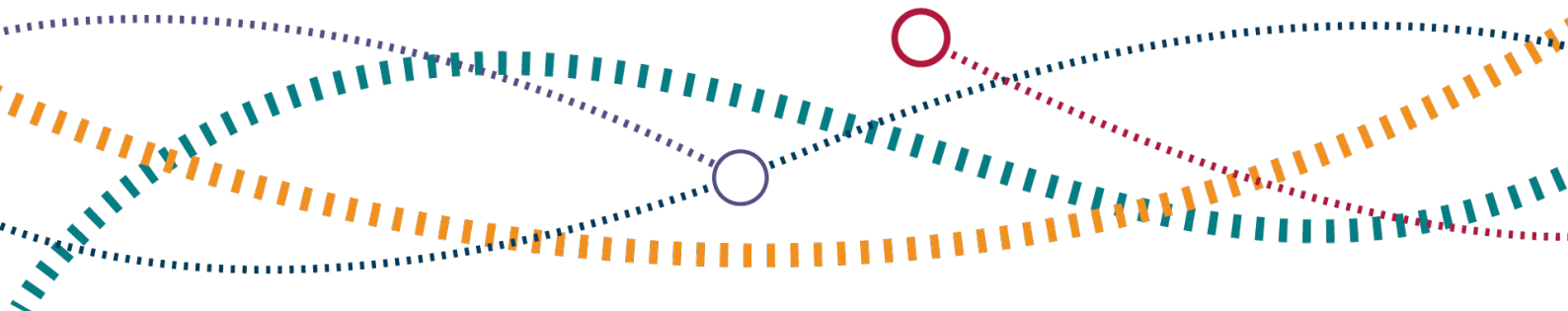




PR23 draft determination:

Executive summary – Scotland

15 June 2023



About this document

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

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">• England & Wales• <u>Scotland</u>

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 Scotland 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, industrial action, as well as declines in passenger and freight train performance. 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 Scotland and its stakeholders to plan, invest in 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 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 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 Scotland. We have published an [equivalent document which focusses on England & Wales](#). The [Scottish Ministers' Statement of Funds Available](#) (SoFA) makes available £4.2 billion of funding for operating, supporting, maintaining and renewing the network in CP7. Accounting for all sources of funding, Network Rail Scotland's total expenditure is forecast to be £4.8 billion, which compares to £4.6 billion (expressed in 2023-24 prices, all net of electricity traction costs) during CP6. However, the available funding is constrained relative to the needs of the asset renewal cycle and it has had to make choices about how the available funding should be prioritised to deliver best value for the railway now and in the future.
- 1.8 The £4.2 billion SoFA is also £221 million greater than the planning assumptions Network Rail Scotland used to develop its CP7 proposals. In its interim strategic business plan which we received on 24 February 2023, and have assessed for our draft determination, Network Rail Scotland has held this funding as contingent risk funding and advised that it will consider how this would be used as its plans evolve. Our draft determination refers to this funding as being unallocated and proposes how Network Rail Scotland could use it.
- 1.9 The UK and Scottish governments each also set out High-Level Output Specifications (HLOSs) detailing what they expect the available funding to deliver in the relevant nations. The [Scottish Ministers' HLOS](#) sets out the Scottish Government's requirements across a broad range of areas. This HLOS expects Network Rail Scotland to maintain a strong standard of safety, manage its costs efficiently and achieve value for money for taxpayers, while maintaining its focus on punctuality, reliability and asset sustainability. It also sets requirements for effective integration of Network Rail Scotland, ScotRail Trains Limited and other industry stakeholders, targeting investment to contribute towards increasing economic growth, climate change adaptation and the achievement of net-zero.

1.10 The Scottish Ministers' HLOS and SoFA were finalised later than anticipated. Consequently, Network Rail Scotland's interim plan for CP7 has been produced to challenging timescales and continues to evolve. Network Rail Scotland has subsequently developed a further iteration of its plan which it provided to us on 26 May and which it intends to publish. Our draft determination is based on the interim plan Network Rail Scotland provided to us on 24 February, plus evidence subsequently received to support those proposals. We have worked closely with Network Rail Scotland and our draft decisions consider how we anticipated its interim plan was likely to evolve. Notable changes to its final SBP include the prioritisation of asset management funding and forecasts for train performance during CP7. We will assess these changes for our final determination. We are issuing our draft determination now so that we can obtain stakeholder views on our proposals. During the consultation period (which runs until 31 August 2023) we expect Network Rail Scotland to consider our proposals for how the available funding could be used and the outcomes that should be delivered in return.

