OFFICE OF RAIL AND ROAD

PR23 draft determination consultation: pro forma

This pro forma is available to those that wish to respond to our draft determination consultation and it is structured around the main areas of the draft determination. Other forms of response (e.g. letter format) are equally welcome, though we would be grateful if these could be structured broadly in line with the areas listed below (where you wish to comment), to aid our review of responses.

Further information on how we will treat information provided to us as part of this consultation is available in **annex A** below.

Please send your response to pr23@orr.gov.uk by **31 August 2023**.

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This information will not be published on our website.

1. General comments on ORR's draft determination for Network Rail in CP7

High-level / general comments on our draft determination. Please use sections below for more detailed responses on specific topics.

Rail Partners is broadly supportive of the draft determination on behalf of its passenger owning group and freight operating company members. We appreciate the continued engagement between ORR and our members during PR23. We also acknowledge that this periodic review has taken place in an uncertain time for the rail industry as it awaits structural change through the reform process, while wider economic challenges affecting the country also persist. Against this backdrop, we understand the need for additional flexibility within the regulatory regime to account for this uncertainty. We also agree with the ORR's approach during PR23 to make limited, proportionate changes to the regulatory regime ahead of CP7 which will help to give further stability.

We welcome the stance ORR has taken with regards to the performance trajectories proposed by Network Rail in its Strategic Business Plans but consider that a further adjustment to Network Rail's performance benchmark is required to account for the projected reduction in network mileage in CP7 so that the methodological approach is consistent with other elements of the performance regime. Performance during CP6 has been unacceptable with both the Passenger Performance Measure and Freight Delivery Metric reaching some of their lowest points since both measures were introduced. We recognise the impact of industrial action on performance and the challenges Network Rail has faced in recovering the engineering backlog post-Covid, but sustained poor network performance is stifling the recovery of passenger demand and suppressing freight growth. Reassuringly, performance has recently turned a corner, coinciding with an increase in regulatory scrutiny from ORR.

We also expect ORR to use the outcomes framework to closely monitor Network Rail's performance across its regions and the system operator during CP7. Rail Partners considers that the Network Rail scorecards approach has not worked effectively in CP6 and a focus on fewer Tier 1 measures using the outcomes framework can help to give greater focus and improve accountability on the metrics that matter most to passengers and freight customers. Where there are signs of underperformance, it is important that ORR acts promptly to challenge Network Rail to establish plans to improve performance making greater use of the regulatory levers at its disposal. This is necessary to provide private sector operators with confidence that a high performing network will be delivered on a long-term basis underpinning investment and supporting rail growth. The performance regime must also support this objective. In our response, we outline some of our concerns with the proposed significant reduction in Network Rail payment rates to TOCs which run the risk of diluting the incentives of the Schedule 8 mechanism on the infrastructure manager resulting in even worse performance and further deterring passengers from using rail. Rail Partners' passenger members therefore support the ORR's decision in August 2023 not to implement the new payment rates in full during CP7. Particularly in light of this new information, our freight members consider that a similar adjustment should be applied to the freight benchmark and cancellations threshold to ensure that the regime is well calibrated and drives the right incentives.

On charging, we have reservations about the methodology ORR has used to calculate charges and are concerned about the impact this will have on the ability of commercial passenger and freight services to compete with other modes. We believe that ORR could be more creative in its thinking around charging to promote rail growth whilst still being consistent with the legislative requirements. The Draft Determination indicates that passenger and freight VUC rates across CP7 will increase by 7% and 18% respectively in real terms compared to CP6, this is despite Network Rail forecasting that service levels will be 88% compared to pre-Covid levels – something which we consider to be unambitious. We would welcome further clarification from ORR as to how these charges have been calculated, especially as Network Rail has become more efficient during CP6. As VUC rates are set to recover the short run marginal costs it appears inconsistent for passenger charges to increase in real terms, in part to account for the projected reduction in traffic. We believe that ORR's approach does not comply with the legislative requirements. On freight, we support the decision not to update the phase in of VUC rates at the PR23 trajectory, but freight charges are still rising significantly which will affect the sector's ability to compete with road freight and is entirely inconsistent with the freight growth target. We consider that a more holistic approach to charging is required to send appropriate price signals to customers about which mode they use.

2. Comments on our supporting draft settlements for the System Operator (SO), Scotland and England & Wales regional documents

For further information, please see our Scotland, System Operator, Northwest & Central, Wales & Western, Eastern and Southern draft settlement documents.

