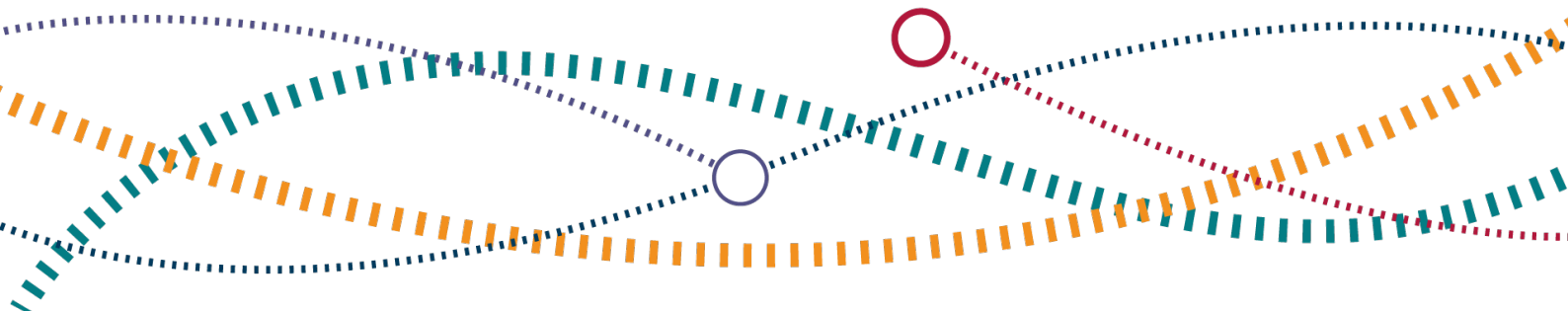




PR23 draft determination:

Executive summary – England & Wales

15 June 2023



About this document

This document provides an executive summary of our 2023 periodic review (PR23) draft determination for England & Wales.

PR23 will determine what the infrastructure manager for the national rail network, Network Rail, is expected to deliver with respect to its operation, support, maintenance and renewal (OSMR) of the network during control period 7 (CP7), which will run from 1 April 2024 to 31 March 2029, and how the available funding should be best used to support this.

This strongly influences:

- the service that passengers and freight customers receive and, together with taxpayers, ultimately pay for; and
- the charges that Network Rail's passenger, freight and charter train operator customers pay to access its track and stations during CP7.

Our draft determination sets out:

- our review of Network Rail's strategic business plan (SBP);
- decisions on its proposed outcome delivery and its planned expenditure to secure the condition and reliability of the network;
- changes to access charges and the incentives framework; and
- relevant policies on managing change and the financial framework.

In addition to **this document**, we have also published as part of our draft determination:

Document type	Details
Executive summaries of our determination	Our key proposals from our draft determination for: <ul style="list-style-type: none">• <u>England & Wales</u>• Scotland
Overviews of our determinations	What Network Rail will need to deliver and how funding will be allocated in:

- England & Wales
 - Scotland
-

Consolidated decisions

A summary of our draft decisions across Great Britain

Introduction

An overview of PR23 and background to our draft determination

Settlement documents

Detailed draft decisions for each of:

- Scotland
 - Eastern region
 - North West & Central region
 - Southern region
 - Wales & Western region
 - System Operator
-

Supporting documents

Technical assessments of:

- Health and safety
 - Outcomes
 - Sustainable and efficient costs
 - National Functions
 - Other income
-

Policy positions

How we intend to regulate Network Rail during CP7 in relation to:

- Financial framework
- Access charges
- Schedules 4 & 8 incentives regimes
- Managing change

Responding to the consultation on our draft determination

We are consulting on our draft determination and welcome comments from stakeholders on any of our documents which form the draft determination on or before 31 August 2023.

Responses should be submitted in electronic form to our PR23 inbox: PR23@ORR.gov.uk. We request stakeholders provide their response using [this proforma](#). We intend to publish all responses on our website alongside our final determination in October 2023. Annex A to our proforma document sets out how we will treat any information provided to us, including that which is marked confidential.

Next steps

After taking account of stakeholder responses, we expect to issue our final determination on Network Rail's delivery and funding for CP7 by 31 October 2023.

We expect to issue our review notices by December 2023 and, subject to Network Rail's acceptance, issue notices of agreement and review implementation notices. These will give effect to the decisions made during PR23 in time for CP7 to commence from 1 April 2024 and for Network Rail to develop its plans for delivery.

