | Asset type | ORR proposal | Network Rail proposal | Network Rail rationale |
|---|---|---|---|---|
| | | | | TA supports the inclusion of an additional £31m of track renewals in Wales & Western on the basis it targets key areas of risk. TA noted that the full £50m proposed by ORR isn't required on the basis that it expects Wakes & Western to be undertaking more track maintenance in CP7. |
| | Structures and tunnels | 100 | 69 | Based on the latest asset information, Wales & Western have increased their structures expenditure by £69m which delivers a 64% increase in volume in CP7. Whilst the proposed increase is lower than the £100m proposed by ORR, Wales & Western consider that the £69m brings the level of activity above TA red lines, addressing ORR's feedback and that this is reflective of wider network prioritisation.<br>TA supports the inclusion of an additional £69m of structures and tunnels renewals in Wales & Western as this is required to support the strengthened stewardship of structures across the region. TA assurance at the time of the SBP set out that Wales & Western needed an additional c. £70m. Following further work with Wales & Western since the SBP, the TA continues to consider that this is sufficient to cover the gap. |
| | Earthworks | 100 | 85 | Wales & Western agreed with ORR's proposal to increase expenditure on earthworks assets in CP7, albeit by £15m lower than the £100m proposed in ORR's draft determination. Wales & Western considered that the level of proposed additional expenditure addresses the concerns raised by ORR and brings the level of expenditure above TA red lines. It also reflects the capacity of the supply chain to deliver additional levels of activity in CP7 (particularly considering lead times to mobilise for additional activity in CP7 Year 1).<br>The TA are supportive of Wales & Western's inclusion of an additional £85m of earthworks renewals in its CP7 plans. We note that this is £15m lower than ORR's proposal and this is largely due to the scope of Wales & Western's earthworks volumes being smaller than other regions, resulting in a lower overall cost. The TA are content that the proposed £85m increase covers the required additional volumes but, as noted above, it will work with regions in CP7 to review and align the scope of earthworks renewals. |

| Region | Asset type | ORR proposal | Network Rail proposal | Network Rail rationale |
| --- | --- | --- | --- | --- |
| Network | Fire safety (in tunnels) | 20 | 0 | At this stage, we haven't identified additional funding in our high-level plan updates for fire safety in tunnels. However, the TA will work with regions to continue to assess the relevant requirements in relation to fire safety and will provide an update as part of our delivery plan. |
| | Remaining high priority areas | 20 | 0 | We have identified other asset types that require additional expenditure which was not identified by ORR in its draft determination, as set out in this table (e.g. in Eastern). On this basis, remaining high priority areas have been identified elsewhere in this table. |
| **Total** | | **550** | **541** | |

Note: NW&C is not included in the table, above, as there is no proposed additional core asset expenditure compared to our SBP.

## Income shortfall

At the time of our SBP, our CP7 income forecast included a £283m overlay to reflect a gap between our SBP forecasts and income assumed in the England & Wales SoFA for CP7. We have provided a breakdown of the shortfall in income at the time of the SBP in table 2.3, below.

Table 2.3: Summary of income shortfall at the time of the SBP

| £m, 2023/24 prices | Shortfall |
|---|---|
| Property and other income | 104 |
| Freight and open access income | 74 |
| Schedule 4 | 105 |
| **Total** | **283** |

Since the submission of our SBP to ORR, we have reviewed the previously identified income shortfall and reduced this by £182m so that the remaining gap in our plans is £100m. We explain the key movements from our SBP in chapter 7 of this document.

## High output capability in CP7

ORR's draft determination proposed not refurbishing our high output ballast cleaning system (BCS) in CP7, delivering a saving of £41m as ORR assumed we would not deliver any high output volumes in CP7. This was because at the time of the SBP, regions had not committed to high output volumes in their plans. We have continued to review the requirements for high output capability and will retain one BCS in CP7 and beyond. We therefore need to retain this mandatory overhaul of the BCS in CP7.

We continue to work with regions to agree volumes of work in CP7. In particular, ahead of our delivery plan, we will undertake a deep dive to fully assess the requirements for the one BCS being retained in CP7 (and beyond).

The current BCS volumes in our CP7 plan do not yet fully utilise our BCS capacity from the one system being retained. Therefore, we have held a £150m provision in our plan (which forms part of the overlay) to capture the as yet unallocated high output costs. These costs were not included in our SBP. This is in addition to the £41m cost in 2024/25 for the mandatory overhaul of the BCS system, which is included in our Route Services plan.

We are retaining our BCS capability (through the retention of one BCS) as we consider we can effectively deploy the system in CP7, but also because it will form a key part of our CP8 delivery approach for track renewals. Removing our BCS capability in CP7 would remove our ability to deliver large track renewals during short windows of access to the network and we would also need to remobilise this capability in CP8 to prevent a longer-term sustainability issue in future control periods. Even if we were to keep the BCS in a 'warm storage' state during CP7, this would incur material costs, which we would need to factor into our plans. We are already right-sizing our high output capability in CP6 and so we aim to start CP7 with a lower overall cost of the high output function during CP7.

## Performance Improvement and Innovation Fund (PIIF)

ORR's draft determination sets out the case for including £40m in our England & Wales CP7 plan for a 'performance improvement and innovation fund' (PIIF), and that this should be included in the System Operator's plan. This is consistent with the current approach to managing the CP6 performance innovation fund (PIF) which was established at PR18 (although noting that this would not apply to Scotland's Railway, where a separate performance fund is proposed, which we respond to in the Scotland's Railway response).

Whilst the CP6 PIF has provided seed funding to over 100 innovation projects with 65 being completed to date, there are opportunities to build on CP6 use and management of the PIF. This includes how we can most effectively manage cross-industry investment in schemes which are innovative and / or seek to improve performance on the network.

Our SBP included £165m funding for RD&I in CP7 (GB wide, managed by our Technical Authority), of which c. £150m is allocated to England & Wales. This will contribute towards delivery of an outcome-focused, balanced portfolio. Improving the performance, reliability and capability of infrastructure is one of four key objectives from our RD&I investment in CP7, enhancing operational performance and supporting freight traffic growth.

From an England & Wales perspective, there is a strong opportunity to align the management and governance of the RD&I funds and PIIF in CP7. We have considered the £40m proposed by ORR, alongside the other expenditure and income pressures set out in our response. Recognising these wider challenges, we have included an additional £20m in the Technical Authority's expenditure for England & Wales taking total RD&I in England & Wales to c. £170m, with the £20m funded in opex and the remainder in RD&I capex. This will include a commitment to invest not less than £20m on performance improvement and innovation initiatives proposed by England & Wales regions and / or passenger and freight operators. This will also complement the approximate £35m of infrastructure performance-focused schemes included in the RD&I pipeline (allocated to England & Wales). Allocating the PIIF to Technical Authority CP7 expenditure in this way will allow us to draw on cross-industry collaboration and engagement with TOCs and freight operators (including innovation Boards), as well as benefiting from well-established Technical Authority RD&I governance arrangements.

While the £20m will be held in the Technical Authority's plan, it will be managed collaboratively with the System Operator with allocation overseen through a new board (or separate part of an existing board) chaired by the System Operator's Chief Network Operator. Ahead of the CP7 delivery plan we will review / revise the governance structure which will enable us to communicate to industry what PIIF will look like and what initiatives would likely be accepted for funding.

Looking ahead to the start of CP7, the System Operator will work with the Technical Authority on opportunities to align approaches to tracking and communicating benefits and supporting the business change associated with deploying new processes and technologies. We will set out further information on our approach to governance of the £20m PIIF element of the RD&I funds prior to the start of CP7 and will keep ORR updated as this work develops.

# 3. Funding the increase in core asset expenditure and additional funding pressures

## Key response points covered in this chapter

**Key response point 3:** To fund the increases in core asset renewals and the other funding pressures we have identified a range of specific savings (and income stretch) within region and function plans and included the remainder as an overlay of c.£600m (2.1%) in regional plans.

## Introduction

ORR's PR23 draft determination identified c.£800m of opportunities to fund the proposed increase in core asset renewals by reducing spend on programmes such as West Coast Main Line North (WCML (N)), digital signalling, Project Reach and Route Services' activities. In this chapter, we set out our proposals for how we can fund the proposed increase in our core asset expenditure in CP7 as well as the other expenditure and income pressures we face in CP7.

## Overview

We have reviewed ORR's suite of options to fund the increase in core asset renewals expenditure and also considered how best to address the additional funding pressures in our plan. To rebalance the funding in our plan, we have followed the principles set out in our SBP to protect safety and train performance whilst retaining 'right-sized' strategic priorities for the longer-term benefit of the network.

Additionally, given the significant uncertainty we face in CP7, we do not want to be overly reliant on a small number of areas in our plan to deliver savings. We also want to maintain as much flexibility as possible in our overall plan to enable us to respond to risk and uncertainty as we develop our delivery plan and during CP7. Therefore, we have developed an alternative approach to funding the increase in core asset renewals expenditure and funding pressures in our plans, set out below:

- We have reduced the level of funding for the WCML(N) programme by £100m (in addition to a £60m reduction in the programme due to the move from the full plan to the risk adjusted plan).
- We have reduced the level of funding for national programmes by c. £130m (of which £90m is within our Route Services plan for England & Wales).
- We have included a 2.1% overlay (c.£600m) within our regional plans to cover the residual at this stage in our CP7 planning.
- We have not further reduced the funding for cab fitment or digital signalling enabling activities in CP7.

- We have retained Project Reach within our plans, but have identified a small reduction of £4m in England & Wales' contribution, compared to the SBP, due to lower project costs offset by a change in the allocation approach.

We consider our approach strikes the right balance between protecting safety and train performance, not being overly reliant on a small number of areas to deliver savings and retaining essential flexibility in our planning. We provide more detail on each of the areas discussed above as well as the rationale for our proposed approach in the sections, below:

## WCML(N) reduction

ORR proposed that we reduce the level of funding to the WCML(N) programme by 25% (i.e. £300m) in CP7 as it considered that complex programmes with large numbers of interactions with external stakeholders, like WCML(N), tend to be delayed. We recognise ORR's concerns set out in its draft determination.

Therefore, we have undertaken a review of the WCML(N) programme, led by experts from our Finance, Technical Authority and Capital Delivery Scotland teams (and independent of the programme) to assess the maturity and deliverability of the CP7 elements of the WCML(N) programme. This review was used to establish appropriate levels of funding required for CP7. This review has not focused on the Crewe programme of work as the Crewe works are well defined, and delivery is actively progressing with costs mature and understood. Therefore, the review focused on c. £520m of activity associated with WCML(N) in our risk adjusted plan, which largely comprises of digital signalling infrastructure renewals. Further information is included in North West & Central's response.

We have summarised the key findings of the independent review, below:

- The timing of critical assets reaching life expiry and the need to renew these assets in advance of HS2 entering service presents a unique opportunity to coordinate activity into one focused delivery programme.
- A significant volume of activity is required to develop the scope of the programme with multiple stakeholders involved.
- The proposed delivery model is complex with both commercial and access strategies in early stages of development.
- The majority of the signalling spend is associated with a relatively new technology, which may be procured from a new supplier, therefore affecting the deliverability of the programme.
- There are opportunities for the programme to reduce their costs further to account for the efficiency opportunities achieved as a result of being an integrated programme (e.g. maximising access opportunities).

Based on the findings of our independent review, we agree that there is an opportunity to reduce the funding allocated to the WCML(N) programme in CP7, albeit not by £300m as proposed by

ORR. Given that the Crewe programme is well developed and underway, we think the opportunity to reduce funding to the WMCL(N) programme comes from the remaining c. £520m allocated to the rest of the programme. Recognising this part of the programme is at an earlier stage of development, we have reduced the level of funding by £100m in CP7 (in addition to a £60m reduction in the programme due to the move from the full plan to the risk adjusted plan). This saving will be achieved, in part, by reducing the costs of some parts of the programme (i.e. not just delaying some activities until CP8).

More broadly, we plan to 'soft ringfence' funding for WCML(N) (as well as the digital signalling portfolio) so that if there is an underspend in this area, this funding can be used for priority needs on the England & Wales network, or else retained for the risk fund (i.e. not retained for reallocation within the relevant region).

## Reduction to national programmes

ORR's draft determination proposed that we reduce the level of England & Wales funding allocated to Route Services by c. £90m in CP7 (£100m network-wide). We have accepted ORR's proposal and have reduced Route Services' funding accordingly. At this stage in the planning process, Route Services has provided an indicative set of reductions to national programmes to achieve the £100m target. As discussed in more detail, below, we will undertake a series of deep dives with regions to explore the programmes that could deliver these potential reductions ahead of our delivery plan, which will include identifying any knock-on impact on regions' delivery in CP7.

We have also identified a further c. £40m savings from our other national functions' plans relating to England & Wales expenditure. This includes a £18m reduction to our Technical Authority plan, £18m reduction to our System Operator plan and £5m from our Corporate Services (including Group Property) plan. More information on the breakdown of these savings are discussed in our System Operator and national function response documents.

## Overlay to regional plans

After accounting for the changes to our plans described above, to fund the increase in core asset renewals and wider funding pressures, we are left with a remaining gap of c. £600m in our plans (depending on the extent of funding required to support high output). To fund this gap, at this stage in the planning process, we have included a modest overlay in our regional plans (2.1% of regions' total plans). Overlays are a pragmatic way to deal with the challenges and uncertainties we face in CP7, at this stage. The modest overlay provides regions with additional time to identify which activities could be de-scoped or deferred to fund additional expenditure and identify any impact this will have on outcomes in CP7.

At this stage, we have not sought to adjust our outcomes to reflect the overlays in our plans, although we expect that some will be impacted once the overlay is worked through. We will use ORR's managing change process to update the outcomes for CP7 between the final determination and CP7 delivery plan, and during CP7 where required.

We have developed a high level 'overlay management plan' that sets out our overall approach to addressing the overlay in our plans across two broad phases:

- **Phase 1: Reducing the size of the overlay ahead of the start of CP7 where possible:** We will undertake cross-company deep dives on key issues that may contribute to reducing the overlay, noting any impact on outcomes. We will continue ongoing TA assurance to challenge appropriateness of plans and will also continue to work on market-led and whole industry planning to identify any opportunities for savings.
- **Phase 2: Managing any remaining overlay within the control period**: Assuming there remains an overlay after the work above, it will be shown in the CP7 delivery plan, allocated to each region. The expectation is that overlays will be managed through natural slippage across the wider region plan (the current overlay is c.£20m-40m per year for each region or 2.1% of plans). With a soft ring fence around key programmes like WCML(N) and digital signalling spend, any underspends in these areas will help to reduce the overlay, whilst regions and functions will continue to explore further opportunities to reduce costs across their plans. Our rolling forecast process will be used to review and track progress against overlays as part of wider business plan / risk funding updates.

We will keep ORR updated as our phase one work progresses including any expected changes in outcomes required as a result of addressing the overlays in our plans.

## Digital signalling

Our digital signalling portfolio comprises ETCS-based signalling renewals, ETCS onboard fitment to the associated fleets, RD&I activity and other enabling activities. Funding associated with each of these activities is allocated to the relevant business area (e.g. signalling renewals costs sit with regions).

ORR's challenges around our digital signalling portfolio focused on the deliverability of our digital signalling renewals and the associated unit rates that have been used for these projects. On this basis, ORR's draft determination proposed reducing funding for our digital signalling portfolio by c. £260m in CP7.

**Digital signalling infrastructure renewals, cab fitment & enabling projects**

As described in the section above on the WCML(N) programme and within our North West & Central response, we recognise ORR's concerns around the deliverability of our digital signalling infrastructure renewals activity within the WCML(N) programme. Therefore, £100m of the total £160m reduction to the WCML(N) programme accounts for the reprofiling of some digital signalling infrastructure renewals. We are also evaluating further opportunities across other select infrastructure renewals schemes through minor re-phasing and scope efficiency and will confirm these in our delivery plan. Given the overlap with the £100m reduction accounted for in the WCML(N) section above, we do not think that there is any further opportunity to reduce the digital signalling infrastructure renewals in CP7.

We have also considered opportunities to reduce cab fitment expenditure in CP7. Following this review, we consider that a further reduction in funding to the cab fitment programme (noting that we have already made a c. £300m reduction as part of the move to the risk adjusted plan) would have a disproportionate impact on our digital signalling objectives, by requiring network-level fleet fitment to be slowed, thereby delaying the earliest dates at which ETCS renewals can be delivered, and jeopardising our ability to affordably renew the volume of signalling equipment required in future control periods.

However, given the scale of funding to the cab fitment and ETCS enablers programme, and consistent with the approach described in the WCML(N) section, we plan to 'soft ringfence' this funding so that if we underspend during CP7, it can be used for priority needs on the network, or else retained for the CP7 risk fund.

In our SBP, delivery of an aligned infrastructure and fleet fitment plan required drawdown from unallocated Group Risk provision; we note ORR's expectation for all digital signalling spend in CP7 to be fully allocated and will address this in more detail within our delivery plan.

**Digital signalling unit rates**

ORR considers that our unit rates for digital signalling infrastructure renewals starting in CP7 should more closely reflect the forecast unit rates developed for the East Coast Digital Programme (ECDP). These rates include the benefit of supplier experience and sunk cost in prior stages and exclude some site-specific costs, covered at programme level. Following review, we believe our unit cost model continues to be an appropriate basis for planning at this stage of development, and do not support proposals to apply a further efficiency challenge to these rates at this stage.

Over the course of CP7, we will continue to refine our unit cost models to take account of data from ECDP and other schemes, engagement with suppliers through the Train Control Supplier Framework (TCSF) and to apply the emergent outputs of the Target 190+ programme to our future planning.

## Project Reach

ORR's PR23 draft determination suggested that we consider removing Project Reach from our CP7 plan on the basis that it considers that it is not a priority for CP7 – delivering a saving of c. £141m. However, ORR also recognised Network Rail's commitment to the project and that other options for realising savings may be preferable.

We remain fully committed to delivering Project Reach. This represents a unique opportunity to bring in significant private sector funding to renew telecoms assets, enabling the early renewal and upgrade of our telecoms assets (at a much lower cost than if we were to wait until the assets were near life expiry) and will deliver a number of safety, resilience and efficiency benefits. For example, the early renewal of our telecoms assets will enable the transition to modern network architecture that is cheaper to deploy and more resilient to failure, reducing the current burdensome demand for 'boots on ballast' to maintain near end-of-life telecom equipment in order to prevent disruption to live railway services.

Project Reach will also deliver wider benefits for passengers and society more broadly, including bringing high-count fibre to rural communities, and delivering improved mobile coverage for passengers on the three mainline routes (particularly in areas that are unlikely to see improvement without intervention from Project Reach, as they pose significant geographic challenges for Mobile Network Operators).

In light of this, we have retained Project Reach in our CP7 plans and remain committed to the successful delivery of this programme in CP7. Since the SBP, we have reviewed and updated our overall forecast of Project Reach costs and benefits, which brings overall spend across GB to £147m (£186m in our SBP). This is largely due to a delay to the start of the programme and a reduction in the kilometres of new fibre funded by the partner. We have also reviewed the allocation of Project Reach funding between England & Wales and Scotland, reflecting that the majority of benefits are expected to fall to England & Wales. Based on the latest allocation of costs, there is a modest reduction to England & Wales' Reach costs in CP7 from £141m in the SBP to £137m. We will keep the Reach cost / benefit allocation under review during CP7 and adjust the allocation if we change our assessment of the benefits that accrue to Scotland.

# 4. Financial adjustments and risk

## Key response points covered in this chapter

**Key response point 4:** We accept ORR's move to our 'risk adjusted' plan for England & Wales and have moved c.£1.5bn of 'contingent' funding in region plans to the 'cash risk' fund.

**Key response point 5:** There is uncertainty around inflation and input price estimates in CP7. While we consider that our latest input prices assumptions are robust, we have held c.£1bn of our £1.7bn input price inflation in our cash risk funding.

**Key response point 6:** Once adjustments have been made for the latest view of inflation and input prices, our total CP7 cash risk fund is c.£1.5bn. We continue to face significant uncertainty in CP7, including from inflation, input price estimates and wider risks, and if these materialise at a significant scale – they will exhaust the available cash risk funding.

## Introduction

This chapter responds to ORR's financial proposals in its draft determination, and it sets out the key changes to our CP7 plans in light of our acceptance of ORR's proposals and due to other developments. It covers the move to the risk adjusted plan, our evolving understanding of the impact of inflation and input prices on our plan, and the management of financial risk and uncertainty in CP7.

## Move to risk adjusted plan

ORR's draft determination assumes that we follow the risk adjusted plan set out in our CP7 SBP, which removes £1.5bn of contingent activity (mainly renewals) from our 'full plan'. ORR proposes that we hold this funding as cash risk funding instead.

We accept ORR's move to our risk adjusted plan for England & Wales. In our latest high level updates to our CP7 plan, which we have shared as part of our response, we have moved £1.5bn of 'contingent' funding from region plans to the 'cash risk' fund. However, reflecting the impact of the latest inflation forecast, which we discuss below, this risk funding is absorbed by the impact of inflation and input prices that we have identified since our SBP submission in February.

We welcome that ORR has recognised that moving to the risk adjusted plan means reduced outcomes compared to our full plan (although it is not clear how it has reflected lower renewals in its performance trajectory setting). We discuss this further in chapter 5.

## Inflation, input prices and headwinds

### Inflation

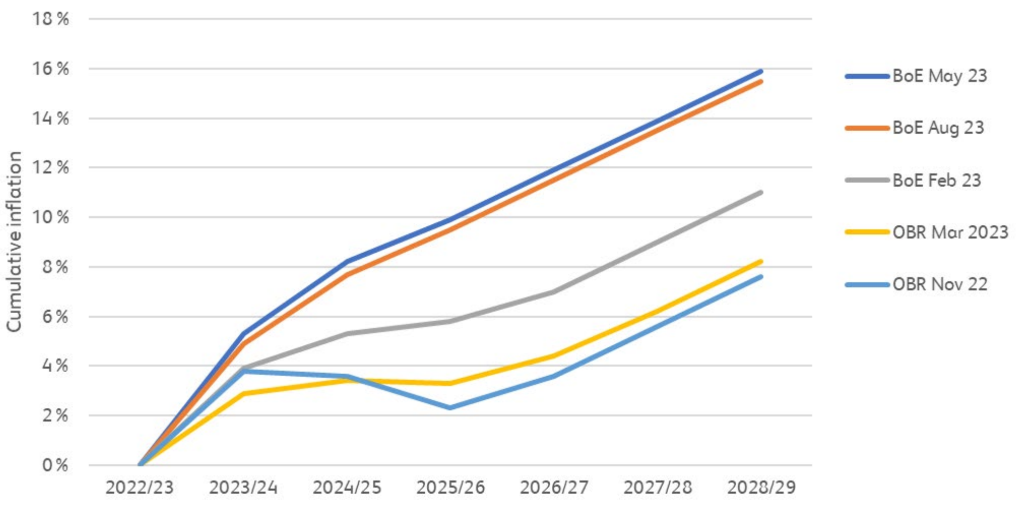
Since the Office for Budget Responsibility (OBR) inflation forecast, used in the SoFA and SBP, was published in November 2022, there have been four new inflation forecasts: March 2023 OBR, and the February 2023, May 2023 and August 2023 Bank of England (BoE) forecasts. Our latest high level CP7 plan updates provided with this response reflect the May 2023 BoE update, given that the August forecast came too late to include in region and function plans, and had not moved materially since the May 2023 outlook.

