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Dear Stakeholder

## **Open letter to launch PR23**

This is a period of significant challenge and change for the railway. Passenger numbers and passenger revenues fell sharply as a result of COVID-19 and remain below pre-pandemic levels. This has driven changes in the industry. Amongst other things, governments have responded by replacing passenger franchise agreements with new concession-style agreements in which train operators receive a management fee for providing a specified service, without them taking revenue risk. In both Scotland and Wales, most passenger train services are being brought under direct, public-sector control.

There will be further changes in the future. The Williams-Shapps Plan for Rail, published on 20 May, sets out the UK government's vision for wide-ranging reforms to the structure and operation of the industry. This is intended to address the challenges the railway is facing and enable it to deliver more effectively for the full range of customers and for taxpayers. It will include the creation of a new body – Great British Railways – that will both own the railway infrastructure and let and manage the passenger rail contracts currently awarded by the UK government. It will receive the fare revenue from those services; own, run and maintain Network Rail's existing rail network; and set most fares and timetables. In doing so, it will be held to account by the UK government, with ORR providing independent scrutiny and assurance. The Scottish and Welsh Governments will continue to award contracts and set fares on their services. These changes are expected to take place over the coming years, including through changes to legislation.

This provides a complex background for ORR's next periodic review process (PR23), which is launched today and will conclude in 2023. PR23 will determine the level of funding Network Rail (or, in future, Great British Railways) should receive for its infrastructure operations and what, in return, it should be required to deliver over five years from April 2024, known as Control Period 7 (CP7). We need to accommodate the reforms that have taken place in industry to date and the vision set out by the UK government – adapting the approach to PR23 to support the delivery of a more integrated railway that delivers improvements for customers – while retaining the core benefits from a five year funding settlement.

The importance of the five year funding settlement is recognised in the Williams-Shapps Plan for Rail, which is founded in the need to make long-term decisions about funding the operations, maintenance and renewal (OMR) of the existing track, bridges, stations and other assets that Network Rail owns. The stability created by a five-year funding settlement is essential for Network Rail (and, in future, Great British Railways) to deliver its OMR activity efficiently and effectively.

The periodic review process protects the value of these national assets for current and future generations with an enduring focus 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 (or Great British Railways as its successor body) must be subject to stretching but realistic efficiency targets.

The challenging financial environment for the railway means that in PR23 we will need to ensure there remains an appropriate level of investment in existing assets to support these four objectives. We will seek to facilitate governments' aspirations, be it to invest more for the railway, to drive growth, to support regional levelling-up and/or to deliver net zero carbon in the coming decades. There also remain considerable challenges to address such as the impact of severe weather on the network. We will stretch 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 & safety regulation in doing so.

PR23 will set clear outputs, appropriate for the level of agreed funding, and provide a clear framework through which ORR will hold to account for delivery of these during CP7. PR23 is currently focused on Network Rail. However, the UK government has indicated that Great British Railways will adopt, and be held to account for delivering the commitments that Network Rail enters into for CP7. This will help provide stability for investment during a period of change and there will need to be appropriate, agreed flexibility to allow Great British Railways to evolve as it builds integrated plans for the railway.

PR23 will build on the PR18 framework, reflecting that it has broadly worked well to date. For example, in CP6, Network Rail is delivering tough efficiency targets and has started to embed cross-industry initiatives to improve performance. We have also seen the System Operator grow in effectiveness, including in its agility to revise the timetable as a result of the pandemic and changing passenger/industry needs. The periodic review process is well placed to adapt to the changes that are happening over coming years – past periodic reviews have successfully adapted to reflect previous industry challenges and the many changes in the organisation of Network Rail. There are also important opportunities in PR23 to bring greater alignment between Network Rail and train operators to support the delivery of the best possible service for passengers and freight users. We will need to work together with governments, Network Rail, devolved transport authorities and industry to achieve this.

