Les Waters
Head of Licensing

Company Secretary
Network Rail Infrastructure Limited
Waterloo General Office
London
SE1 8SW

3 May 2023

Network Rail's network licence: consent to "DevCo" proposals

1. On 6 February 2023, Network Rail requested consent from the Office of Rail and Road ("ORR"), pursuant to Condition 16 (*Financial ring-fence*) and Condition 17 (*Land disposal*) of its network licence, that the activities to be carried out by its subsidiary company, to be known as "DevCo", should not be subject to those two network licence conditions.

2. Subsequently, on 8 March 2023, Network Rail also requested consent under Condition 16 to allow its funding for property joint venture ("JV") investment to be transferred to DevCo, as those activities would be carried out by DevCo.

3. Network Rail's applications for consent can be found at Annexes A and B.

Decision

4. We have considered the information supplied by Network Rail and pursuant to conditions 16 and 17 of its network licence, ORR consents to the proposals, as proposed by Network Rail in its correspondence of 6 February 2023 and 8 March 2023, as follows:

Condition 16 (Financial ring-fence)

5. In respect of Condition 16.1(c), ORR consents that:

   Network Rail may transfer to DevCo no more than the amount hypothecated for JV investment in CP7 – currently estimated to be £111m – subject to ORR's Final Determination for CP7.

6. This consent is subject to the condition that:

   Network Rail must take all reasonable steps to eliminate, as a minimum, the risks it has identified of potential parent company liability, financial or otherwise, arising from its DevCo subsidiary and its activities, structure and/or governance.

7. ORR also confirms that the activities of DevCo shall not be subject to Condition 16.

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Condition 17 (Land disposal)

8. Pursuant to Condition 17.1(b)(iii), ORR confirms that Network Rail’s subsidiary DevCo shall not be subject to Condition 17.

Reasons for decision

Background

9. As part of its aims for rail reform, the UK Government wants Great British Railways (“GBR”) to maximise outcomes from development around stations and railway assets. The Department for Transport (“DfT”) would like to combine its property development company, London and Continental Railways Limited (“LCR”), with some of Network Rail’s property team, to merge their land and property capabilities and resources into a single entity, considering that a single company would deliver the UK Government's property aims more effectively than the two companies do separately. DfT would like to bring forward the merge so that it occurs now, separate to the formation of GBR, so that early benefits may be achieved.

10. It is expected that Network Rail will acquire LCR via a share purchase for nil consideration and for LCR to be absorbed into an existing property subsidiary of Network Rail Infrastructure Limited (“NRIL”), the new working name for which is “DevCo”. DevCo would be consolidated in Network Rail's Group accounts and NRIL’s regulated financial statements. It is expected to operate mainly autonomously but with some matters reserved for NRIL and for DfT.

11. DevCo would be created from the acquisition of LCR’s staff, revenue streams, land and buildings, and cash reserves. NRIL would transfer some staff from its Group Development team who have expertise in railway and joint ventures. DevCo would pay their salaries subsequently. None of NRIL’s property would be transferred in the creation of DevCo. However, the CP7 anticipated funding of £111m for JV investment, as given in Network Rail’s Strategic Business Plan is proposed to be passed through to DevCo.

12. DevCo would be set up as a legally separate company from Network Rail, dedicated to property development. It is intended that the way DevCo is set up will mean that NRIL will not be held liable for DevCo’s liabilities and activities. NRIL would not act as a parent company guarantor for DevCo.

13. The proposal intends that DevCo will deliver development projects whilst working closely with each of the Network Rail regions, which control railway land and whose individual agreement is required for their land to be released for development. Network Rail’s land disposal controls will still be in force and where NRIL has ORR consent to a disposal to DevCo, DevCo is to pay the market rate.

14. It is expected that DevCo’s dividends to NRIL will be reinvested into the railway, thereby reducing the UK Government’s funding requirement.