We support the ORR's decision to insist on a point target for the performance measures assessed within the Network Rail outcomes framework, rather than accept the range approach that Network Rail had proposed in its Strategic Business Plans. Setting a specific target is important as it gives clarity to industry and makes it easier to hold the infrastructure manager to account. We also agree with the ORR's decision to challenge Network Rail to be more ambitious in the performance trajectories it has set out, which avoids 'baking in' poor performance experienced during CP6 and sends a clear message around the importance of performance to passengers and freight customers.

With the constrained funding available we agree with the recommendations of the ORR that Network Rail regions should prioritise investment to mitigate asset depreciation and improve network resilience. This includes additional renewals expenditure, and additional funding for earthworks and vegetation management to avoid having to close down routes. We agree that additional efficiency challenges and reprioritisation of some activity should be used to fund this work.

On freight, we welcome the £72m within Network Rail's Strategic Business Plan to invest in structures to support heavy axle weights. Within this limited funding it is important that structures at greater risk of having their capability degraded, or routes that support high volumes of freight traffic are prioritised. Our engagement with freight operators has indicated that many of these structures are in the Southern and Eastern regions, so it is important that the funding is allocated in a way that reflects this. As a wider point, we support ORR's concerns that Network Rail is not maintaining the network to the Network Capability it is funded to deliver. This is something which should be addressed to avoid the risk that bulk freight services are unable to operate on certain lines where they have contractual rights to do so.

3. Our review of Network Rail's stakeholder engagement

For further information, please see our assessment of each region and System Operator engagement with its stakeholders in our draft settlement documents under section 2 above.

In keeping with the ORR's views on Network Rail's stakeholder engagement, we understand that engagement has varied significantly depending on the Network Rail region. Looking ahead, we would welcome a more consistent and joined-up approach to engagement across Network Rail's regions – particularly to benefit national passenger and freight operators whose services cross NR's regional boundaries.

We understand that Network Rail's ability to engage with stakeholders has been limited in part due to the late publication of the high-level output specifications (HLOS) and Statements of Funds Available (SoFAs). The subsequent delay in the publication of their Strategic Business Plans has also made it difficult to engage and seek operator feedback. We recognise that this is largely outside of Network Rail's control and caused by wider economic and political pressures. However, this has undoubtedly compromised the ability of operators, as Network Rail's customers, to influence and challenge Network Rail's plans to deliver for them. Where engagement has been sought it has often occurred at very short notice, placing a high requirement on operators' limited resource. The lack of transparency during the business planning process has led to additional uncertainty during this periodic review compared to previous ones. This is something that must be improved during PR28.

4. Our review of Network Rail's proposed outcomes

For further information, please see section 3 of our England and Wales and Scotland overview documents and our related supplementary document on outcomes.

Rail Partners welcomes the proposed outcomes framework outlined by ORR in the draft determination. We agree with the movement away from the scorecard approach, which train operators do not consider has worked during CP6. We support the use of a select number of Tier 1 success measures and agree with the metrics ORR has selected at this level as they are well aligned with outcomes railway users value most from the railway.

As ORR will publicly report on these success measures, it will give Network Rail a clear incentive to focus on their delivery and it will also help to improve accountability. It is recognised that ORR will continue to monitor a wider range of metrics through its Tier 2 'supporting measures' and Tier 3 'additional assurance' measures as part of its routine monitoring. We do not agree that ORR should not publicly report on these measures. Reputational incentives are the most powerful tool that ORR possesses, and it should use them to the full. It should monitor all measures closely as they may help to highlight the causes underpinning underperformance against some of the Tier 1 metrics. Furthermore, subject to the proposed change process, ORR must be able to elevate measures to higher tiers as it deems necessary should it consider that Network Rail is significantly underperforming in some areas, to ensure that the infrastructure manager is duly focussed on improvements.

The strong focus on performance in the Tier 1 measures is welcome. In particular, the inclusion of cancellations as a Tier 1 measure for both passenger and freight operators is welcome as rail users face greater disruption when their trains are cancelled rather than delayed. Punctuality is a factor passengers and freight customers value highly when using rail, but through CP6 performance has declined – suppressing freight growth opportunities and the return of a financially sustainable passenger railway. It should also be noted that a significant proportion of train operators' fees within their current National Rail Contracts are reliant on good network performance. In addition to ORR's decision to largely reject the performance trajectories set out by Network Rail in its Strategic Business Plan on the basis that they were unambitious and risked baking in the poor performance experienced during CP6, the focus on performance in the outcomes framework sets out a clear message that performance, particularly sustained disruption, must improve and will be closely monitored by ORR during CP7. The Network Rail freight benchmark has not been adjusted to account for the forecast reduction in mileage during CP7, leading to a more lenient benchmark when accounting for CP7 forecast mileages. This runs counter to the strong messaging about performance in the draft determination.