PR23 must also reflect the range of private and public interests that are affected by the infrastructure's performance, including other infrastructure operators, privately owned and operated parts of the network, the rail freight industry and open access passenger rail services. It should also support private investment and innovation throughout the railway's supply chain.

The rest of this letter sets out our overall approach to PR23 against this complex backdrop. We are seeking your views on this approach and the key themes we identify that will shape how we adapt our approach.

## PR23 overview

PR23 will be a collaborative, cross-industry process which sets three things:

- **Funding and outputs** – the funding for Network Rail's OMR activity in England & Wales and in Scotland for five years from 1 April 2024, and what it must deliver for that funding;
- **Holding to account** – how Network Rail will be held to account for the delivery of those outputs in CP7; and
- **Charges and incentives** – the framework for the contractual charges (reflected in Schedule 7 of the track access contracts) and the performance and possessions regime (Schedule 8 and Schedule 4 respectively) that will apply in CP7.

Key decisions on funding availability and required outputs are made by the UK government (for England & Wales) and by the Scottish Government (for Scotland) as the principle funders of the infrastructure. The Secretary of State and Scottish ministers each provide clear objectives for the railway through the High-Level Output Specification (HLOS). They also set out the funding they will make available to deliver this in the Statement of Funds Available (SoFA).

To help inform the HLOSs and SoFAs, ORR provides independent, expert advice and assurance to funders. Once the HLOSs and SoFAs are set, Network Rail develops detailed business plans that set out what OMR it can deliver within the funding being provided, including how it can meet funders' objectives. ORR scrutinises these plans and makes a final determination about the allocation of that funding between regions (and other business units) and the outputs they must deliver over a control period.

In our role, ORR draws on its expertise in economic regulation, railway engineering, cost management and as health and safety regulator. Our objective is to determine a package of funding and outputs that is balanced, fair, stretching and deliverable, and supports the effective operation of the whole of the railway for its users and for the nations.

An interim step in the process will be the comprehensive spending review (CSR) expected in autumn 2021. This is not a formal part of the periodic review process but will help inform understanding of the potential level of funding that may be made available for the whole of CP7. Network Rail is supporting funders in preparing information as part of the CSR and we will provide advice and assurance to funders.

We set out an initial, indicative view of the timeline for PR23 in Annex 1. This may change to enable us to adapt as the implementation plan for the Williams-Shapps Plan for Rail becomes clearer.

## **PR23 framework**

In determining funding and outputs for CP7, we remain focused on the four core objectives of the periodic review, namely: safety, asset sustainability, performance and efficiency. We will set an outputs framework for Network Rail centred on these core objectives, as well as reflecting what is important to funders, rail users and wider society. For example, we expect to place increased focus on the outcomes passengers and users care about (such as overall delays) and on environmental outcomes.

The PR23 framework will build on what has worked well in PR18. In PR18 we made substantial changes to reflect Network Rail's reclassification as a public-sector body and the move to devolve more responsibilities from Network Rail's centre to its local regions (or routes, as they were then referred to<sup>1</sup>). One of the key changes we made was to have separate settlements for each of Network Rail's (then) routes, as well as its System Operator and Freight and National Passenger Operator (FNPO) function.

This approach has worked well - by making greater use of comparative regulation as part of a wider toolkit of monitoring, reporting and enforcement, we (and Network Rail) are more easily and effectively able to identify those routes and regions that are performing well (and why), and those that are not. This has enabled us and Network Rail to learn from the differences between regions, and Scotland. It also enabled us to use this information in holding Network Rail to account at both central and regional levels.

In particular, this approach has supported the successful development of Network Rail's leadership capability and performance at the regional level and in Scotland. The Williams-Shapps Plan for Rail indicates that the regional organisation in England and Wales is likely to remain an important feature in the future industry model.

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<sup>1</sup> Network Rail moved from a structure of five regions, supporting 14 routes, as part of its 2019 Putting Passengers First programme.

