Carl Hetherington
Deputy Director EMS

Oliver Mulvey, Deputy Director, Rail markets,
Department for Transport

Paul Marshall, Group Controller, Network Rail

31 March 2021

Dear Oliver and Paul,

ORR's review of Network Rail's RF11 delivery plan update for the financial year 2021-22

As you know, Network Rail (NR) is close to completing its annual update to the control period 6 (CP6) delivery plan for its operating, maintenance and renewals activities (OMR). The plans set out, for 2021-22 and the remaining years of CP6, what it is forecasting to deliver and its income and expenditure forecasts.

This letter provides ORR's final comments on the last update to the plans before NR publishes a revised plan no earlier than 6 May 2021 (this date has been delayed due to the pre-election period). As explained in our 15 January 2021 letter (the RF8 letter), ORR conducts its review of the CP6 annual delivery plan updates in two key stages.

In the first stage, we reviewed the re-forecast of the plans that NR undertook at period 8, known as RF8. We documented that review in the RF8 letter (see Annex B). NR has made some changes to its plans at RF11 (the period 11 re-forecast), which we have reviewed. For some of the issues that we raised in the RF8 letter (e.g. metallic structures), NR has not had time to address them for RF11, but will consider them for next year's plans.

NR's RF11 plans are consistent with the Department of Transport (DfT's) financial limits for 2021-22 and the remainder of CP6. The plans also remain broadly aligned with the current delivery plan and the 2018 periodic review (PR18) Final Determination. Consistent with our RF8 letter, we consider that the RF11 plans do not include any major changes[1] that could require sign-off from the Secretary of State (SoS).

[1] Note: NR has allocated further risk funding to be spent given the challenges this year, e.g. from the impact of Covid-19. However, as we understand it, this is not a major change to the plan for DfT as this funding was provided to pay for risks, which it is doing.

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The PR18 risk funding process has worked well and has provided planning stability for NR. However, there are still significant financial risks for the remainder of CP6. NR's remaining risk funding for the last three years of CP6 is £847m[2], which is relatively low. This is especially so in the context of the emerging risks noted in this letter, including the uncertainty over the recovery from Covid-19. We recognise the unexpected impact of Covid-19, but there has been a reduction in the available risk funding in the two years since the 2019 Business Plan (BP19)[3] of £1,808m[4]. The situation is particularly challenging in Scotland, where NR is considering difficult decisions to create funding headroom and remain within funding limits. This is a growing concern for the remainder of the control period given the high levels of uncertainty and the financial risks that NR faces.

The Regions remain committed to deliver at least the levels of train performance set out in PR18 and most Regions have proposed more stretching passenger train performance targets for 2021-22 in their long-term scorecards compared to the current delivery plan. NR's Executive is providing challenge to ensure that the improvements made over the past 12 months are retained where possible. As a result, some additional stretch may be included in NR's national and regional annual scorecards for 2021-22. This may happen around the same time as the DfT-contracted operator performance requirements are reviewed. We consider this approach reasonable.

It is important that changes to the plans are transparent and any potential effects on safety, asset sustainability, performance, and income/expenditure are clearly identified and explained.

In Annex A, we have provided some comments on the plans and our views on the process for producing the RF11 plan and how it has improved since RF8.

Unless we are referring to a specific region or part of NR, the numbers in this letter and Annex A are for Great Britain.

I am happy to discuss any of the points in this letter with you.

Yours sincerely,

Carl Hetherington

Carl Hetherington

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[2] This now includes £308m of Crossrail income.

[3] Risk funding in BP19 was £2,655m and did not include £308m of Crossrail income.

[4] The funding has been used for a number of issues including managing the impact of Covid-19, earthworks and improvements to track worker safety.

Annex A

There have been some changes to the plans since RF8

NR has made some changes to its plans at RF11 compared to RF8. For example, NR's planning assumption is now that passenger numbers will recover through 2021-22 with an approximate 80% return to pre-Covid-19 levels by the end of 2021-22. The train performance forecast has also improved, meaning that schedule 8 income is forecast to be £258m higher. In addition, remaining risk funding has increased by £84m to £847m and headcount at the end of CP6 is now forecast to be lower than the forecast at RF8.

We raised renewals phasing as an issue at RF8. We note that NR has now smoothed out the peak in Year 3 renewals in the RF8 plans into years 4 and 5. To do this NR has included a c£170m central overlay[5]. As a result, the RF11 phasing of renewals is aligned with the 2020 Spending review and DfT's financial limits. However, the Regions will still need to refine their renewals phasing plans to ensure they are fully consistent.