In our response to the PR23 policy framework consultation, Rail Partners proposed that freight growth was included as a 'Tier 1' measure reflecting that it was a government priority. We are pleased to see that the ORR has agreed with this proposition as confirmed in its holding Network Rail to account policy consultation. We also agree with using the freight moved metric which captures both tonnage and distance. Installing freight growth as a success measure will ensure that all Network Rail's regions are focussed on delivering for freight on their infrastructure and will help to achieve a greater level of awareness of freight customers' requirements from the rail network. We do not believe that, overall, ORR's Draft Determination is consistent with achieving the freight growth target, particularly in relation to the access charging proposals. As stated in our response to question 1, ORR needs to be more creative in its approach to access charges.

It is important that ORR monitors the delivery of freight growth closely to ensure that Network Rail and freight operators collectively remain on track. Freight operators will work closely with Network Rail to identify where the opportunities for growth are so that they can provide the capacity to accommodate an increase in freight services and enable existing services to become more productive, building on the successes of longer, heavier, and more direct trains which were possible during the pandemic.

We also support the inclusion of asset sustainability as a Tier 1 measure. The messaging in the draft determination around asset sustainability is concerning as assets are expected to age significantly during CP7, which will affect the performance of passenger and freight services. While the funding available necessitates some asset depreciation, minimising the impact of this must be a core focus of ORR and Network Rail during the next Control Period. This is clearly also important from a safety perspective.

5. Our assessment of accessibility

For further information, please see section 12 of our outcomes document.

Accessibility is a priority for the rail industry and must be dealt with through a cross-industry approach to ensure that the railway is accessible to rail passengers. As an industry we must continue to strive towards a service where all passengers can turn up and go. Recent figures from ORR's 2023 annual rail consumer report highlight that demand for passenger assistance continues to increase, and that broadly passengers are satisfied with the service they receive, but train operators must continue to improve the service they provide. There is also a key role for Network Rail as the infrastructure manager to improve the accessibility at stations.

We note ORR's view that a safety success measure is not required within Network Rail's outcomes framework. This is because there is already a range of legal obligations on Network Rail to provide accessible infrastructure. ORR already has a duty to ensure Network Rail is meeting its regulatory requirements in this regard. We encourage ORR to monitor and enforce the industry's obligations in relation to accessibility.

6. Our review of Network Rail's proposed costs and income

For further information, please see sections 4 and 7 of our England and Wales and Scotland overview documents and our related supplementary documents on our Sustainable and Efficient Cost assessment and other income – property and charges.

Rail Partners welcomes the funding made available in the SoFA allocation, which represents a real terms increase, despite the challenging economic environment, and significant additional funding made available by government during CP6 to support the continuation of rail services during Covid. We recognise that despite this real term increase, there will be significant cost pressures facing Network Rail which will require it to act efficiently and prioritise its activities to deliver for passengers, freight customers and funders. It will also restrict Network Rail's ability to take a whole-life cost approach to its asset maintenance and renewal activity, leading to additional cost challenges in future control periods.

It is important that the final determination accounts for the uncertainty of future inflation and the impact it could have on the ability of Network Rail to deliver renewals activities. Rail Partners therefore agrees with the ORR's view that the risk provision outlined in Network Rail's SBP was insufficient in this regard. The risk adjusted provisions appears more sensible in order to account for this economic uncertainty.

The impacts of climate change have had a significant impact on network performance during CP6, and improved network resilience must be a priority to restore train operator confidence in the performance of the network. We agree with ORR's decision that additional structures at risk should be renewed with reallocated funding from a reprioritisation of activity and efficiency challenge. This includes core asset funding for earthworks across some of the Network Rail regions, which is welcome as earthworks have been a long-standing issue affecting network performance. The approach to prioritise available funding towards higher income routes also appears logical to prevent disruption to services which make a significant contribution to farebox revenue. This approach must also consider routes which have a high volume of freight traffic.

We note that given the funding available for renewals and maintenance, Network Rail might have to make use of operational measures such as speed restrictions to mitigate potential safety impacts of lower than required renewals expenditure. This is not in the interests of passengers or freight customers and will affect the ability of rail to compete with other modes. ORR must ensure, as far as possible, that this measure is used sparingly through its monitoring of asset sustainability to ensure that further reprioritisation of renewals occurs during the control period if necessary. Regarding asset sustainability, Network Rail notes that it does not expect to recover asset condition and performance to CP6 exit levels until CP11 in England and Wales, and CP12 in Scotland. This is deeply concerning for rail users and is a significant risk that network performance could continue to decline. There is a pressing need for a longer-term approach to asset management to avoid further decline and maintain asset performance levels over the longer-term.