Consideration of regulatory issues

15. **Condition 16 (*Financial ring-fence*)** protects Network Rail's funders and customers from the company being exposed to risks that are not part of its role as the GB rail infrastructure operator; it is restricted from taking part in activities that are not part of its core business – not Permitted Business. Network Rail must ask ORR for consent to carry out any activities that are not part of its core business, unless it is *de minimis* (small scale), business. The activities of DevCo do not constitute Permitted Business and the pass-through of allocated funding to DevCo is not considered to be small scale. Our chief concern with any proposed Network Rail non-core activity is the scope for liability to fall on NRIL, and therefore for any losses to need refunding from core operations, maintenance and renewal ("OM&R") activities.
16. Network Rail has stated, with supporting analysis, that it will not be held liable for DevCo's liabilities because each of DevCo and NRIL are considered to be legally separate entities and NRIL is not a parent company guarantor.
17. Network Rail has confirmed to us that the reserved matters for NRIL to determine would be anything that could impinge on the safety and operation of the railway. Network Rail has also confirmed that the existence of reserved matters and that certain group-wide policies being in place would not be so extensive as to constitute a shadow director role, so no liabilities would arise consequentially.
18. Network Rail's analysis identified several practical ways – that could apply to any group company – to minimise any potential risks that could give rise to a duty of care to third parties contracting with the subsidiary. These included considerations around:

    - Corporate structure – and the separate operation of subsidiaries.
    - The overlap of directors between parents and subsidiaries.
    - Corporate governance formalities – such as good records of regular board meetings, the prompt filing of returns, the operation of separate accounts for companies in the same group.
    - "Holding out" – ensuring that corporate identities are not misrepresented; that third parties are clear with whom they are dealing to lessen the scope for allegations that a third party thought it was dealing with the parent company.
    - Employees and agents – being clear of the messaging employees or agents of the subsidiary company are giving when dealing with third parties to avoid a third party thinking a subsidiary acts on behalf of its parent.
    - Insurance – reviewing company insurance portfolios to ensure that employers' liability policies are in place to cover liabilities arising from employees of past and present subsidiaries.
19. We have received confirmation from DfT that it is aware of the proposals and that it approved the proposals in March 2023, conditional on ORR's consent being granted.

20. Given Network Rail's statements and analysis and that DfT has been through its own checks and assurance process such that it has approved the outline business plan, we are satisfied that Network Rail's position on non-liability for DevCo, and therefore the Government's interests, have been considered.

21. However, in order to protect NRIL's OM&R budget from potential calls to provide increased funding into DevCo, we consider that in granting a consent it is appropriate to place a limit on the funding that NRIL can provide. In Network Rail's Strategic Business Plan for CP7, some £111m is hypothecated for JV investment by end-March 2029. To restrict funding to that limit we are adding a condition to our consent limiting NRIL funding for DevCo to the amount provided in our PR23 Final Determination.

22. With regard to the potential liability risks that Network Rail has identified (in the paragraphs above), we consider that Network Rail, being aware of such potential risks, should take all reasonable steps to eliminate those risks, whether financial or otherwise, and so we are making our consent conditional on this point.

23. With our conditional consent in place as an additional protective safeguard to NRIL, we are satisfied that we can confirm a derogation of the terms of Condition 16 to DevCo.

24. **Condition 17 (*Land disposal*)** requires Network Rail to gain ORR consent before disposing of any land. This protects against land being lost where it is reasonably likely to be needed for the railway in future. Network Rail has stated to us that there will be no bulk transfer of land when DevCo is formed; instead DevCo will seek to buy Network Rail land on a case-by-case basis at market value, with Network Rail having gained ORR's consent for each transaction. This represents no change to today's arrangements.

25. We would not regulate DevCo directly, but NRIL's DevCo subsidiary would – like its parent company – be subject to our land disposal controls. Network Rail has therefore asked that we confirm that the DevCo land that will be acquired from LCR shall not be subject to Condition 17. We consider it is logical to agree to this, given that the LCR land in question is not currently subject to regulatory control over its disposal. Network Rail has also asked us to clarify that DevCo will not require further consent to dispose of any land acquired from Network Rail, where NRIL's disposal to DevCo has already received ORR consent.

26. On this basis, and since the land disposal licence condition will continue to apply to and protect the railway interest in NRIL's property assets, we consider that we can confirm that a derogation from Network Rail's land disposal controls for land held by DevCo can apply to DevCo.