Risk funding is tight particularly in Scotland

NR's confidence in delivering its CP6 plans within the remaining funding is now 71% (or a P71[6] position) up from a 65% position at RF8, but below the more robust 80% position at the start of the control period[7].

NR's remaining risk funding for the last three years of CP6 is £847m, an increase of £84m since RF8. We recognise the unexpected impact of Covid-19, but **there has been a reduction in risk funding in the two years since BP19 of £1,808m**[8]. The increase is largely due to the inclusion in RF11 of £308m of Crossrail income (from the 'Crossrail supplementary access charge' or CSAC), which was not included in the BP19 risk funding. At RF8, this income was included within the opex and renewals budgets, but NR had not identified how it would be spent. Improved schedule 8 forecasts have also partly contributed to an increase in the remaining risk funding. These changes are partly offset by cost increases, such as in Southern on Feltham re-signalling (£93m) and additional earthworks expenditure in 2020-21 (£68m).

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[5] This adjustment has not been allocated to the Regions yet.

[6] The letter P followed by a number represents the confidence that NR has in delivering its plans within that level of funding. In this case, the 71% confidence level means that the £847m of remaining risk funding is sufficient to cover 71% of the potential risks NR faces over the remainder of the control period.

[7] To cover the P80 risk position would require risk funding of £1,236m.

[8] Risk funding in BP19 was £2,655m.

We also note that NR has not included in risk funding the additional committed £460m efficiencies for England & Wales. This is because NR is being cautious and assuming that £460m of these additional efficiencies will either become a cash saving to DfT by way of a lower drawdown of the network grant (c£280m) or are efficiencies that do not have a cash effect in CP6 (£180m).

However, NR Scotland has taken a different approach and included all of the additional efficiencies of £40m in risk funding (both the c£20m of cash savings and c£20m of non-cash savings). This seems less prudent than the approach taken in England & Wales, given that there is less certainty whether the £20m of non-cash savings will be available for risk funding. But, we note that risk funding is much tighter in Scotland and that NR Scotland are trying to deliver as much of the £40m savings as possible as a reduction in cash costs. They are also looking at other opportunities.

NR still faces a number of potential risks over the remainder of the control period and it is not clear if all of these are included in NR's current financial risk modelling. Some of these we commented on in our RF8 letter such as potential further work on Track Worker Safety improvements. NR is still considering the full implications of this issue[9].

The remaining financial risk position also varies across the Regions[10]. **NR Scotland's position is the most challenging[11] (it has £57m[12] of remaining risk funding but NR has identified £106m of financial risks)**. NR Scotland is considering difficult decisions to create funding headroom and remain within funding limits[13]. These limits are separate for OMR and enhancements. The decisions that

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[9] We also note the recommendations from the taskforces led by Lord Robert Mair and Dame Julia Slingo and the continuing impact of climate change and weather events, which are hard to predict. Links to the reports are available in this report: [Resilience of rail infrastructure - update report to the Secretary of State March 2021 (networkrail.co.uk).](networkrail.co.uk) Before the reports were published, NR included some additional expenditure in its plans to address these issues. We have asked NR for an update on the impact of these reports on its CP6 plans, if any, for its period 4 re-forecast (RF4) in 2021-22.

[10] The financial risk modelling that NR's Business Planning Team has carried out is supplemented by bottom up type analysis by the Regions. It is helpful to have different ways of quantifying financial risks and we note that the Regions' own financial risk assessments are slightly more optimistic about the remaining level of risk funding.

[11] It is important to note that Scotland's risk funding is ring-fenced from the other Regions. So, if there is not sufficient risk funding in Scotland, NR cannot transfer funding from the other NR Regions.

[12] This includes both the £40m of additional efficiencies (which are not treated this way in England & Wales as noted above) and £82m of additional cost reductions, some of which in England & Wales have been identified as options instead of being added to the risk funding. We also note the numbers for Scotland do not include any savings that might be agreed in the on-going wider funding discussions with Transport Scotland.

[13] For example, NR Scotland is currently developing plans to defer £30m of renewals to later years after the end of CP6.

NR Scotland makes need to be consistent with its obligations, including those set out in our PR18 Final Determination, the framework agreement, the network grant letter and the Scottish Government's budgeting rules.

It is also important that NR Scotland's changes are transparent and any potential effects on safety, asset sustainability, performance, and income/expenditure are clearly identified. These changes should also be consistent with NR's health and safety duties.

Since RF8, the Regions have further explained how they will manage the remaining financial risks. This has been helpful but we think that NR could set out these actions more clearly in its plans or other documents (e.g. identifying the process for switching on/off projects). This needs to provide funders and stakeholders with the necessary understanding of the trade-offs and the short and longer term implications (e.g. into control period 7 (CP7)) of the potential decisions on safety, asset sustainability, performance and income/expenditure.