Executive summary

Context

- 1.2 Periodic reviews like PR23 are one of the principal mechanisms by which ORR holds the infrastructure manager for the mainline rail network in Great Britain, Network Rail, to account and secures value for money for users and funders of the railway. The periodic review determines what Network Rail is expected to deliver with respect to its operation, support, maintenance and renewal (OSMR) of the network during control period 7 (CP7), which will run from 1 April 2024 to 31 March 2029, and how the available funding should be best used to support this.
- 1.3 PR23 is being conducted amid a complex and challenging context for the rail industry: the sector continues to recover from the pandemic against a backdrop of inflationary pressures, recent industrial action, as well as declines in passenger and freight train performance. Policy development around rail reform also continues. The sector must also meet the challenges of climate change by contributing to a low-emissions railway and planning for severe weather events. In recognition of this context, our approach to PR23 is designed to deliver a secure basis for Network Rail and its stakeholders to plan, invest and provide services.
- 1.4 We set out at the start of PR23 in our [June 2021 launch letter](#) that our focus during the process would remain on four objectives:
- **safety:** the rail network must be maintained in a safe condition for all of its users, workers and the public;
 - **performance:** the railway must be customer-focused, making effective use of its capacity to deliver passenger and freight services that are punctual and reliable;
 - **asset sustainability:** assets must be planned and managed to deliver their greatest value over the course of their operational lives; and
 - **efficiency:** Network Rail must be subject to stretching but realistic efficiency targets.
- 1.5 There also remain considerable challenges to address, such as the impact of severe weather on the network. We said that we will challenge Network Rail to deliver more for both current and future customers, drive further efficiencies and

support the effective operation of the whole railway, joining up our approach to economic and health and safety regulation in doing so.

- 1.6 Network Rail is funded by the UK and Scottish governments for its activities in England & Wales and Scotland respectively. The UK and Scottish government's continued support for the railway allows for a real-terms increase in expenditure for operating, supporting, maintaining and renewing the network across Great Britain during CP7. This amounts to approximately £44.8 billion in total across the GB network (projected expenditure net of electricity traction costs, which are passed through directly to train operators). This compares to £42.7 billion in CP6 (expressed in 2023-24 prices).
- 1.7 This document considers England & Wales. We have published an [equivalent document which focusses on Scotland](#). Accounting for all sources of funding, [including the UK Government's Statement of Funds Available \(SoFA\)](#), Network Rail's expenditure in England & Wales is forecast to be £40.0 billion in CP7, compared to approximately £38.2 billion in CP6 (expressed in 2023-24 prices, all net of electricity traction costs). However, reflecting wider fiscal conditions, funding for CP7 is constrained relative to the needs of the asset renewal cycle. This requires Network Rail to make choices about how expenditure should be prioritised to deliver best value for the railway now and in the future.
- 1.8 The UK and Scottish governments also set out High-Level Output Specifications (HLOSs) detailing what they expect the available funding to deliver in the relevant nations. The [UK Government's HLOS](#) for England & Wales wants Network Rail to maintain a strong standard of safety, deliver cost efficiency and support revenue generation while contributing to national and local growth priorities and levelling up, and maintain focus on punctuality, reliability and asset sustainability, including resilience to climate change. It also sets requirements relating to security, system operation, stakeholder engagement, and financial management.
- 1.9 The UK Government's HLOS and SoFA were finalised later than anticipated. Consequently, Network Rail's plans for CP7 have been produced to challenging timescales and continue to evolve. Our assessment of these plans has taken account of this and we have also sought to evaluate new information provided to us since we received Network Rail's plan at the end of February 2023. Network Rail subsequently published this plan on 19 May 2023. At this point in the process we are issuing our draft determination based on the information as it currently stands so that we can obtain stakeholder views.