We have, however, carried out a high-level assessment of the impact of the latest August 2023 forecast on our plans that we have reviewed. Whilst inflation for 2023/24 is marginally lower than the May 2023 forecast, inflation through CP7 is largely unchanged. Our initial estimate of the impact on our CP7 plan from this latest forecast is that, when combined with our latest view on how staff costs may move to reflect changes in inflation, there is no increase in our net CP7 cost. Therefore, we think that our response is broadly consistent with latest forecasts.

As shown in figure 4.1, recent inflation forecasts are materially higher than the November 2022 OBR forecast. We note that ORR's draft determination took account of the impact of the March 2023 OBR forecast by recognising an additional cost to our plan of c.£600m. ORR's analysis of the CPI impact broadly reflected our own assessment at the time. However, since then, the outlook has deteriorated.

The May 2023 BoE forecast is significantly higher than the March 2023 OBR forecast used by ORR and so our latest plan updates need to recognise the higher cost of inflation. Compared to our SBP, the impact of CPI inflation, before any updates for input prices or headwinds is £1.4bn for England & Wales across CP7 (i.e. £800m higher than assumed by ORR's draft determination).

Figure 4.1: CP7 cumulative inflation forecasts (OBR and Bank of England)




Source: Bank of England and Office for Budget Responsibility inflation forecasts

**Input prices**

We have also updated our input price assumptions as part of our plan updates. Our latest input price assumptions total £1.7bn over CP7, which is £0.4bn higher than our SBP. Our assumptions are higher because they now reflect a greater understanding of how the current high, but falling, inflation environment is likely to impact our costs in CP7. Our latest assumptions, which are informed by analysis we have commissioned from Oxera, are significantly higher than the £0.7bn assumed by ORR in its draft determination (which reduced our assumptions at the time by £600m), based on analysis by Europe Economics.

We consider that Europe Economics analysis was flawed because:

- It did not take account of the current inflationary environment – in particular the effects of inflationary contractual increases, which use backward-looking indices, which reflect a period when inflation was higher, which will lead to additional input prices over CP7.
- It applied a generalised model originally developed for the water sector that does not reflect Network Rail's unique circumstances compared to the other regulated industries.
- It was systematically biased against identifying input prices – in particular, it was too focused on mitigating the risk of finding them where there are none, at the expense of failing to find input prices where they are likely. For example, EE's analysis uses a small number of data points and uses strict statistical significance criteria, which is inconsistent with regulatory precedent. We estimate that there is only a 15–30% chance that EE would correctly identify RPEs if they do exist in several parts of its analysis.
- The use of materiality thresholds meant that input prices for about 21% of opex and 13% of renewals were not considered. Thresholds were also applied inconsistently, allowing negative input prices for electricity when it is only c.2% of opex.

Our high level CP7 plan updates that our regions and functions have submitted as part of our draft determination response reflect our latest assessment of input prices. This incorporates updated contractor and materials forecasts from BCIS and latest pay forecasts for CP6 and CP7 since the SBP.

A key factor driving higher input prices in CP7 is the impact of the lag between when contractual uplifts are applied compared to the headline rate of inflation. For example, contracts that have effect in 2024/25 will generally use quarter 4 2023 outturn inflation to uplift costs for 2024/25. Whilst this lag would normally be immaterial when inflation is relatively stable, the expected rapid slowdown in inflation from significantly higher levels of inflation means that contractual costs for 2024/25 are expected to be higher than the in-year inflation. Our contractual approach has delivered input price benefits earlier in CP6 (i.e. when headline inflation was rapidly rising and many of our costs were rising by inflation contractually linked to the previous year's inflation).

Excluding lag impacts, discussed above, our latest analysis suggests that our pre-efficient costs are subject to cost increases (assuming a stable inflationary environment) of CPI+0.5% for opex and CPI+1.1% for renewals. Opex costs are expected to increase by more than CPI. For renewals, costs increase by more than CPI because our materials and contractor prices have generally risen quicker than headline inflation. Including lag impacts that we expect to see at the start of CP7, pushes up our input prices assumptions. They increase to CPI+1.0% for opex and CPI+1.7% for renewals.

Table 4.1 sets out input price assumptions from ORR, Network Rail and Oxera. Whilst there are some differences between our own estimates and those from Oxera, both are materially higher than ORR's draft determination assumptions. Our latest assumptions are slightly higher than

Oxera's due to a combination of different modelling approaches (Oxera's being more high-level) and the use of slightly different source data.

Table 4.1: Input price assumptions for opex and capex

| Assumptions | Opex | Capex |
|---|---|---|
| SBP | 0.5% | 1.8% |
| ORR draft determination | 0.3% | 0.5% |
| Oxera analysis | 0.9% | 1.4% |
| Network Rail latest (excl. lag) | 0.5% | 1.1% |
| Network Rail latest (incl. lag) * | 1.0% | 1.7% |

* Our plans include the inflation lag affect into input prices as described above, this significantly impacts year 1 and 2 whilst inflation is falling which affects the average for the control period.

We recognise that there is an element of uncertainty in forecasting inflation and input price effects over a five-year period. Therefore, whilst we consider that our latest input prices assumptions are robust, our draft determination response shows £1.0bn of our £1.7bn input price assumption being held in risk funding (leaving the £0.7bn, which ORR recognised in its draft determination, in region and function plans), which forms part of the £1.5bn risk funding explained below.

**Headwinds**

We have revised our headwinds assumptions in region and function plans since the SBP. At the time of the SBP we proposed reducing headwinds by 50% as a result of constrained funding and the significant impact of inflation and input prices on our CP7 plan. However, given the tight timescales, we did not flow this proposal through to our region and function plans. ORR's draft determination agreed with our proposed reduction in headwinds. Our high level CP7 plan updates are broadly consistent with the draft determination proposal as we have now reduced the headwinds in region and function plans by 50%.

This change represents a stretch in our plan against our past experience of headwinds and so we will have to work with ORR to manage expectations on our ability to absorb the types of impact that the headwinds funding is designed to accommodate, such as additional activity from more stringent standards.

Note that our latest assumptions reflect some re-categorisation of headwinds in Route Services into pre-efficient cost changes and input price effects to better reflect the nature of these costs. Overall we have reduced the headwinds in region and functions plans, compared to the SBP, by £0.3bn, compared to ORR's draft determination assumption of £0.4bn.

**Net impact on our plans**

The combined effect of changes for inflation, input prices and headwinds compared to our SBP are shown in table 4.2.

Table 4.2: Impact on CP7 plans from inflation, input prices and headwinds

| £m, 2023/24 prices | Change in costs from SBP |
|---|---|
| Input prices | +0.4 |
| CPI inflation impact | +1.4 |
| Headwinds adjustment | -0.3 |
| **Overall impact (in cash terms)** | **1.5** |

## Financial risk and uncertainty

Our CP6 approach of holding funding outside our core plan to manage risk and uncertainty during the control period, accompanied by budgetary flexibilities agreed with Government, has generally been seen as successful at mitigating externalities and supporting the efficient delivery of our CP6 plans.

Whilst recognising the funding constraints we face for CP7, we have sought to retain the key benefits of our CP6 approach in CP7. Our SBP included £2bn of risk funding, made up of £500m cash risk funding and £1.5bn of funding for contingent activity in region plans. It also assumed the continuation of government financial flexibilities. However, ORR's draft determination proposed that our CP7 plan includes £2.15bn of cash risk funding in CP7 created by: a) moving the £1.5bn of contingent activity into cash risk funding, and b) including £0.15bn of funding from ORR's assessment of headroom following a number of adjustments to our financial assumption (e.g. inflation, input prices, headwinds).

We recognise the importance of including risk funding in our plan, given we have no other material sources of funds in the control period that other regulated businesses may have, such as issuing debt or equity. However, we do not consider that there is now sufficient funding available to entirely follow ORR's proposed approach. The principal reason is the impact of the higher inflation forecasts that we have seen since the SBP. Whilst we accept ORR's proposed move of £1.5bn of contingent risk funding into cash risk funding, this has been absorbed by the additional c.£1.5bn of additional cost from the higher costs of inflation and input prices (net of headwinds reductions).

As discussed in the section above, our high level CP7 plan updates assume that we hold £1.0bn of our £1.7bn input prices assumptions in cash risk funding. This means there is a total cash risk fund of £1.5bn – with the ultimate value of this dependent on how input price effects materialise during CP7.

We recognise that this level of risk funding is lower than ORR's proposal, and it does leave a tight plan, but we consider that this is manageable – not least because we have used the risk funding for precisely the reason it was designed.

We do not think it is necessary, or helpful, to take out further activity from plans now to increase risk funding, given that assessing the 'correct' level of risk funding is not an exact science. Instead, we propose maintaining a strong focus on cost management and programme oversight during the control period to mitigate risks and live within our overall funding envelope for CP7. The flexibility of ORR's approach to managing change will be important in successfully managing risks in CP7. We have noted in the previous chapter that we will 'soft ring fence' the WCML(N) and digital programme funding and if there is any programme slippage we could add these funds to the risk fund; and the further work to develop market-led initiatives could feasibly also provide additions to the risk fund.

We have updated our statistical analysis and our assessment of the key drivers of financial risk in our plan. This analysis reflects that we have absorbed £1.5bn of inflation costs into our core plan since the SoFA funding was determined, and that we expect materially lower Schedule 4 and 8 costs in CP7 (subject to ORR's final determination on this issue):

- Our statistical analysis suggests that we would require an additional £2.7bn of funding to have an 80% likelihood of delivering our planned outputs (i.e. P80).
- Our high-level assessment of the main drivers of risk in CP7 covers risks such as those arising from the Schedule 4 & 8 regimes, inflation, efficiency and income. Our top-down analysis suggests a total of £3.7bn for these risks on a mid-to-worst case basis. We discuss these risk drivers further in chapter 6.

We recognise that the risk funding in our current plan is materially lower than CP6. However, our experience of CP6 gives some reassurance that we can manage within current levels of risk funding. In CP6 we used £1.3bn of risk funding on risks that materialised during the control period, such as Covid-19, higher inflation and industrial action. The remaining £1.4bn was spent on additional activity. Given the funding constraints we face, we do not think we have sufficient funding available to hold a higher value of risk funding, which means that we will have to continue to keep a tight focus on cost control and retain as much flexibility as possible within our plans to react to changes in circumstances during the control period. In chapter 6, we discuss further how we would likely respond to a situation where the impact of risks materialising is greater than the risk funds available.

ORR's draft determination also explains that it intends to increase our scrutiny of and, transparency around our management of financial risks in CP7. Since the publication of the draft determination, we have been working with ORR, DfT and HMT to agree principles for the use, and oversight, of risk funding. We welcome continued discussions with ORR and Government to confirm these arrangements for CP7.

# 5. Outcomes (with a focus on train performance)

## Key response points covered in this chapter

**Key response point 7:** We have raised with ORR our significant concerns around its proposed approach to setting CP7 train performance trajectories. Recent discussions with ORR to find an alternative, more appropriate, approach to setting the CP7 regulatory baselines for train performance (the '2+3' approach) are a constructive step forward, however it is essential that targets for years 1 and 2 of CP7 are realistic and underpinned by credible assumptions and evidence.

**Key response point 8:** We welcome that ORR has accepted our overall efficiency target of £3.2bn for the risk adjusted plan. Delivering these efficiencies will be extremely challenging not least given the nature of the approach it has been necessary to take to asset renewals.

## Introduction

ORR's draft determination includes proposed baselines for each CP7 regulatory success measure ('tier 1'), in which it would hold Network Rail to account against. We welcome that ORR has recognised that moving to the risk adjusted plan means reduced outcomes compared to our full plan, although it has not recognised this for its proposals on train performance outcomes.

Our Scotland and England & Wales region response documents respond to ORR's proposed regional baselines for regulatory success measures and our System Operator response document responds to ORR's proposals for holding the System Operator to account. This chapter provides a summary of our response across England & Wales (and Great Britain where relevant), including on ORR's approach to developing regulatory baselines. A summary of our key points for each measure is set out in table 5.1. We have not sought to structure this chapter by the government's five long-term strategic objectives for the railway or our strategic themes as we have focused our response around ORR's proposals. However, we will seek to align our delivery plan to our strategic themes.

Table 5.1: Summary of our response to ORR's draft determination outcomes proposals

| Area | Measure(s) | Key points |
|---|---|---|
| Safety | Fatalities & Weighted Injuries<br><br>Train Accident Risk Reduction | Safety measures are specified as regulatory supporting measures (tier 2) rather than success measures in ORR's draft determination. We remain strongly committed to the safety forecasts for our risk adjusted plan, set out in the SBP. We will update our forecasts for tier 2 supporting measures in our CP7 delivery plan. |
| Passenger Train Performance | Passenger On Time<br><br>Passenger Cancellations | We have significant concerns with ORR's draft determination approach to setting performance trajectories, the metrics it has chosen, and the credibility of its performance expectations. ORR's alternative proposal to set trajectories for train performance (the '2+3' approach) is a constructive step forward, however it is essential that targets for years 1 and 2 of CP7 are realistic and |

| | | |
|---|---|---|
| | | underpinned by credible assumptions and evidence. We will provide supporting evidence to inform ORR's final determination between this response and 14 September 2023. |
| Freight | Freight Cancellations<br><br>Freight Growth | We do not agree that ORR's proposed trajectories for freight performance are credible, particularly given the volatility of the measure and the inherent uncertainty in forecasting. We will provide supporting evidence to inform ORR's final determination between this response and 14 September 2023.<br><br>ORR's draft determination accepts our methodology and forecasts for freight growth. We have not made any changes to these forecasts. Delivering freight growth is also dependent on there being sufficient demand from freight users and freight operators willing and able to provide haulage. |
| Efficiency | Efficiency<br><br>Financial Performance Measure | ORR's draft determination sets efficiency baseline trajectories for each region in line with our risk adjusted plan. There are challenges to delivering these targets, including the impact of inflation and delays to rail reform legislation. ORR will also monitor the financial performance measure through CP7, with trajectories set to monitor performance against annual budget. |
| Environmental sustainability | Scope 1 & 2 carbon reduction<br><br>Biodiversity | We are accepting ORR's proposed baselines for all regions. We will continue to develop detail on the activities that will contribute to our targets to support regulatory monitoring in CP7. |
| Asset sustainability | Composite sustainability index | Having reflected changes to our renewals expenditure in our plans for CP7, we are providing ORR with a more accurate forecast of CSI to inform the final determination. |

As set out above, we have included a 2.1% overlay in regional plans. Addressing the overlay will require careful trade-offs and could affect the plans for delivery of some outcomes. However, at this stage, it is too early to quantify the impact. We will keep ORR and stakeholders sighted on our thinking as it evolves and apply ORR's managing change policy as required.

Beyond this, we will need to evolve our plans to respond to emerging risks and continue to balance outcomes within our funding settlement. The level of uncertainty we face in CP7 reinforces the need for a flexible approach to monitoring outcomes and holding Network Rail to account, including an effective managing change policy to enable us to respond appropriately when risks materialise. We provide our response to ORR's policy proposals in chapter 8.

## Safety

ORR's draft determination does not set out tier 1 success measures for health and safety monitoring in CP7 (as health and safety legislation compliance takes precedence). However, Train Accident Risk Reduction and workforce Fatalities and Weighted Injuries are both tier 2 supporting measures which we provided forecasts for in our SBP and remain an important part of our business planning.

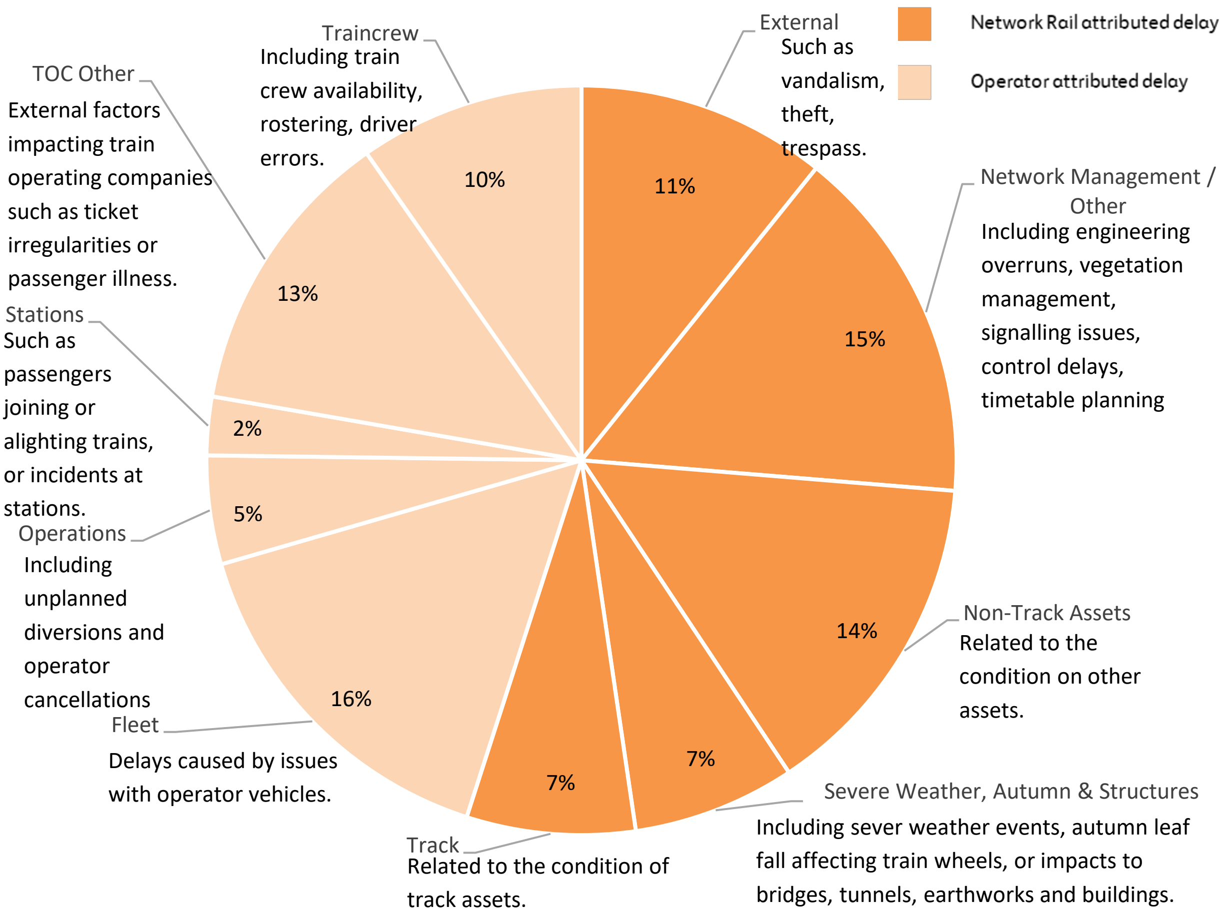
We will deliver a safe plan in CP7 to support our vision to get ‘everyone home safe, everyday’, and remain strongly committed to the Train Accident Risk Reduction and workforce Fatalities and Weighted Injuries forecasts for our risk adjusted plan, set out in the SBP. Chapter 7 provides more detail on the further work we have done to understand the change in safety risk profile (between CP6 and across CP7) further and identify suitably effective risk controls.

We will provide updated forecasts for tier 2 supporting measures in our CP7 delivery plan (subject to working with ORR to address our response on the regulatory monitoring framework in chapter 9).

## Passenger train performance

ORR’s draft determination highlights the importance of realistic and ambitious train performance targets for CP7. We have been clear in our ambition to deliver the best possible train performance, and that we want to improve performance in CP7. It is fundamental to grow the confidence of passengers, freight and stakeholders in rail and underpin continued volume and revenue growth. As a whole industry outcome (with train operators responsible for around 45% of train delay) this will require close alignment and strong collaboration between Network Rail and operators. Figure 5.1 shows the main factors impacting passenger train performance in CP6 to date (July 2023) and their relative delay contribution, and how delays are attributed to Network Rail or Train Operators (noting that the splits are largely as we set out in our SBP).

Figure 5.1: Factors impacting train performance in CP6




ORR's draft determination approach risks creating misaligned incentives between Network Rail and operators through setting point value targets for all years of CP7, the metrics it has chosen, and the draft baselines it has set. Since publication of the draft determination we have engaged with ORR to set out our concerns. We see the approach to date as inconsistent with DfT's HLOS expectation that the targets are not only ambitious but also realistic and align with train operator plans. ORR's approach does not provide the space needed to align with the development of train operators' annual business plans, and proposed trajectories are not supported by credible evidence.

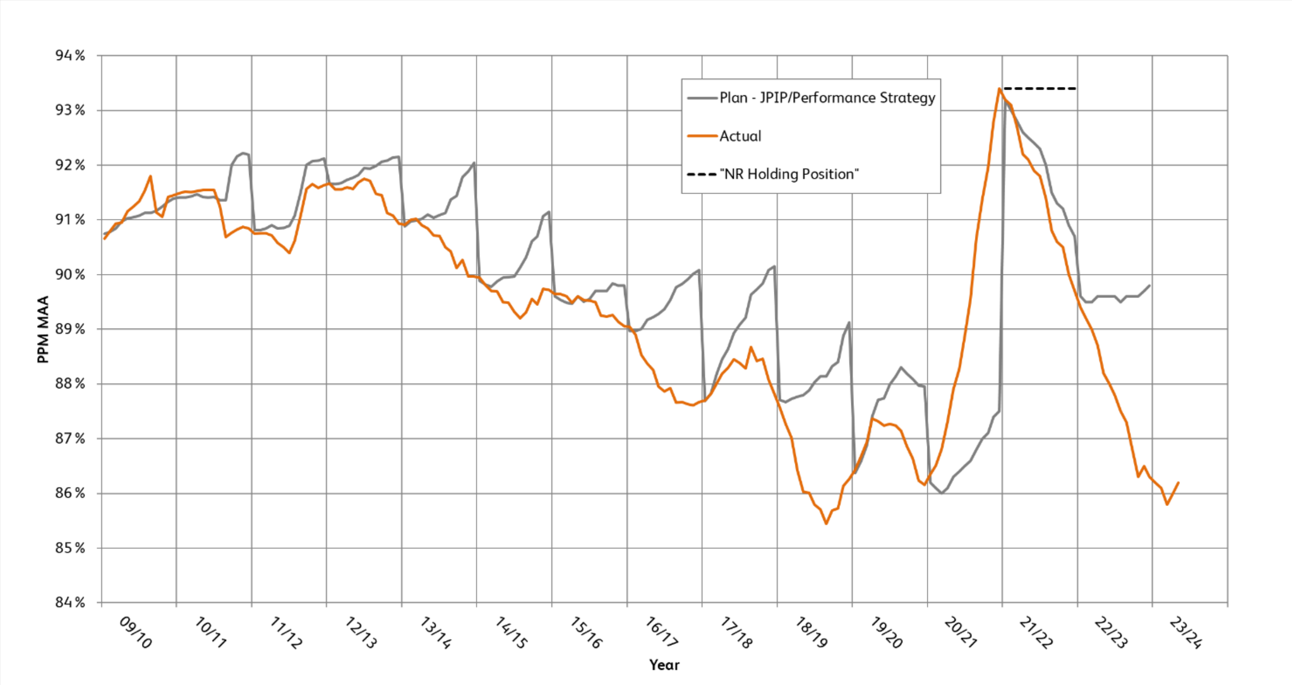
This section summarises our concerns with ORR's draft determination approach (including our view on ORR's emerging alternative proposal), metrics and proposed trajectories for passenger train performance. Our response on freight train performance is in the following section. Scotland's Railway's response addresses ORR's Scotland specific proposals. We strongly encourage ORR to review and reflect on the evidence we are providing alongside this response to inform credible regulatory baseline trajectories in the final determination.

