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Your Ref:
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Dear Richard

RESPONSE TO FINAL DETERMINATION

Our respective Boards met recently and we have since had some useful discussions to clarify our understanding on how the Final Determination would be implemented. In the light of these discussions, I am writing to provide Network Rail's response to your Final Determination.

I would like to reiterate my comments about the very constructive process. This has been challenging for everyone involved but it is also a great strength that we are able to be very clear about the outputs which the nation wants to buy from the railway and to have stability of funding for a period of years. It will be important that the consequences from the reclassification of Network Rail do not unintentionally undermine the company's flexibility to manage the business in collaboration with its partners to achieve these requirements in the most efficient way.

We believe that this review presents an opportunity for the whole industry to build on success from the last decade while addressing the further challenges which are clear to everyone concerned. The level of continued investment in additional capacity or other improvements is greatly needed and it will be important for us all that the commitment to sustainable investment is maintained. The review is therefore great news for the long term health of our railway, which is increasingly recognised as one of the most successful railways in Europe.

In terms of the development of our plans, we are in a stronger position than in previous control periods. Although there are some major challenges, we know what needs to be done and we have plans for delivery which are owned by the routes which, in turn, have stronger collaborative relations with train operators. We will publish our delivery plan at the start of the control period and this sets out what we will deliver. Each business unit has its own plan and, with the exception of track renewals, the size of the central overlay is smaller than at the same stage in previous control periods.

Response to the review notices

ORR published review notices on 20 December 2013 under paragraph 4 of Schedule 4A to the Railways Act 1993. The review notices provide Network Rail with the right to make objections. I confirm that following extensive discussions at our Board and in the light of further discussions with ORR, Network Rail is not putting forward any objection to the review notices. I explain below some of the issues which the Network Rail Board has considered in reaching this decision.

Train performance

The Board of Network Rail has considered very carefully the issue of train performance over the last few years and we are committed to further improvements both in actual performance and in our understanding of the drivers of performance. This has also been a major focus of our discussions with operators both at a local level and nationally at National Task Force (NTF) or Rail Delivery Group (RDG). We have also had extensive discussion with ORR and governments on this matter, both in the context of CP4 and CP5.

In accepting your Final Determination:

- we recognise our responsibility for the missed CP4 train performance targets
- we are committed to delivering the end-CP5 train performance targets
- to achieve the end-CP5 train performance targets, we are committed to delivering our plans and to embedding a culture of continuous improvement throughout our business
- we will need support from the rest of the industry, governments and the ORR to achieve the end-CP5 train performance targets as they require changes that are not entirely within our control
- despite the above, we do not expect to meet the England & Wales passenger train performance targets in the early years of CP5
- we will produce a summary performance plan at the start of CP5 and during CP5 we will produce climate change resilience plans for the longer term.

Our position on these issues is explained further in the appendix to this letter. In particular, it is clear that we will start CP5 at a lower level of performance than was assumed at the time of the Final Determination. Although we have concluded that the industry can still meet the targets for the end of the control period we will not be able to improve as quickly as assumed in the Final Determination and we will not be able to do so in all circumstances (including extreme weather conditions).

Given that we do not expect to meet all the train performance targets in the early years of CP5, we assume based on discussion with ORR that delivery of our plans combined with evidence of continuous and balanced improvement, would be regarded as evidence that we are doing everything reasonably practicable to meet the reasonable requirements of customers and funders in this area. Once we have reached the performance targets in the Final Determination, we would expect to revert to a more conventional output-based approach to compliance with our licence.

Financial performance measurement

We have held extensive discussions with ORR since the Final Determination on how we will measure success in CP5. Our Boards had committed to this process and we remain strongly of the view that it is essential for us both to be clear about the regulatory consequences of different scenarios. We welcome your support for the principle of a balanced scorecard assessment and a single measure of overall financial performance which includes adjustments for variances in outputs. As you know, we also consider that this should, in principle, be symmetric so that the business can celebrate success as well as rightly being penalised for non-delivery of commitments.

We understand that ORR remains committed to a single measure of financial performance and agrees with the broad methodology which has been developed jointly to adjust for missed train performance outputs and sustainability. We are disappointed that we have not been able to make more progress on agreeing the details and we are keen to conclude these discussions before the start of the control period. We are concerned, for example, that unnecessary ambiguity could result in ongoing concerns and distraction around potential double-counting of adjustments.