We therefore propose to retain key features of the current framework for CP7 when determining funding and outputs for the infrastructure owner, including:

- **Regional regulation and separate settlements:** We will continue to set separate settlements, with each region having its own funding and outputs to deliver, as well as having a separate determination for Scotland. We will continue to use a range of information to inform our monitoring of how regions are delivering the requirements placed on them;
- **Specific System Operator settlement:** This reflects the national System Operator's critical role in delivering a customer-focused railway through its role in timetabling and ensuring effective use and development of the network; and
- **Specific focus on delivery to freight users:** This reflects the need to ensure that the infrastructure owner is sufficiently focused on delivering outcomes for freight users and recognising the important role it plays in enabling growth in freight traffic.

Our review will remain focused on Network Rail's OMR. Enhancements sit outside of the CP6 settlement and we expect this will remain the case for PR23. Similarly, we do not expect funding for Great British Railway's new functions, such as letting and managing concessions, to sit within the PR23 settlement. However, we will retain flexibility to include additional aspects within the scope of the review if required.

We will also retain differences in our approach between England & Wales and in Scotland, where appropriate. We will continue to work with DfT and Transport Scotland to adapt the PR23 process to address their different priorities and needs as infrastructure funders.

However, as discussed above, the current challenges facing the railway, and the opportunity of rail reform, mean that there are things we must approach differently in PR23. We have identified three key themes that will drive our approach:

1. **Whole-industry approach:** The PR23 framework needs to incentivise Network Rail to work in an integrated way with the rest of industry to deliver the outcomes that passengers and users care about. It also must reflect the financial challenges facing the railway industry and wider economy and ensure that Network Rail has deliverable plans in place that support driving down costs across the industry as a whole. In addition, Network Rail's plans for CP7 must align with the 30-year strategy for the railway as this develops.
2. **Adapting to change and uncertainty:** The PR18 settlement has already proved flexible in response to changes during CP6. We must remain agile in our approach to accommodating change during PR23 and throughout CP7 while maintaining appropriate certainty over the funding available and what needs to be delivered in return. We will also seek to ensure that the CP7 settlement does not

lock-in uncertain forecasts of passenger demand and revenues. We must ensure that the charges and incentives frameworks reflect the changed commercial dynamics in the industry. Any changes to these frameworks in PR23 must also be proportionate given the future changes to the access regime anticipated by the Williams-Shapps Plan for Rail. This need for flexibility will be built into our considerations from the very outset of PR23 and will be supported by close working with all parties, so that we can fully reflect the implications of changes in a developing context; and

- 3. Supporting effective integrated decision-making:** Throughout PR23 we will seek to ensure that Network Rail and ORR facilitate funders' decisions through effective assessment of the trade-offs and choices, given the financial challenges faced by the railway as a whole. We will provide transparency about the impact of decisions on outcomes for the railway using our joint expertise as economic and safety regulator. In doing so, we will ensure that there is appropriate engagement with all stakeholders in the decision-making process and that their views have been taken into account.

We will develop the PR23 framework and the charges and incentives framework in line with these three themes.

## Next Steps

This letter marks the formal start of the PR23 process. Work is ongoing as Network Rail develops its plans and we work closely with DfT and Transport Scotland to provide advice and assurance in advance of the HLOSs and SOFAs. We will ensure that the views of industry are taken into account throughout this process. However, we will ensure that we are also proportionate and targeted in the way we engage with stakeholders during the process, recognising the impact that the rail review implementation programme will have on industry resources.

We expect to provide further information on how we will approach the overall framework for CP7 in spring 2022. We will also consult separately on the framework for charges and performance incentives. As part of this we have today also issued our consultation on Schedule 8.

If you have any views on the issues set out in this letter, on the themes we have identified for PR23 and/or on areas we should explicitly consider in the PR23 framework, please contact us via [pr23@orr.gov.uk](mailto:pr23@orr.gov.uk) by 10<sup>th</sup> September.

We plan to publish all responses to this letter on our website. Should you wish any information that you provide, including personal data, to be treated as confidential, please be aware that this may be subject to publication, or release to other parties or to disclosure, in accordance with the access to information regimes.