**Approach to setting regulatory trajectories**

For each England & Wales region, ORR's draft determination sets point value trajectories for On Time and Cancellations for all years of CP7 (at or beyond the most challenging end of our forecast ranges). We do not think that this approach recognises the inherent uncertainty in forecasting train performance, or the wider industry processes that make this impossible to do properly at this time, and does not enable effective alignment with train operator plans. We provided our SBP forecasts as ranges to recognise these factors.

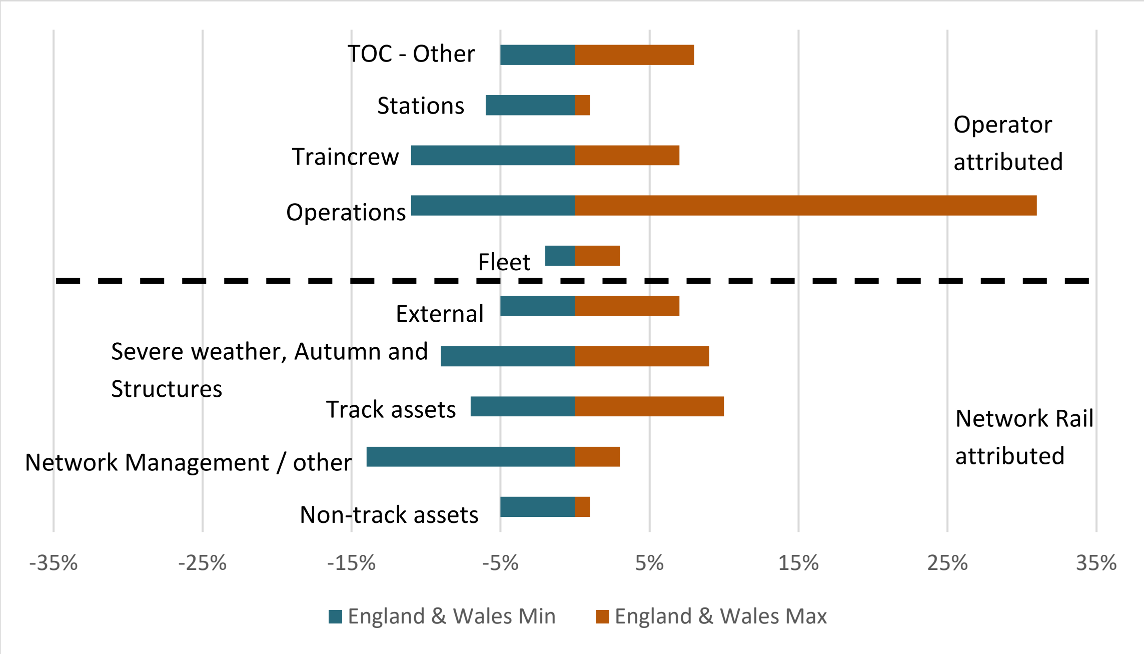
Train performance is influenced by many factors that all impact on each other. As shown in figure 5.2, the past 15 years have demonstrated the industry's inability to set realistic industry train performance targets. We provided a version of this in our SBP, and the below demonstrates the continued challenges in setting realistic targets for performance.

Figure 5.2: National PPM (Public Performance Measure) actual compared to target.



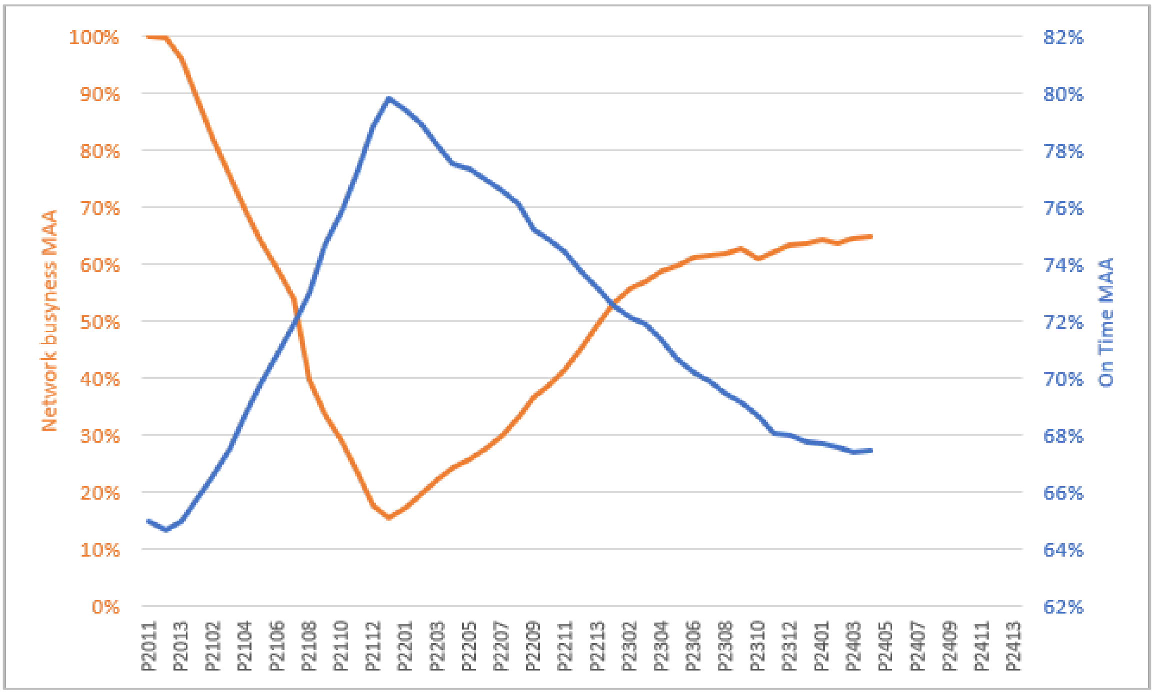

This is due in large part to the variability in factors such as weather and uncertainty around external factors (such as trespass – see figure 5.3 for more detail). Forecasting for CP7 presents even more of a challenge, with many inputs that we know to materially impact train performance still uncertain. These include service patterns (which will be influenced by DfT and operators' annual business planning decisions) and passenger numbers. Figure 5.4 shows the correlation between network usage and punctuality. There remains wider uncertainty around the ongoing impacts of industrial action and contractual arrangements mean that some industry parties may be reluctant to provide honest forecasts of performance if the reality is not aligned with contract assumptions and targets, even if indicative.

Figure 5.3: Delay per 1,000 train miles variability by category relative to projected performance




Note: This graph shows minimum and maximum values from 2014/15 to 2022/23 (with relevant adjustments for years impacted by the pandemic)

Figure 5.4: On Time relative to network usage




Note: Network busyness is a proxy measure derived from the product of weekday train count and Network Rail managed stations footfall (each appraised as a percentage of pre-Covid-19). The calculation is simplistic in using the average of the last 13 period values.

But most notably, Network Rail cannot develop robust train performance forecasts for whole industry performance measures without appropriate input from operators. ORR's draft determination notes that Network Rail is responsible for around half of all delay, with operators responsible for the other half. ORR's draft determination states that point values have been used to provide clarity on the performance levels against which it will monitor Network Rail. We have found ORR's draft determination to provide absolutely no clarity on this as it does not set out the expected Network Rail, operator or external contributions to whole industry performance baselines. We have separately asked for that clarity in correspondence between the issuing of ORR's draft determination and the submission of this response (i.e. our letters of 13 July and 8 August) but this has not been forthcoming.

Fundamentally, given that operators are contractually obliged to develop their business plans only annually, there is very limited information on train operator plans or performance assumptions for CP7. This includes 2024/25, where the annual business planning process is yet to be finalised, and which will establish the contractual commitments for operators. It is essential for the whole-industry measures that Network Rail is being regulated against (On Time and Cancellations) that train operator assumptions are properly considered in the regulatory target setting process. Performance expectations for DfT operators for future years are indicative only, where they exist, and are only formally established shortly ahead of the relevant financial year. Moreover, those forecasts especially for 2024/25 are likely to take a conservative view on the sustained impact of industrial action given that there is no prospect of resolution in sight. We do not understand why ORR would find it legitimate to take a more optimistic view than DfT.

We understand that, as we submit this response, ORR still intends to set regulatory baselines for train performance as point values in the final determination. However, we have had constructive discussions with ORR and in light of the issues we have raised, ORR has set out a proposal which would mean that the final determination will include firm targets for the first two years of CP7, while trajectories for years 3-5 will be indicative and subject to a reset (codified in the final determination) through consultation. This would also reset the Schedule 8 benchmarks and payment rates for Network Rail and passenger operators as well as reviewing the suitability of regulatory success measures, both in England & Wales and Scotland.

Whilst this approach does not mitigate all the challenges and significant uncertainties remain, we recognise it as an improvement over the approach in the draft determination and we are working with ORR to provide the information required. However, given the approach has only emerged in the last few weeks we have agreed with ORR that we will provide evidence to support credible passenger performance trajectories as an addendum to this document by 14 September.

Discussions so far on this approach have been positive. It is important to provide appropriate transparency on how Network Rail will be monitored in CP7, in particular, we expect the final determination to confirm the following points which we have discussed with ORR:

- **Scope of the reset:** From discussions with ORR, we assume that the reset for passenger performance baselines in years 3-5 of CP7 will be a true reset for all regions (including On Time and Cancellations forecasts for Scotland, subject to reviewing the suitability of regulatory success measures) that reflects realistic performance assumptions and without pre-conception of what performance levels should be delivered. As part of the reset we would assume that the Schedule 8 parameters for England & Wales and Scotland would be recalibrated, including benchmarks, payment rates (providing an opportunity to implement the full c.75% reduction in years 3-5 of CP7 based on the latest evidence) and sustained poor performance (SPP) thresholds, as well as the relevant parameters within Schedule 4 (e.g. the ACS).

- **Level of ambition**: Our detailed plans include ambition for Network Rail to improve its contribution to train performance during CP7 based on the expected CP6 exit point despite some of the challenges that CP7 brings, already described in our SBP and this response. However, if we cannot confidently assume improvement to operators' contribution for any year of CP7, we do not expect to commit to stretch on their behalf as that would be irresponsible on our part. We believe it is entirely reasonable to expect ORR to be clear on the assumptions it makes for the level of ambition on operator contributions to performance.
- **CP6 exit position**: Our ambition to improve from CP6 exit is dependent on the actual CP6 exit position for performance. If this changes from the current forecast, we expect to work with ORR to reflect this in regulatory baselines through the managing change process as appropriate.
- **Managing change:** We understand from discussions with ORR that the proposed reset does not impact our ability to trigger the managing change policy where relevant (and the proposed in-control period recalibrations for Schedule 8), although we expect the likelihood of requiring it to be lower as the new approach recognises the greater uncertainty in later years of CP7.

As highlighted above, we have agreed to provide detailed information in an addendum to this response to support ORR to develop its final determination. We are sharing information iteratively with ORR and will continue to discuss and clarify the information as it reviews draft determination responses and makes final determination decisions. We will provide:

- Our assumptions on Network Rail and operator contributions to CP6 exit performance forecasts, providing a clear baseline to compare actual CP6 exit performance to and reflect in the regulatory baselines as appropriate.
- Our assumptions on operating context, external factors and operator contributions impacting CP7 performance forecasts, to support transparent baselines for CP7 (and the managing change process as appropriate).
- Our detailed bottom-up CP7 performance plans, including where we have applied additional stretch, demonstrating that our plans are realistic and ambitious.
- Point value forecasts for On Time and Cancellations that reflect the P50 forecast from bottom-up plans (for Network Rail and operators), and additional stretch that Network Rail is committing to, for the first two years of CP7.
- Refined forecast ranges for all years of CP7.

**Metrics**

All metrics have strengths and weaknesses, and no single measure can provide a complete picture of train performance. ORR recognises this in the draft ‘holding to account’ policy (consulted on earlier this year), and in its monitoring, it will also consider supporting measures and additional assurance. However, the status of regulatory success measures and how they are reported on is likely to, unsurprisingly, dominate decisions and behaviours. It is critical that ORR continues to assess the behaviours and decisions the regulatory success measures drive, and adapt the measures as needed to support industry performance improvement, as well as having regard for the interactions and implications of the success measures.

On Time and Cancellations metrics (ORR’s CP7 regulatory success measures for passenger train performance) were introduced at the start of CP6 as part of a basket of measures developed by the National Task Force to provide a rounded view of passenger train performance. This also included Time-to-5, Time-to-15, and Average Passenger Lateness. Taken together, this basket of measures provides a good representation of the performance factors that impact on customer satisfaction across the different types of railway operation in the UK. We do not, however, agree that ORR’s chosen regulatory success measures will drive improved collaboration and performance alone.

ORR states that it has chosen whole-industry measures to drive collaboration to deliver the best outcomes. Using whole industry measures to incentivise performance outcomes relies on Network Rail and operators working together. On Time is not aligned with punctuality metrics used for most operator targets (Time-3). While there is strong correlation between the measures, this is not perfect, so the misalignment is likely to, to some degree at least, distort incentives and create tension and confusion in network management decisions. Concerns about a move to ‘on time’ regulation, rather than balancing performance outcomes, has already been raised by the Operators’ Planning and Performance Forum. Our Scotland response also sets out the challenges of using On Time for Scotland given the specific HLOS performance requirement to use Public Performance Measure as its primary measure for performance in CP7. The Scotland response also includes proposed new On Time figures reflective of ongoing conversations since the draft determination was published. Given this misalignment, it is not clear how ORR’s proposed trajectories take into account the lack of incentives for operators to investigate and tackle sub-threshold delay (which accounts for 42% of On Time failures through CP6 to date) through Time-3 targets. As indicated in our regional responses, we do not believe that ORR’s proposed trajectories are realistic without aligned incentives to resolve sub-threshold delays. It is vital to consider the risks associated with misaligned incentives as part of ORR’s final determination and overall Holding to Account approach.

While we support the concept of whole-industry measures to reflect passenger experience, ORR cannot reasonably expect using whole industry measures to drive collaboration when its incentives regime often has the opposite effect. The Schedule 8 regime works based on delay attribution which encourages an industry culture of blame, rather than collaborative working. Through Schedule 8, operators can be financially penalised when they invest to help mitigate reactionary delay, which is not driving the right behaviours to deliver the best passenger outcomes. ORR did not take the opportunity to fundamentally reform the incentives regime through PR23, so using whole-industry measures cannot be expected to counteract financial incentives to bring about more collaboration.

As well as the behaviours metrics can drive for performance itself, the impacts on wider industry priorities must be considered to deliver the right outcomes overall. Following the impacts of the pandemic, we have reviewed use of the On Time measure and found that it may not drive behaviours that prioritise industry revenue recovery, and ultimately the long-term financial sustainability of the railway. On Time treats each planned station stop equally, so is most influenced by high frequency services stopping at lots of stations. This is often not consistent with the lines and services where most passengers are impacted by delay, and where the knock-on impact on revenue is greatest.

Through the reset approach, ORR has agreed that regulatory success measures will also be reviewed. We ask that ORR works with industry to begin this work as soon as possible to bring true alignment to performance incentives and monitoring. We recognise that there are benefits and flaws for most performance measures but given the importance of collaboration to deliver the best outcomes, removing misalignment wherever possible is essential.

**Trajectories**

ORR's draft determination trajectories are at, or are beyond, the most challenging end of the forecast ranges we provided in our SBP. While we continue to challenge ourselves to deliver the best possible performance in CP7, our analysis shows that a number of the proposed trajectories in ORR's draft determination are not credible or realistic in the CP7 operating context. Recognising the funding pressures we, and wider industry, face in CP7, setting baselines at an unrealistic level will set the industry up to fail. This will cause unnecessary reputational damage to the whole industry, slowing down the industry's efforts to bring passengers back to rail and recover industry revenue. Setting Schedule 8 benchmarks against unrealistic baselines would further add to funding pressures by causing unnecessary financial flows, diverting investment away from performance improvement. It is even more important to set realistic Schedule 8 benchmarks given ORR's decision to set payment rates that are not based on the economic evidence available.

For each passenger train performance success measure, we have set out our concerns with the proposed regulatory trajectories below, and for freight performance our response is included in the following section. Each region response provides specific evidence on the credibility of ORR's proposed regional trajectories. We strongly encourage ORR to review and reflect on this, and additional evidence we are providing, ahead of its final determination so that it sets credible regulatory baselines which are ambitious yet realistic.

<u>On Time</u>

The trajectories ORR has set for On Time are at the most challenging end of our forecast ranges, and more challenging than our forecast range for North West & Central. The top end of the On Time ranges we submitted reflected possible performance if risks are at the lower end of potential impact, opportunities are at the higher end of potential benefits (including an overlay for our ambition to achieve whole industry improvement) and if weather and external events are relatively benign.

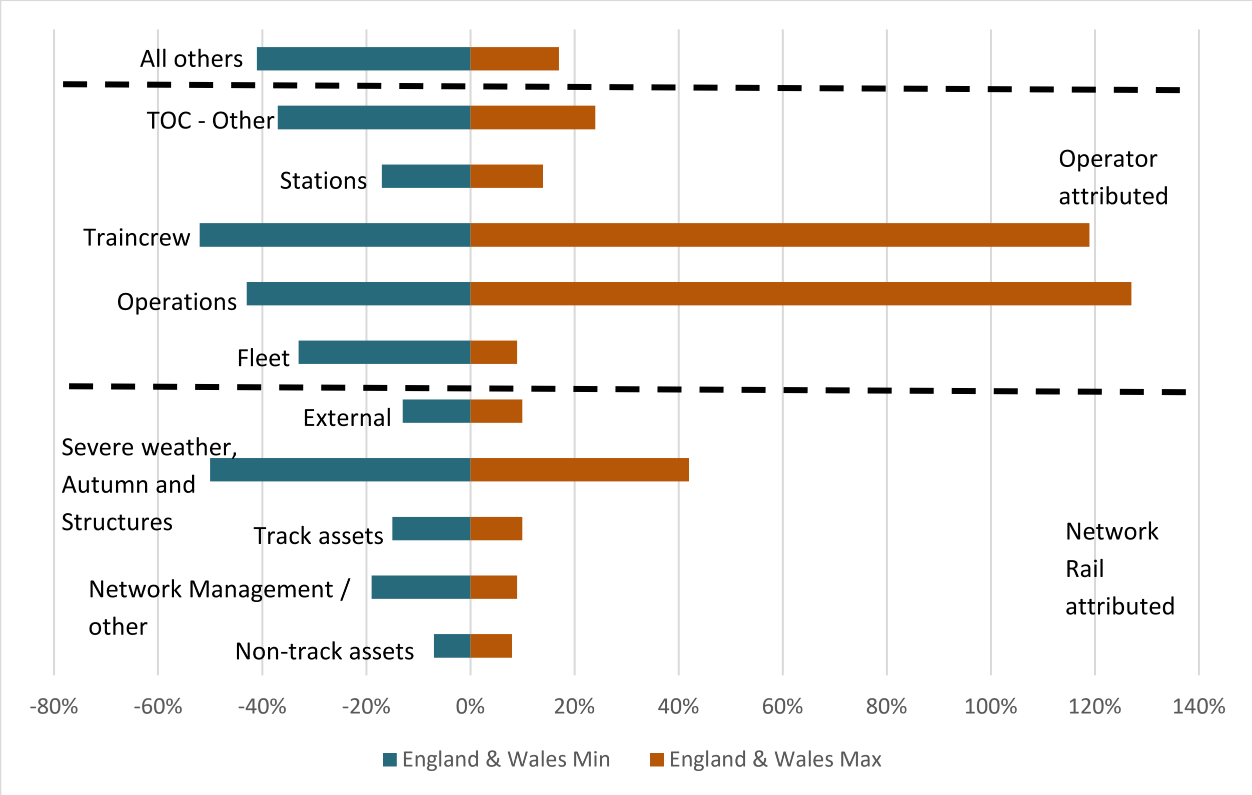
With the very limited commitments available from operators for future years' performance, we do not see ORR's proposed trajectories as realistic or being built on robust evidence. We continue to engage with operators to seek more opportunities for performance improvement, but we cannot assume improvement from operators beyond the small number of schemes they have been able to commit to in our performance modelling.

Additionally, given the move to our risk adjusted plan alongside wider funding pressures, there is a higher level of performance risk in CP7. ORR's draft determination does not provide supporting evidence for how this has been considered in setting the proposed performance trajectories, and only points to one minor area that was not specifically included in our detailed bottom-up plans (use of Performance Improvement Management System (PIMS) and the Risk Management Maturity Model for Performance (RM3P) – which are enablers and not direct contributors to performance improvement). ORR's draft determination recommended the addition of a Performance Innovation and Improvement Fund (PIIF) in CP7, which we discuss further in chapter 2. Based on experience in CP6, we do not currently expect this to deliver significant in-control-period benefits, as it does not provide funding for wide roll-out of schemes and there is very limited funding in regional plans to adopt schemes.

<u>Cancellations</u>

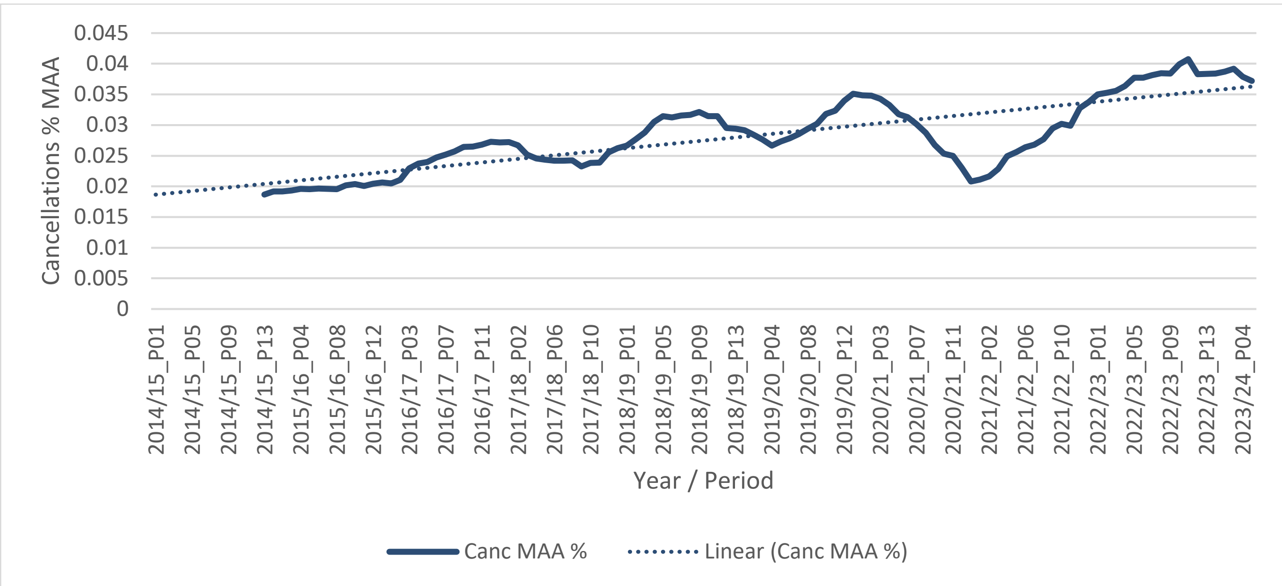
In addition to the points on On Time (moving to risk adjusted plans and the lack of available information on operator commitments), we see ORR's draft determination trajectories for cancellations, set at the same level for all years and regions, as particularly unrealistic. Given the level of variability in this measure shown in figure 5.6 below, the operating context for CP7, the recent trends in cancellations levels (see figure 5.7) and the train crew and industrial relations context, it is unclear why ORR believes this to be credible, and ORR has not provided any assumptions or evidence that support the trajectories. This would require a significant improvement from CP6 exit forecast to year 1 of CP7, and ORR has not set out where this step change would be expected from (specifically, operators or Network Rail). It also has not set out how the proposed regulatory baselines reflect the expected operating context for CP7, specifically that it is likely to be materially different from past trends that ORR states it has drawn conclusions from – given that some regions have never achieved this level of performance and different regions will require a different balance of performance management approaches. For example, as set out in chapter 7, the planned reduction in asset renewals in CP7, and subsequent increase in refurbishment and maintenance of assets, is likely to lead to the requirement for more operational controls (such as speed restrictions) towards the end of CP7. This may impact train performance and it is not clear that this has been considered by ORR.