Rail Partners supports the Performance Innovation and Improvement Fund (PIIF) which will help to improve the performance of passenger and freight services. In our response to the financial framework consultation, we highlighted the value our members have found from the Performance Improvement Fund during CP6. The improved governance for CP7 is welcome and will ensure that the funding is allocated as efficiently as possible to maximise the improvements realised from the PIIF.

To address the cost challenges facing Network Rail in CP7, the infrastructure manager should be encouraged to identify opportunities to increase other income streams. This includes maximising the value from Network Rail owned properties.

7. Our review of Network Rail's National Functions

For further information, please see our related supplementary document on national functions.

Rail Partners recognises that the regulatory approach to Network Rail's National Functions must be proportionate given that the focus of ORR's regulation via the outcomes framework will be on Network Rail's regions and system operator where most of its funding is allocated. That said, with constrained levels of funding in CP7 it is important that all units of Network Rail are challenged to deliver efficiently so that the envelope of funding made available in the SoFA extends as far as possible.

We welcome ORR's challenge to Route Services on the costs outlined in the SBPs. We agree with the decision to apply an additional efficiency challenge so that its funding is more consistent with that allocated during CP6. This will create additional funding for renewals that are much needed to deliver a high-performing rail network for passenger and freight operators.

As a wider point, the National Functions will be able to deliver more efficiently if there is regular engagement with Network Rail's regional functions. We note ORR's view that this has improved, and we encourage Network Rail to ensure this continues during CP7.

8. Our assessment of health and safety

For further information, please see section 5 of our England and Wales and Scotland overview documents and our related supplementary document on health and safety.

Despite the constrained funding available in CP7, it is critical that safety on the rail network is not compromised. Rail Partners is therefore reassured that Network Rail considers that its approach to asset management in CP7 will not result in a reduction in safety for customers and staff. We recognise that Network Rail intends to use a Market-Led approach to prioritise expenditure on high value routes. While this appears logical, the approach must continue to closely monitor risk on other lines too so that safety is not compromised.

Network Rail's management of earthworks and drainage in CP6 has been suboptimal and we agree with the ORR's view that the recommendations of the Weather Risk Task Force must be integrated within Network Rail's plans for CP7. With the growing impacts of climate change likely to present further challenges to rail infrastructure, and consequently safety in CP7, this must be a priority area for Network Rail. It is important that the infrastructure manager takes a more proactive approach to mitigating these risks during the Control Period to minimise disruption to services and ensure that safety levels are maintained. This should include clear lines of accountability between Network Rail's routes and regions. We note Network Rail's intention to use operational controls during the CP7 to mitigate these risks. As noted in response to question 6, we are concerned that this approach is not in the interest of passengers and freight customers, so such measures should be minimised where possible. While such measures can help to prevent safety risks, it should be noted that the introduction of operational controls such as speed restrictions will introduce new safety risks for Network Rail to manage.

9. Access Charges in CP7

For further information, please see section 10 of our England and Wales and Scotland overview documents and our related supplementary documents on access charges.

As Rail Partners has communicated to ORR through bilateral engagements following the publication of the draft determination, we have reservations with the approach to charging used by ORR in the periodic review. We do not believe that it is consistent with the legislative requirements.

The draft determination indicates that VUC rates will increase in real terms for passenger operators by 7% on average during CP7 – though the actual increase will depend on vehicle type. Such a steep increase, which is meant to represent the short-run marginal cost of changes in traffic levels (the EU's definition of costs directly incurred) is inconsistent with Network Rail's SBPs which assume a substantial reduction in network traffic largely due to the modelled reduction in passenger services – which may not materialise should passenger operators be given the contractual freedoms and incentives to recover passenger numbers. ORR notes that this reduction in passenger traffic is a factor leading to an increase in VUC rates. This is illogical and does not satisfy the costs directly incurred legal requirement, which determines that variable charges are set to recover the short run marginal cost from the operation of each service. This indicates that the ORR's methodology, which we note has been used during previous control periods, is flawed. We would like to understand this methodology in greater detail and would welcome further engagement on this matter. As noted in the policy position paper, engagement with industry on the recalibrated rates has been limited which is concerning given the importance of the charging regime to any commercial operator.