In view of this, if you are seeking confidentiality for information you are providing, please explain why. If we receive a request for disclosure of the information, we will take full account of your explanation, but we cannot give an assurance that confidentiality can be maintained in all circumstances. An automatic confidentiality disclaimer generated by your IT system will not, of itself, be regarded as binding on ORR.

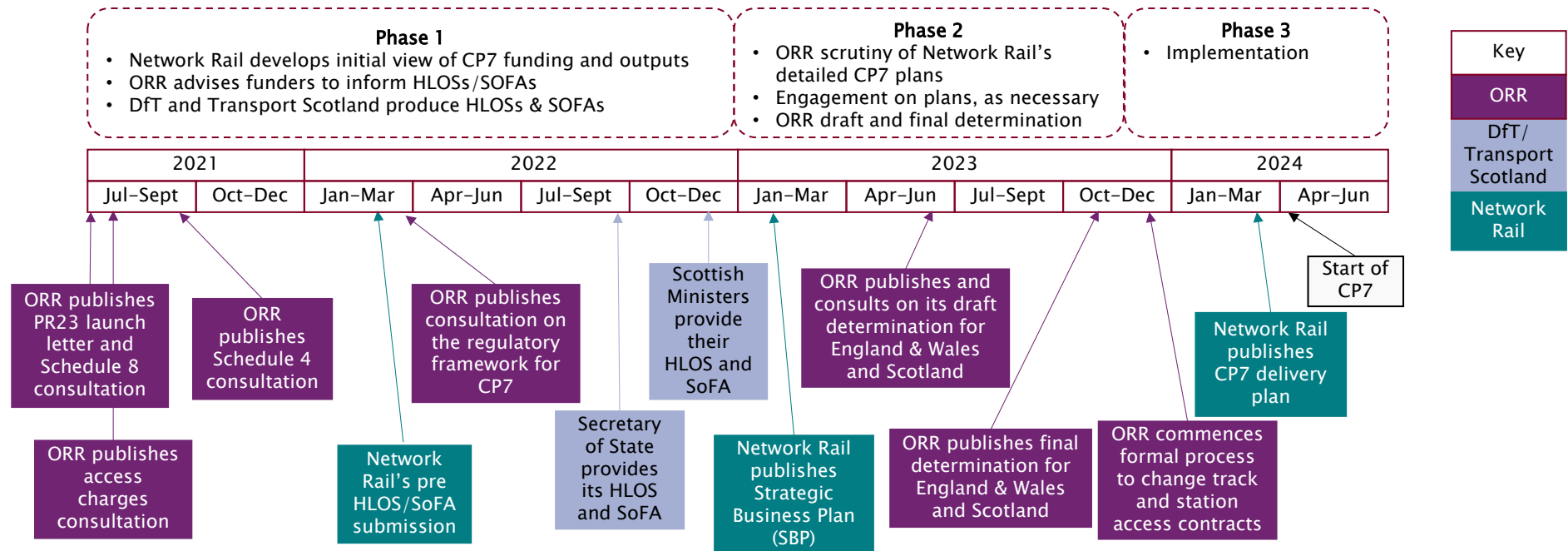
If you are seeking to make a response in confidence, we would also be grateful if you would annex any confidential information, or provide a non-confidential summary, so that we can publish the non-confidential aspects of your response.

Yours sincerely

A handwritten signature in black ink, appearing to read 'Daniel Brown', with a stylized flourish at the end.

**Daniel Brown**

## Annex 1 – Indicative PR23 timeline



\* There will be further consultations on the specific design of Schedule 8, access charges and Schedule 4 in the first half of 2022 - the consultations on these topics will provide more information on next steps.

\*\* The outcome of the comprehensive spending review in autumn 2021 may go some way to setting the funding envelope for the first two years of PR23 and is likely to be an important factor in determining the content of the HLOSs and SoFAs.

\*\*\* This timeline may change to enable us to adapt as the implementation plan for the Williams-Shapps Plan becomes clearer.