Figure 5.6: Cancellations Variability by category relative to projected performance




Note: shows minimum and maximum values from 2014/15 to 2022/23 (with relevant adjustments for years impacted by the pandemic)

Figure 5.7: National cancellations by financial year and period




## Next steps

To support ORR in setting credible performance trajectories for all measures in the final determination, which establish clear expectations for Network Rail, we will provide supporting evidence in an addendum to this response between this response and 14 September 2023. This will provide our view of ambitious yet realistic point value trajectories for years 1 and 2 of CP7, and forecast ranges for years 3-5, as well as detailed performance modelling, assumptions and details of engagement with operators.

If ORR makes different assumptions to those that have informed our modelling and forecasting, this would need to be transparently set out in the final determination so we can understand the expectations on Network Rail. Relatively minor changes in underlying assumptions can have a material impact on forecasts, so having a clear and consistent understanding will be vital to explain how our forecasts are evolving compared to final determination baselines. If ORR does not set out alternative assumptions but sets unrealistic performance trajectories in the final determination, we will be forced to trigger managing change to move to trajectories supported by robust and credible evidence.

We are continuing to engage with operators and will consider how detailed operator train performance plans impact the assumptions and forecasts we have provided. We will also work to address the overlay currently in region plans. Our ambition is that addressing the overlay does not impact on performance, however, we will consider any further risks and uncertainty to our forecasts as well as aligning plans with detailed operator plans. As these assumptions mature (particularly for train operator contributions), we will consider how they differ to those underpinning ORR's final determination trajectories and may trigger managing change for regulatory trajectories before the start of CP7 should there be significant differences.

## Freight

ORR's draft determination sets proposed outcome trajectories for freight train performance and freight growth. These are key outcomes for the freight industry in CP7, as well as freight safety, identified through our ongoing stakeholder engagement.

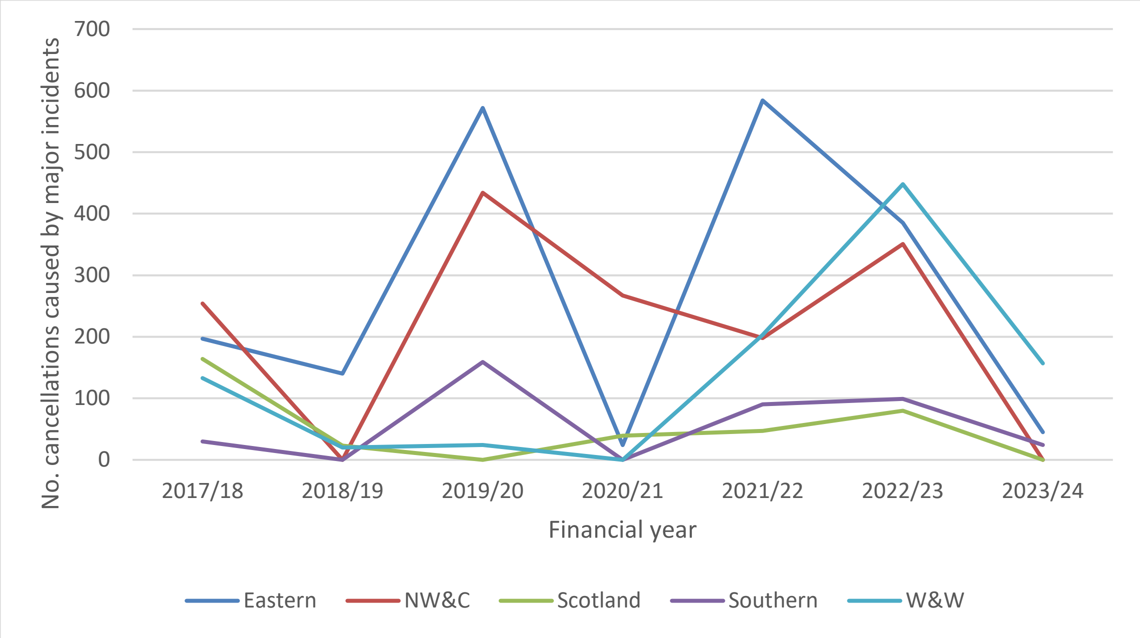
This section sets out our refined view of ambitious yet realistic freight performance trajectories and key issues we would like ORR to consider in its approach to monitoring freight performance. It also covers how our updated plans will continue to support freight growth in CP7.

### Freight performance

The trajectories ORR has set for Freight Cancellations are at the most challenging end of our forecast ranges, and more challenging than our forecast range for some years and regions. Given the move to our risk adjusted plan, we do not think that ORR's approach recognises the level of risk and uncertainty in CP7, particularly for freight cancellations which is knows to be a volatile measure.

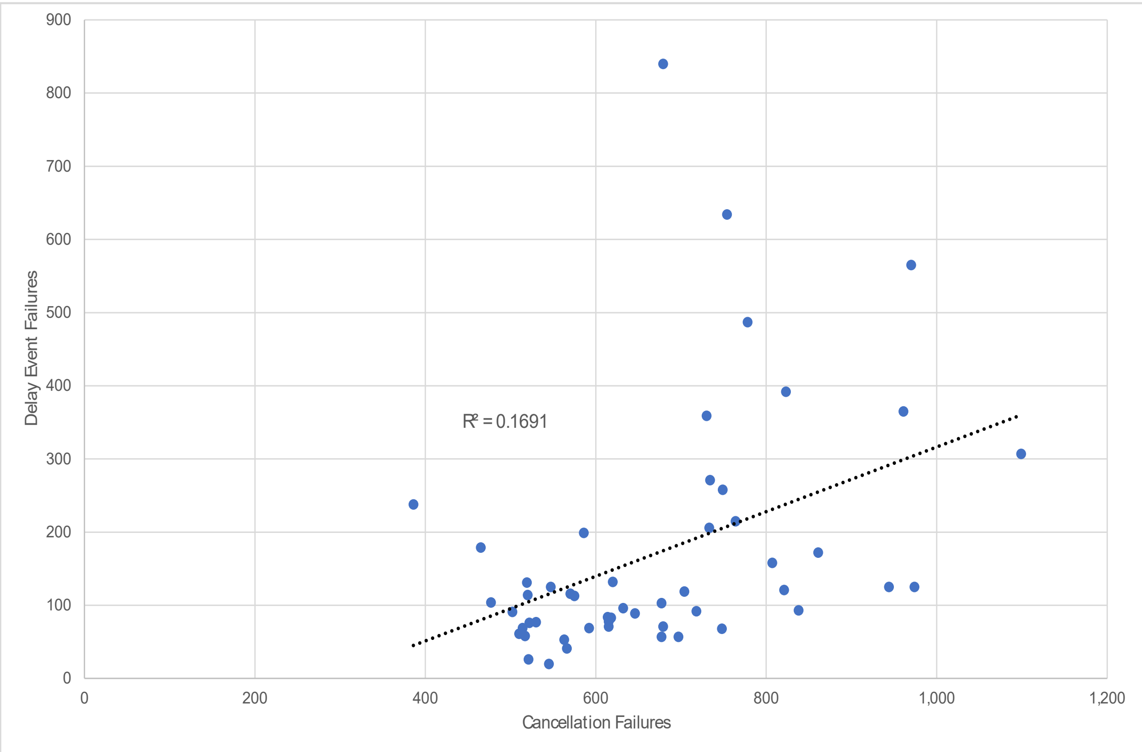
We have previously highlighted concerns to ORR that using freight cancellations as a success measure will be ineffective in incentivising performance. The timing and location of shock events that lead to high rates of freight cancellations, such as flooding and asset failures, are generally unpredictable. As shown in figure 5.8, the impact of major incidents can vary significantly from year to year in each region. Additionally, industry timetabling arrangements mean that incidents can lead to freight cancellations over a number of days, unlike passenger trains for which emergency timetables are used.

Figure 5.8: Number of cancellations caused by large impact incidents 2017/18 to date, by region




The correlation between delay event failures and freight cancellations is low at 16.9% (see figure 5.9), so we cannot assume that our wider performance plans will consistently impact freight cancellations. This means that one or two significant events in a region can significantly overshadow performance over the rest of the year, result in misleading reporting and negatively impact motivation (particularly where events may be outside of Network Rail's control).

Figure 5.9: Correlation of delay event failures and cancellation failures April 2017 – March 2022 (not including 2020/21 due to impacts of pandemic)



The operating context and funding level for CP7 leads to higher risk to performance, including changing weather patterns and ageing assets. We highlighted in our SBP, and even with the additional asset expenditure included in our draft determination response, our overall focus on life extension is likely to impact the reliability of our assets, particularly towards the end of the control period. While we are planning interventions to protect performance on key freight routes, these wider factors and the level of variability in freight performance must be considered to set ambitious yet realistic trajectories. It is also important that the variability of the freight cancellations metric is considered in ORR's approach to monitoring.

Regions have continued to refine their freight train performance forecasts since our SBP submission. We recognise that the freight industry may reasonably expect specific performance commitments over the duration of CP7, so despite the challenging operating and funding context, we are setting an ambition to maintain our CP6 exit freight performance over CP7. We are currently forecasting CP6 exit performance to be 1.8% for freight cancellations when factoring in autumn/winter impacts for the final year of CP7. This will be refined through the next rolling forecast update of our plans later this year. If the actual CP6 exit position is better than this, we will seek to maintain that through CP7.

**Freight growth**

ORR's draft determination recognises that our plans align with the opportunity and requirements to drive freight growth across GB in CP7. ORR has accepted our methodology and forecasts for freight growth. We have not made any changes to these forecasts for our draft determination response (7.5% growth for England & Wales), and have also provided a GB level forecast to ORR to support its monitoring.

Delivering our freight growth targets requires making sufficient paths available to freight operators, that the network is capable of supporting freight traffic in the most effective and efficient manner where required, that there is sufficient demand for paths from freight users, and that freight operators are willing and able to provide the haulage. The wider funding pressures we face in our plan mean that we are reviewing how we deliver the outcomes we set out in our SBP, including freight growth, and we will work with stakeholders to understand how best to deliver our commitments to provide the capacity and network capability to support freight growth. In particular, regions will manage their structures portfolio to continue to enable heavier freight traffic on key routes, in line with the approach we described in our SBP, which is a vital part of the forecast growth.

Our System Operator response provides more information on the work we are doing to develop our CP7 delivery plan for freight growth.

## Efficiency

ORR's draft determination sets efficiency baseline trajectories for each region in line with Network Rail's forecasts, totalling £3.2bn across England & Wales. ORR notes that this total is based on 10% in opex efficiencies and 15% in capex efficiencies, which ORR has found to be credible.

As we have reviewed and updated our plans following ORR's draft determination, we have maintained our targets of 10% opex and 15% capex efficiencies. Our separate financial submission and success measure forecasts set out our targeted efficiencies by region (direct and allocated) totalling £3.2bn. As our plans mature we are seeing movements between categories of efficiency, particularly as regions embed efficiencies enabled by national functions. We are providing our current view of the expected efficiencies in each category to ORR alongside this response, will continue to develop detail on initiatives as we produce our CP7 delivery plan, and have provided more commentary on opex efficiencies in chapter 7. Regular readiness reporting will provide assurance that our CP7 efficiencies are deliverable. Reflecting these targets in 2023/24 prices and incorporating latest inflation assumptions, we have provided our updated efficiency plans to ORR.

As discussed in chapter 3, we have also discussed and shared with ORR our methodology for calculating Project Reach efficiency, which is based on allocating benefits across the implementation period.

While we continue to commit to the overall efficiencies in our plans, there are risks and challenges to delivering these targets, particularly given the volatility of our workbanks and the impact of inflation on our plans. Additionally, around 30% of total CP7 efficiencies relate to Network Rail's share of the industry savings expected from rail reform, which is likely to be more challenging to achieve given delays to reform legislation. We have previously been clear that not all reform initiatives require legislative reform (e.g. joint property strategies, workforce modernisation and optimising access initiatives), so ORR support to drive / deliver whole-system savings will be instrumental in enabling Network Rail to meet these efficiency targets.

We see value in ORR monitoring both the total efficiencies and the percentage of efficiencies achieved so that monitoring remains proportionate to the wider financial and economic context. ORR will also monitor the financial performance measure through CP7, and has set trajectories in line with our existing CP6 approach to target performance in line with annual budget.

## Environmental sustainability

ORR's draft determination sets proposed regulatory trajectories for Scope 1 & 2 carbon reduction and Biodiversity. These baselines align to our risk adjusted plan for all regions except for Southern. Our Southern response provides our updated position on this. This section provides our overall response to key points from ORR's draft determination, as well as in relation to the recent Independent Reporter review of our Scope 1 & 2 carbon reduction plans. We agreed with ORR the priority areas for our response which are covered below.

### Carbon reduction

ORR's draft determination includes Scope 1 & 2 Carbon reduction targets in line with our forecasts for our risk adjusted plan for all regions except for Southern. We have continued to develop our risk adjusted plans to consider ORR's draft determination proposals and have updated our scope 1 & 2 carbon reduction forecast for Southern. We are accepting ORR's proposed baselines for all regions.

The Independent Reporter has reviewed our plans for carbon reduction and highlighted the need for more detail on the activity and initiatives that will contribute to delivery of our targets. In particular, it is important that we and ORR are able to monitor the factors that are in and out of our direct control. We do not believe we should decouple grid decarbonisation from our position, as it is important to understand the overall level of carbon reduction and we are progressing grid decarbonisation through Network Rail led initiatives (such as corporate power purchase agreements). However, we agree that it is important to understand which activities are contributing to carbon reduction and how Network Rail is contributing directly. This will help to demonstrate that our carbon reduction targets are ambitious but realistic within the funding available and provide a clear monitoring baseline for CP7.

Alongside this response, we have provided a breakdown of the activities and funding contributing to our carbon reduction forecasts for each region. This demonstrates that the majority of the target will be achieved by factors within our control, including grid decarbonisation through securing a second corporate power purchase agreement (procuring electricity directly from an energy producer), and that we are committing appropriate funding to achieving our targets, balanced with other outcomes across our plans.

We are continuing to refine the details of our carbon reduction plans as we develop our CP7 delivery plan and will engage with ORR on how our carbon plans evolve so that ORR can continue to monitor against an up-to-date baseline. This includes further development of our plans for Zero Emissions Vehicles. In addition, ORR has recommended that we review the methodology to aggregate our carbon reduction forecasts. We will explore this over the coming months and update our trajectories based on weighted averages. Again, we will progress this as we develop our CP7 delivery plan and continue to engage with ORR.

Financial efficiencies from sustainability are captured in detailed regional efficiency plans. We will continue to develop initiative level detail as we agree our CP7 delivery plan.

**Biodiversity**

ORR has asked that we develop further detail on the activities that will contribute to achievement of our biodiversity targets. This will be developed as we progress our CP7 delivery plan, particularly in relation to our vegetation management plans. We will continue to engage with ORR as we develop this.

We are still embedding the new biodiversity measure. While we are using the best methodology available, there is a margin of error that must be considered in monitoring year-on-year percentage changes. Qualitative assessment will likely be an important part of ORR’s monitoring in this area to provide a balanced assessment throughout the control period, and we will work with ORR to agree the right approach to this, including the development of supporting evidence for the evaluation of progress in this area.

## Asset sustainability

ORR's draft determination proposes an increase to Network Rail's core renewals expenditure to mitigate potential risks to asset performance during CP7 and future control periods. ORR estimated the impact of increases to core renewals expenditure on the composite sustainability index (CSI) in draft baselines in the draft determination, and asked that we provide more accurate forecasts in our response. Having reflected changes to our renewals expenditure in our plans for CP7, we are now able to provide a more accurate forecast of CSI. We have provided the forecast and methodology to ORR, which is based on:

- Updated renewals volumes in regions' plans
- Revised changes in inventory and expected condition at the end of CP6
- Recalibrated model results

## Other outcomes

ORR's draft determination also sets out an assessment of our plans in a number of other key areas, although there are no success measure trajectories proposed. This includes:

- Customer satisfaction
- System operation
- Network capability
- Network availability and possession management
- Accessibility

**Customer satisfaction** continues to be a priority for Network Rail, with a focus on customer information, our managed stations and customer service. We measure customer satisfaction at an overall level and at our managed stations, which will be regulatory supporting measures in CP7.

**System operation** outcomes are discussed in our System Operator response to the draft determination, which will be assessed against supporting measures and additional assurance in CP7. This covers key areas of focus in our Network Licence including timetable planning and access planning, and how our plans have continued to evolve, such as the closure of the Industry Timetable Technical Strategy (ITTS).

**Network capability** proposals in ORR's draft determination seek to give operators assurance that capability non-conformance will be closely monitored in CP7. ORR proposes to monitor this through additional assurance arrangements, which are still to be discussed and agreed as we prepare for CP7, but we have engaged closely with independent reporters to inform the development of the proposals. It is important that we continue to assess the capability requirements of the network against changing travel patterns and, where possible, reduce costs by optimising the capability of the network. We will continue to work with ORR to provide assurance that our proposals, engagement and decisions on Network Capability are appropriate and reflect the industry's wider priorities.

**Network availability and possession management** will assess how Network Rail balances necessary engineering work, efficiency and disruption to services. We have various internal and external assurance mechanisms in place to support this and have worked with ORR to inform proposals on how this will be monitored in CP7. Engineering work is essential to maintain network safety and reliability, and we want to deliver this in the most efficient way possible. We continue to learn more about the impacts of disruption and passenger and freight user preferences. We expect our approach to evolve in CP7 to reflect the markets we serve. The optimal balance may change, and will need flexibility in ORR's monitoring to reflect this.

**Accessibility** will be monitored through additional assurance including against existing legislation and regulatory commitments, and we will work with ORR to agree further supporting information (e.g. data on lift and escalator condition). We have also introduced an updated Diversity Impact Assessment included in the updated Network Rail standard NR/L2/OHS/00135, which will further embed thinking about diversity and inclusion, and demonstrate that we are meeting our Public Sector Equality Duty.

# 6. Responding to challenges, uncertainties and opportunities

## Key response points covered in this chapter

**Key response point 1:** Given the challenges and uncertainties we face in CP7, it is essential that ORR is flexible and pragmatic in its approach to regulating Network Rail, recognising the high level of anticipated change as PR23 is concluded, and the challenges we face during CP7.

## Introduction

This section summarises some of the key challenges, uncertainties and opportunities in our CP7 plan, and underlines the importance of ORR taking a flexible and proportionate approach to regulating Network Rail in CP7, with this being a critical enabler to setting the industry up for success in CP7. This brings together a number of topics that are also discussed in other chapters of this document.

## Overview of challenges, uncertainties and opportunities

As set out in chapter 1, we consider that our CP7 plan is deliverable, providing a number of critical assumptions hold (notwithstanding that our work on reducing the overlay in regions' CP7 plan prior to the start of CP7 may impact outcomes). Recognising the challenging and uncertain economic environment, as well as other uncertainties, there are a number of significant risks to being able to deliver our CP7 plan. As set out in chapter 4, our high level assessment of the total of these risks is £3.7bn on a mid-to-worst case basis. A summary of the main drivers of risk in CP7 includes (noting this is not an exhaustive list):

- General inflation and our own input price inflation is higher than assumed in the latest Bank of England inflation forecasts, with a resulting impact on our cost base / input prices including lagging impact.
- Assumptions on inherently uncertain factors impacting train performance may not be correct, which would impact our ability to deliver train performance. The impacts of this would be both reputational for the whole industry, and financial through the impact on the performance regime – exacerbated by ORR's recent decision to lower its originally proposed reduction in Schedule 8 payment rates from 75% to 45% which is discussed further in chapter 11.
- We cannot deliver our CP7 efficiency plans, especially if there is not cross-industry (including ORR) support for the c.30% element that relates to our share of industry reform-related efficiencies.
- Weather related incidents cause higher than forecast levels of service disruption, cost and reputational impact during CP7.
- Unanticipated safety or asset management issues arise in CP7 which we must divert funding to.

- Exiting CP6 at a different level than currently forecast puts extra pressure on the delivery of our CP7 plans and outputs from the outset.
- Changes in existing legislation which were not anticipated at the time of the HLOS, impacting on railway activities and resulting in additional cost.
- Lower levels of income (from access charges and property income) as a result of lower services and footfall than the plan currently assumes, which could be a railway specific cause or due to wider economic factors.

We have mitigations and controls to manage these risks. During CP7, our corporate Enterprise Risk approach, through which causes, consequences, controls and actions are closely monitored, will provide a mechanism where these risks can be kept under review. However, the extent to which we are able to manage the impact of each of these risks should they materialise will vary in CP7.

If some, and not necessarily all, of these risks were to materialise at a material scale, our CP7 risk fund, even at the level ORR proposed in its draft determination (which has subsequently been reduced by the impact of updating our plans with the May 2023 Bank of England CPI forecasts, which ORR did not take account of in its draft determination), would very likely be insufficient to absorb the impacts. If the risk fund is depleted then this would likely require us to reduce activity, including the various national programmes we have in our plan. We would need to assess the knock-on impact on outcomes and utilise the managing change process to align spend with outcomes. As we have discussed above, flexibility by ORR both in making its CP7 decisions and its monitoring and regulation during CP7 is an important way to manage the risks and uncertainties we are facing.

Ultimately if the impact on the plan was deemed to be too great then we may need to seek a control period re-opener (as per the arrangement set out in track access contracts). This would be a time consuming exercise and involve provision of a new HLOS/SoFA by DfT and it is something that we would want to avoid.

We also recognise there may be a range of opportunities during CP7, particularly as we expect there to be far greater alignment in decisions about infrastructure and train services under Great British Railways (GBR), with material financial benefits. The delays in rail reform and establishing GBR only serve to push back and reduce the opportunities available in CP7. We will continue to work with the GBR Transition Team (GBRTT) to support their work and be ready for GBR.

As discussed in chapter 3, continuing our work on market-led and whole industry planning will be key to reducing the current overlay in regions' plans – and there may be opportunities beyond this to support the delivery of our plan during CP7. Realising this opportunity will hinge on a whole industry approach to planning and delivery, as well as broader industry, government and regulatory support. There may also be third party funding / co-funding opportunities, which we will continue to pursue actively during CP7.