Our assessment of Network Rail's plan and our draft determination

- 1.10 We have carried out a detailed review of Network Rail's plans. For England & Wales, the plan includes two scenarios for expenditure. The first assumes that a £0.5 billion centrally managed fund is used to manage risks that emerge during CP7. The second is a 'risk-adjusted' plan which is supported by descoping up to £1.5 billion of renewals and other activities across Network Rail's regions in England & Wales, if risk materialises. Our assessment and draft determination considers Network Rail's risk-adjusted plan, which creates a £2.0 billion total provision for risk. This is because our experience of monitoring Network Rail during CP6 and the uncertainty likely in CP7 suggests that more than £0.5 billion will be needed to manage unanticipated risks and that this plan is the most likely to be delivered.
- 1.11 Our draft determination sets out for CP7:
- how the available funding should be used, what should be delivered in return (including on train performance) and how we will hold Network Rail to account for delivery of the outcomes specified in PR23;
 - changes to the charges and incentives framework (including the proposed infrastructure charges, incentive rates and performance benchmarks that will feature in track access contracts); and
 - settlement decisions for the England & Wales regions (Eastern, North West & Central, Wales & Western, Southern), Scotland and the System Operator (SO).

Key proposals from our draft determination

- 1.12 In the following sections we provide the key proposals from our draft determination for England & Wales.

Outcomes with a focus on train performance

We expect no further decline in train performance, and for Network Rail to deliver ambitious but deliverable improvements for passengers and freight customers.

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- 1.13 Passengers and freight customers expect trains to be reliable and run on time. Whole industry train performance is therefore important for maintaining and improving satisfaction for those using the railway and Network Rail must play its part in delivering this. Our draft determination proposes ambitious yet realistic train performance levels using whole industry measures for punctuality and reliability.
- 1.14 Recognising the difficulty in accurately forecasting train performance, we are applying an appropriate level of flexibility in how we hold Network Rail to account for its contribution to train performance (as proposed in our recently published [policy consultation](#)) and our proposals for [managing change](#) during CP7.
- 1.15 We also propose £0.04 billion is reserved for a train performance improvement and innovation fund (PIIF) in England & Wales. This is intended to kick-start collaborative, cross-industry solutions with the aim of improving train performance between train operators and Network Rail. We propose it is funded from adjustments we propose to Network Rail's financial assumptions.
- 1.16 We also expect Network Rail to deliver freight growth and improve environmental outcomes by moving towards a low-emissions railway and enhancing biodiversity. Our draft determination sets expectations for relevant success measures.

Asset performance and sustainability

Network Rail should reconsider its prioritisation of a small proportion of expenditure to fund core renewals.

- 1.17 In comparison to CP6, Network Rail proposes to conduct fewer asset renewals during CP7. Within each of its regions it has sought to prioritise its proposed expenditure on renewals, including in a manner which is consistent with the UK Government's HLOS: to support revenue generation while contributing to national and local growth priorities and levelling up. It refers to this as its 'market-led' approach.
- 1.18 We are satisfied that the constrained funding which requires Network Rail to prioritise its expenditure does not need to result in undue concerns for asset safety or performance during CP7, if risks are fully assessed and managed. However, our review process has identified that the needs of some key assets have not been sufficiently prioritised. Some of these assets are particularly vulnerable to the effects of climate change.

- 1.19 Our draft determination proposes a re-allocation of expenditure towards core renewals which is relatively modest within the context of a £40 billion plan. Specifically, we propose that Network Rail should reallocate £0.55 billion of expenditure to increase core renewals. This proposed reallocation of expenditure aims to manage asset sustainability to deliver better safety and, ultimately, train performance outcomes than Network Rail's original plan.
- 1.20 We have identified a range of options for how the necessary expenditure on core renewals could be funded from within the existing plan. Through our assessment and challenge of the plans we have identified several projects or programmes which could be reprioritised or rephased, releasing approximately £0.8 billion over CP7.

Health and safety

We expect Network Rail to demonstrate its understanding of, and how it will manage, the change in risk profile which results from conducting fewer renewals.

- 1.21 Network Rail proposes to manage the risks posed by the reduction in renewals by increasing its maintenance activities and using operational controls, for example speed restrictions. We recognise that a decrease in renewals and an increase in maintenance in comparison to CP6 is necessary due to the constrained funding available.
- 1.22 Whilst we consider that the additional expenditure we propose on core renewals ought to address the main vulnerabilities we have identified in our assessment of its plan, there are two key areas of its risk assessment that we expect Network Rail to consider further. Specifically, our draft determination expects Network Rail to demonstrate:
- how it will manage the shift in risk profile which results from conducting fewer renewals and taking a more maintenance-based approach to management and operation of its infrastructure; and
 - that its maintenance plans are sufficient to support the increased demand on its maintenance function.

