ORR's review of Network Rail's Delivery Plan update (RF8) for the financial year 2022-23, January 2022

A. Purpose and background

This note presents ORR's views on Network Rail's RF8[1] delivery plan update as of December 2021. This update relates to Network Rail's planned activities for the rest of control period 6 (CP6).

Network Rail updates its CP6 delivery plan for its operating, maintenance and renewals activities (OMR) on an annual basis[2]. ORR reviews the updated plans to help hold Network Rail to account against the PR18[3] Final Determination[4]. We provide our high-level findings from our review to DfT, which uses this to help advise senior officials and Ministers about whether Network Rail is on track to deliver the high-level output specifications (HLOSs) within the agreed funding envelope for CP6. This includes the process for the Secretary of State's (SoS's) approval of any major changes to the updated delivery plan[5]. We also provide separate assurances to Transport Scotland, which are based on Network Rail's RF6 information (this is driven by the timing of the Scottish Government's budget setting process). However, for transparency purposes, we also share this note on our RF8 review with Transport Scotland.

In section B, **we present a summary of our findings, including our emerging views on the issues we expect Network Rail to consider for its next delivery plan update (RF11).** We will separately provide Network Rail with some views on each region and some of the central functions.

Our review does not consider any corresponding changes in Network Rail's scorecard outputs, reflecting the fact that Network Rail does not consider this until

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[1] This is Network Rail's re-forecast of its plans at period 8, known as RF8.

[2] Network Rail also updates its enhancements plan as part of its RF update. However, for the purposes of this review, and as agreed with DfT, we do not hold Network Rail to account for the delivery of CP6 enhancements.

[3] This is our Periodic Review 2018, known as PR18. In our PR18 final determination we set out what Network Rail is expected to deliver in CP6 and the funding available to do so.

[4] Specifically, we focus on Network Rail's delivery against the Delivery Plan 2019, which set out how Network Rail intends to deliver the PR18 Final Determination.

[5] Specifically, if there are any material differences in outcomes, risk profile and/or the financial position compared with the original delivery plan for the control period, these will need to be agreed with the SoS and must remain consistent with any of Network Rail's regulatory commitments.

RF11[6]. In the main body of the note, we refer to specific examples from the regions and functions to help expand on the points made. Unless we are referring to a specific region or part of Network Rail, the numbers in this note are for Network Rail as a whole.

B. Summary of our emerging views

1) **Our overall view is that the RF8 plans appear broadly aligned with the current 2021-22 Delivery Plan. However, there is a risk that the coronavirus (COVID-19) pandemic (including current and future variants) and economic uncertainty (e.g. inflation) will continue to impact Network Rail's ability to deliver.**

We have not identified any major changes in the RF8 plans that could require sign-off from the SoS. This is with respect to the current delivery plan for 2021-22 and the remaining years of CP6. Overall, the RF8 plans remain broadly aligned with the current Delivery Plan, as well as the Delivery Plan 2019 (DP19) that the SoS approved for CP6 following the PR18 Final Determination.

However, it is worth noting a caveat to this. Reflecting the timings of Network Rail's submission, the impacts of the Omicron variant of COVID-19 have not been fully reflected in the RF8 updates. While Network Rail has made some adjustments in its RF8 plan to reflect this (e.g. it revised its forecasts on property income to reflect lower station footfall numbers), Network Rail will need to consider this more fully for its RF11 update in February 2022. This means that more changes to the final plan at RF11 would need to be considered. Furthermore, it is possible that other, future variants of COVID-19 could emerge that would have implications for Network Rail's ability to deliver.

Nevertheless, Network Rail's early view (outside of the RF8 submission) is that income should not be significantly impacted by the Omicron variant, reflecting the fact that lower income from track access charges tends to be offset by increased schedule 8 income. Capital delivery, however, may be affected by increased staff absences (in Network Rail and the supply chain) and, in turn, deferred work. Reflecting this, since its RF8 plan, Network Rail asked DfT to increase the level of funding (by £350m) it can rollover into year 4 of CP6. DfT has approved this increase.

2) **Network Rail's delivery of its renewal works is broadly on track when compared with the 2021-22 delivery plan. However, Network Rail has not yet sufficiently demonstrated that it has considered the implications of**

[6] We will consider any changes to Network Rail's scorecards as part of our RF11 review. We also consider Network Rail's scorecard outputs as part of our Annual Assessment of Network Rail's performance.

changes to its renewals plan on the performance of the network and longer-term asset condition.

Over the course of CP6 we would expect that the volumes of renewals that Network Rail seeks to deliver will deviate from the DP19 in response to, for example, changes in known asset condition, the level of reactive repairs undertaken and the need to respond to changing environmental factors.