27. **Condition 19 (*Cross-subsidy*)**. Network Rail has considered whether any part of the proposal to establish DevCo, including the initial transfer of land and other assets (as part of the merger with LCR), or the ongoing operation of DevCo, could give rise to any cross-subsidy from NRIL's ring-fenced business to DevCo. Such

cross-subsidy is prohibited under network licence Condition 19. Network Rail has stated that no unfair cross-subsidy would arise and it has also stated that its assessment has been part of its business planning and due diligence process. We have been provided with evidence that Network Rail has independent analysis that supports the proposal.

28. Network Rail has stated that any secondees supplied to DevCo would be on an arm's length commercial terms arrangement and cross-charged to DevCo. Alternatively, or in addition, some staff with NRIL Group Property may be transferred to DevCo permanently. Network Rail is to assure itself that these arrangements would not impact adversely its ability to carry out its role as infrastructure operator in compliance with its network licence obligations.

29. We have considered whether there are any likely implications for the ongoing and future **operation of the railway** and consider that the proposals themselves do not raise any issues. Our land disposal licence condition will continue to apply to NRIL and we will continue to safeguard the future development of the railway through that control.

30. We have also reviewed Network Rail's proposals from a **competition** perspective, relating to avoidance of unfair cross-subsidy. We have noted the importance of ongoing assessment and scrutiny by Network Rail to ensure that implementation of the proposals avoids unfair cross-subsidy and is thereby compliant with network licence **Condition 19 (*Cross-subsidy*)**. We note also that, once established, DevCo will be an undertaking for the purposes of the Competition Act 1998 and its conduct is therefore subject to competition rules.

31. Subject to the terms set out in this letter, we hereby provide consent to NRIL, pursuant to Conditions 16 and 17 of Network Rail's network licence, so that it may proceed with its proposals for DevCo, as described.

32. In reaching our decision we have considered our Railways Act 1993 section 4 duties as appropriate, and have given particular weight to our duty to exercise our functions in a manner which we consider best calculated to "*protect the interests of users of railway services*".

33. This consent is valid from this day onwards. ORR may modify or revoke this consent in a notice given to the licence holder if it appears to ORR requisite or expedient to do so having regard to the duties imposed on ORR by section 4 of the Railways Act 1993.

Les Waters

Les Waters

Duly authorised by the Office of Rail and Road

Annex A

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T [Redacted]
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6 February 2023

By email only

Dear Les

Application for Regulatory Consent under LC16 & LC17

The railways play a significant role as a public service and there are opportunities to do more to support economic growth and unlock better land and housing developments to improve services for our local communities. The Williams-Shapps Plan for Rail sets out how a future Great British Railways ("**GBR**") would work with partners to support better development near stations in order to unlock sites available, for example, for suitable housing schemes.

This letter specifically concerns one of the initiatives related to delivering the Government's ambition, to optimise its property development capabilities. This proposal is looking at the creation of a new railway property development company within Network Rail's overall business structure, which combines the capabilities of London and Continental Railways Ltd ("**LCR**") and Network Rail Infrastructure Limited's ("**Network Rail**") Group Property Development and Sales function. The purpose of this initiative is to unlock significant potential benefits from railway development, which are currently constrained under the existing incentives and structures.

As has been discussed with the ORR over the last few months, the elements that make up DevCo, including our assessment of the requirements we need to comply with, are outlined in more detail below.

1. Background

LCR is wholly owned by the Department of Transport ("**DfT**") and specialises in the management, development and disposal of property assets within a railway context and, in particular, property assets associated with major infrastructure projects. LCR was responsible for the delivery of the High Speed One ("**HS1**") railway including new stations at

Stratford International and Ebbsfleet, as well as the rebirth of St Pancras International. Today, having divested HS1, LCR's primary focus is on property development and land regeneration as exemplified by the regeneration of the King's Cross lands, rail lands at Stratford and Manchester Mayfield.

Whilst Network Rail's property development arm (NR Group Development) and LCR have each achieved some success in their respective property development and land regeneration functions, there are significant barriers under the current arrangements to maximising value and to unlocking the significant potential benefits from railway-led development. In particular:

- Network Rail is resource constrained and is focused on delivering railway improvements, and funding constraints and its regulated status, limit its ability to work with the private sector to unlock development value across its property estate (including via its property development Joint Ventures (JVs)).