Safety

The Regions' RF11 plans did not fully explain the safety implications (if there are any) associated with the changes to the plans. For example, NR provided some assurances that deferrals and other proposed cost reductions will not result in adverse safety outcomes but did not provide any supporting evidence. **It is important that changes in the plans are transparent and any potential effects on safety are clearly identified. These changes should also be consistent with NR's health and safety duties**.

Similarly, NR also provided assurances that recruitment of safety critical roles is continuing. However, the Regions' RF11 plans did not set out any of the actions it will take to manage any occupational health and safety risks from a lower headcount in the RF11 plans (e.g. from excessive workloads and insufficient resource). [Redacted].

With the exception of Eastern, the other Regions do not seem to have considered in their RF11 plans the potentially significant safety risks from trees suffering from Ash Dieback[14]. NR should consider in its plans how it would manage this.

Finally, we note that the two Task Forces led by Lord Robert Mair and Dame Julia Slingo have now reported to NR. We recognise that there has not been enough time

[14] Ash dieback is a disease affecting ash trees, which is likely to likely to lead to the decline and death of the majority of ash trees, including those lineside of the network.

for NR to include the effects for CP6 in the RF11 review and it is still reviewing the recommendations[15].

Headcount and other organisational changes

In the latest RF11 forecast, headcount is expected to be 42,454 at the end of CP6, which is a reduction from NR's original Putting Passengers First (PPF) requirement of 44,398. In our RF8 letter, we asked NR to explain the possible implications of the lower forecast headcount. We are broadly satisfied from our engagement with NR's Regions that there should not be an impact from these changes in headcount on NR's ability to deliver its plans.

[Redacted].

We note that the RF11 plans do not reflect the recent organisational changes NR is making (such as the removal of the Network Services and Group Transformation functions). These changes take effect from 1 April 2021 and we expect to see updated figures in due course to allow for meaningful comparisons during the year.

Renewals

At RF11, the **Regions are generally planning to deliver the overall renewals volumes broadly in line with the PR18 Final Determination for the remainder of CP6**. However, there are some changes. In particular, we note that for RF11, there has been an increase in the volume of renewals work at the end of CP6 for some asset types such as signalling and telecommunications. There have also been some instances of Regions deferring work into later years after the end of CP6.

Based on what we have seen, we are not expecting significant changes in the Composite Sustainability Index (CSI) at the end of CP6. However, this is not as clear for Scotland, as it has not firmed up its renewals volumes for years 3 to 5, and probably will not do this until RF4 in 2021-22.

We note that **NR needs to carry out more work to assess and manage deliverability risks associated with the revised renewals plan** – including assessing the deliverability of the Year 3 work at Christmas 2021. It will also need to consider aligning the Year 5 plans with CP7 requirements as plans firm up, to avoid inefficiencies in the supply chain, e.g. from step changes in volumes.

At RF8, we raised concerns about the relatively low levels of expenditure on metallic structures (i.e. Bridges) in the plans. We have seen some initial signs in the Regions' RF11 plans that they are attempting to address this issue. However, this remains an area of concern and will be the focus of an assurance review by us in 2021-22.

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[15] This will include showing how it will implement the recommendations in the reports and how they affect CP6 and CP7.

Maintenance

Since RF8, NR has made some improvements in the way in which it captures and reports on maintenance volume data. This is a positive development but NR needs to do more work to improve this.

We are also concerned about a lack of focus in the plans on the outputs of the maintenance work. NR needs to consider how to improve this, e.g. possibly having an output-based maintenance scorecard measure, similar to that used to measure renewals activities. We also note that any future changes to the maintenance parts of the plans should consider that there is already a shortfall of work carried forward from control period 5 (CP5). We identified this in PR18, where we noted a need to increase maintenance activities.

We are currently reviewing the maintenance issues we want to look at in more depth and are planning a wide-ranging piece of work in 2021-22 to inform the 2023 periodic review (PR23). One area of focus will be around the introduction of technology to deliver improvements in maintenance. In addition, we will be seeking to understand how 'make or buy' decisions in this area are being made.

Efficiency

As we noted in our RF8 letter, **NR made good progress in Year 1 towards our challenge to deliver £3.5bn of efficiency improvements in CP6**. We completed a review of the Regions' Year 2 efficiency plans in January 2021, and considered how prepared NR is to deliver efficiency improvements for the rest of CP6. We concluded that **the majority of the Regions are generally well prepared to continue to deliver their efficiency plans. However, we have identified areas of concern with NR Scotland's plans, which it has accepted and is working to address**. **We consider that whilst the Regions have made continued progress, significant risks remain** – Network Rail's CP6 efficiency plan was always loaded toward the end of CP6 and Covid-19 has impacted on the development of some efficiency plans that were in their infancy.