We recognise your concern that we should not pick-and-choose which outputs to deliver based on our assessment of the cost against the consequences of failure – that is not our intention. Instead, we consider that there is significant benefit in being able to signal the importance of each of our commitments, to quantify the benefits in an overall financial performance assessment and to avoid the potential distraction from debating adjustments if we fall behind target even temporarily.

We also welcome your proposal to discuss the consequences for the Management Incentive Plan with our Remuneration Committee.

Other issues

We sought clarification of your intention on a range of further issues and we have received your views on these matters.

Of particular importance is the treatment of rollover. We therefore welcome your confirmation that the funding provided in CP4 for enhancements, FTN-GSMR and ORBIS will remain available through rollover to CP5. By contrast, we have acknowledged that for ongoing renewal programmes such as track this need not apply and we have satisfied ourselves that this will enable us to sustain the asset consistent with our asset policies effectively by rolling over renewals into CP6 and beyond.

We do not understand why ORR has not agreed with us that discrete electrification/power supply and building projects should be treated in the same way as enhancements. This is because your Final Determination assumed that we will complete these discrete projects and we consider that they are still necessary without the potential for other projects to be rolled over into CP6 or beyond. In the case of Paddington, for example, this work clearly needs to continue and is already funded in CP4 so we are surprised that this funding might effectively be removed by not allowing rollover to CP5.

Similarly, we have explained our concerns about renewal of track on the Stirling Alloa Kincardine line. Since we published our Strategic Business Plan, we have identified that this track is deteriorating more quickly than we assumed. This is because the original work which was done before we took over the line was below the standard which we would normally expect. In the circumstances, it is not reasonable to have expected us to anticipate the scale of the requirements with any certainty at the time of the transfer or when we produced the SBP. Moreover it is clear to us that the ORR did not take account of the latest information in reaching its determination. We propose therefore that this should be treated as an additional requirement under the investment framework.

Finally, we are pleased to see the additional funding for investment to further reduce risk at level crossings across Great Britain. Seeking to maximise the level of risk reduction across the portfolio of level crossings will undoubtedly lead to some challenging decisions on a crossing-by-crossing basis. We would like to discuss how we deal with these issues.

It is important that we discuss and agree the way forward on the above matters before we finalise our delivery plan.

Narrative

We very much welcome the discussions which we have had about the need for a more positive narrative which enables the industry to deliver and then to celebrate success while recognising the need for continued improvement. I am sure that Mark Carne will be enthusiastic about taking forward these discussions so that ORR's regulatory stance can to help him to achieve the next phase of the company's transformation. We are also keen to build on this with governments and the RDG.

I am copying this letter to Philip Rutnam at the Department for Transport, David Middleton at Transport Scotland. As we have discussed, we propose to make a statement about our decision on Monday at which point I also propose to share this letter with members of the Rail Delivery Group.

Yours sincerely

A handwritten signature in black ink, appearing to read "David Higgins". The signature is fluid and cursive, with a long horizontal stroke extending to the right.

David Higgins
Chief Executive

Appendix: Further explanation of CP4 train performance issues

We recognise our responsibility for the missed CP4 train performance targets

It is clear that many of our CP4 train performance targets have not been met, and while there have been many other successes, we recognise that this has not been satisfactory. Our performance against the CP4 train performance targets will clearly be a key element of the overall assessment of what the business has achieved in CP4, including the final assessment of net Financial Value Added (FVA).

Although some of the reasons for our targets being missed are outside Network Rail's control, we are also clear that Network Rail must accept responsibility and seek to remedy the situation both by driving further improvements in our own business and by working collaboratively with train operators, governments and ORR to address broader cross-industry issues. For example:

- the number of asset failures has fallen significantly over the control period, but in some areas this has not fallen by as much as we assumed at the start of the control period and it is now clear that even the improvement which we targeted would have been insufficient
- although we have experienced a series of extreme weather situations in the last few years, we accept that it is our responsibility to manage our assets sustainably and to work with operators to mitigate the impact of such external events on rail users
- although traffic growth has been greater than assumed at the last review and supporting this growth is the right thing to do, it is our responsibility to find solutions which enable us collectively to respond to this opportunity in a way which does not unduly compromise performance.

We are committed to delivering the end-CP5 train performance targets

Looking forward, it is essential that we are realistic about what can be achieved. Delivery of the train performance targets for the end of CP5 already required us to deliver substantial planned improvements in train performance alongside increased traffic volumes, increased passenger loadings and extensive engineering works. In the light of the recent deterioration in performance, we now also need to improve from a lower starting point.