Whilst overall the profile of total spend on renewals in years 2, 3, 4 and 5 of the control period is broadly flat (£3.9bn in year 2 to £4.2bn in year 5), the position on spend and volume varies across the different asset types (we will provide more information on this in RF11). In particular, as signalling work has already been more backloaded, we note the deferral of some signalling renewals (including, for example, Sandhill in North West & Central to later in 2021-22 and the delay to the introduction of an European Train Control System (ETCS) scheme in Wales & Western to 2023-24). We note that the regions remain generally confident in delivering their signalling renewals, though Network Rail's Technical Authority (which provides internal assurance over Network Rail's activities) recognise that there is a delivery risk with signalling.

With respect to track renewals, Network Rail is deferring some of this work. This is creating some delivery risks, which to date have been exacerbated for this particular asset area by inefficient planning and poor reliability of the 'high output' machinery used in the renewal of track in large projects. Network Rail has not achieved the required productively levels this year on 'high output' work and it now intends to reduce its planned volumes of 'high output' work for the rest of CP6, which will also result in increased costs. In January 2022, we commenced a targeted assurance review on plant (including high output) to understand better what the issues are and will report in early spring 2022. It is important that Network Rail considers the implications of this issue in future re-forecasts.

In our review, we also noted examples of Network Rail implementing a more short-term approach to asset stewardship (e.g. refurbishment instead of renewal) without clearly showing the longer-term impacts on future maintenance and renewals requirements and whole life costs.

Network Rail has agreed to conduct an in-depth review by Q1 2022-23 of the impact of taking a more short-term approach to asset stewardship and deferring or descoping renewals. In the immediate term, Network Rail appears to have effective mitigations in place through its maintenance work (showed through internal assurance review work by its Technical Authority in this area). We are also undertaking targeted assurance reviews in this area, which we expect to conclude early this year, and will consider this issue with Network Rail following the conclusion of each review.

For RF11, Network Rail should provide a clearer overview and explanation of renewals deferrals and the effect on the performance of the network and longer-term asset condition.

3) **There is a continued lack of reporting in Network Rail's executive packs on maintenance activities undertaken that make it difficult for us to provide assurance in this area.**

As indicated at previous reviews, we are concerned that Network Rail did not provide us with sufficient information in its executive packs about its maintenance activities, particularly about its delivery of maintenance activities against the original DP19. This has made it difficult for us to determine how Network Rail is performing in this area and how its current delivery compares with what it committed to in the PR18 Final Determination. Network Rail has made progress in its maintenance reporting, and we note that it has recently agreed a maintenance performance indicator. We expect that this indicator will be included in the RF11 submission (as a draft if necessary).

4) **Network Rail's remaining risk funding is similar to RF11 last year but is very low in Scotland where the situation has deteriorated further since RF11 last year.**

At RF8, Network Rail has £710 million of risk funding remaining for the end of 2021-22 and the last two years of CP6, which it estimates will cover circa 67% of potential risks. This is lower than the 71% at RF11 last year and the 80% at the start of CP6. However, given the impact of COVID-19 and that we are now a further year into CP6, this is becoming a more reasonable position. The effect of COVID-19 (including current variants) and the current high inflation rates[7] will have a negative impact on risk funding, which is not fully reflected in the plans at RF8. The inflation forecasts are also very uncertain.

To date, £1.9 billion of risk funding has been drawn down from the risk fund in CP6. Of this, £1.3 billion has been used for financial risks (e.g. the impact of COVID-19 and rising inflation) and £0.6 billion for new activities (including £0.3 billion for the Track Worker Safety Task Force). However, not all of this has been spent – £1.0 billion of the risk fund has been allocated to years 4 and 5.

Network Rail's risk modelling suggests that a further £1.2 billion of risk could emerge in the last two years of the control period. Of this, circa £0.8 billion relates to potential cost and inflation increases. There is also continuing uncertainty around COVID-19 (including the Omicron variant and potentially further variants).

The situation is particularly challenging in Scotland, where the remaining uncommitted risk funding is £13 million at RF8[8]. This position is worse than for the

[7] As of December 2021, the Consumer Price Index (CPI) was at 5.1%, which is above the Bank of England target of 2%. This is caused by well-publicised supply chain issues, higher energy costs and COVID-19 related effects. Network Rail considers that it experiences higher inflation than general measures such as CPI. For example, it says it is much more exposed to cost increases in specific materials such as concrete, steel and in the supply chain, which can increase at rates higher than CPI.

[8] To note this is an evolving situation evidenced by further information from Network Rail Scotland's period 9 forecast. Network Rail Scotland would recognise £20m as the remaining risk funding at RF8 after a change to group numbers.

E&W regions, especially as Network Rail Scotland does not have access to the E&W central risk funding pot (reflecting that funding between Scotland and E&W is ring-fenced). This means that Network Rail Scotland faces difficult decisions to improve the risk funding position, such as potentially deferring work in years 4 and 5 to CP7.