NR's efficiency challenge increases through CP6 and Covid-19 has had a significant impact on its business. In particular, we are aware that the Regions are facing increased cost pressures on some asset types, and that some planning assumptions made at the start of CP6, including the level of efficiencies that national framework contracts would deliver, were too optimistic.

Overall, NR is confident in its ability to deliver its required £3.5bn of efficiency improvements in CP6. **It has also committed to deliver an additional £0.5bn of efficiencies and is reviewing how it will deliver them**. The elements of the plans that are made up of cash-based efficiencies are forecast to increase to £300m. Network Rail is assessing options to deliver further efficiencies in these areas, however, this is at an early stage.

Some of the Regions had differing views and approaches on some issues like the increases in CEFA[16] contract costs and track unit rates. One of the advantages of a regional structure, is that NR can learn from having different approaches (or views) on issues like these. We consider that NR can do more to draw these differences out and understand them. NR has recently confirmed that it will be introducing a centre of excellence that will be doing this as part of its role, which is a positive development.

We will continue to monitor its delivery of efficiencies closely and will report in more detail on its progress in our Annual Efficiency and Finance Assessment in July 2021.

Scorecards and customer targets

For RF11, **NR provided us with updated long-term scorecards and templates showing progress in customer engagement and agreeing more detailed annual customer targets**.

Our review of long-term scorecards found that the **Regions remain committed to deliver at least the levels of train performance set out in PR18. Most Regions have proposed more stretching passenger train performance targets for 2021-22 compared to the current delivery plan**.

NR's Executive is currently providing challenge to ensure that the improvements made over the past 12 months are retained where possible. This may result in some additional stretch being included within NR's national and regional annual scorecards for 2021-22. **We note that unless NR further updates the long-term scorecards to reflect these changes, this will result in a misalignment between the long-term and annual scorecards for 2021-22**.

NR Scotland has retained the performance targets set in the PR18 Final Determination (as per Scottish Ministers High Level Output Specification) and we consider that those remain sufficiently stretching.

The System Operator has revised its scorecard to take account of the views of the System Operator Advisory Board and the findings of its Customer Advocacy Survey. We consider this a positive development.

We are also aware that the freight team has strengthened its engagement with its customers to understand and document their priorities, and track its actions to meet them. We consider that these are positive developments. Freight train performance targets are currently going through the managing change process because of a change in the calculation methodology. However, we do not expect the level of challenge to deviate significantly from the current delivery plan. As with passenger train performance, NR's Executive is currently providing challenge, which may result

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[16] The Civil Examination Framework Agreement (CEFA) is a contract between NR and one (or more) contractors who specialise in inspecting structures, buildings, earthworks, or other assets.

in some additional stretch being included within NR's national and regional annual scorecards for 2021-22.

Given the uncertainty caused by Covid-19, **NR is proposing to review its national and regional annual scorecards in 2021-22. This may happen around the same time as the DfT-contracted operator performance requirements are reviewed**. We consider that this is a reasonable approach.

In our mid-year update on NR's delivery of performance[17], we said that NR must revise its business plans and establish appropriately challenging but deliverable train performance targets through engagement with industry stakeholders. Where possible NR and operators have also sought to align customer targets with other forecasts and targets in the Emergency Recovery Measures Agreements (ERMAs[18]).

Overall, the customer agreement templates provide us with evidence of positive engagement with train and freight operators, which is consistent with NR's own internal audit findings. We note that there is further work to do to complete the process of agreeing customer scorecards and ensuring full alignment with the long-term scorecards.

Quality and timeliness of RF11 plan information has improved

Compared with RF8, **NR has made a significant improvement in the quality and timeliness of both the information provided on the RF11 plans, and its engagement with us**. For example, we have been provided with some of the internal executive submissions. We have also had a number of meetings with NR's Regions and other business units. This has allowed us to understand more easily the key changes made to the plans from RF8 to RF11.

Overall, this new process has improved the quality of our review of the RF11 plans compared to our RF8 review. We will discuss further with NR how to capitalise on these improvements for next years' review. We will also discuss further improvements, such as the Regions providing more explanation of the safety implications associated with changes made to the plans.

[17] ORR 2020-21 mid-year review letter to Network Rail - Train service performance - December 2020

[18] In Scotland, for the ScotRail and Caledonian Sleeper franchises, these are Emergency Measures Agreements (EMAs).

Annex B – See attached