## Importance of flexibility

The risks and opportunities highlighted in this chapter, as well as throughout our draft determination response, stress the importance of ORR applying flexibility both over the remainder of PR23, and into CP7. We note that other regulated companies, including those in the water, energy and airports sectors, are experiencing similar uncertainty but have regulatory protections and tools to respond that Network Rail does not (e.g. inflation protections, easier interim charges reviews, and the ability to raise capital from private equity and debt investors). While we have identified a risk fund for CP7, as discussed above, its size is comparatively small compared to the scale of the risk and uncertainties we face. This underlines the need for adaptability and proportionality in ORR's approach to how our outcomes for CP7 are defined and monitored, alongside our expectation that the approach should be consistent with Government's principles for economic regulation.

We already know that we may need to enact the managing change process between the final determination and the start of CP7, as we work through the overlays in regions' plans and the resultant impact on CP7 outcomes. Should the risks / opportunities described above materialise during the control period (along with any others), we need an agile and flexible regulatory framework to be able to respond to changing circumstances, so that we can deliver the best level of safety, train performance, cost efficiency and asset management for passengers and freight within the funding available.

As discussed in chapter 8, we support the principles of ORR's managing change and holding to account policies, and robust and challenging regulation more generally, but more broadly we consider it is essential that ORR recognises in its final determination that we are (through PR23), and will continue to (in CP7), facing an unprecedented level of change and uncertainty. In chapter 8 we set out our concerns that the current provisions in the draft managing change policy will not provide sufficient flexibility in being able to manage the scale, frequency and complexity of the change we anticipate in CP7.

We are concerned that the requirements of the draft policy may not be proportionate nor enable an agile approach to managing risks, particularly where changes are unexpected and / or outside of our control. It is also essential that there is overall coherence in ORR's approach, recognising the interplay and balance between different areas of our plan, as well as avoiding duplication with other, existing stakeholder engagement and reporting processes.

Overall, we are concerned that ORR considers the managing change policy as sufficient to deal with the level of uncertainty we are facing in CP7, particularly as the policy sets out potentially burdensome requirements for the level of change we expect through the control period (for example proposing that every £50m change to risk funding during the control period would need to be progressed as a 'consulted change' as defined by the draft policy, which we note would also be duplicative with other reporting arrangements in place). We also note that the draft policy includes an expectation that consulted changes will not be made frequently, and has evolved only slightly from CP6. We do not believe this reflects the fundamentally different funding, operational and regulatory landscape for CP7.

In summary, we have a collective responsibility to avoid any mechanisms that create false expectations, tensions, and unnecessary and inefficient bureaucracy in progressing the changes that we know will be necessary both before, and during CP7. We have had relatively recent experience, in CP5, of regulatory decisions that were too rigid and delivery fell short. This caused c.£1.2bn of Schedule 8 costs to Network Rail in CP5, and generated significant stakeholder concerns. Overall, flexibility in how we manage our activities during CP7 will be critical for Network Rail and the industry being set up for success in CP7.

# PART B – Overview of further developments of our CP7 plans since the submission to ORR in February 2023

# 7. Further development of our plans

## Key response point covered in this section

**Key response point 9:** We will deliver a safe plan in CP7 to support our vision to get 'everyone home safe everyday' and remain strongly committed to the safety outcomes set out in our SBP. We have developed a bow tie risk assessment framework which we will use to demonstrate our understanding of the change in risk profile as a result of conducting fewer renewals in CP7 (due to renewing at less than steady-state levels and through the shift to the risk adjusted plan, discussed below), including assessing the level of alignment between our maintenance and renewals plans, and how we will manage this.

## Introduction

Since the submission of our England & Wales SBP and Scotland Railway's interim SBP to ORR at the end of February 2023, we have undertaken further work to improve our CP7 plans. In this section, we provide an overview of this work, focusing on areas that ORR has identified needed further development in its draft determination. As discussed in chapter 1, we have not undertaken a full plan update to respond to ORR's draft determination due to the short timescales for responding.

The improvements we discuss in this chapter cover a range of areas. The sections on safety risk profile, alignment of maintenance and renewals plans, and weather resilience and climate change adaptation are applicable to both England & Wales and Scotland's Railway. The sections on market-led planning, income and operations and support costs are specific to England & Wales.

## Safety risk profile (GB)

### Overview

We will deliver a safe plan in CP7 to support our vision to get 'everyone home safe, every day', and remain strongly committed to the Train Accident Risk Reduction and Workforce Fatalities and Weighted Injuries forecasts for our risk adjusted plan, set out in the SBP and discussed in chapter 5 of this document.

ORR's draft determination set out the need for us to demonstrate how we will manage the shift in risk profile resulting from undertaking fewer renewals (compared with CP6) and taking a more maintenance-based approach to management of the infrastructure in CP7. We recognise that the planned reduction in asset renewals in CP7, and subsequent increase in refurbishment and maintenance of assets, is likely to lead to the requirement for more operational controls (such as speed restrictions) towards the end of CP7.

To understand the change in risk profile (between CP6 and across CP7) further and to identify suitably effective risk controls, we have developed a bow tie risk assessment framework which has been tested and endorsed by stakeholders. The bow tie risk assessment framework will be completed at both a network and regional level, and will set out in a very clear and logical manner the threats and mitigations that influence what we consider to be the central risk – infrastructure is unable to safely support the delivery of the train plan. It will also support our regions in further embedding market-led planning and informing asset management decision making during CP7, demonstrating that the risks on all regions have been reduced so far as is reasonably practicable (SFAIRP).

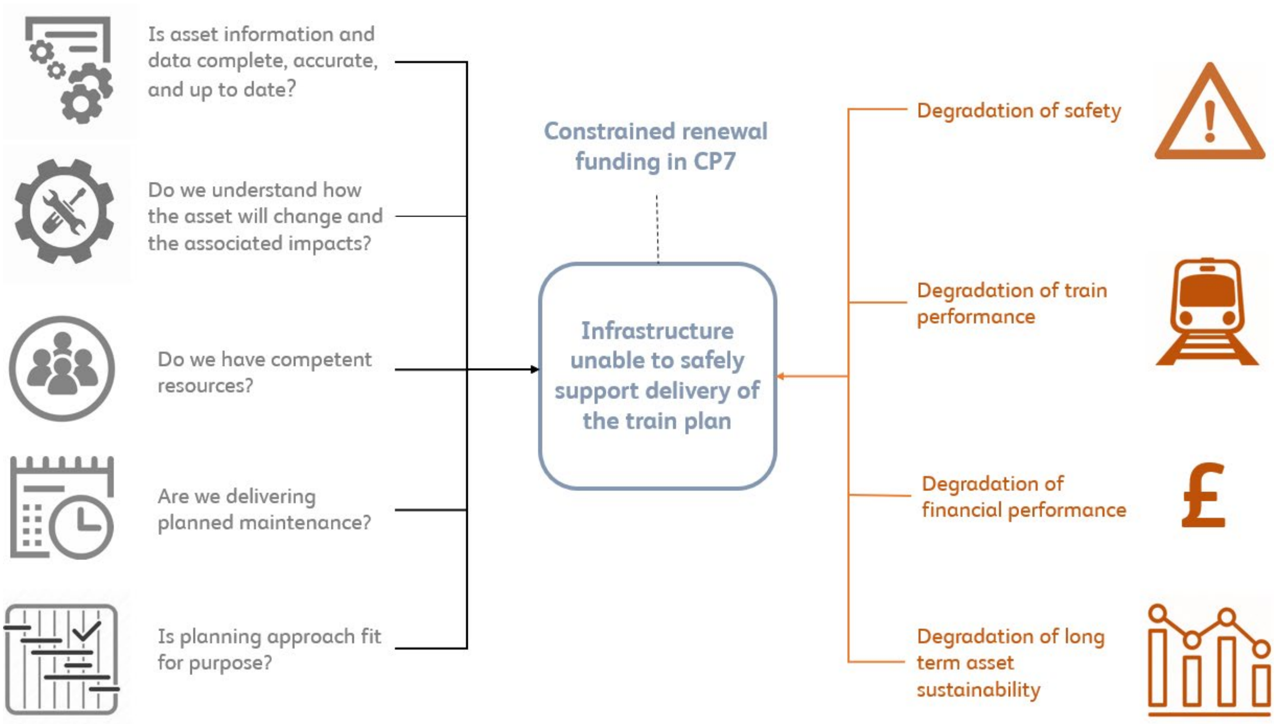
The development of the bow tie risk assessment framework complements our existing and well-established safety risk management approach. This includes our Enterprise Risk approach where causes, consequences, controls and actions are closely monitored, along with our assurance / governance approach across the business which applies the three lines of defence model (discussed in our SBP) and will continue to apply in CP7.

This includes the hierarchy of risk controls we use when making asset management related decisions, for example undertaking a partial renewal / refurbishment and component replacement instead of a full renewal to mitigate the risk. We shared a more detailed overview of our current approach to monitoring safety risk with ORR in April 2023 to support the development of its draft determination.

**Bow tie risk assessment framework**

The bow tie risk assessment sets out the core principles to assess the shift in risk profile as a result of undertaking fewer renewals in CP7, as well as the key operational mitigations we may need to implement. We have summarised the framework in figure 7.1, below, and provided the full safety bow tie risk framework in a separate supporting document.

Figure 7.1: Summary of the safety bow tie risk framework




We have already taken steps to populate the bow tie risk assessment framework at a national level for the assets most affected by the reduction in renewals activity in CP7 (i.e. track, structures and earthworks). To date, we have focused on how to evaluate the asset risk and the potential secondary consequences of the increased use of operational control of risk, and any risk transfer that may take place from Network Rail to train operators. We have determined that whilst signalling, overhead line equipment and telecoms assets may have clear failure modes, they do not have significant train accident risk failure modes, although such failures do lead to performance risk. Therefore, in populating the bow tie risk assessment framework, we have prioritised track, structures and earthworks, given they are the significant precursor of train accident risk.

The nature of the bow tie risk assessment means that it can be used to evaluate the risks associated with lower levels of renewals activity in CP7 by asset type, and is scalable at different levels (e.g. line of route to national). More broadly, it also supports us in evaluating specific areas of concern. For example, we have used the safety bow tie risk assessment to demonstrate the alignment between our maintenance and renewals plans in CP7. We have developed a comprehensive set of questions which enable us to assess the level of alignment between our maintenance and renewals plans (including that the funding provisions for maintenance activities in CP7 are scaled appropriately) and identify any gaps which we will seek to address as part of the development of the CP7 delivery plan and into CP7. Our TA assurance report provides a summary of regional responses to each of the questions, and we also discuss the alignment of our maintenance and renewals plans in more detail later in this chapter. We will also be able to use the safety bow tie risk assessment to assess the alignment between our asset management and operational plans and will seek to do so as part of the development of our delivery plan.

Fully developing and populating the bow tie risk assessments at a national and regional level will take time. Therefore, we will continue to iterate and populate it after our draft determination response, and this will be developed as part of our CP7 delivery plan. We have welcomed ORR's constructive engagement and input on the development of the framework over the draft determination response period, and its support for the approach to populating these as part of our CP7 delivery plan. We will continue to engage with ORR, and keep it updated as our work progresses.

**Occupational health**

ORR's draft determination also asked for additional evidence of the implementation of our occupational health strategy, including the region's and function's plans to deliver these priorities in CP7. In particular, ORR set out its expectations that we provide more information on the following areas within our plans:

- Demonstrate how its strategic objectives for employee occupational health will be achieved.
- Demonstrate how asbestos management will be assured during CP7.
- Provide delivery plans and milestones for the ongoing investment in track worker safety to consolidate gains made during CP6 and improve longer term sustainability.
- Demonstrate plans and necessary expenditure to deliver the next phase of its fatigue improvement programme.

We discuss each of these, in turn below.

Employee occupational health

Our primary focus is the insourcing of our occupational health service, to reduce costs and deliver a service that reflects the needs of our business in CP7 and beyond. Our medicals focus on overall health and wellbeing, and have targeted questions to pick up on potential occupational ill-health as early as possible. Our TA response to ORR's draft determination includes an annex which provides an overview of our high-level occupational health strategy. Our strategic outcomes are summarised below:

- An improved Health Risk Management Framework, including reduced exposures to silica dust, weld fume, reduced hand arm vibration levels and continued control of asbestos. We will continue to improve our framework to enable staff alertness.
- Reduced sickness absence.
- Work focused and evidence based services to keep colleagues in work or return them sooner.
- Improved Diversity & Inclusion experience of our colleagues in work.
- Contribute to improve staff engagement and experience.

The TA will continue to work with the regions to develop detailed implementation plans for this strategy as part of the development of our CP7 delivery plan. Further region-specific information on employee occupational health can be found in their responses. Our TA has reviewed these and is satisfied with the alignment to national strategy at this stage.

Asbestos management

We continue to work with the regions to improve our management of occupational health, particularly ballast dust and asbestos. During CP5 and CP6 we ran an extensive programme to identify the types and locations of asbestos across our infrastructure. We are pleased with the progress made with our Asbestos Risk Management System (ARMS), with this now well populated and a useful tool to manage the risk associated with asbestos. This will be a key component in assuring that our approach to managing asbestos in CP7 is safe and appropriate.

We have also set out our key priorities for asbestos management in CP7 and assuring that it is undertaken in a safe manner:

- Assuring our understanding of asbestos locations across the network.
- Encouraging staff and contractors to utilise the data contained in ARMS before undertaking work on the network.
- Assuring that staff work correctly and safely when at or near locations containing asbestos.
- Removing asbestos when it is sensible to do so (i.e. when the asset is at or near end of life) noting that not disturbing asbestos and leaving it alone is our best control to prevent exposure to asbestos.

Each of our regional responses provide more details on their approach to asbestos management in CP7. Our TA has reviewed these approaches and is satisfied that they are aligned to the national priorities at this stage.

Track worker safety

As set out in our SBP, we have significantly reduced safety risk for our track workers, including removing the need for hundreds of thousands of manual maintenance tasks, and so reducing risk. Unassisted lookout working has been reduced by 98%. We will continue to invest in track worker safety in CP7 and have summarised some of the key programmes of work below:

- **RailHub:** At the end of December 2022, we deployed RailHub which is a replacement for a previous line blockage system and tool which enabled us to plan our work safely. RailHub supports our employees in complying with safety standards when planning work on or near the track. By the end of CP6, we will have further enhanced the system and introduced new functionality such as Incident Response Packs, Access Register Phase 1, and the Management Information dashboard. In CP7, we are exploring the potential to expand RailHub to become an industry wide solution with c. £20m of funding included within our plans to undertake this activity.
- **Enhance the current Controller of Site Safety (COSS) competence**, including the training content for both initial and recertification courses. The COSS course provides staff with the technical training to carry out the role of a COSS, focusing on planning and executing safe systems of work on or near the line, managing the safety of work groups/individuals and interaction with the signaller for line blockages. This will be enhanced to include non-technical skills and safety leadership learnings (e.g. attention to detail, communication, interpersonal relationships and allowing people to challenge unsafe behaviours are important in improving safe behaviours and leadership). We will share the training and development material with the supply chain, with COSS being an industry wide competence. This will support the industry in further developing capable, confident, and competent Safety Leaders. All non-technical skills, and safety leadership content and scenarios will be incorporated COSS initial courses by December 2024. COSS recertification will have these elements included incrementally from June 2023 – December 2024.
- **We have established the Possession Limit Controls project** to identify and enable alternative possession protection methods to replace the traditional method of placing worksite marker boards. The project was instigated following RAIB recommendations after a double near miss of trackworkers laying possession protection near Camden Junction in 2017. The intent of the action is to eliminate the risk of workforce being exposed to 'strike by train' risk whilst setting up the protection arrangements for a possession. We plan to have implemented the full programme by June 2025.

We will share our more detailed region-specific plans and key milestones as part of the CP7 delivery plan.

Fatigue improvement programme

We have introduced a new fatigue standard in CP6 which enables us to improve our approach to fatigue management (e.g. changing rostering principles so employees work no more than 60 hours a week where possible). We are committed to continuing to improve our approach to managing fatigue in CP7 and plan to invest c. £1m to further develop our control framework. A key part of this will be to support discussions around alertness and creating a work environment that enables our employees to feel more alert at work. For example, we are introducing a new rostering tool called MyRoster that will allow rostered staff to update their hours worked in real time, supporting us in implementing a new shift pattern that improves staff alertness. This rostering tool will also provide information that will enable us to assess the level of employee alertness and develop improvement actions where needed.

We will also encourage our employees to continue to discuss any issues that may be impacting their alertness at work with their managers and will support individuals in finding solutions that work for them. Like all businesses, we recognise that our employees will be managing both personal and work commitments and that this may impact our employees' alertness levels. We are absolutely committed to improving our approach to fatigue management in CP7 and beyond, with the importance of this highlighted by the two recent road traffic accidents where the drivers fell asleep following working on the network. We know we need to do more, and we are making changes now so that we can improve the safety of our workforce.

More information can be found in our TA response to ORR's draft determination, and regions' responses to the draft determination settlement documents.

## Alignment of maintenance and renewals plans (GB)

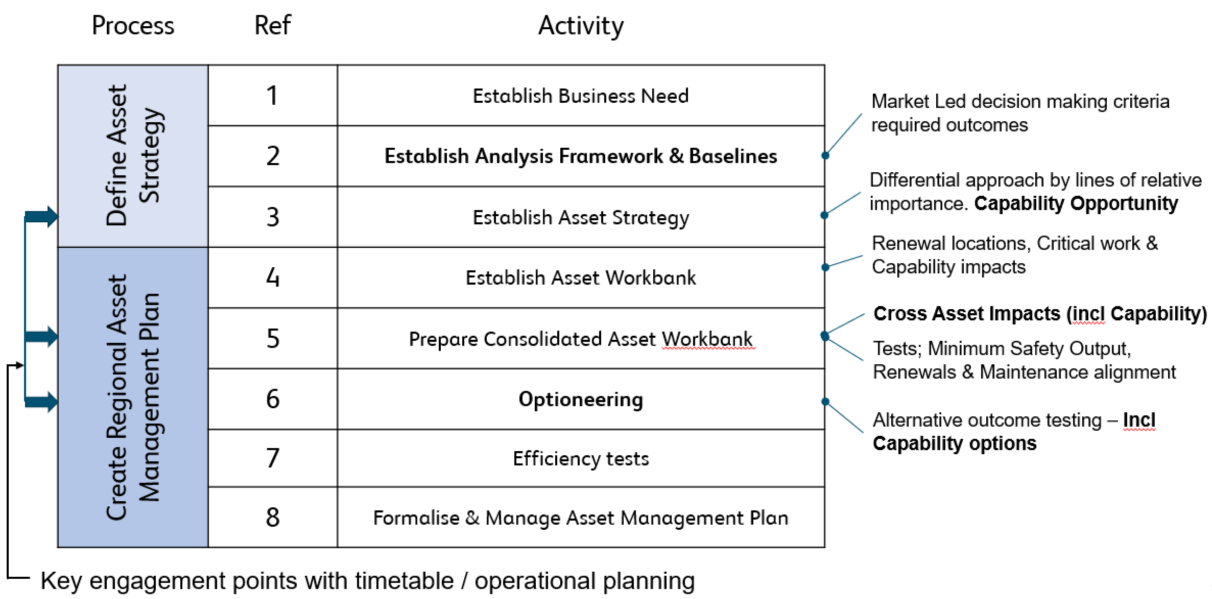
### Further development of our maintenance and renewals plans

ORR's draft determination asked us to further demonstrate alignment between our maintenance and renewals plans in CP7. This is consistent with a key next step identified in our SBP, where we set out that we needed to undertake further work to better align our maintenance and renewals plans for CP7 and committed to sharing updated maintenance plans with ORR in April 2023. ORR's draft determination did not account for our updated CP7 maintenance plans, which demonstrated a significant improvement and better alignment between maintenance and renewals volumes (while noting further work was required). We have shared a summary of this information alongside our response to support ORR's review ahead of the final determination.

As part of the development of our CP7 delivery plan, we will continue to iterate and further align our maintenance and renewals plans. This will be supported by the sharing of best practice across regions. For example, we will further embed the 8-step approach that Scotland's Railway has used to further align their maintenance and renewals plans in CP7 and beyond (as shown in figure 7.2, below) across all England & Wales regions. A key part of this 8-step approach is to assess the implications of the latest renewals plans through a series of collaborative workshops with asset management and maintenance teams to create greater alignment in our plans, including generating mitigating actions to address any risks (covering both increased maintenance and operational interventions). Scotland's Railway's response provides more detail on their approach.

Each of our England & Wales regions have largely followed this 8-step approach but we recognise that some of our regions are at an earlier stage in this process. This has been identified through the safety bow tie risk assessment which assessed the level of maintenance and renewals plan alignment. We have included a summary of each region's progress within our TA's assurance report.

Figure 7.2: Summary of approach to aligning maintenance and renewals volumes




### Impact of lower renewals on maintenance activity

In its draft determination, ORR considers we have overstated the relationship between maintenance and renewals volumes (i.e. that we needed to do more maintenance given reduced levels of renewals). As stated in our SBP, we used our experience and knowledge from previous deferrals, and expert judgement supported by modelling, analysis and case studies, to estimate the change in maintenance demand as a result of more assets becoming at or beyond the estimated end of asset life (which will be contributed to by a lower level of renewal activity in CP7 even with the increased expenditure discussed in chapter 2). These overarching estimates have been supported by the work undertaken in regions, to understand local variances.

Our assurance has helped us to strengthen the articulation of the related improvements that will need funding and scale adjustments to maintenance tasks. We strongly believe that proposed maintenance funding at a network level is appropriate given the changing pattern of work and the investment we will need to commit to better data, strengthened people capability and improved access management and operational controls. In particular, we have sought to strengthen the evidence of what maintenance tasks on which asset forms would vary across CP7. We will continue to update and validate our estimates of this relationship, and adjust our actual delivery, throughout CP7 as we see the impact of lower levels of renewals volumes on our maintenance activity.

### Detailed maintenance points

ORR made a number of more detailed points in its draft determination around maintenance. We respond to these points below. We have also summarised our response to the relevant maintenance actions in ORR's consolidated list of actions in a separate supporting document to our response. Our region response documents also provide information on each of these areas.

Modernising maintenance

ORR's draft determination states that it requires Network Rail to demonstrate that it will deliver the necessary efficiencies within the resources available and sustain the required capability to maintain the assets. As discussed with ORR, we are committed to delivering the equivalent of £100m of full year savings by the end of CP6. This is enabled by a number of changes but the cost saving itself is primarily a headcount reduction. We think the benefits that we have identified for CP6 are stretching but realistic. We do not think there are any further, material opportunities from the maintenance modernisation programme in CP7, over and above the savings already identified to be delivered in CP6 (and these efficiencies have been factored into our CP7 starting position).

Alongside this, as part of the voluntary redundancy process, ensuring that we retain the right knowledge, capabilities and expertise in CP7 and beyond was a key part of the selection panel process. Where experienced individuals are leaving the organisation through the voluntary redundancy programme, we have increased the go live criteria for that route so that they must have a clear plan in place to address any capability gaps before going ahead with the proposal under modernising maintenance.

Dedicated drainage teams

ORR's draft determination considers that our proposal not to pursue dedicated drainage teams in most regions is not consistent with one of the recommendations made in the action plans developed following the Lord Robert Mair and Dame Julia Slingo reviews on managing rail infrastructure in more frequent extreme weather. The draft determination includes an action to provide evidence of delivery of the Mair recommendation with respect to drainage management and provision of maintenance resource.