Following the cost reduction exercise initiated after discussions between Network Rail Scotland and Transport Scotland, Network Rail Scotland has identified £53 million of renewals[9] that could be deferred in whole or in part to increase risk funding (although £24 million is likely to be required for Carmont related costs).

After its initial cost reduction exercise, Network Rail Scotland has recently identified potential additional ways to reduce operational spend by a further circa £25 million by the end of CP6, though it has yet to decide which (if any) of these cost reductions it will take forward. It is also not clear whether the initiatives will deliver these benefits. Network Rail Scotland has provided us with some high-level information on where these savings could be made. However, we note that the internal process has not yet concluded (including sign-off by the region's executive team) nor have we reviewed the potential savings yet. Delivering these cost reductions are likely to be extremely challenging and it is currently unclear whether the circa £25 million of additional savings can be achieved.

We have included this issue (i.e. Network Rail Scotland's financial risk position and how it manages it) on the regulatory escalator and will continue to keep it under close review in the run up to RF11. We also note that Transport Scotland would like CP6 funding to be returned, if possible, which Network Rail Scotland is taking into account when it considers how much risk funding it needs for CP6.

5) **Network Rail's approach to managing the allocation of risk funding among the E&W regions and the Group risk fund would benefit from further consideration by Network Rail.**

Network Rail needs to strike a balance between using risk funding to address cost increases that have happened, making sure there is enough risk funding to cover future risks and not leaving unused risk funding at the end of the control period. We recognise that getting this balance right is difficult and that the risk funding process overall in CP6 has provided stability to the planning process.

The E&W regions are working under unclear assumptions about what risk funding they are realistically likely to have available to them for the whole of CP6 and the process for accessing the group risk funding. Our initial view is the regions may not be holding enough risk funding to manage the risks they face[10]. Network Rail needs to show that the balance between risk funding being held at the centre and in the regions is appropriate.

We understand that the regions are being encouraged to identify robust business cases in forthcoming business planning rounds to utilise the available risk funds held

[9] This includes deferrals from signalling, structures, buildings and telecoms.

[10] [Redacted]

centrally. However, we consider that Network Rail's governance for ensuring that risk money is used in the most efficient way across the company may benefit from some improvements. For RF11, Network Rail needs to make it clearer whether a region has low risk funding because it is underperforming, being faced with higher risks than expected and/or has insufficient risk funding as some risk funding has not yet been released from the central risk fund (at RF8, Network Rail's group function is holding £398 million of risk funding).

6) **Network Rail is forecasting that it will deliver £2.1 billion of the overall £4.0 billion of efficiency savings in year 4 and 5. This will be challenging.**

Network Rail considers that it is broadly on track to deliver £4.0 billion of efficiencies in CP6[11]. However, it will become increasingly challenging to meet its efficiency targets – in years 4 and 5, Network Rail is forecasting to deliver £2.1 billion of the overall £4.0 billion of efficiencies.

We agree with Network Rail's overall assessment with respect to efficiencies. However, as noted above, there is a significant level of financial risk remaining over the last two years of the control period (e.g. on workforce reform and challenges with respect to the supply chain). Furthermore, Network Rail's ability to deliver the level of efficiencies in its plan is dependent on it delivering the planned level of renewals volumes (these volumes are expected to increase in the last two years of CP6), which as we note above is increasing the possibility of some of them being deferred into CP7.

Furthermore, we note that Network Rail is also forecasting £0.9 billion of headwinds for CP6 (i.e. cost increases outside of its control), with the most significant category of these being from the impact of COVID-19 on its operations (£280 million). We will continue to monitor its reporting in this area as this is a highly uncertain area of Network Rail's expenditure, something which Network Rail has highlighted in its risk modelling.

7) **[Redacted]**

[Redacted]

8) **Network Rail has not provided us with sufficient information in its executive packs about the potential safety implications of its plans, which has made it difficult for us to assure them. We also require further information to understand how it is implementing the Lord Mair and Dame Slingo recommendations.**

In our review of Network Rail's plans at RF11 last year (and as set out in our corresponding letter), we raised concerns about Network Rail not explaining any safety implications associated with changes to the plans. At this RF8 review, we found a similar issue: most executive packs did not set out (however briefly) the safety impacts of the changes (including explaining why this was the case) or, if there were no safety impacts of changes, why Network Rail concluded this was the

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[11] [Redacted]

case. We understand that Network Rail's general approach is that each region or function has devolved accountability for safety (with their own engineering function being expected to manage the safety of the relevant infrastructure). However, our RF8 review highlighted that Network Rail (including the Technical Authority and the regions) did not clearly show any explicit safety review of the impact of the changes made to plans, even at a high level.