Rail freight operates within a highly competitive freight and logistics sector, and the track access charges paid by rail freight companies determine rail's ability to compete with other more carbon-intensive modes such as road where charges including road fuel duty have remained unchanged in over a decade. Against this backdrop, we welcome the ORR's decision not to increase variable usage charges applied to freight services by the recalibrated PR23 trajectories, and instead continue to use the phase-in trajectory outlined during PR18. A £77m increase in VUC, as indicated by the PR23 recalibration methodology, would have been significantly detrimental to the commercial viability of rail freight services and suppressed freight growth that government is committed to. Even under the PR18 trajectory, VUC freight rates will increase by 18% on average in real terms, which represents a £41m increase over the course of the control period. We would like to understand from ORR how this is consistent with delivering the rail freight growth target. Setting charges on the basis of long-run efficient costs for Network Rail would be more in line with supporting the freight growth target and is something ORR has done in the past.

We note that the ORR still intends for freight VUC caps to be unwound through CP8, which creates a major cliff edge for the rail freight industry. It is therefore important that there is early engagement with the ORR and funders during CP7 ahead of PR28 to identify a long-term solution to rail freight charges which satisfy regulatory and legal requirements while supporting the growth of rail freight services and the government's decarbonisation agenda. This would include taking a cross-modal view of freight charges, so that pricing better captures the externalities of different freight services. Rail Partners has previously called for the charging regime to incentivise operators to operate using low-carbon traction (e.g. electric or sustainable fuels) through discounts in track access charges.

We note the proposal to keep Infrastructure Cost Charges (ICC) broadly constant in real terms (£5 per train mile), for interurban open access services. Open access passenger services play an important role within the GB rail market, by creating competition and therefore customer choice with existing DfT contracted operators. Open access train operators have improved service quality within the markets they serve, grown passenger demand and improved connectivity. As such, it is important that the regulatory settlement supports an enhanced role for open access services, while recognising the ORR's duty to have consideration for the funds available to the Secretary of State. While imposing ICCs on open access services clearly affects the commercial viability of these services, in CP6 it has not stopped the successful introduction of a new open access service, Lumo. Rail Partners also notes that additional open access services between London and Wales are due to start shortly, with a further application to run services between London and Stirling also submitted for ORR's consideration. Therefore, it seems appropriate to continue to impose an ICC on open access services in CP7 where the criteria are satisfied, subject to the same phase-in arrangements which acknowledge the significant start-up costs associated with commencing a new service (e.g. procurement of rolling stock). We also note that ORR is consulting on imposing an ICC for airport services at the same rate as interurban services. As there is currently only one open access service providing direct links to airports, and there has not been any recent applications to introduce new services, it is unclear whether this market could bear the additional cost and this proposal would instead deter investment and further limit the prospect of competition in these markets despite the aforementioned benefits to passengers.

We note that freight ICCs will fall, except for biomass services, and this is to account for the increase in VUCs and EAUCs paid by freight operators to ensure that the overall level of cost recovery is set at the right level and reflect each market's ability to bear the additional cost. While the reduction in ICCs is of course welcome, due to the rise in VUC rates, overall charges paid by freight operators will increase and will make rail freight less attractive to prospective customers, running counter to the government's strong commitment to rail freight growth and the decarbonisation agenda.

10. Schedules 4 & 8 Incentives in CP7

For further information, please see section 11 of our England and Wales and Scotland overview documents and our related supplementary documents on incentives.

While Rail Partners understands the rationale for providing the option for operators to opt out of Schedule 4 for the duration of CP7, both pre-empting future reform, and to reflect current contractual arrangements where many operators do not hold revenue risk, we are concerned about the impact his may have on the incentive properties of the possessions regime.

The principles of Schedule 4 are that it should incentivise Network Rail to provide operators reasonable notice ahead of engineering work and encourage them to undertake this work as efficiently as possible. This enables operators to inform customers such that they can make their travel plans in advance and helps to minimise disruption caused to passenger and freight services. A Schedule 4 opt out would mean that operators are no longer compensated for restrictions of use on the network, and it therefore seems unlikely that any commercial operator is likely to opt out of the regime in its entirety – noting that in CP6 open access passenger operators chose not to pay the Access Charge Supplement and therefore were only compensated in cases of severe disruption. Should a significant number of operators choose to opt out of Schedule 4, both for the entirety of CP7, or subject to the creation of GBR, Rail Partners is concerned that this will dilute the incentive properties of the regime on Network Rail – leading to more late notice possessions and overrunning engineering works. We would like to understand from ORR how the incentive properties of Schedule 4 will be replaced.

Already during CP6, with DfT operators no longer holding revenue risk, passenger and freight operators have reported an increase in the number of late notice possessions called by Network Rail. While initially this was understood to be necessary to address the backlog in engineering works following Covid, this behaviour has not subsided. Such disruption has a significant impact on passenger and freight operations and has also undermined customer confidence in rail services. Rail Partners has highlighted this in its response to the Informed Traveller Timeline consultation, which proposed moving the deadline formally from twelve to eight weeks – something which passenger owning groups and freight operators were strongly opposed to. We are pleased that ORR has decided not to pursue this proposal. This is a behaviour that must be deterred during CP7, and it is unclear how the introduction of an opt-out mechanism will promote this if Network Rail no longer needs to compensate some operators.