The Mair recommendation set out that consideration should be given to having dedicated drainage maintenance teams across all routes, rather than drainage being only one of the activities for which off-track section managers are responsible. We have fully considered the Mair recommendation and interpreted this to mean that we should have more people undertaking drainage maintenance as a dedicated activity. We have also tested our interpretation of the action with Lord Mair who agreed that this is about increasing drainage resource and treating drainage assets as a parent asset.

Therefore, every region has increased its drainage maintenance and inspection resource, through a mix of permanent staff and labour only sub-contractors and will have delivered this step up by the end of CP6. In some regions, this has also resulted in the creation of dedicated drainage teams. The difference in approach across regions reflects that we are a devolved business, with each region able to make the right decision for their region – reflecting the local geography and operating context. However, as set above, in all regions, we have increased our drainage resource with drainage assets now being treated as a parent asset.

We have also implemented policies and processes that underpin the treatment of drainage and lineside as a parent asset and this includes the development of a competence framework and associated training material.

Impact of climate change and adverse weather on maintenance

ORR's draft determination sets out that having reviewed our SBP, it found evidence of omissions in our plans which need to be resolved. We were unable to find any further detail explaining the basis for this concern. We have increased our maintenance expenditure in CP7 to support us in mitigate the impact of climate change and extreme weather on our network, compared to CP6 levels. This was set out in our March 2023 supplementary advice to ORR on environmental and sustainable development and WRCCA activities in CP7, as well as our April 2023 supplementary advice on our CP7 maintenance plans.

Competence management

Our regions have sought to understand the headcount and competence requirements for maintenance in CP7, taking into consideration the impact of lower levels of renewals activity in CP7 on our maintenance activity. Our regions have also considered the expected improvements in productivity through the implementation of modernising maintenance, the implementation of new technology and the adoption of additional risk-based and reliability-centred maintenance practices in their competence plans.

Through the development of the safety risk bow tie framework and the assessment of the alignment of our maintenance and renewals plans, we recognise that we need to do more to strengthen our competence management plans in CP7. We will provide an update on competency plans as part of our delivery plan as well as throughout CP7, where necessary to reflect changing needs.

**Detailed renewals points**

Asset data strategy

ORR's draft determination asked us to provide a clear asset data strategy as part of our response to its draft determination. Improving our use of asset data in CP7 and beyond will further support our framework for making decisions around asset investment, including understanding the relationship between maintenance and renewals volumes and assessing any change in our safety risk profile as a result of undertaking fewer renewals in CP7.

We have updated our asset data strategy, working closely with our regions and have shared this as part of our supporting information to ORR. We will provide key milestones as part of our CP7 delivery plan.

## Weather resilience and climate change adaptation (GB)

ORR's draft determination made a number of statements in relation to our draft Weather Resilience and Climate Change Adaptation (WRCCA) plans which we shared with ORR in February 2023, alongside the submission of our CP7 SBP.

ORR identifies that there is a significant variation in the level of planned expenditure on WRCCA activities between regions. This difference is largely driven by each region having a slightly different view of which CP7 maintenance and renewals activities are being undertaken because a primary benefit of the scheme is to improve the network's resilience to extreme weather and climate change. Since the submission of our draft WRCCA plans, we have created a consistent methodology for identifying maintenance and renewals activities where a primary or secondary benefit of the scheme is to improve the network's resilience to extreme weather and climate change. This will be reflected in the updated WRCCA plans which we will share with ORR alongside our delivery plan in March 2024.

ORR's draft determination also identified that none of our regional SBPs or draft WRCCA plans identify cost efficiency savings that could be achieved by delivering partnership or/and nature-based solutions. We are exploring opportunities to increase the use of nature-based solutions when undertaking resilience improvements and will collaborate with third parties to support activities undertaken outside the railway boundary (e.g. catchment based flood management schemes). We will provide an update on this as part of our final WRCCA plans.

Finally, in its draft determination, ORR considered that the draft WRCCA plans did not clearly commit to outputs from all the activities planned, or provide sufficient clarity on funding for mitigation measures, the residual level of risk or how this is managed. We are seeking to address this as part of our final WRCCA plans and will engage with ORR throughout this process.

## Market-led planning (England & Wales)

Our SBP described our market-led and whole-industry approach to planning for CP7. With rail industry revenue significantly lower than forecast pre-pandemic, pressures on wider Government financing, alongside ageing assets and the impacts of climate change, Network Rail's funding for CP7 needs to go further than previous control periods. Market-led and whole-industry planning approaches enable us to make better value for money decisions in a constrained funding environment by prioritising our investment according to what markets value most, and accessing whole-industry levers to deliver this in the most effective and efficient way. It also supports the England & Wales CP7 HLOS expectation that Network Rail should prioritise investment to support key revenue generating areas of the network while providing an appropriate level of service to areas where revenue is typically lower.

In our SBP, our regions reflected market-led thinking in how they have prioritised CP7 asset investment to respond to increasingly constrained funding. While we have always taken a market-led approach to planning to some degree (for example, categorisation of track based on the level of usage and revenue risk, and possession planning to minimise disruption), with better whole industry data to understand how markets are changing following the pandemic, regions have been able to take a more granular approach to best manage their investment within the funding available. This has been planned within existing processes, standards and industry frameworks, such as assessment of safety risk.

As discussed in chapter 3, continuing to work on market-led and whole industry planning to identify opportunities for savings will be a key part of our overlay management plan. More broadly, we are seeking to explore more ambitious market-led and whole-industry opportunities to make the best value for money decisions. This may require changes to standards and processes, so we are working closely with stakeholders, including ORR, to develop decision support tools that continue to protect our priorities such as safety, while enabling us to realise the opportunities from changing demand and industry structures. Whilst we expect ORR to continue to challenge us on our market-led planning we also ask for ORR to be supportive of our overall aims and the importance of this programme, and for it to provide meaningful support to help address industry or regulatory obstacles where appropriate.

## Income (England & Wales)

As part of the high-level updates to our CP7 plan, we have updated our CP7 income forecasts to reflect the latest information we have available on access charging price lists, traffic forecasts and our property income forecast.

We explain in chapter 2 that our SBP included a shortfall in income of £283m over CP7, compared to the assumptions used to calculate the CP7 SoFA. Our latest income forecast is set out in table 7.1, below. Overall, our income forecast is £310m higher than our SBP. However, excluding EC4T income, our forecast is £123m lower than our SBP. This primarily reflects the removal of the £283m SBP income overlay, noting that £182m of this overlay is now reflected in property and access charging income, with £100m addressed through lower costs in our plan. There is also a reduction in the TOC insurance premium of £33m which reflects a change in the way that we will manage insurance arrangements in CP7 (offset by lower opex costs).

Table 7.1: Summary of latest CP7 income forecast

| £m, 2023/24 prices | CP6 | SBP | DD response | Change vs. SBP |
|---|---|---|---|---|
| Franchised variable and fixed passenger access charges | 8,095 | 7,184 | 6,952 | -232 |
| Freight and open access charges | 495 | 459 | 552 | 93 |
| Stations and depots charges | 2,105 | 3,021 | 3,241 | 220 |
| Electricity for traction (EC4T) | 2,834 | 4,063 | 4,496 | 433 |
| Property and other income | 1,049 | 1,730 | 1,525 | -205 |
| Schedule 4 access charge supplement | 1,639 | 2,268 | 1,456 | -812 |
| Schedule 4 & 8 costs | -1,800 | -2,343 | -1,529 | 814 |
| **Total** | **14,417** | **16,383** | **16,693** | **310** |
| Total excl. EC4T income | 11,583 | 12,320 | 12,197 | -123 |

### Franchised passenger income

We have updated our franchised passenger income forecasts, which cover the variable usage charge (VUC), the electrification asset usage charge (EAUC), stations charges, and the fixed track access charge (FTAC). Compared to the SBP, our forecast for the VUC, the EAUC and the stations long term charge have all increased to reflect the latest cost information in our CP7 plans. We have applied our view of the current draft price lists for these charges to our forecast of traffic levels. Further information on access charges is set out in chapter 12.

We have also updated our forecast of FTAC income, which is lower than the SBP. This is because we assume that higher variable charge and stations long term charge income is offset by lower FTAC income to broadly maintain overall franchised access charging assumptions from the SoFA.

**Freight and open access income**

Since the SBP, we have updated our CP7 freight income forecast to reflect the latest draft variable track access charge rates for freight operators, alongside our updated freight traffic growth forecasts. This has resulted in a higher income forecast of c.£50m in CP7, compared to the SBP.

We have updated our open access income forecasts, which includes assumed additional income from Grand Union Trains services which are expected to start in December 2027. We have also reviewed our assumption in relation to the impact of the proposed move of Heathrow Express Operating Company to the latest template open access track access agreement. The potential income loss from this change is uncertain – it depends when this takes place and also any the value of any new charges that can be levied as a result of ORR’s current consultation on infrastructure cost charges for open access services to major airports. Given this uncertainty our latest high-level CP7 plan updates assume that we will continue to receive this income in CP7 (the SBP assumed that we would lose the majority of this income in CP7). We will review and update our forecast following the conclusion of ORR’s consultation – we are providing ORR a separate response to its consultation.

**Schedule 4**

We have updated our Schedule 4 costs and Schedule 4 access charge supplement forecasts as part of the high-level updates to our CP7 plan. Our latest forecasts use Schedule 4 costs based on our latest view of CP7 maintenance and renewals activity, and assume ORR’s proposed reduction in Schedule 8 rates of 45% (which flow into Schedule 4 payments). Consistent with PR18, we have also included expected costs from emergency timetables, based on our CP6 experience. The reduction in forecast Schedule 4 costs is offset by a reduction in Schedule 4 ACS income so there is no net impact on our income forecast from these changes.

In our SBP, we explained that the SoFA did not include funding to reflect that freight Schedule 4 payments are not offset by an access charge supplement and that freight Schedule 8 cancellations are assumed to be non-zero at the start of CP7. We think that our SBP estimate of £74m for these costs is still robust and so we have maintained this assumption in our latest high-level plan updates. This funding shortfall is reflected in our overlay.

**Property and other income**

ORR's draft determination proposed an increase in our property sales income forecast to align with the levels of sales we have achieved in CP6 (i.e. £90m more than the England & Wales SBP assumption). The SBP included an overlay that broadly aligns to the proposed property income stretch included in the draft determination. Whilst we accept ORR's proposed stretch, this will be challenging to deliver as we have a decreasing pipeline of sales opportunities and face a difficult market outlook. However, we are continuing to assess the potential for other opportunities which will help to contribute to the stretch target.

Since the SBP, we have included £23m of additional property income in region plans (Southern £15m and Eastern £8m) with the remaining stretch (£67m) held in Group Property. Ahead of the delivery plan, we will review the stretch held in Group Property with the expectation that the majority of it moves into regions, given responsibility for property assets is devolved to the regions.

We have recently agreed changes to our insurance arrangements with train operators so we will no longer charge certain insurance premiums – this income has previously been included for CP7 in the 'property & other income' line in our financial tables. This shows as a £33m reduction in income in our latest high-level CP7 plan update. However, we also see an equal offsetting reduction in costs, which means that there is no overall impact on our CP7 funding, with expected cost savings across the wider industry.

We have not yet updated our income forecasts of the Crossrail supplemental access charge (CSAC), as ORR has not yet determined the cost of debt estimate that is a key part of the calculation of the charge. We will update our forecast once we have clarity on the cost of debt assumption – we are happy to discuss this with ORR.

## Operations and support costs (England & Wales)

### Operations

For CP7 operations activity, ORR's draft determination agreed with our principles of reducing vacancy gaps, better managing fatigue among operations staff and professionalising operations competence as outlined in the SBP – we welcome this. However, ORR did ask us to provide further information on changes to operations costs from CP6, and to demonstrate that our CP7 plans are efficient.

To respond to ORR's draft determination, our regions have provided further information on the changes to operations activity, which is set out in waterfalls and accompanying commentary, and covers: the impact of decisions taken in CP6 that will continue to have an impact in CP7; one-off CP6 costs that are not expected to impact CP7; and additional activity / costs in CP7.

Region-specific information can be found in each of the region responses that accompany this overall response. Our England & Wales CP7 operations post-efficient costs (£3.9bn) are c.£70m lower than CP6. Please note that CP7 operations costs in our latest high-level plan updates are c.£130m higher than the SBP, which is primarily due to the release of a workforce reform provision from group, which mainly impacted Eastern region. We summarise the key movements in cost between CP6 and CP7, below.

In CP6 regions invested in operations delivery to improve train service delivery and to make improvements in management of fatigue in our operations workforce. Regions sought to close vacancy gaps to minimise the impact on operational performance from the gap between signaller notice periods and new signaller recruitment / training period. We have also added headcount in signalling, control and response teams to improve the resilience of our operational teams and to support new services such as from the Elizabeth Line. These changes have helped to reduce performance disruption, reduce delay during service interruptions, and to better understand and mitigate causes of delay.

Many of the changes in CP6 took place part way through the control period and so to help compare between CP6 and CP7 on a like-for-like basis, regions have calculated a CP7 'baseline', which adjusts CP6 costs for these types of issues (e.g. reflecting a full five-year impact of additional CP6 costs). For example, the impact of inflation on energy bills and other opex costs flows into the full control period impact in CP7. This CP7 baseline also adjusts for any one-off costs from CP6, which are largely additional costs incurred to protect our workforce and passengers during Covid-19.

In CP7, we will continue to direct funding at improving resilience in our operations teams. For example, Southern and Eastern are seeking to build on progress in CP6 to close vacancy gaps. The impact of this strategy is also strengthened by the new national rostering principles secured as part of the settlement of industrial action that includes significant productivity elements which will reduce costs, including agreements that will reduce turnover of signallers. We also see targeted spend to resource teams to comply with the new fatigue standard, and to comply with continued investment to professionalise operations competency, with a focus on quality assurance of competence. Regions are also making investments in operational security, both to meet legislative requirements in this area and to mitigate the performance impact of railway crime-related disruption.

Some movements in CP7 operations costs reflect changes in categorisation of costs between support, operations and maintenance costs in CP7, that are not reflected in our CP6 numbers. For example, in CP7, North West & Central's station costs are included in operations rather than in support (increase in pre-efficient costs by £168m), with a corresponding reduction in support costs. There are also movements from operations to support, such as £45m of North West & Central's telecoms spend.

In our latest high-level CP7 plan updates, our regions have continued to commit to delivering 10% efficiency in operations costs by the end of the control period (£259m), even in the face of challenges from persistent inflationary pressure, and our ambition to improve train performance in CP7. Efficiency plans reflect a range of specific interventions by each region, and include delivery improvements, commercial initiatives, technology improvements from RD&I initiatives and operational benefits of signalling renewals, as well as stretch in plans that will be addressed as we move towards the delivery plan.

**Support**

We have continued to review our CP7 support costs since the SBP. Region and function-specific information can be found in the individual responses that accompany this overall response. Our England & Wales CP7 support post-efficient costs (£4.6bn) are c.£500m higher than CP6. CP7 support costs in our latest high-level plan updates are c.£160m lower than the SBP, which is primarily due to changes in group provisions for workforce reform, previously held as support costs – these have now been released into region plans. We summarise the key movements in cost between CP6 and CP7, below.

In CP6, support costs have increased as a result of higher utility and contract rates, and higher-than-forecast pay awards from recent negotiations with trades unions. However, these increases have been partially offset by headcount reductions in national functions during the control period. Establishing a devolved business has moved costs from functions to regions, and we have incurred some additional costs in regions to deliver the benefits of the move to the devolved business model.

As with operations, many of the changes in CP6 took place part way through the control period and so to help compare between CP6 and CP7 on a like-for-like basis, regions have calculated a CP7 'baseline', which adjusts CP6 costs for these types of issues (e.g. reflecting a full five-year impact of additional the additional CP6 costs). For example, the impact of inflation on energy bills flows into a full control period impact in CP7. This CP7 baseline also adjusts for any one-off costs from CP6, which are largely additional costs to protect our workforce and passengers during Covid-19 and benefits of one-off pay and reward reductions (e.g. performance related pay). However, this also includes region-specific costs such as North West & Central's CP6 train performance improvement plan, and its targeted initiatives to improve reliability for passengers travelling to the Commonwealth Games in Birmingham.

Our CP7 plans shows an increases in support costs due to a number of factors. More than half of this increase (c.£300m) relates to Route Services from the combination of additional costs to support the growing IT and digital estate and the maintenance of intelligent infrastructure tools (c.£130m), as well as the movement of infrastructure monitoring costs from capex to support costs in CP7, which reflects a change in delivery model in CP7 (c. £150m). Changes in the classification of System Operator costs as operations costs in our CP6 numbers, which are shown as support costs in CP7, account for c.£150m of the movement. There is also a c.£300m adjustment in North West & Central to reflect classification differences between our CP6 numbers (which are aligned to our regulatory accounts) and CP7 numbers. Other drivers of higher costs in CP7 come from additional resources to improve environmental management, manage biodiversity improvements and legislative compliance, and support weather resilience activities. There are uplifts in crime and security expenditure including an increase in dedicated disruption teams and enhanced security at stations, as well as additional costs from leases to support the transition of our road fleet to zero emissions vehicles. There are some offsetting reductions across plans from lower group provisions and a reduction in corporate services costs over CP6.

Our CP7 support costs forecast include £297m of efficiencies across regions (£105m) and functions (£192m). This includes commercial efficiencies from joint property strategies (e.g. accommodation sharing) and improved contracting strategies (e.g. benefits on re-tendering of contracts). Improved delivery is also expected to drive savings. There will also be benefits from technology improvements from moving to a data as a service delivery model for infrastructure monitoring and region-enabled efficiencies through improvements in use of data and IT systems.

We note that ORR's draft determination set out a prioritised action for us to consider the findings of ORR's external benchmarking study (led by consultants Steer) investigating support costs and agree any changes to support approach or expenditure arising from this. ORR has not yet shared this study and so we have not been able to take forward this action as part of our work to respond to the draft determination.

# PART C – Our policy responses (GB wide)

# 8. Change and flexibility

## Key response points covered in this chapter

**Key response point 1:** Given the challenges and uncertainties we face in CP7, it is essential that ORR is flexible and pragmatic in its approach to regulating Network Rail, recognising the high level of anticipated change as PR23 is concluded, and the challenges we face during CP7.

## Introduction

As we have progressed through PR23 the significant level of uncertainty we continue to face for CP7 has become even more clear. As we respond to ORR's draft determination, there remain areas of our plan that we know require further review (such as our approach to addressing the current overlays in regions' CP7 plans, discussed in chapter 3), as well as continued uncertainty on the CP7 operating context, wider financial and economic pressures, and train operator plans.

The introduction of the managing change policy for CP6 recognised that Network Rail needs to continue to adapt and evolve plans to consider wider circumstances and adopt continuous learning and improvement. We support this principle for CP7 and the continued need for a managing change policy to enable changes to be considered, effectively communicated and reflected in regulatory monitoring. However, relying on a single policy, which has, at times, been unduly burdensome, is not appropriate to manage the scale, frequency and complexity of change we expect to see in CP7. It is vital that ORR's approach to change and flexibility evolves to enable us to manage the unprecedented levels of uncertainty for CP7. The managing change policy itself needs to be appropriate and effective, as well as ORR's wider regulatory framework.

We expect plans to change as we develop the CP7 delivery plan, and it is likely that we will need to trigger the managing change policy before the start of CP7. We expect the CP7 managing change policy to be published alongside the final determination so that it can be used to manage and communicate changes ahead of CP7 starting as required. It is therefore essential that ORR's approach to monitoring in CP7 recognises that our delivery plan will move on from this response and the final determination (reflecting that, as with other points during the periodic review, they reflect points in time). We are already engaging with ORR on how best to provide assurance on our delivery plan as it develops, and we will provide transparent information that allows ORR to monitor our up-to-date plans. We also recognise throughout CP7 we need to capture and transparently describe changes to outcomes and financials to provide line of sight between plan updates.

In this chapter we set out the key principles which need to be reflected in a flexible regulatory framework for CP7. Our main points discuss:

- The need for flexibility to manage uncertainty in CP7.
- Improving the managing change policy to make it easier to understand and use in CP7.

## The need for flexibility to manage uncertainty in CP7

As discussed throughout this document, there is significant continued uncertainty which will require an agile and flexible approach over the remainder of PR23 and during CP7. ORR's draft holding to account policy for CP7 highlights the principles of regulatory best practice that it will adopt in CP7; risk-based, targeted, proportionate and transparent. We note that these are similar to Government's principles for economic regulation highlighted in chapter 1, which also include adaptability, coherence and predictability. To reflect these principles, ORR's approach needs to recognise that:

- Risks will continue to evolve, and we will manage this on a rolling basis. The requirements of the draft managing change policy may not be proportionate to enable an agile approach to managing risks, particularly where changes are unexpected and outside of our control, requiring us to balance outcomes appropriately.
- Small changes can have a material impact across a number of outcomes. There will be fluctuations, as there have been in previous control periods, around point value forecasts as we experience and respond to external events, and balance outcomes across our plan. This will not always lead to formally triggering managing change, but is important to consider in ORR's monitoring.
- The scale and nature of challenges needs to be considered in the round to take a proportionate approach to monitoring. While an issue may appear material against the final determination or other expectations, it may be necessary to manage a much more significant risk across our wider plans, particularly as risk funding is so limited. ORR has not consistently recognised the interplay and balance between areas of our plan through PR23, often assessing impacts in isolation. Overall coherence of ORR's approach is key.

This needs to be reflected throughout a flexible regulatory framework. While this includes the managing change policy, which enables us to formally communicate and manage changes to certain elements of the final determination, the need for flexibility must be reflected throughout ORR's approach to monitoring and engaging with Network Rail, including:

- ORR's Holding to Account approach: managing uncertainty in CP7 will require agility in our planning and day-to-day operations. As we flex and adapt our plans and delivery to changing circumstances, ORR will need to take an adaptable and pragmatic approach to monitoring and regulatory interventions, even where this doesn't formally trigger managing change (for example, in monitoring input delivery through supporting measures). It is also important that ORR considers our plans holistically and takes a coherent approach, recognising that given the range of funding pressures we face in CP7, we will need to carefully balance our activities and outcomes.
- Incentives frameworks: while changes in the incentives framework are likely to be linked to the managing change policy (i.e. a change to train performance outcomes), ORR will need to consider the wider implications of changes and adopt a practical approach so that incentive regimes remain proportionate and reflect the wider operating context.

- Regulatory and contractual frameworks: We have set out our intention to take a market-led and whole-industry approach as we continue to develop our CP7 plans, which will support us to address the overlay currently in plans and deliver whole-industry efficiencies. This is supported in the England & Wales HLOS. Through evolving discussions, ORR has also been supportive of the approach. In practice, ORR's support will be key to enable appropriate flexibility in industry contractual frameworks (such as the Network Code) and the regulatory framework (such as the network licence) to enable rather than impede whole-industry delivery. This is particularly important given delays to rail legislation reform.

We are concerned that ORR considers the managing change policy as sufficient to deal with the level of uncertainty we are facing in CP7, particularly as the policy sets out potentially burdensome requirements for the level of change we expect through the control period. While the draft holding to account policy reflects a more proportionate approach (e.g. recognising that there will be fluctuations in performance), it predominantly leans on the managing change policy as a mechanism to change our plans and outcomes trajectories). ORR's draft managing change policy includes an expectation consulted changes will not be made frequently, which demonstrates that ORR has not understood and reflected the level of uncertainty we are facing in CP7. The policy has only evolved slightly from CP6 and we do not believe this reflects the fundamentally different funding, operational and regulatory landscape for CP7. Under the draft policy, Network Rail would not be able to progress with a consulted change without receiving ORR's formal opinion. The policy, and ORR's overall approach, needs to reflect the level of agility needed so that it is not a blocker to change, particularly given the level of potential change in CP7.