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

1.11 We have carried out a detailed review of Network Rail Scotland's interim plan and challenged whether it:

- is consistent with the Scottish Ministers' HLOS and SoFA;
- makes appropriate choices between maintaining the network, renewing it to raise asset condition and spending to maintain the network to support the performance of passenger and freight operators in the near-term;
- includes a reasonable degree of stretch;
- provides a credible response to challenges which have emerged during CP6 (e.g. on weather resilience);
- is deliverable; and
- enables Network Rail Scotland to continue to operate its network safely and meet its legal obligations.

1.12 Our assessment and subsequent draft decisions are consistent with our legal duties, including those set out in the Railways Act and the Equalities Act, and the guidance provided to ORR by Scottish Ministers.

1.13 Our assessment informs our draft determination which 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 Scotland, Network Rail's regions in England & Wales and the System Operator (SO).

Key proposals from our draft determination

1.14 In the following sections we provide the key proposals from our draft determination for Scotland.

Outcomes with a focus on train performance

We use the Scotland train performance measure as the primary measure of performance in the CP7 outcomes framework and set a stretching baseline trajectory in each year of CP7 which is consistent with Scottish Ministers' expectations. We expect Network Rail Scotland to play its part in delivering this significant improvement for rail users.

- 1.15 Passengers and freight users expect trains to be reliable and run on time. Our determination sets success measures which encourage improvements in whole industry performance.
- 1.16 The Scottish Ministers' HLOS includes a focus on performance and expects Network Rail Scotland to enable the Scotland train performance measure of 92.5% in each year of CP7. This represents the percentage of trains arriving at their final destination within five minutes after the scheduled time but does not consider those that were late due to speed restrictions during severe weather or to allow for connecting train or ferry services. Recognising the importance of this target to the Scottish Ministers, we have:
- set the 'Scotland train performance measure' as the primary success measure in the CP7 outcomes framework; and
 - set the baseline trajectory for this measure at 92.5% for each year of CP7.

- 1.17 This is an improvement on CP6 performance and is required to increase satisfaction for those using the rail network in Scotland. We will hold Network Rail Scotland to account for playing its part to deliver improved performance in CP7, where it must also work effectively with train operators to deliver innovative cross industry initiatives. The ‘Scotland train performance measure’ will be the primary measure we use for monitoring and reporting on Network Rail Scotland’s delivery of passenger train performance during CP7.
- 1.18 We recognise that there are some potentially significant risks to the delivery of this trajectory for each year of CP7. This is because it is stretching in comparison to historical levels of performance and so requires both Network Rail Scotland and train operators to play their part in delivering significant improvements for passengers. We will hold Network Rail Scotland to account for its contribution towards delivering this trajectory. To support this, we propose a targeted train performance fund which would be split between asset renewals and operational interventions, for example working collaboratively with train operators.
- 1.19 The targeted train performance fund would only apply in Scotland. It should be funded from any remaining unallocated funding once Network Rail Scotland has considered our other proposals to increase expenditure on core renewals and should reflect an appropriate balance between provisioning for risk (which we explain below) and further funding for performance. For illustration, based on the 24 February interim plan we calculate that approximately £100 million could be available for a targeted performance fund. However, we anticipate this amount will change as Network Rail Scotland evolves its plans and assumptions on available funding change (e.g. due to updated inflation forecasts).
- 1.20 Our main focus in CP7 will be to hold Network Rail Scotland to account for its contribution to the ‘Scotland train performance measure’ target of 92.5%, as described in the Scottish Ministers’ HLOS. Our draft determination also commits to holding Network Rail Scotland to account for a Freight Cancellations and Lateness target in a manner that is consistent with the Scottish Ministers’ HLOS.
- 1.21 We will use the ‘On Time’, ‘Passenger Cancellations’ and ‘Freight Cancellations’ measures in the CP7 outcomes framework to provide another reputational incentive, by reporting comparisons between regions across Great Britain. The ‘On Time’ baseline trajectory will also be used in setting the baselines for the incentives which encourage Network Rail Scotland and train operators to reduce the delays they cause to each other. Our draft determination includes trajectories for ‘On Time’, ‘Passenger Cancellations’ and ‘Freight Cancellations’ which are more stretching than those forecast in Network Rail Scotland’s interim plan.

- 1.22 We also expect Network Rail to facilitate 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

Increasing expenditure on core renewals should be Network Rail Scotland's highest priority when considering how any unallocated funding is used.