Whilst we note that there are not a significant number of changes in Network Rail's plans, it is important that where changes are being made that these are transparent and that any potential effects on safety, and mitigations required as a consequence, are clearly identified in its executive packs to help ensure that no safety risks materialise at a later date. We expect Network Rail to discuss any safety implications with us at a regional and functional level prior to RF11 in March 2022, and throughout the year to avoid being in this situation next year.

Furthermore, Network Rail is currently at the early stages of delivering the recommendations arising from two recent independent reviews that looked at how the railway can more effectively manage its earthworks and drainage assets to better cope with extreme weather (Lord Robert Mair and Dame Julia Slingo)[12]. In its RF8 submission, Network Rail clearly showed how it would address these recommendations. However, more detailed information is needed on how Network Rail will implement them, including their individual costs and how they will be funded (e.g. from the risk fund).

9) **The plans did not provide enough clarity on the costs and savings associated with the changes made to the Track Worker Safety arrangements. Furthermore, the plans did not clearly set out whether the removal of the open line 'walking' arrangements had been considered.**

Network Rail has recently accelerated its programme for implementing the improved Track Worker Safety arrangements required by our improvement notice, through its Safety Task Force. The capital implementation costs of this programme are now forecast to be £254m (post efficient) in CP6 (this is £229m sponsored by the Technical Authority and around £25m for planning delivery in the Regions). Network Rail's forecast of the on-going operational costs (e.g. automated warning systems) is £147m (post efficient) in CP6. We are concerned with the clarity of the reporting of these costs, although we recognise that it is not straightforward identifying these costs separately from the costs of dealing with COVID-19. For example, it is not clear what all these operational costs are and how they differ (or not) to normal operational costs. Network Rail should provide better transparency of these costs at RF11. In particular, showing that the costs have been incurred efficiently.

The programme will also deliver other benefits (e.g. more time on tools and reduced Schedule 8 costs). In total, Network Rail's Technical Authority's analysis suggests savings of up to £100m. It is confirming with the Regions, how much of these

[12] The Rail Accident Investigation Branch report on Carmont is also due to be published in February 2022.

savings (if any) are currently in the RF8 forecast, e.g. checking there is no double counting and how much of the savings are in cash.

It is also unclear whether the removal of open line ‘walking’ arrangements (which relates to workers walking between work locations or from an access point to where they will carry out their work) has been taken account of in regional plans. We are currently discussing this issue with Network Rail so that it uses a safe and efficient way to deliver the required work. This may have implications on the cost of future ‘walking’ arrangements.

C. Business planning process

Network Rail has continued to make improvements in the quality and timeliness of both the information provided in the plans and its engagement with us. For example, each of the regions and functions met with us in November – based on an informal ‘check-in’ – to ensure we had early sight of potential or existing issues ahead of receiving the formal executive submissions. These sessions have provided an opportunity to have a transparent two-way conversation and allowed us to understand the material changes more easily. This was helpful given the timings for this review were extremely tight.

However, further improvements and more timely engagement are needed from Network Rail in the way it develops its process for year 4 and 5. This is because in undertaking our review of Network Rail’s plans, we seek to make use of Network Rail’s own processes to minimise the burden on Network Rail. However, for this to work, Network Rail needs to engage with us and DfT at the right time to take account of our views as it develops the process, including in advance of agreeing any changes to the RF process for years 4 and 5. We will continue to engage with Network Rail on this and welcome its commitment to involve us, as well as funders as appropriate, more closely as a key stakeholder in this.

D. Next steps

We are keen to work with Network Rail to ensure that the issues raised in this note are resolved in advance of RF11 where possible. In addition to Network Rail reflecting our findings on the overall Delivery Plan update (as set out above) we expect Network Rail to additionally provide for RF11:

- assurance around the longer-term impacts of being behind on its effective volumes in the areas of plain line, switches & crossing and structures;
- ‘shadow’ reporting of Network Rail’s maintenance numbers;
- an explanation of the reasoning on the level of risk funding available to each of the E&W regions;
- an explanation on the policy/approach to determining the allocation of regions’ risk funding;
- regional/functional meetings to discuss any safety implications of changes to the plan prior to RF11;
- more detailed information on the implementation of the Lord Mair/Dame Slingo recommendations, including the individual costs of each recommendation and how they will be funded; and

- better transparency on the costs and savings associated with the changes made to the Track Worker Safety arrangements.

To ensure Network Rail provides this information at RF11, we will include the issues discussed above in our 'issues tracker' and discuss them at our monthly business planning liaison meetings. As part of this we will agree with Network Rail which points should be included in the tracker and the criteria for closing them.

We will also work with Network Rail on a more iterative basis to understand how the business plans are evolving, including making use of existing ORR and Network Rail meeting structures to facilitate this.