While ORR has issued assurance that the Schedule 8 performance regime will not be switched off for future GBR operators until GBR is established and they are satisfied that there is an alternative incentive arrangement in place, it is not clear how this regime will function. Further detail may arise when the GBRTT Commission recommendations are published or as more detail on the performance elements of future Passenger Service Contracts is shared. Rail Partners notes the joint GBRTT/Network Rail position that it would be beyond the ORR's regulatory role for it to have visibility of the financial incentives that GBR places on its operators. This appears to be important in order for the ORR to be satisfied that the future performance regime does encourage all parties to contribute to a high performing railway. It is understood that Schedule 8 will continue to apply to all non-GBR operators, which is welcome as any commercial operator will continue to value the incentives and protections provided by the regime, but there are concerns that the incentive properties will be heavily diluted if Schedule 8 does not apply to operators responsible for running most traffic on the network.

Regarding the ORR's decision to enable a mid-Control Period recalibration of Schedule 8, Rail Partners recognises the rationale for creating this option, particularly after the experiences of Covid on train services during CP6. The need for greater flexibility to respond to material changes in traffic levels or funding must be balanced against the benefits of a stable regime. It is therefore important that the threshold for a recalibration exercise to take place is set high to avoid uncertainty and deterring investment from commercial operators in assets and initiatives that improve performance. Rail Partners continues to see value in ORR also retaining the option for a time-limited recalibration to be undertaken which provides ORR with the option to return to the payment rates agreed prior to the beginning of the control period should it become apparent that the figures from the updated recalibration no longer reflect traffic on the network.

Rail Partners, on behalf of its passenger members, had significant reservations about the proposed new payment rates from Network Rail to TOCs, and the impact on the incentive properties of the regime. As noted in the PR23 consultation documents, and through our involvement in the passenger and freight recalibration working groups, it was proposed that Network Rail payment rates would be heavily reduced, by c.75% on average, due to the adoption of a new methodology modelling the impact of disruption to passenger services on revenue. Whilst passenger operators had previously agreed to the recalibration methodology, their owning groups have disagreed with the outcomes for reasons detailed below. We understand that ORR has now reconsidered this approach following engagement with both Rail Partners and its owning group members. While Rail Partners owning group members welcome the decision not to implement the new payment rate methodology in full, and instead use a blend of the PR18 and PR23 methodologies, we have outlined the rationale for our initial concerns below.

Through the recalibration working group, ORR will be aware that the freight operators' preference was for the new methodology for TOC payment rates to be implemented in full. This was on the basis that the change in methodology had previously been agreed by the passenger working group and any manual adjustment to the payment rates would affect the freight element of the regime. ORR's decision to use a balance between the PR18 and PR23 methodologies has been made to address concerns on the weaking of incentives on Network Rail and to avoid a large change in the payment rates in one step. While Rail Partners understands that ORR has made this compromise to avoid harming the performance incentives of the passenger performance regime, it raises the question why ORR was willing to diverge from the methodology on this matter while sticking rigidly to the methodology for freight elements in the Schedule 8 regime, despite similar concerns about the dilution of incentives on Network Rail and the impact of significant swings in regime being expressed.

The rationale for Rail Partners' passenger members views on the Network Rail payment rates are as follows. Firstly, such a significant reduction in the payment rates was inconsistent with the ORR's position to make limited, proportional changes during PR23. Secondly, as passenger traffic makes up the majority of the traffic on the network, a sizeable reduction in the payment rates would heavily dilute the incentives on Network Rail to limit the disruption it causes to train operators and is therefore inconsistent with the performance targets set out by ORR in the draft determination. This is particularly concerning as the current periodic review is taking place in the context of levels of poor network performance, affecting both passenger and freight services.

We know that passengers and freight customers value performance highly when deciding how they travel or move their goods. Diluting the incentives on Network Rail would likely worsen performance, making the railway less attractive to passengers and harming the recovery of passenger services. Delivering a high performing railway is key to delivering government's ambition to grow the rail freight market, and the efforts of industry to recover passenger numbers and achieve a financially sustainable rail industry. Diluting incentives on Network Rail risks undermining these ambitions. Furthermore, given the link between the performance and possessions regime, a reduction in the Schedule 8 payment rates would affect compensation TOCs receive when possessions and undertaken, which would not incentivise Network Rail to make efficient use of possessions. We also note that the semi-elasticities determined through the approach are only estimates and therefore are not necessarily reflective of the true relationship between disruption and revenue. Rail Partners' passenger members consider that it would be prudent to conduct a more thorough review of the new methodology before it is implemented. While not explicitly referenced within the Schedule 8 mechanism, there is also a link between the payment rates received by TOCs and the compensation paid to passengers via the delay repay mechanism. It is unclear how operators would have been able to cover the delay repayments for disruption outside of their control should Network Rail payment rates have fallen steeply as initially proposed.