- 1.23 In the constrained funding environment Network Rail Scotland proposes to conduct fewer renewals during CP7 in comparison to CP6. It proposes to manage the risks posed by the reduction in renewals to safety, performance and asset sustainability by increasing its maintenance activities and using operational controls. It anticipates an increase in service affecting failures of assets towards the end of CP7 and a decline in overall asset sustainability.
- 1.24 However, we are satisfied that the constrained funding does not need to result in undue concerns for asset safety or performance during CP7, if risks are fully assessed and managed. Our review of Network Rail Scotland's interim plan 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. Therefore, our draft determination proposes that Network Rail should allocate a further £50 million to expenditure on core renewals in Scotland. The proposed allocation of funding aims to manage asset sustainability to deliver better safety and, ultimately, train performance outcomes than Network Rail Scotland's interim plan. We consider our proposed increase in expenditure on core renewals should be Network Rail Scotland's highest priority when considering how it will use any unallocated funding.
- 1.25 Our assessment has also identified expenditure that is higher than we consider is necessary during CP7. The opportunities that we have identified could release up to approximately £16 million of additional funding. However, the total funding released will depend on how Network Rail profiles and prioritises expenditure.

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.

- 1.26 Network Rail Scotland 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.
- 1.27 While 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 interim plan, there are two key areas of its risk assessment that we expect Network Rail Scotland to consider further. Specifically, our draft determination expects it 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

Network Rail Scotland has more work to do to demonstrate how it will deliver its efficiency target.

- 1.28 We expect Network Rail Scotland to maximise the value of the constrained funding during CP7 by delivering safety, performance and asset sustainability as efficiently as possible, but its target must also be deliverable. It is proposing to deliver £429 million of efficiencies during CP7 (£380 million of efficiencies delivered by Network Rail Scotland and £49 million of efficiencies allocated from national functions). Our assessment (including evidence from CP6) is that this will be a challenging target. Ahead of our final determination we expect Network Rail Scotland to review its efficiency proposals and demonstrate that they are deliverable.
- 1.29 We have reviewed the wider financial assumptions underpinning the interim plan. While we find that some areas of the plan potentially overstate the efficient cost levels for CP7, the funding released by the more conservative assumptions we propose is largely offset by the latest inflation projections.

Risk funding

Network Rail Scotland faces potentially significant risks and we have identified opportunities to increase its risk provision to help manage these.

- 1.30 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 an adequate risk provision. Further risks, such as inflation, demonstrate the need for sufficient provision during CP7. Network Rail Scotland may also be exposed to more financial risk than is reasonable during CP7 because of its stretching efficiency target. However, Network Rail Scotland's proposed £206 million fund is much lower than its £329 million CP6 fund. To manage exposure to financial risk, we propose that Network Rail Scotland increases its provision using a proportion of the funding which remains once it has prioritised our proposed increase on core renewals. It should also reflect an appropriate balance between provisioning for risk and further funding for performance (which we describe above). Based on the values in the 24 February interim plan the provision could be increased by up to approximately £100 million.

Funding our proposed increases in expenditure

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

- 1.31 We anticipate the overall funding will be adequate for Network Rail Scotland to deliver its commitments across the network in CP7. Based on the interim plan we received on 24 February, we have identified several sources Network Rail Scotland could use to fund the increases in expenditure proposed in our draft determination. These have a net value of up to approximately £251 million, comprised of:
- £221 million of funding which is included in the SoFA but was not anticipated when Network Rail Scotland developed its plan;
 - up to £16 million resulting from choices Network Rail could make to reprofile and reprioritise its expenditure in its national functions; and

- approximately £14 million which is the net value of adjustments we propose to its 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).

1.32 We summarise the adjustments we propose in our draft determination in Table 2.1 below. We consider £50 million should be prioritised for core renewals. The balance of any remaining funding should be allocated to providing more adequate risk provision (for example, closer to the amount set aside in CP6) and a targeted train performance fund. For illustration, based on the 24 February interim plan, we calculate that the amount for risk funding would be approximately £100 million and £100 million for the targeted train performance fund. However, we anticipate these amounts will change as Network Rail Scotland evolves its plans and as assumptions on available funding change, (e.g due to updated inflation).

Table 1.1 Our proposed adjustments to Network Rail Scotland’s level of expenditure

Draft determination proposal	£m, 2023-24 prices
Difference between planning assumptions and SoFA	221
Financial adjustments	14
Reduced expenditure on projects and programmes	16
Additional expenditure for core renewals	(50)
Additional expenditure for risk provision	(101)
Additional expenditure for targeted train performance fund	(101)
Net position	-

Access charges

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

1.33 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.

Incentives

Contractual incentives will be adaptable to material changes in circumstance and payment rates will be lower.

- 1.34 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 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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