- Whilst LCR's public corporation status means that it is better resourced and aligned to working with private sector partners, it requires full collaboration with Network Rail in order to unlock potential from railway-led development. Without aligned priorities and incentives for it to release land, Network Rail cannot fully collaborate with LCR to capitalise on both organisations' skills in regeneration and development.

Network Rail and LCR have therefore been tasked by DfT to evaluate the potential to merge the land development strengths of the respective organisations and unlock existing constraints.

The proposed solution is for Network Rail to acquire LCR by way of a share purchase for nil consideration, and for LCR to become a subsidiary of Network Rail; LCR would subsequently be rebranded, the working name for the development entity being "**DevCo**".

2. The DevCo Proposal

DevCo is proposed to be a ring-fenced, dedicated property development company and a wholly owned subsidiary of Network Rail Infrastructure Limited ("**NRIL**"), which will combine the capacity and capabilities of:

- Network Rail's expertise in rail land development; and
- LCR's expertise in land assembly and regeneration.

DevCo's purpose would be to accelerate rail-led development through the delivery of a balanced project portfolio in terms of value, scale, geography, timing and risk. Its key strategic objectives will be as follows:

- Firstly, to maximise financial returns from development opportunities that deliver a combination of: (i) an increasing and sustainable dividend stream that can be reinvested into the operational railway, thereby reducing the need for Government support; and (ii) sufficient capital to reinvest into the development project pipeline and to meet the ongoing running costs of the combined business.

- Secondly, to generate significant public value from rail and adjacent land,[1] leveraging the Government's unprecedented transport investment and working collaboratively with Network Rail at a regional level to incentivise more development land to be released (with resulting benefits in the form of railway improvements and enhanced financial returns); and

- Thirdly, to leverage wider rail investment opportunities to maximise benefits for both passengers and taxpayers.

Accordingly, it is envisaged that the following activities would be in scope for DevCo:

- Existing and potential Network Rail/LCR development projects;

- Managing Network Rail's interests in its existing - and potential new - JVs with private sector partners (currently Solum, Enbloc, Innova and TOG) (see Third Party Partnerships below);

- Land promotions – i.e. the delivery of smaller regional projects, typically with a housebuilder partner;

- Strategic projects – notably major station redevelopments, such as Victoria, Liverpool St, Bristol Temple Meads; and

- the provision of property services to DfT.

Importantly, as indicated below, DevCo is expected to generate enhanced financial returns (compared to the *status quo*) from the promotion and development of Network Rail and LCR property. DevCo's governance arrangements will provide it with the operational flexibility to maximise value and capitalise on these opportunities.

3. DevCo – governance

DevCo will benefit from strong governance arrangements, with its own Board and appropriately experienced non-executive directors, to ensure that it has the financial and human resources it needs to deliver its strategic objectives. It is proposed that DevCo will

[1] Government's published High Level Output Specification 2022 (HLOS) at paragraph 12 states that the Secretary of State expects that the railway makes a strong contribution to growth priorities, enabling regeneration and progress on housing objectives.

have public corporation status[2], sitting outside of Network Rail's ring-fenced Permitted Business (see Regulatory Consents below) so that it can carry out the "in scope" development activities across its property portfolio.

This structure will provide DevCo with the flexibility to deliver its development project pipeline whilst maintaining strong alignment with the Network Rail regions which control the railway land and whose buy-in is required for land to be released for development. It will also enable DevCo to partner effectively with private sector and local authority partners and to attract and retain skilled development staff and to match resource levels to its pipeline of projects.

Prior to launch, LCR and Network Rail will work together to develop a business plan which combines the best of both organisations, refocusing resource where the benefits are greatest. This will involve bringing together both organisations' pipelines, using LCR's experience around land assembly and its relationships with local stakeholders to improve NR's projects, and NR's railway and joint venture expertise to help decide where resources will best be utilised. This will lead to an optimised project portfolio.

4. DevCo – funding and money flows

From a funding perspective, DevCo will enable and support the delivery of Network Rail's CP7 development and sales targets. It will therefore receive the funding which is currently allocated in CP6 and CP7 to NR Group Development to enable it to do so.