Based on the above, Rail Partners' passenger members did not consider that it was appropriate to implement the new methodology in full in CP7. It was simply not credible to suggest that passenger behaviour to poor punctuality is 75% less than previously predicted. Therefore, ORR's decision to choose a payment rate that balances both the current and new methodologies and is constant throughout CP7 seems appropriate, avoiding a significant reduction in the payment rates for CP7 and therefore maintaining strong incentives on Network Rail. This will enable a more detailed review of the new methodology ahead of CP8 such that industry has greater confidence in its representativeness, particularly as the impacts of disruption on passenger demand post-Covid are likely to become much clearer.

Freight members understand that part of the rationale for setting the rates higher than the rates implied by the PR23 payment rate methodology was to minimise the swing and avoid diluting the incentives on Network Rail. However, a similar approach has not been adopted in the freight regime where similar concerns have been expressed. For instance, the 23% reduction in the FOC Benchmark and 40% increase to the cancellation threshold are both planned to be implemented in full for CP7. It is important that an adjustment is made to freight parts of the regime to minimise what would otherwise be a significant financial swing and avoid a dilution of the incentives on Network Rail to minimise cancellations to freight services – something which customers value highly.

Regarding FOC performance benchmarks, Rail Partners has outlined to the ORR through the recalibration working group that it considers it necessary to make an adjustment to the benchmark to account for two things. Firstly, recent FOC performance levels have been significantly worse than the proposed CP7 proposed benchmark, which is a consequence of the relatively historic period used for the recalibration exercise to avoid Covid-impacted years. Secondly, data provided by Network Rail to the recalibration working group has indicated that there has been an 18% rise in FOC-on-FOC interactions during 2022/23, compared to the 5-year recalibration period and this shows no signs of changing during CP7 given the increased diversification within the market. Rail Partners recognise that ORR has been clear that the threshold for making any adjustments to the recalibrated numbers in PR23 has been set high, but the threshold has never been articulated and there is now a precedence for adjusting following the ORR's decision to change its approach to the TOC payment rates in the Schedule 8 regime. Rail Partners would like to understand why the ORR deemed that the evidence presented by FOCs did not meet the threshold for an adjustment and would urge you to reconsider this view following new information concerning Network Rail payment rates.

It is right that the FOC benchmark is set at a level that incentivises operators to invest and innovate in order to limit the impact of their services on network performance. However, by setting a benchmark at a level that does not sufficiently account for current performance levels, which show no signs of subsiding in CP7, and the dynamics of the rail freight market, freight operators are unlikely to achieve their benchmark in many periods during the control period. This will have a significant financial impact and risks damaging the commercial viability of freight services, in turn affecting rail freight growth. Again, ORR needs to take a holistic view of all of the parameters of the regime in its final determination in order to support the freight growth target. It is crucial that decisions around Schedule 8 are taken holistically and consistent with other decisions on unwinding of caps on charges and consistent with policy objectives to avoid aspects of the periodic review pulling in opposite directions.

As a wider point, we are concerned that discussions about both the freight and Network Rail benchmarks have not occurred concurrently. Instead, ORR has indicated its intention not to adjust the freight operators' benchmark while discussions concerning the Network Rail benchmark remain ongoing with operators having limited visibility of these discussions. Such an approach does not allow freight operators to consider the Schedule 8 regime in CP7 in its totality.

Rail Partners would also note that the Network Rail freight benchmark has not been adjusted for a reduction in traffic whereas other elements of the regime have been. The proposed target based on 5% Freight Cancellations and Lateness (FCaL) compares against an equivalent FCaL target of 5.23% in CP6. If the CP6 FCaL target was to be adjusted by forecasted mileage changes in CP7, then the Network Rail Benchmark would be the equivalent of 4.89% FCaL. The effective softening of the Network Rail Benchmark in CP7 is again inconsistent with industry ambitions for a high-performing and reliable railway and we ask that there is more ambition applied. To ensure that the approach to benchmarking is conducted consistently, we believe it is necessary for the Network Rail benchmark to be adjusted accordingly.

11. Financial framework for CP7

For further information, please see section 12 of our England and Wales and Scotland overview documents and our related supplementary document on the financial framework.