## How the managing change policy should be improved

**Core assumptions and principles of the policy**

ORR's draft managing change policy appears to be based on a core assumption that Network Rail will have a choice on whether to proceed with change, that consulted and exceptional changes will be rare and the impacts will be easy to isolate and describe. The policy needs to recognise that the areas on which we face most uncertainty in CP7 are not within our control, and we will have to react to changes across our plans. This includes inflation, operator funding and business plans, and industry reform. If our assumptions on any of these change, we will have to respond accordingly and adapt our funding allocations and outcomes accordingly. The level of change we have already seen throughout the periodic review as a result of external factors indicates these changes will be much more frequent than the draft policy anticipates.

We request that the policy makes clearer the distinction between changes that Network Rail instigates and changes we must make to respond to external factors, and how ORR expects us to manage these. While there is a clear need for transparency and communication for both, our response and ORR's actions need to be proportionate to the level of control we have.

It is also important to provide clarity on how changes set by funders should be managed. This is particularly relevant to Scotland's Railway where Scottish Ministers' have 87 specific requirements which, over a five-year period, may change as Ministerial priorities evolve in a time of such uncertainty (noting any financial implications and knock-on impacts would also need to be considered). To support improvements in this area we suggest working with ORR and funders as the policy is finalised for CP7.

**The link between safety and economic regulation**

While ORR's draft policy highlights the need to consider impacts of changes on safety, it is not clear how the policy accounts for the impact of safety decisions on the wider plan. To respond to safety risks, we may need to make decisions that have financial impacts and require us to balance the outcomes we can deliver. We recommend that the policy highlights safety as a core principle, and sets out how ORR will ensure alignment across safety and economic regulation.

**Identifying relevant changes**

We agree with ORR's draft policy that not all changes to our plans are relevant under the policy. Clarity on the baselines for change is essential (i.e. not every expectation in ORR's final determination would constitute a relevant change). ORR's draft policy sets out a number of outputs that ORR monitors performance against, but is not clear on their relevance for the managing change policy. We believe that relevant changes are against:

- The baseline funding and outcomes expectations which ORR will set out in the Final Determination (for financial and outcomes changes).
- The accountabilities set out in the network licence (for accountability changes).

The current draft of the policy makes no reference to the accountabilities of business units set out in the network licence. Additionally, paragraph 1.7 refers to accountabilities of 'core' national functions, which are not clearly defined in either the draft determination or the licence.

We are also concerned that the draft policy risks duplication around engagement on the use of risk funding. For example 'Box 1' in the policy states that spending risk funding on rising inflation costs would be considered a notified change because regions have agreed to it. This would not constitute a change to our plans, rather it would be spending risk funding on what it was originally intended for – to manage risk in our plans. We are already discussing arrangements for governance around risk funding with ORR and we are keen to discuss how this is described in the managing change policy further so that the policy is proportionate, and does not set out unreasonable or duplicative expectations.

**Outcomes changes**

It is particularly important to properly review the managing change policy in the context of the changes being made to the outcomes framework for CP7. The policy was originally written in the context of a CP6 outcomes framework based around our scorecards, which we update through a controlled process each year. The CP7 outcomes framework seeks to set regulatory trajectories in the final determination for all five years of the control period, without a standard annual change process. ORR's policy expects nearly all changes to outcomes to be consulted or exceptional (requiring a formal written opinion), and that consulted and exceptional changes will be rare. We recognise that ORR wants to monitor against clear and stable baselines, but as we have seen through PR23 to date, that is likely to be an unrealistic expectation that has led to inappropriate requirements in the draft managing change policy and the wider regulatory framework. As currently drafted, ORR's proposed managing change policy sets conditions for changing to regulatory trajectories which we do not see as realistic or reasonable. Our key concerns are:

- The materiality threshold proposed by ORR does not recognise that relatively minor changes can have a significant impact on our plans and outcomes, particularly with constrained funding and very limited provision for risk.
- The draft policy expects that changes to regulatory trajectories would only be made if the change or impact was unforeseen in Network Rail forecasts (or ORR baselines where these differ to Network Rail's forecasts – again, highlighting the importance of having clear assumptions underpinning ORR's baselines, particularly where these differ from Network Rail's proposals). This assumes that final determination trajectories will be based on clear, robust, evidence-based assumptions against which we can describe change. In particular, ORR's approach to defining train performance trajectories in the draft determination does not fulfil this at all, making the policy impossible to practically apply. Our full response to ORR's proposals on train performance are in chapter 5.
- The expectation that changes will likely be outside of Network Rail's control also doesn't reflect the level of risk and constraint in our plans. We expect to continue to make careful trade-offs in our CP7 plans to continue to prioritise outcomes appropriately, which may be within Network Rail's control and will lead to changes.
- The requirement that changes have a material impact for future years assumes that we will have information available to accurately forecast the impact for future years. As set out in chapter 5 of this response, the current contractual arrangements for operators means we often will not have information on operator business plans for more than one year ahead so accurately forecasting train performance impacts in future years is an unrealistic expectation. ORR's recognition of this in its overall approach, in respect of forecasting train performance for years 1 and 2 of CP7, is critical.

We see the policy as overly burdensome for the amount it will need to be used, notwithstanding the '2+3' approach for train performance. Considering what we still need to work through ahead of CP7, the uncertainty we continue to face across a number of outcomes (e.g. wider industry impacts on efficiency and train performance), and the expected changes during the control period due to wider financial pressures, we strongly recommend that ORR reconsiders the principles and approach to flexibility on outcomes. This applies across managing change as well as the wider regulatory framework.

**Financial changes**

The policy also does not appear to reflect the funding context for CP7 and the limited risk funding available. Changes to funding allocations may be more likely in CP7 as a result.

The impacts of the uncertainty we're facing may be widespread and complex so it may not be possible to boil down the explanation of changes to an isolated cause and effect as currently expected in the draft policy. We also think it's important to give ORR transparency of the cumulative impact of changes. Progressing consulted changes for every £50m change to risk funding (as currently proposed by ORR) would miss the bigger picture and also create unnecessary bureaucracy. We do not think this is a proportionate approach.

We recognise the importance of being transparent about the use of risk funds. We already engage with ORR on the use of risk funds in CP6 and intend to maintain this transparency in CP7. More widely, we have recently agreed principles for the use of CP7 risk funding with Government and ORR. These principles set out how we will provide increased transparency of the scope and use of risk funding in CP7. We think these principles give ORR sufficient visibility of the use of the CP7 risk funding.

We recognise that where risk funding is not required for risk in CP7, and is instead used to fund new activity, this would constitute a relevant change under ORR's draft policy. However, where risk funding is used to address risks that have materialised, we do not think this is part of managing change and would be reported through the rolling forecast (RF) process as it is not new activity.

We are keen to work with ORR on how we can proportionately strengthen engagement on financial changes and use existing processes to provide transparency, particularly for use of risk funds, rather than create additional burden through managing change.

In addition to the requirement for flexibility across the regulatory framework, we have identified specific areas where the managing change policy should be improved. For example, where we think there are inconsistencies with the overall purpose of the policy, principles for economic regulation, and / or the planning context for CP7.

**Determining levels of change**

We are concerned that parts of the draft policy contradict the criteria for determining levels of change, and that ORR's proposed approach to exceptional changes is inconsistent with Network Rail and ORR accountabilities.

Sections 3 and 4 of the draft policy suggest ORR may reclassify consulted changes to exceptional changes, including if it has concerns about how Network Rail's decision reflects ORR's opinion. As a requirement of our network licence, Network Rail is responsible for complying with the managing change policy. Regardless, the level of change is determined in the policy by materiality so ORR reclassifying changes because it disagrees with Network Rail's decisions following ORR's formal opinion is unacceptable. We agree that discussion with ORR on the level of change, and how we decide to progress a change, is important to provide transparency. However, ORR's proposed approach to classifying changes itself takes accountability for licence compliance away from Network Rail, impacting ORR's ability to then independently regulate us on how we have applied the policy. Additionally, it leaves the policy open to misuse should ORR decide to reclassify and then block changes without good reason.

Under our devolved model, region and function ownership of plans and outcomes, and agreement to changes, is a core element of our governance and business planning approach. This needs to be more appropriately reflected in the policy. In describing the levels of change, ORR's draft policy includes contradictory and confusing information in relation to agreement from business units (paragraphs 3.1-3.4). This needs to be consistent with ORR's draft criteria for determining the level of change: materiality, ability to hold Network Rail to account and business unit agreement. If a business unit agrees that a change does not impact on commitments to customers, the materiality and ability to hold Network Rail to account would classify this as a notified change (rather than ORR's proposal that any reduction to business unit funding set out in the final determination would be a consulted change). Our recommended approach supports the principles of devolution, with regions and functions continuing to own their plans and outcomes, and enables ORR to hold the relevant business unit to account.

**Process**

We recommend that the process for managing change should form part of the local arrangements that ORR and Network Rail will use to implement and manage the policy and not defined in the formal policy itself. This would allow flexibility on the implementation and workings of the policy to be updated within the control period without having to request an edit to the policy which would require formal consultation as per network licence requirements.

We welcome working further with ORR to define the new process for CP7 once the other components of the policy have been updated. In particular, building on our CP6 experience, we think the requirements of the policy could be better aligned with existing processes to minimise duplication. For example, through the rolling forecast process we engage with stakeholders, funders and ORR to discuss and agree changes to our plans. Where practical, the policy should enable use of existing processes rather than setting an additional burden, such as correspondence and additional information requests. Additionally, information requested in relation to changes to be proportionate and targeted (in line with ORR's wider approach to information requirements set out in the network licence).

Stakeholder engagement (including with ORR) is a fundamental part of business planning, including agreeing annual scorecards with funders. We are concerned that we will be at risk of continually reviewing and engaging on changes, and duplicating effort. The policy should seek to rely on existing processes wherever possible to minimise additional burden. An effective and proportionate policy for CP7 would focus on the need to communicate effectively on changes, without creating undue burden and / or duplicating other established processes.

Some specific process points also need to be clarified in the policy. The provision of the change log 'periodically' should be clear that this does not mean every period (i.e. every four weeks), but rather means at an agreed frequency. Additionally, references to timeliness, and the treatment of similar changes, should recognise that some changes may involve sensitive information and therefore the process should be adapted accordingly.

**ORR's involvement in the managing change process**

The draft policy outlines proposals for ORR's involvement in the managing change process, as well as some other references to actions ORR may take throughout the policy. We welcome that the policy is clear it shouldn't be a barrier to making urgent changes. However, we have concerns with how some of these proposals on non-urgent changes align with ORR's role as independent regulator, governance processes within ORR, and principles of economic regulation:

- Paragraph 1.8 of ORR's draft policy says 'should Network rail make a Relevant Change without complying with this policy, this would be a break of the network licence and ORR may take action'. Elsewhere in the policy, ORR clearly recognises there may be occasions where it's necessary for Network Rail to progress changes outside of the policy. Regardless, ORR's holding to account policy is clear that ORR's board will make a final decision on whether there has been a breach taking into account Network Rail's response to any investigation. The managing change policy should be clear that ORR will follow due process to determine whether there has been a breach, consistent with wider commitments on holding to account.
- Under the draft policy, Network Rail would not be able to progress with a consulted change without receiving ORR's formal opinion. Clarity is required on ORR's commitment to timeliness so it is not a blocker to change, particularly given the need to be agile in CP7.
- Paragraph 3.6 sets out that ORR may ask Network Rail to include or remove headline success measures, and if Network Rail does not make the changes, ORR will have the option of making its own changes. We are concerned that this is inconsistent with ORR's wider approach to agreeing the outcomes framework for CP7, which has been subject to industry and public consultation to agree success measures. It would be inappropriate for ORR do this without consultation and risks further misalignment on industry metrics (which we reference in the train performance section of this response). Regardless of consultation, the policy should be clear that ORR requests will be consistent with the network licence which requires Network Rail to provide information ORR reasonably requires. If it is not reasonable for Network Rail to report on measures to ORR (for example, measures that are no longer used anywhere in Network Rail or across industry), we do not expect ORR to require Network Rail to direct resource to reporting processes.
- ORR's draft policy sets out the conditions under which it would change the regulatory trajectories it uses to hold Network Rail to account. Network Rail and wider industry will still agree appropriate annual targets – for example through joint train performance strategies. If these differ from the trajectories ORR is using, and changes do not meet ORR's materiality threshold (which is challenging to demonstrate as highlighted above), ORR is still at risk of using out-of-date trajectories and causing confusion through public reporting. This would contradict ORR's stated objective to provide transparency on what ORR and wider stakeholders expect of Network Rail. The materiality threshold should be reconsidered to enable changes that bring about consistency in the targets the industry is using to assess performance, and reporting publicly.

- ORR's draft policy sets out the information ORR may require to provide its opinion on consulted changes. In some cases through CP6, ORR has asked us to pre-emptively demonstrate future compliance across the board before implementing a change. While it is not unreasonable for ORR to seek assurance on specific areas, pre-emptively guaranteeing compliance is often impossible, and inconsistent with ORR's wider, risk-based approach to regulation. ORR's approach needs to be proportionate in CP7.

**Structure and clarity of the policy**

We have raised concerns throughout CP6 that the existing managing change policy is difficult to interpret and apply. We do not believe the proposed CP7 policy resolves this as it is repetitive and doesn't align with the way changes are managed in reality.

To provide transparency on how ORR will give effect to our regulatory obligations, the policy needs to be coherent. We recommend that the policy is restructured by the type of change to better reflect how it will be applied in practice. We also recommend clearer and simpler language to make the policy easier to interpret.

# 9. Outcomes framework

## Introduction

Overall, the new tiered outcomes framework for CP7, set out by ORR in the PR23 policy framework and technical consultation conclusions (hereafter referred to as December 2022 policy conclusions), provides a clear structure for holding Network Rail to account. Our response to these consultations and ORR's CP7 holding to account policy consultation emphasised the need for flexibility in the regulatory framework and a proportionate approach to holding Network Rail to account. Responding to ORR's draft determination has continued to demonstrate the need for flexibility, as highlighted in chapter 8, as we continue to adapt our plans, learn more about metrics and seek to align industry priorities.

ORR's draft determination identifies some slight changes, refinements and clarifications to the measures in the CP7 outcomes framework since publication of the December 2022 policy conclusions. In this section we set out some overriding observations on the principles relating to the CP7 outcomes framework. We have provided a supporting document to ORR with specific feedback on individual measures (including highlighting that OPI will no longer be monitored by Network Rail in CP7 and that the ITTS programme has closed). Where there is no change between the December 2022 policy conclusions and the draft determination, and we have no additional feedback, we have not provided comments on the measure.

## Success and supporting measures

In addition to providing our feedback on specific measures in our supporting information document on the outcomes framework in CP7, we have some overriding observations on the principles relating to the CP7 outcomes framework:

- ORR previously highlighted in its December 2022 policy conclusions that the outcomes framework would be aligned to the train performance requirements set out in the HLOSs. The draft determination is misaligned to this principle. We recommend that Freight Cancellations and Lateness (FCaL) is used as Scotland's Tier 1 success measure for freight performance, rather than freight cancellations. This is in line with the rationale to hold Scotland's Railway to account on the Scotland Performance Measure rather than On Time for passenger performance. The different status of measures for Scotland's Railway needs to be much clearer in ORR's final determination (e.g. in tables of success measures). As drafted in the draft determination, this distinction risks being lost in detail.
- We appreciate the clarity provided in the draft determination that the primary focus of ORR's monitoring and holding to account will be against region and England & Wales settlements and that the Great Britain trajectories are purely for providing an overview of performance expectations and for informing any future changes to trajectories (e.g. due to geographical boundaries). We recognise the slightly different status of GB level trajectories for Freight Cancellations and FCaL.

## Additional assurance

ORR's supporting document on outcomes makes multiple references to 'additional assurance', 'enhanced monitoring', 'developing leading and lagging metrics', and 'ad-hoc analysis'. We assume that ORR is considering these measures for use as part of tier 3 (additional assurance). In some cases, for example Network Capability, there are ongoing discussions between ORR and Network Rail on CP7 monitoring arrangements. We do not expect ORR to set out tier 3 measures in its final determination without relevant discussion and agreement with Network Rail, particularly as one of the principles set out in the framework is that additional assurance data and requirements would be defined outside of the PR23 process. We will continue to work with ORR ahead of the start of CP7 to discuss proposed tier 3 measures, recognising that in some areas we need to develop new and more effective metrics (for example in relation to accessibility and network capability) and in other areas feedback on the suitability of existing measures.

## Grading of CP7 plans

ORR's draft determination introduction refers to its consideration of grading our plans for the final determination, on the basis this could help drive improvements in the production of future business plans. To date ORR has not issued assessment criteria around how it would undertake any grading of our regions' and functions' plans. Therefore we are unclear how grading based on objective and pre-communicated criteria could be applied in practice. Furthermore, without clear expectations on what would warrant a top 'grade', we would not realistically be able to act on ORR's grading to drive improvements to future business plans. We will continue to reflect on areas of ORR's draft determination (and ultimately its final determination) where improvements and / or requests for further clarity have been identified, as well as ongoing insight and dialogue with ORR, to support our CP7 delivery plan development.

## Next steps

We look forward to working with ORR ahead of the publication of its final determination to clarify and agree the principles relating to the framework highlighted above, as well as discuss our views on the success and supporting measures, set out above (and in our supporting information on the CP7 outcomes framework) and commence discussions on additional assurance arrangements. It will be important to have a consistent understanding and up-to-date definitions for all measures ahead of delivery plan and we will continue to discuss this with ORR.

In addition to working with ORR on the principles of the framework and the associated measures it is important we agree how monitoring will work in practice. Ahead of the delivery plan, we will work with ORR to agree and implement the monitoring arrangements for CP7 (e.g. through existing mechanisms such as the Data Protocol). This should include reviewing these arrangements so they are fit for purpose and in line with the CP7 framework and operating context, rather than continuing with legacy arrangements from previous control periods.

In developing and publishing our delivery plan we will also work with ORR to agree the information and forecast requirements (including for supporting measures) to support monitoring

CP7. Where we have previously provided forecasts for supporting measures in our SBP, these are subject to change our delivery plan. We will also be working with ORR to confirm that they are using the most up to date forecasts provided, for example in the case of Train Accident Risk Reduction (TARR) which ORR references in the draft determination.

# 10. Financial framework

## Scope

This chapter covers our response on ORR's proposals for the CP7 financial framework. In particular we focus on our CP7 cost of capital estimate, government budgetary processes, network grant arrangements and the management of financial risk.

## CP7 cost of capital estimate

We note ORR's updates to our CP7 cost of capital estimate, which are based on following guidance from the UK Regulators Network (UKRN) that was not available when we produced our estimate for the SBP.

The overall cost of capital value proposed in ORR's draft determination is slightly higher than that proposed in our SBP. ORR has taken a different approach to calculating the cost of equity, based on using recent CMA decisions, which is driving the difference. We do not have any material issues with ORR's approach in general.

We have updated our analysis to align with ORR's cost of equity calculation. We have also updated the cost of capital estimate for the latest estimates of our cost of debt – this is important for some supplemental charges we receive on historic investment. This update takes the latest view of inflation forecasts and the latest view of our new debt costs, which when combined result in a slightly higher cost of debt than estimated in the SBP.

The updated cost of capital is shown in table 10.1, below.

Table 10.1: Comparison of CP7 cost of capital estimates

| Component | SBP | Draft determination | Network Rail latest |
|---|---:|---:|---:|
| Cost of equity (real CPI) | 4.44% | 4.69% | 4.69% |
| Cost of debt (real CPI) | 2.33% | 2.33% | 2.47% |
| **WACC (real vanilla CPI)** | **3.12%** | **3.27%** | **3.30%** |
| CPI/RPI wedge | 0.70% | 0.47% | 0.7% |
| Cost of debt (real RPI) | 1.63% | 1.86% | 1.77% |
| WACC (real vanilla RPI) | **2.42%** | **2.80%** | **2.60%** |

Source: Network Rail's CP7 SBP, ORR's PR23 draft determination and latest Network Rail analysis

We note ORR's use of the CPI/ RPI wedge of 0.47%. Our working assumption for the CPI/RPI wedge is between 0.7% and 1.0%, based on historic data. We would welcome a discussion with ORR as it finalises the final determination to agree the appropriate wedge to use across our CP7 plan.

## Network grant arrangements

We agree that it is important to confirm network grant agreements before the start of the control period. We note ORR's proposed timescales in the draft determination and are working with DfT and Transport Scotland to put network grant agreements in places as soon as possible, noting that progress will largely depend on DfT's internal governance processes. We will keep ORR updated on our progress as it works towards the final determination.

We note that ORR is consulting on changes to grant dilution provisions in track access agreements as part of its consultation on changes to model contracts. This proposal would reduce the length of time between a dilution event being triggered and the increase in FTAC payments from three months to one month. Given the close working relationships we have with Government, we do not expect grant dilution provisions to be required during CP7, and would seek to resolve any issues related to the payment of network grant through our regular discussions with Government during the control period. However, we do not have any objections to ORR's proposed changes to grant dilution.

## Government budgetary processes

We agree with ORR that the current flexibilities are important in maximising value for money for rail users and taxpayers.

Network Rail's current CP6 financial flexibilities are critical to being able to efficiently manage our activities. These financial flexibilities have supported more effective and efficient asset management, and have allowed for better responses to issues, (e.g. Covid). The current arrangements provide flexibility to optimise delivery of engineering work to minimise impact on passengers and freight customers. They also allow regions to make decisions that optimise the balance between maintenance and renewals to minimise overall costs.

Our SBP was developed on the basis that we have the same financial flexibilities in CP7 as we have benefited from in CP6. Therefore, we welcome the confirmation we have recently received from Government that our CP6 flexibilities will continue in CP7.

## Other financial framework issues

Management of financial risks: We discuss our proposed approach to managing financial risk in CP7 in chapter 4 above so do not repeat the content here.

Regulatory asset base (RAB): we note that ORR will not use the RAB to calculate our allowed revenues for CP7. We agree with ORR's decision to retain the current approach for the setting and updating of RAB balances for CP7.

Rebates: we note ORR's view that rebates of government grants by Network Rail back to governments should only be made in exceptional circumstances and should not create risks to the financial sustainability of our business.

Re-opener provisions: we agree with ORR that the current re-opener provisions in track access agreements should be retained as they provide a backstop mechanism to review the determination in light of material unforeseen circumstances during the control period.

# 11. Incentives

## Key response points covered in this chapter

**Key response point 10:** We do not support ORR's decision to now not fully implement its original proposals for c.75% (average) lower Network Rail Schedule 8 Payment Rates at the start of CP7.

## Introduction

This chapter provides an overview of our response to ORR's draft determination policy consultation on Schedules 4 & 8. Given that ORR has already consulted at length on the proposals set out in its Schedules 4 & 8 incentives regime policy document and we have already provided our views prior to ORR's conclusions in October 2022, we have focused our response on its key proposals or where we do not support a proposal.

This chapter also sets out our views on ORR's recent proposal to not fully implement the reduction in Network Rail Schedule 8 payment rates at the start of CP7. This was not set out in ORR's draft determination but has however been discussed in recent weeks.