The level of funding in CP7 will be dependent on the Final Determination. DevCo will use LCR's existing revenue streams and cash reserves to fund its initial activities, so it is not envisaged that further funding from DfT will be required. DevCo's intended public corporation status will enable it to recycle receipts from property promotion and development activity into future projects, so that it can be sustainably self-funded. DevCo will also be able to utilise JV structures to get access to external capital, with £98m being earmarked for JVs in the draft CP7 Settlement.

DevCo is therefore expected to deliver a step change in the value generated through the development of railway land. It will do this by:

- delivering substantial operational cost savings across the combined organisation (allowing more resources to be focused on development activities); and

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[2] Public corporations (PCs) is a term from National Accounts, which are based on the European System of Accounts (ESA10). The Office for National Statistics (ONS) determines, which public bodies are public corporations. A key implication of being a PCs is that they sit outside of the central government's department's accounting boundary, therefore assets and liabilities are not consolidated in the department's accounts. Subsequently, the PC classification provides budgetary flexibility to operate a commercial business.

- generating a significant uplift in land values (i.e. the difference between the value of the relevant land pre- and post-development minus developer costs) compared to the current position.

In turn, Network Rail (as the shareholder of DevCo) will benefit from improved financial returns which (net of any surplus which DevCo reinvests in further development opportunities) will be reinvested in the operational railway, thereby reducing the Government's funding requirement.

5. DevCo – third party partnerships

DevCo will deliver many of its outcomes through working with selected and incentivised delivery partners, both at a strategic and at a project or service level. By forging strategic partnerships with other public and private landowners and agencies (including Transport for London ("**TfL**"), Homes England and various Combined and Local Authorities), DevCo will be able to access additional strategic land to create development opportunities which have greater public value and local impact through aligned interests, as well as harnessing more substantial pools of investment funding to support them. These partnerships have the potential to unlock significant collaboration benefits, but Network Rail is not currently resourced to be able to maximise these.

These third party partnerships are expected to be ultimately self-financing and any profits which are realised through the operation or eventual winding up of the JVs will be split between DevCo and the relevant partner(s), reflecting each party's relative contribution in the form of land value and/or equity and the balance of risk and reward within the JV. This will be determined following a due diligence process which is modelled on Network Rail's established governance and risk management frameworks for its existing property development partnerships.

6. Network Rail's approach to managing risk

As noted above, DevCo will benefit from a strong governance and risk management framework, and will draw upon each organisation's experience of property promotion and development activity (particularly in relation to railway assets – both in their own capacity and, in Network Rail's case, via its property JVs). DevCo will also have robust financial controls and there will be appropriate assurance and governance to ensure that DevCo's activities remain within the scope of its business plan.

These principles are also reflected in the modelling of the financial returns which DevCo is likely to generate: a sensitivity analysis is being carried out to identify how changes in assumptions could impact the overall cost-benefit analysis. As noted above, Network Rail is expected to benefit (as shareholder) through an enhanced dividend (reflecting the improved land value uplift and cost savings).

A clearance process for the release of land will be put in place to ensure that the integrity of railway operations is protected and the trade-off between competing land uses is understood and considered in value for money terms.

7. Regulatory approvals

The final business case for DevCo will need to be approved by DfT, HMT, the Network Rail Board and LCR Board before it goes ahead (see Timescales below).

We have assessed Network Rail's Network Licence and have set out below the implications for how Network Rail intends to comply with its obligations. For the reasons indicated below, regulatory consent is sought from ORR in relation to Licence Condition 16 (LC16) and Licence Condition (LC17) ahead of the governance approvals for this proposal.

*Network management (*Licence *Condition 1)*

We consider that the proposed arrangements are consistent with our Network Management Duty described in LC1.

Regulatory Accounts (Licence Condition 9)

As a limited liability company subject to the Companies Act, and as a subsidiary of NRIL, DevCo will maintain separate accounting records in line with LC9, which will be produced in accordance with statutory requirements and generally accepted accounting principles. DevCo will also publish separate annual accounts that meet statutory and regulatory requirements. These reporting mechanisms will provide full transparency of DevCo’s activities and the ORR will have the ongoing ability to monitor DevCo's activities and to request any information that it reasonably requires of DevCo pursuant to Part I of the Railways Act 1993.