Consistent with Rail Partners' response to the financial framework consultation, we agree that the CP6 financial framework remains largely fit for purpose and limited changes are required. This is because the CP6 framework reflects that Network Rail is a publicly funded body and this has not changed. We recognise that overall decisions on the financial framework are subject to the approval from the Department for Transport and Transport Scotland as the funders of Network Rail's settlement.

The periodic review is taking place within a challenging economic environment and these pressures, particularly regarding inflation, are unlikely to subside by the time that CP7 commences. As such, it is key that ORR monitors Network Rail's finances closely to ensure that it is operating efficiently and will be able to deliver on the commitments set out within its Strategic Business Plans (subject to amendments proposed in the draft determination). Where wider economic circumstances mean that Network Rail is unable to deliver on any of its commitments, this should be communicated promptly to train operators as their primary customers.

Owing to the uncertainty described above, we agree that it is appropriate that ORR continues to monitor the capital costs ahead of the final determination to ensure that it remains appropriate within a volatile environment. We support ORR's approach to compare the proposed cost of capital outlined in Network Rail's SBPs with the values used by other regulated sectors in the UK. We support the adjustments to the *Total Market Return* and *Risk-free rate,* to ensure compliance with the guidance set out by the UK Regulators Network. ORR should closely monitor Network Rail's cost efficiency and require recovery plans if it is falling short.

12. Managing Change in CP7

For further information, please see section 13 of our England and Wales and Scotland overview documents and our managing change consultation document.

*Under **section 3.4** of the **managing change** consultation document, we are seeking stakeholders' views on if the threshold for categorising change to the allocation of Network Rail's centrally held risk fund is appropriate. Currently in the policy we propose that changes up to £50 million (fifty million pounds) are notified and changes above this threshold are consulted.*

Rail Partners is broadly supportive of the of the proposed managing change policy and recognises that it has not changed substantively from the CP6 policy. As private sector businesses, the owning groups of passenger operators and FOCs will continue to value a stable regime which enables them to invest with certainty, therefore it is important that changes are limited and, if material, subject to an industry consultation process.

We understand that it is necessary to have a mechanism which provides flexibility for ORR to allow adjustments to Network Rail's plans and how they are regulated during the Control Period in order to reflect changes to the industry or the wider economic environment that are clearly outside of Network Rail's control. It is important that ORR is satisfied that changes are based on exogenous factors, and we welcome the requirement on Network Rail to demonstrate this. The proposal to reduce the number of 'levels' of change to three from four in this control period appears logical.

As addressed in response to question 4, Rail Partners supports the outcomes framework and the success measures proposed to monitor Network Rail's performance. We note that through the managing change policy, changes could be made to the baseline trajectories or methodologies used to calculate these headline measures. Such changes should not be made lightly as it risks undermining the effectiveness of the framework in holding Network Rail to account. It is critical that this mechanism is not used to 'bake in' underperformance. Although there Is merit to having a limited number of success measures to ensure focus and accountability on delivering, should it become clear during the control period that Network Rail is falling significantly short on some of the supporting measures within the framework and this is affecting the delivery of passenger and freight services, ORR must be able to use the managing change policy to escalate these measures.

13. Are there any other comments you would like to make?

None.

Thank you for taking the time to respond.

Annex A: Publishing your response

We plan to publish all responses to this consultation on our website.

Should you wish for any information that you provide 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. These regimes are primarily the Freedom of Information Act 2000 (FOIA), the UK General Data Protection Regulation (UK GDPR) the Data Protection Act 2018 (DPA) and the Environmental Information Regulations 2004.

Under the FOIA, there is a statutory code of practice with which public authorities must comply and which deals, amongst other things, with obligations of confidence. 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.

Any personal data you provide to us will be used for the purposes of this consultation and will be handled in accordance with our privacy notice, which sets out how we comply with the UK General Data Protection Regulation and Data Protection Act 2018.

Consent

In responding to this consultation you consent to us:

- handling your personal data for the purposes of this consultation; and
- publishing your response on our website (unless you have indicated to us that you wish for your response to be treated as confidential as set out above.)

Your consent to either of the above can be withdrawn at any time. Further information about how we handle your personal data and your rights is set out in our privacy notice.

Format of responses

So that we are able to apply web standards to content on our website, we would prefer that you email us your response either in Microsoft Word format or OpenDocument Text (.odt) format. ODT files have a fully open format and do not rely on any specific piece of software.

If you send us a PDF document, please:

- create it directly from an electronic word-processed file using PDF creation software (rather than as a scanned image of a printout); and
- ensure that the PDF's security method is set to no security in the document properties.