Efficiency and financial assumptions

The proposed efficiency target is stretching but realistic

- 1.23 We expect Network Rail to maximise the value of the constrained funding during CP7 by delivering safety, performance and asset sustainability as efficiently as possible. Network Rail's risk-adjusted plan implies scope for at least £3.2 billion of efficiencies in England & Wales during CP7. After careful scrutiny of the plans, including top-down and bottom-up assessments, we consider this target will be stretching but deliverable.
- 1.24 We have also reviewed the wider financial assumptions underpinning the plan. Whilst we find that some areas of the plan potentially overstate the efficient cost levels for CP7, we find that in other areas developments since the submission of the plans would largely offset these (e.g. revised inflation projections).

Risk funding

Network Rail should focus on its risk-adjusted plan to maximise its risk provision and so support it to manage potentially significant financial risks.

- 1.25 Recent experience of the Coronavirus (COVID-19) pandemic, industrial action and other initiatives requiring urgent funding (including responses to safety concerns) demonstrate the ongoing importance of adequate risk funding. Further risks, such as inflation, demonstrate the need for sufficient provision during CP7.
- 1.26 If Network Rail focuses on its 'risk-adjusted' plan then it can reallocate £1.5 billion of funding from contingent renewals and other lower priority activities to its risk fund. Combined with other financial opportunities we have identified, which would maximise Network Rail's income and release funding to cover inflationary pressures, this would create approximately £2.0 billion of risk-funding. This is less than in the current control period but is calibrated to what we consider is affordable given the funding available for CP7.
- 1.27 We have also identified a small amount of additional funding (circa £0.15 billion) which could be added to the provision for managing risk.

Funding our proposed increases in expenditure

The overall funding should allow Network Rail to deliver its commitments across the network in CP7.

- 1.28 We anticipate the overall funding will be adequate for Network Rail to deliver its commitments across the network in CP7.
- 1.29 The £0.8 billion of options we have identified for Network Rail to reprioritise and rephase expenditure are more than sufficient to cover the required spend on core assets. Therefore, Network Rail can choose which of these it uses to fund our proposed additional £0.55 billion of core renewals, ensuring that revisions to the initial plan are minimised.
- 1.30 Our proposed adjustments to Network Rail's financial assumptions (i.e. to input prices, forecast property income and to account for the anticipated cost of the latest Office for Budgetary Responsibility (OBR) inflation forecast) have a net effect of releasing £0.19 billion funding. We propose this is used to fund the £0.04 billion performance improvement and innovation fund with the remaining £0.15 billion used to increase Network Rail's provision for risk.

Access charges

We will support freight growth ambitions while ensuring that rates move closer towards being fully cost reflective.

- 1.31 Our draft determination sets out draft decisions for Network Rail's access charges, to ensure that it recovers the costs of maintaining and renewing the network fairly from different users (as well as from taxpayers).
- For freight (and charter) operators, we will continue to maintain a cap on the variable usage charge such that rates will increase on average along the same trajectory as set in PR18. Capping freight usage charges in this way is also consistent with the way in which freight growth projections have been developed for CP7. Our proposed approach will therefore support freight growth ambitions in CP7, while ensuring that rates move closer towards being fully reflective of the costs of their use of the network (as required by relevant legislation).

- Open access operators providing interurban services will continue to contribute to Network Rail's fixed cost recovery through an infrastructure cost charge (ICC), which we are holding broadly constant in real terms. This will provide a stable long-term signal about the cost of entry, and will support greater access on relevant parts of the network without discouraging prospective new services elsewhere. We are also giving consideration to the relevance of an ICC for open access services to major airports, though this is subject to further work. We expect to provide an update on this by the end of July.

Incentives

Contractual incentives will be adaptable to material changes in circumstance and potential rail reform, and payment rates will be lower.

- 1.32 Our draft determination includes incentives which encourage Network Rail and train operators to minimise the impacts of disruption. Schedule 8 in track access contracts places incentives on Network Rail and train operators to limit the disruption they cause and therefore to improve network performance. We propose to allow for the update of Schedule 8 parameters during the control period, in the event that there are material changes in circumstances. We will also allow for the removal of relevant incentive payments between Great British Railways and its contracted operators, if it is established and if there is sufficient legislative change to permit the removal of payments.
- 1.33 This is consistent with our intention for the PR23 settlement to be robust to the outcomes of rail reform. We are now recalibrating the incentive regimes in readiness for CP7. We are expecting Network Rail payment rates to be significantly lower in CP7 due to the adoption of new evidence on how passengers respond to disruption.



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