Financial ring-fencing (Licence Condition 16)

Under LC16, Network Rail is restricted in its activities to either Permitted Business, *De Minimis* Business or where ORR has provided its consent. With regard to the first, the activities of DevCo will not be associated with Permitted Business as defined by the Licence because land assembly and land disposal do not constitute Network Business or Permitted Non-Network Business.

Network Rail has determined that it would not be appropriate to proceed under the *de minimis* business for the following reasons:

- *De minimis* relates to “minimal things” and in this context refers to small matters compared to Network Rail’s annual expenditure. We do not consider the activities of DevCo will be on such a small scale.

- The purpose of DevCo is to realise maximum benefits of commercial development activity and the available headroom under *de minimis* is likely to be reached given this commercial strategic objective.

Request: in light of the information above (including the governance and risk management framework which will apply to DevCo's activities), Network Rail requests specific consent from the ORR pursuant to Network Licence condition 16.1(c) that DevCo activity shall not be subject to the constraints of the financial ring fence LC16. This includes DevCo's ability to enter into third party partnerships, such as JVs, as part of its BAU activities.

Land disposal (Licence Condition 17)

Under Licence Condition 17 (LC17), any disposal of land by Network Rail is subject to LC17 land disposal consent and the condition applies to any subsidiary of NRIL, so LC17 will apply to the disposal of land by Network Rail to DevCo and to a disposal of land by DevCo.

DevCo will inherit all LCR land and property which is currently not required for the operation and function of the railway so it would be illogical to apply LC17 to such land and property simply because of the formation of DevCo as a subsidiary of NRIL.

DevCo will undertake a certain level of site acquisition from third parties associated with a development scheme but not for railway purposes and therefore such land should not be burdened with LC17 processes as it has never been part of the railway use estate.

Additionally, it is proposed that before any Network Rail land is transferred to DevCo, the existing clearance and LC17 compliance processes are applied. The prerequisites of that process will be considered as necessary:

- such land must have been through the Network Rail Clearance land disposal process and the disposal must comply with any conditions imposed by that Clearance process; and

- Network Rail will have assured itself that it will have complied with Land Disposal LC17 in respect of the disposal to DevCo, on terms as if DevCo is an arm's length body (as if LC17 was amended to reflect this characterisation).

Crucially, all land owned by DevCo will have already passed the LC17 Condition for disposal to third parties because such land: (A) was either inherited from LCR; or (B) was acquired by DevCo for a non-railway purpose or (C) has passed the relevant hurdles (outlined above) when transferred to DevCo by Network Rail.

Request: Network Rail therefore asks ORR for confirmation of its specific consent pursuant to Network Licence condition 17.1.(b)(iii) that on a disposal of its land, DevCo shall not be subject to the constraints of the Land disposal LC17 subject to the prerequisites at (iA, (Bi), or (C) being adhered to.

Cross subsidy (Licence Condition 19)

Under LC19, Network Rail is restricted from unfairly cross-subsidising any Affiliate or Related

Undertaking or any other related business. LC19.2(b) contains an exception to the extent that any investment capital is provided by Network Rail for any new enterprise or project which does not or is not likely to have an initial rate of return at normal commercial levels.

Network Rail has considered whether any part of the proposal to establish DevCo, including the initial transfer of land and other assets (as part of the combination with LCR), the ongoing operation of DevCo, and/or the conclusion by DevCo in the future of new partnerships with other public or private sector authorities, could give rise to any cross-subsidy from Network Rail's ring-fenced business to DevCo (or indeed to third party development partners or JV partners) pursuant to LC19. Network Rail is confident that no unfair cross-subsidy would arise for the following reasons:

First, DevCo's activities mark an evolution of Network Rail's existing property development activities, which it carries out on its own account via its property development arm and via its property development JVs with private sector development partners (such as the Solum JV with Kier, which the ORR has previously approved). Network Rail has developed established ways of working in partnership with those third parties and DevCo will draw on that expertise to harness development opportunities on a commercial basis.

Second, as noted above, DevCo's vision is to be a self-funded property development business which will operate at arm's length from Network Rail's ring-fenced network business. In particular:

- DevCo will sit outside of NR's ringfenced network business and will undertake projects which will range from one-off land sales to land promotion schemes, to over-station developments, through to large scale and longer-term placemaking developments. It will be governed by a new, independently chaired, oversight Board, which will oversee its property activities.

