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Dear Gian Carlo,

Establishing Network Rail's efficient expenditure

This letter sets out Network Rail's response to ORR's 'Establishing Network Rail's efficient expenditure' consultation, published on 26 July 2011.

We welcome the opportunity to comment on ORR's proposed approach, the methods ORR intend to use, the range of studies ORR intend to undertake and the work Network Rail will do. We found the document helpful as it sets out more clearly than in previous periodic reviews the information to be provided by Network Rail and the information that ORR expects to develop itself.

Overall approach

The process of establishing Network Rail's efficient expenditure will require strong programme management from both ORR and Network Rail. There is a large programme of work to be managed, and we will need to work closely with ORR to develop a better process that enables (a) ORR to understand what it will receive from us and (b) us to understand the purpose of ORR's studies thereby enabling us to provide appropriate input. We look forward to continuing the recent discussions with ORR on the overall approach in order to establish a clear way forward.

We also believe there is great value in early discussion around the format and shape of the evidence that is required so that we have a common understanding of what 'good' looks like.



We understand ORR's intention to carry out both detailed 'bottom up' and 'top down' benchmarking of Network Rail against national and international comparators and agree that greater consideration should be given to bottom up analysis. Over the last 12 months, we have already embarked on a major programme of bottom-up benchmarking, working with our European comparators. We have made considerable progress in building relationships with these partners and we must therefore be particularly careful that ORR's programme of work is coordinated in such a way that these relationships are maintained, or even strengthened. This applies to support, operations, maintenance, renewal and enhancements activity.

Great care should be taken in any simple comparison of unit costs, especially for international railway benchmarks. In our own benchmarking work we have found many issues around comparability of data, including, for example, different accounting conventions and some railways not recording unit costs for all but basic, repeatable activities.

In PR08, Network Rail's data was provided on a geographical level by England & Wales and Scotland. In PR13, we will be providing and analysing information at a more disaggregated level. The quality of this disaggregated information will continue to be improved as we devolve greater responsibility for the management of the network to the routes.

Support and operations expenditure

We agree with the overall planned approach to assessing these costs and only have one comment to make.

We believe it is crucial that opportunities for savings in BTP costs are assessed at an industry wide level and that all parties to the periodic review clearly understand how Network Rail and other industry players may be able to influence BTP costs.

Maintenance and renewal expenditure

We agree with the overall planned approach to assessing these costs. We would, however, like to make the following observations in the areas of econometric analysis and unit costs.

We have raised concerns with ORR on its international railway econometric model, including the completeness and consistency of historical data, the functional form of the model and the structural variables considered. We are committed to working with ORR to address these issues and work towards development of a more suitable model.

We agree with the inclusion of a 'steady state' adjustment to the level of renewal costs, especially when it applies to all countries in the sample. The methodology described is not dissimilar to the approach we are considering and we look forward to developing this approach further with ORR over the coming months.

We also agree that benchmarking should always take outputs into account. In much of our European benchmarking and better practice work we are finding that some railways do deliver a lower level of output for a lower cost. For example, one major railway undertakes lower levels of maintenance on its electrification assets and spends significantly less on its maintenance than Network Rail. However, this railway records fifty per cent more delays arising from electrification asset failure. Similarly, other railways undertake far less grinding than we do but incur more broken rails.

We have co-operated with ORR and partner railways in the ORR-led study on local maintenance spend described in Section 5.35. We believe that even more detailed line comparison studies are the way forward for this type of work although securing adequate data from our partners is likely to be challenging. We are already doing this through the UIC Asset Management Working Group and EIM.

We agree that, to reach an overall view on efficiency, evidence from each area of study needs to be reviewed to inform understanding of other areas. We are committed to working with ORR to find the best way of bringing the conclusions of all these studies together to draw appropriate conclusions.

As set out in Section 5.24, we agree that Network Rail should use unit cost information for developing accurate forecasts of costs associated with activity plans and for developing robust asset policy. It should be noted, however, that a significant change in contracting strategy may mean that historical unit costs are not the most appropriate data to use in the development of these forecasts or policies. Where this is the case, we may use information we have in relation to the new contracting strategies.

Table 5.3 does not show "how the company must present its unit costs data in its SBP...". Rather, it shows how much of Network Rail's expenditure on maintenance and renewals should be covered by respective unit cost frameworks. We have shared with ORR our draft improvement plan that outlines how we

propose achieving the targets indicated and we will continue to share with ORR our progress towards achieving these targets.

Enhancements expenditure

We agree with the planned approach and have no further comments.

If you wish to discuss any aspect of this response, please do not hesitate to contact me in the first instance.

We look forward to engaging in more detail with ORR as the periodic review progresses.

Yours sincerely,

A handwritten signature in black ink, appearing to read 'C Lloyd', written in a cursive style.

Calvin Lloyd
Head of Periodic Review