Alongside this response, we provide further justification in our supporting information document on incentives which we have provided alongside this detailed response to ORR's draft determination. This supporting information also provides more detail on our views on the two components of the regime which were still being consulted on in ORR's October 2022 Schedules 4 & 8 conclusions and consultation on outstanding matters.

We note that ORR's proposed '2+3' approach for setting regulatory baselines for train performance has an impact on the Schedules 4 & 8 regimes (as the Schedule 8 benchmarks and payment rates will be reset in year 2 for years 3-5) and will require an automatic recalibration. This is discussed in chapter 5 and, therefore, we have not sought to repeat our response around this in this chapter.

We are also responding separately to ORR's consultation 'Implementing PR23: Consultation on drafting changes to access contracts', on the contractual wording which enables changes to Schedules 4 & 8 in line with the policy changes proposed (e.g. Schedule 4 & 8 reopeners).

This response has been reviewed and endorsed by GBRTT in respect of ORR's policy decision on the application of Schedule 8 to GBR's future operators in the event of legislative change.

## Response to ORR's draft decisions on Schedule 8

### Network Rail Schedule 8 payment rates

ORR shared the draft Network Rail Schedule 8 payment rates for CP7 with the industry in May 2023, which showed a c.75% decrease in the level of the payment rates compared to CP7 levels (though this varies significantly across different operators with some service groups seeing decreases under 50% and others well over 90%). Since then, ORR has undertaken informal consultation with the industry on the proposed rates, with the majority of train operators raising concerns. ORR have proposed applying a single transitional adjustment to the semi-elasticities (50% reduction) which underpin the Network Rail payment rates. We have been clear throughout these discussions in our support of the draft Schedule 8 Network Rail payment rates, and do not agree with ORR's recent proposal to not fully implement the lower Network Rail Schedule 8 payment rates at the start of CP7.

ORR's proposal will mean that the Network Rail Schedule 8 payment rates for CP7 will be, on average, c. 45% lower than CP6 levels. This artificial adjustment to the payment rates means that ORR has ignored the latest evidence and cross-industry agreed methodology. This evidence has faced significant scrutiny and peer review and corroborates with the studies used to estimate the CP6 Network Rail payment rates for London and South East (LSE) train operators. This evidence points to significantly reduced passenger responsiveness to delay than was estimated previously, indicating that the full c. 75% adjustment is more accurate.

ORR's decision will result in train operators being overcompensated for delays caused by Network Rail, and freight and charter operators. It will hinder cross industry collaboration to drive improvements in performance as train operators will financially benefit if we underperform. This is not consistent with ORR's statutory duty to promote improvements in train performance when it undermines cross industry collaboration which is essential to driving improvements in performance in CP7. We discuss this more in our chapter on outcomes.

We understand that during ORR's informal consultation, some operators expressed concern that our business cases for performance improvement would be weaker using the fully reduced payment rates. Any impact could be mitigated by developing alternative ways to calculate the financial benefits from improving performance within business cases, as we have explained to ORR. One approach would be to include wider socioeconomic benefits into the business case. We consider it is flawed to let a consequential impact of lower payment rates drive the decision not to implement them in full when we know that there are alternative ways to manage this impact.

Given the constrained level of funding in CP7, ORR's currently proposed performance targets (notwithstanding the '2+3' approach and the reset for years 3-5), and the likelihood of a tight risk fund, any performance shortfall would have a material impact on Network Rail. Given ORR's decision on Schedule 8 payment rates, this risk is likely to be exacerbated. Phasing in payment rates significantly increases the financial risk in our CP7 plan. It ultimately detracts from our ability to fund essential asset renewals and performance improvement initiatives if we are liable for larger sums of money under Schedule 8. This in turn risks becoming a vicious cycle as we are then less able to meet our Schedule 8 benchmarks.

This is not a hypothetical risk; in CP5 we paid out c.£1.2bn (2023/24 prices) in Schedule 8 payments to operators and had to divert funding from core asset renewals to finance this. If that cost was reduced by c. 75%, in line with the latest evidence, our overall cost would have been c. £250m, i.e. still a significant level of financial risk.

We have also produced scenarios of outturn passenger train performance versus the implied benchmark from the regulatory performance targets set out in ORR's draft determination to estimate our Schedule 8 liability in CP7. This analysis shows that if we perform at 2022/23 levels, our expected Schedule 8 cost would be c.£65m per year (assuming Network Rail Payment Rates are reduced on average by 45% vs their CP6 levels). This liability increases further if we perform at the lower (i.e. worse) end of our SBP ranges where our potential liability increases to c.£145m per annum.

From this, it is clear that we face significant financial risk through Schedule 8 in CP7, and that this risk is heightened as a result of ORR's decision to incrementally introduce the reduction to Network Rail Payment Rates. In light of this, we are not clear on how ORR has accounted for the risk of defunding vital infrastructure works in CP7 as a result of inaccurate payment rates and unrealistic benchmarks. Given the overall level of financial risk we are facing in CP7, and ORR's comments in the draft determination that CP7 risk funds may not be sufficient, we are particularly unclear on the overarching rationale for ORR's payment rate decision.

One way to mitigate this risk would be to introduce a 'dead band' around Schedule 8 payments where money flows within these thresholds are paid into an industry performance improvement fund which both Network Rail and train operators can use to fund performance improvement schemes. We would welcome the opportunity to discuss this with ORR and consider this option builds on the successful Schedule 8 overlays that have been introduced in CP6.

A further, simpler means of reducing this risk would be to introduce the full 75% reduction in payment rates at the start of CP7 (since this number is backed by evidence and is not arbitrary) and take time to review the evidence underpinning payment rates in time for the full recalibration ahead of year 3 of CP7. This would ensure that payment rates were fully evidence based in all years of CP7, whilst providing a committed opportunity to update them if sufficient new evidence was available which significantly changes the outcome vs the payment rates already calculated. This approach reduces overall financial risk to all parties as the payment rates would be lower than under ORR's proposed incremental introduction which is likely to lead to significant perverse payment flows which are not backed by evidence.

We therefore maintain the view that ORR should not apply adjustment to Network Rail payment rates. We have responded to ORR separately on this subject highlighting our concerns around the alternative approaches proposed, as well as setting our support for the full implementation of the 75% reduced draft payment rates and the full integration of the semi-elasticity approach.

**Other draft decisions on Schedule 8**

<u>In-control period recalibrations</u>

We strongly support ORR's proposal to include a provision in the track access contract which allows it to initiate in-control period recalibrations and that this should be available to all operators. We note that this would enable additional in control period recalibrations alongside the automatic recalibration as part of the '2+3' approach proposed for setting regulatory baselines for performance in CP7. However, we would appreciate additional clarifications and assurances from ORR in its final determination on how the need for in-control period recalibrations of Schedule 8 will be monitored, and how in-control period recalibrations will be initiated and carried out in practice.

Additionally, we ask that ORR will recalibrate in the event of a reduction in TOC caused cancellations back to longer term average levels. We have substantial concerns about our financial risk in the star model if this materialises, and believe that ORR needs to address this, particularly in light of its decision to transitionally introduce the reduction in Network Rail payment rates. We estimate that our financial risk in the star model where cancellations revert back to longer term average levels (assuming payment rates are reduced by 45% in years 1-2 and 75% in years 3-5 of CP7) is around £65-105m across CP7. Clearly this outflow would be larger if the full 75% reduction in payment rates was not implemented for years 3-5, with an estimated control period risk of £200-300m.

We have also updated this analysis to look at how cancellation levels have evolved since the recalibration period and have found that the percentage of TOC poor performance which is due to cancellations has fallen on average by 2% over the last 10 periods. This 2% difference would lead to a c.£5.5m cost to Network Rail in the star model (over 10 periods) if we assume that the benchmark is based on the level of cancellations within the recalibration period (as it will be in CP7) and with payment rates reduced by 45% on their CP6 levels – thus proving that the risk to Network Rail in CP7 is already beginning to materialise.

Schedule 8 switch-off for GBR operators

We agree with ORR's decision to proceed with its proposal to 'switch off' Schedule 8 where legislative change permits and note that this is aligned with GBRTT's view. The ability to turn off the majority of Schedule 8 payments between GBR and its future contracted operators will enable the successful transfer of operator contracts to GBR, whilst simultaneously simplifying the incentives that GBR specified operators face.

Sustained Poor Performance (SPP) and open access operators

We support ORR's decision to introduce a mechanism into the track access contract for open access operators to adopt the SPP clauses in CP7, where they wish to. We have responded separately to ORR's contractual framework consultation around the wording to be included in the model open access contracts and will manage separately any bespoke SPP clauses required in individual contracts where applicable.

Recalibration of Schedule 8

ORR is leading on the passenger Schedule 8 recalibration. We will continue to work closely with ORR on the development of the remaining passenger Schedule 8 parameters and emphasise the importance of ORR allowing flexibility both within the PR23 recalibration and CP7. This is particularly key in the case of Network Rail's benchmarks, which are linked to our performance trajectories and the proposed '2+3' approach.

We continue to lead on the freight and charter Schedule 8 recalibration and have already shared the results of this work with operators and ORR where available. The methodologies used to recalibrate the regimes parameters are consistent with what ORR has concluded via its decision letters, engagement with the working group, and what has been set out in ORR's draft determination. More broadly, given ORR's decision to not fully implement the full c. 75%

reduction in the Schedule 8 Network Rail payment rates in the passenger Schedule 8 regime, we would expect this decision to flow through into the freight and charter Schedule 8 regimes to ensure that the star model balances and to avoid Network Rail to be out of pocket purely by the design of the Schedule 8 regime.

We continue to work on the recalibration of the remaining parameters and are on schedule to share the final results with industry operators in early November.

## Response to ORR's draft decisions on Schedule 4

In summary, we support ORR's draft decisions on Schedule 4 and set out our views in each of the areas, below.

**Schedule 4 opt-out mechanism**

Overview

We welcome ORR's proposal to introduce an additional circumstance under which operators can opt-out or back into the regime, depending on whether the franchising/contracting authority changes. This approach provides flexibility for industry reform.

Introducing the Schedule 4 opt-out mechanism

As ORR suggests in its draft decisions, passenger operators require an understanding of the level of Access Charge Supplement (ACS) payable in return for full Schedule 4 protections. We intend to provide draft ACSs for all passenger operators (including open access) shortly once we have the required information from ORR. This will enable passenger operators to take a decision on whether to pay the ACS in return for full Schedule 4 payments, or to 'opt-out' of Schedule 4 by no longer paying an ACS, and in return receiving little (in the case of open access operators) to no Schedule 4. Freight operators do not pay an ACS, so any opt-out decision would remove their Schedule 4 payments which are provided without any return ACS payments to us.

Following a period of review, we will provide ORR with operator decisions on the Schedule 4 opt-out once window for operator decisions has passed in late October. We agree with ORR that where an operator does not communicate a decision to us, ORR should assume that the operator's existing contractual entitlement to Schedule 4 compensation remains unchanged from CP6 to CP7, including in the case of freight and open access operators. When providing ORR with operators' decisions on the opt-out, we will clearly state where we have not received a response and therefore assume the current Schedule 4 arrangements will continue.

As stated in our response to ORR's October 2022 consultation, we agree that the opt-out decision should be maintained for the entirety of the control period. We also agree with the list of limited circumstances where the opt-out decision can be reopened during the control period as set out in paragraph 2.1 of ORR's draft determination policy document on Schedules 4 & 8, for example when the franchising / contracting authority changes.

**Schedule 4 reopener within CP7**

We support the two Schedule 4 reopener provisions proposed by ORR in its draft determination. We are going through a period of transition at Network Rail which includes our Better Timetabling for Passengers and Freight (BTPF) programme which:

- Regularises the improved flexibility in timetable change timescales that has been realised throughout the Covid-19 pandemic period.
- Aligns to wider reform work in anticipation of the transition to GBR.

If BTPF is successfully implemented during CP7, we agree with ORR that this will have an impact on Schedule 4, specifically the notification thresholds and factors which exist in the passenger regime. We, therefore, strongly agree with ORR that Schedule 4 should be reopened to update the notification thresholds and factors to apply from the date upon which the new BTPF timetabling process is first implemented.

As notification thresholds and factors impact on the amount of Schedule 4 payable by Network Rail, we also agree with ORR that the ACS should be updated to reflect this change; ensuring that on expectation, the amount of ACS received is equal to the amount of Schedule 4 to be paid (excluding any Schedule 4 payments for enhancements).

Given the current uncertainties surrounding BTPF, as well as the misalignment of control periods and timetable change dates, we agree with ORR that a reopener provision is the optimal solution as it provides flexibility to adapt the regime to changing circumstances while ensuring that on expectation the regime remains net neutral and retains its incentive properties to encourage efficient possessions.

Similarly, if ORR initiates any in-control period recalibration (‘2+3’ approach reset, or in-control period recalibration) where the Schedule 8 Network Rail Payment Rates are agreed to be updated, this will alter the amount of Schedule 4 payable. If this situation arises, we agree with ORR that a recalibration of the ACS would be required such that on expectation, the amount of ACS received is equal to the expected Schedule 4 compensation payable. As noted above, our response to ORR’s consultation ‘Implementing PR23: Consultation on drafting changes to access contracts’ will note the need to ensure the relevant wording is included in the track access contracts to enable this change.

**Recalibration of Schedule 4**

We continue to lead on the recalibration of Schedule 4 and have already shared final Schedule 4 cost parameters with passenger operators, and all Schedule 4 parameters with freight operators. We are aiming to share draft ACS quotes with operators in September 2023, though this is subject to ORR confirming the Schedule 4 notification factors to be used and providing the data inputs needed from the Schedule 8 passenger recalibration.

The methodology used to calculate each operators ACS is the same as that used at PR18, and reflects the methodology set out in ORR’s draft determination. This covers restrictions of use from maintenance and renewals activity, based on our latest CP7 plans, and from emergency timetables, based on our CP6 experience.

# 12. Access charges

## Introduction

In this chapter, we set out our response to ORR's draft determination policy consultation on access charges.

## Overview

In broad terms, we agree with the decisions made in ORR's draft determination in relation to our access charges for CP7. In particular, we're supportive of ORR's draft decisions to:

- Endorse the simplification of our Fixed Costs Model.
- Retain the existing methodology for setting the Variable Usage Charge (VUC) for PR23 for passenger operators (including open access operators).
- Limit the refund of new VUCs to a maximum of 12 months.
- Removing the facility for new train services to obtain 'bespoke' Modelled Consumption Rates and remove Generic Consumption Rates.
- Simplify the charter steam slot charges.

We support these decisions for the reasons as set out in our consultation on our access charges published on 11 November 2022, and our subsequent conclusions document published on 19 May 2023.

## Freight and charter VUC phasing-in policy

We strongly support the positive impact that rail freight has on the UK economy and the wider environmental benefits it brings. We also actively encourage growth in all rail traffic, including freight and charters and our regions and functions provide active support for this, and our CP7 SBP contains various initiatives to support the growth and success of rail freight. However, we do not agree with ORR's decision, as set out in its draft determination, not to implement the cost reflective VUCs for freight and charter operators, which have been recalibrated using the PR23 VUC model. Instead, ORR decided that these VUC rates should increase during CP7 along the same real terms trajectory as set in PR18, to reach cost-reflective rates calculated in PR18, by the final year of CP7. We note that ORR's decision does not deliver PR18 cost reflective rates by the final year of CP7 (in real terms) because of its decision not to correct for inflation drift and continuing to apply the lagged contractual approach to indexation.

We believe that all operators should pay fully cost reflective VUCs as recalibrated using the PR23 VUC model. This uses the same methodology which underpins those rates recalibrated using the PR18 VUC model, and ORR concluded was still appropriate for use in PR23. We firmly believe that rail growth can be achieved with all operators paying a fully cost reflective charge for accessing the rail network and in doing so, it will reduce the reliance on public subsidy to fund our railways.

Accepting that in PR18 ORR determined that VUCs would not be cost reflective until the final year of CP7, we would, under that approach, have seen an altered phasing trajectory that would see the increases from the PR23 VUC recalibration phased in over CP7. ORR estimated in its draft determination that the impact of delaying the phasing-in of the cost reflective PR23 recalibrated rates means that freight operators will pay £36m less. This loss of income needs to be subsidised by the taxpayer.

It is our view that any financial incentives for freight operators to maintain / increase rail freight should come directly from other sources rather than through the phasing of access charges, which distorts important price signals and decision-making at the margin by the industry.

The VUC is set to reflect the 'wear and tear' damage that each individual vehicle (and commodity combination for freight traffic) causes on our network, with vehicles that cause more damage incurring a higher charge and vice versa. The VUCs therefore play a key role in encouraging operators to make informed decisions about rolling stock strategy and incentivises a move towards more track friendly vehicles. If an operator continues to see only the partial effect of the true charge for a given vehicle, over an extended period of time (expanded on below), then this will only serve to distort those incentives and may influence decisions to delay investment in more traffic friendly vehicles or making track friendly modifications to vehicles.

As discussed earlier in this chapter, in PR18 ORR determined that freight and charter VUCs should be phased in to reach full cost reflectivity by the final year of CP7, a period of 10 years; this was in addition to the 5 years already allowed in PR13 following the recalibration of the track damage formulae. The decision to delay the implementation of the increases resulting from the PR23 recalibration, by phasing them in over CP8, will mean that VUCs for freight and charters will have been phased-in over a period of 20 years.

In its draft determination, ORR notes that it has given consideration to its legal requirements underpinning the VUC in relation to the 2016 Regulations which require that direct costs must be recovered from train operators. It further notes that, as set out in PR18, it is satisfied that it has the flexibility to allow for changes to the level of the VUC (driven by major changes in direct costs) to be brought in over a period of time. In its PR18 draft determination, ORR states that capping / phasing-in must not be open-ended or indefinite, and that there must come a time when full costs are charged.

We would suggest that extending the phasing in of VUCs for freight and charter operators to cover a period of 20 years (CP5-CP8 inclusive), while not technically 'open-ended' is not within the spirit of the legislation. We would also question if the real terms average increase of c8% seen in the PR23 recalibrated rates, would constitute a major change in direct costs.

In our supporting information document on access charges, we set out our concerns around how implementing ORR's PR23 draft determination policy could impact policy and cost recovery through the VUC in future periodic reviews if those recalibrations yield real terms increases again.

For the above reasons, we would ask ORR to reconsider the VUC phasing-in profile detailed in its draft determination, by giving consideration to an approach that would see full cost reflectivity achieved either by the end of CP7 (as per the stated policy position set in PR18 and subsequently in ORR's consultations and conclusions on our access charges in PR23) or reached either by year 2 or year 3 of CP8. The latter we would suggest strikes a reasonable balance between competing considerations.

## Uncapped freight VUC rates

ORR's access charges draft determination policy document states that around a quarter of freight VUC rates are currently uncapped, meaning that they are already cost reflective. We are disappointed with ORR's decision to hold these rates constant in real terms in CP7. While it may introduce some minor changes to our PR23 VUC model, we believe it would be appropriate to either reflect the fully cost-reflective rates based on our PR23 recalibration exercise at the start of CP7, or to introduce a different phasing-in policy where those freight VUC rates which are currently uncapped would be fully cost reflective by the final year in CP7. This would mean an increase in rates which are being held constant unnecessarily and would ultimately mean that less public subsidy is required. It would also reduce the impact of any real terms increases in these rates in future recalibrations.

# PART D – Next steps

# 13. Next steps

We will continue to engage with ORR to support the development of its final determination. This includes providing further information on train performance between this response and 14 September 2023, and we will keep ORR updated on our progress as we work towards addressing the overlays in region plans. Given the financial challenges we are facing, and reflecting the continued need for tough choices and funding prioritisation, continuing to explore market-led whole industry opportunities as part of addressing the overlays, as well as the further iteration of our plans is absolutely critical. We are committed to driving this forward and continuing engagement with ORR on what this means in practice for CP7.

More broadly, ahead of rail reform, it is important the industry works together to identify opportunities to deliver better outcomes for our customers, the communities in which we serve and the taxpayer. All organisations across the railway system have important roles to play in building trust and confidence in the industry, following the challenges faced during CP6, and the need to improve revenue, become more cost efficient and alignment around whole industry train performance planning and delivery. Flexibility and agility from all organisations, including ORR, will be vital in order to enable the industry to succeed in CP7 and beyond.

Following the publication of ORR's final determination, regions and national functions will update their CP7 plans in early 2024 (notwithstanding Network Rail's decision to accept or raise objections to the final determination in February 2024). This will form the basis for our CP7 delivery plan, which we will submit to ORR in March 2024. Our regions and national functions will continue to engage with their customers as they further develop their CP7 plans. We also plan to publish final CP7 price lists, consistent with the final determination, in December 2023.

# Annexes

# ANNEX 1: Updated England & Wales CP7 financials

Table 1: Summary of CP7 England & Wales expenditure, consistent with our draft determination response

| £bn, 2023/24 prices | CP6 (RF3) | SBP | Draft determination response | Draft determination response vs SBP |
|---|---|---|---|---|
| Operations | 3.98 | 3.78 | 3.91 | 0.13 |
| Maintenance | 10.49 | 10.29 | 10.25 | -0.04 |
| Support | 4.09 | 4.74 | 4.58 | -0.16 |
| Industry costs and rates * | 1.53 | 1.67 | 1.68 | 0.01 |
| Electricity for traction (EC4T) | 2.82 | 4.06 | 4.50 | 0.43 |
| **Total operating expenditure (excl. EC4T)** | **20.09** | **20.48** | **20.43** | **-0.06** |
| Renewals | 16.62 | 15.86 | 15.03 | -0.83 |
| Other capital expenditure | 2.11 | 2.36 | 1.74 | -0.62 |
| **Total capital expenditure** | **18.73** | **18.22** | **16.77** | **-1.45** |
| ETCS | 0.00 | 0.81 | 0.81 | 0.00 |
| **Total Expenditure** (excl. EC4T) | **38.82** | **39.52** | **38.01** | **-1.51** |
| Input prices moved to risk funding | 0.00 | 0.00 | -1.01 | -1.01 |
| **Total Expenditure** (excl. EC4T and input price adjustment) | **38.82** | **39.52** | **37.00** | **-2.52** |
| Risk funding | 0.00 | 0.50 | 1.51 | 1.01 |
| **Total Expenditure** (incl. risk funding, excl. EC4T) | **38.82** | **40.02** | **38.51** | **-1.51** |

*Excluding BTP costs

Table 2: Summary of CP7 England & Wales income, consistent with our draft determination response

| £bn, 2023/24 prices | **CP6 (RF3)** | **SBP** | **Draft determination response** | **Draft determination response vs SBP** |
|---|---|---|---|---|
| Passenger access charges (VUC, EAUC, FTAC) | 8.09 | 7.18 | 6.95 | 0.23 |
| Stations and Depots: Station LTC, Stations Lease, QX and Depots | 2.10 | 3.02 | 3.24 | -0.22 |
| Freight and open access track access charges | 0.50 | 0.46 | 0.55 | -0.09 |
| Electricity for Traction (EC4T) | 2.83 | 4.06 | 4.50 | -0.43 |
| Property and other income | 1.05 | 1.73 | 1.52 | 0.20 |
| Schedule 4 access charge supplement | 1.64 | 2.27 | 1.46 | 0.81 |
| Schedule 4 and 8 costs | -1.80 | -2.34 | -1.53 | -0.81 |
| Network grant | 27.24 | 27.70 | 26.32 | 1.38 |
| **Total Income** | **41.65** | **44.08** | **43.01** | **1.07** |
| **Total Income (excl. EC4T)** | **38.82** | **40.02** | **38.51** | **1.51** |