- DevCo intends to develop a balanced portfolio of residential, commercial and mixed-use projects to deliver a competitive financial return for its shareholder, Network Rail, whilst at the same time delivering operational improvements for the railway and sustainable public value through social and environmental impacts. Whilst this output will be based primarily around land which Network Rail already owns, it is envisaged that DevCo will be able to access additional strategic land through working with selected and incentivised delivery partners (including Transport for London (TfL), Homes England and various Combined and Local Authorities) to create development opportunities which have greater public value and local impact through aligned interests.

- DevCo expects to generate a commercial rate of return on its property development activities. Based on its current business plan, DevCo is expected to generate a competitive return on investment as a result of cost savings and improved cashflow which will be reflected in the level of dividend payable to its shareholder over time. This has been modelled in the Outline Business Case for DevCo.

Third, in accordance with LC17, DevCo will pay market value for any land which is transferred from Network Rail at the time of its formation.

Fourth, it is envisaged that some of Network Rail's Property Development team will be transferred (via TUPE) to DevCo but this will be quite small in number (approximately 35 individuals) and their future salary costs will be borne by DevCo. As such, DevCo will not benefit from any cross-subsidy or economic advantage over equivalent private sector operators.

Fifth, as regards the provision of shared services by Network Rail to DevCo, these are not expected to be significant and any Network Rail Group costs will be charged to DevCo (in line with other NRIL subsidiaries) on an arm's length basis.

Sixth, DevCo will be self-funded and will act as a self-contained commercial business, so it is not expected that Network Rail would fund or invest in DevCo's activities over time. As regards the provision of funding, funding will be made available to DevCo from the CP6 and CP7 settlements (and potentially from future settlements) as and when further capital is required (on an equivalent basis to the way in which funds are currently made available to Network Rail's property development arm and to its JVs, i.e. Solum, Blocwork and Innova).

Under these circumstances we are satisfied that any funding and resources relating to the establishment and operation of DevCo would not constitute an "unfair cross subsidy" within the meaning of LC19.1. We do not therefore consider it will be necessary for Network Rail to rely on the exception set out in LC19.2.

As regards to any proposed JVs between DevCo and partners such as Homes England or TfL, these will be subject to an up-front assessment of the relative contributions, and the appropriate balance of risk and reward which flows from the commercial terms of each partner's contribution to the venture, in order to ensure that no cross-subsidy will arise either to the JV or to the relevant development partner (in accordance with the requirements of LC19). This assessment will form part of the business planning and due diligence process which is undertaken at the outset.

8. Timescales

The timeframe for this proposal is set out below. Given the intention to commence the approvals for the Outline Business Case ("**OBC**") for DevCo in March 2023, with the regulatory 'iron-fence' around being a key enabler for its activities, **Network Rail is seeking to secure the ORR's consent under LC16 and LC17 by 24 March 2023**.

The key milestones for the project are as follows:

- OBC to be completed and ready for approvals by 25 February 2023;
- OBC approvals from DfT, HMT, the Network Rail Board and LCR Board to be sought by 31 March 2023;
- Network Rail TUPE consultation to commence in April 2023;

- LCR share purchase to take place between April 2023 and September 2023 depending on the readiness analysis; and
- DevCo to be established by October 2023 at the latest.

In summary, regulatory consent is sought from ORR in relation to LC16 and LC17 ahead of the governance approvals for this proposal.

Yours sincerely

[Redacted]

Head of Regulatory Compliance & Reporting

For and on behalf of Network Rail Infrastructure Limited

Annex B

Extract of email received from Network Rail on 8 March 2023

"In terms of our request from ORR in relation to LC16, the greyed ask on the letter, we would like to update that with you to the below:

Request: 1) in light of the information above (including the governance and risk management framework which will apply to DevCo's activities), Network Rail requests specific consent from the ORR pursuant to Network Licence condition 16.1(c) that DevCo activity shall not be subject to the constraints of the financial ring fence LC16. This includes DevCo's ability to enter into third party partnerships, such as JVs, as part of its BAU activities. 2) CP7 funding for JV investment (currently £111m but subject to final determination) is transferred to DevCo as start-up funding, with DevCo being NR's delivery vehicle for its JV investments."