We have concluded that this improvement is still achievable by the end of CP5 and we remain committed to these targets. In particular, we recognise their importance to our immediate customers, to passengers and freight users and to the taxpayer. Our success is, however, fundamentally dependent upon delivery of our plans and the other issues outlined below.

We are committed to delivering our plans and to embedding a culture of continuous improvement throughout our business

We were clear in the development of our Strategic Business Plan that we would need to do some things very differently in CP5 if we are to be successful in meeting the new challenges that we face and we remain committed to continuing with these changes. The key plans underpinning the improvement in performance have been subject to extensive review over the last few years as part of the periodic review process and we remain committed to these plans. For example:

- **Asset management** - we have developed sustainable asset management policies which have been independently validated as best practice and we have developed asset management plans consistent with these policies which are owned at a local level – we are continuing to improve these policies and will deliver the required maintenance and renewal activities to underpin the reliability of our assets and hence train performance;
- **Delivery** - during CP4 we made significant organisation changes including devolution and changes to our maintenance organisation which presented challenges at the time but which now place us in a stronger position to drive further improvements for example through greater local attention to basics such as seasonal preparation – further changes such as the depot project, improvement in national functions which support the route teams, improved sharing of best practice between routes, and implementation of the track renewals ten point plan will help us to make further improvements in delivery which will underpin train performance;
- **Operations** - our longer term plans for improved operational excellence centre around the development of the National Operating Strategy (NOS) including the development and delivery of ETCS and Traffic Management – we will begin to see the benefit of this in CP5 and we are looking at how we can accelerate our plans through much stronger cross-industry leadership; and
- **Performance analysis** - our understanding of the drivers of train performance has improved substantially and is now as good as any other railway but we recognise the opportunity for further improvement – it is clear to us, for example, that although robust asset performance is a critical underpinning for a reliable train service, this is alone not sufficient and our plans to further improve the robustness of our analysis will help inform our own decisions as well as those of governments, operators and ORR.

More fundamentally, we are committed to a culture of **continuous improvement** throughout the business. Related to this we are also committed to working with operators to balance the need for additional capacity or improved journey times with the need for reliable train services. Taken together this approach and mind-set should result in the best possible train service in all its dimensions regardless of whether we are already delivering better or worse than our performance output targets.

We need support to achieve the end-CP5 train performance targets

In order to achieve the targets for improved train performance we will need help and support from train operators, governments and the ORR. Much of this is the essence of the JPIP process at a local level with train operators and I return to this matter further below.

In addition, however, achieving these targets will require us to seize opportunities to remove conflicts and optimise timetables across the whole system. Refranchising can be a catalyst for this fundamental timetable change but will require governments to support this through the franchising process. Even more fundamentally, refranchising provides an opportunity for us to achieve stronger alignment between train operators and Network Rail so that we are more obviously working towards the same performance objectives.

We recognise that Network Rail has key responsibilities in these areas and we will highlight to others where changes that they could make would help to make the whole system work more effectively. These issues have been discussed in the past at NTF and we are pleased that RDG now wants to support NTF in this debate. In the short term RDG is due to meet as a group with DfT and we hope to be able to press the importance of this issue.

We do not expect to meet the England & Wales passenger train performance targets in the early years CP5

Despite the above, the Network Rail Board has concluded that it is not realistic to expect the industry to meet the Final Determination England & Wales passenger train performance targets for the early years of CP5. This conclusion is based on the latest views emerging locally through the JPIP process. The plans outlined above can be expected to get us to the end-CP5 train performance target - but they will not do so as quickly as assumed in the Final Determination and they will not do so in all circumstances (including extreme weather conditions).

This is largely because of the starting point being worse than was assumed at the time of the Final Determination. Although a significant part of this deterioration in train performance has been attributable to sustained and varied extreme weather conditions, a return to normal weather conditions would not result in immediate recovery in train performance partly because of the effect which this is having both on our assets and our people. Moreover, even after adjusting for the impact of the weather, the scale of the improvement required in a single year would be much greater than has been achieved for many years even when the base level of performance was at lower levels.

In order to avoid demotivating the people who work every day at the front line of the railway it is essential that our customers, stakeholders and regulator recognise this reality.

We will produce a summary performance plan at the start of CP5 and climate change resilience plans for the longer term

Our plans in most areas are well developed and the priority for the business is to focus on delivery. The JPIPs for the early years of the control period are also well advanced and we are continuing to develop plans for how we will improve timetables.

We will continue to work with operators, NTF and RDG on the refinement of these plans and discuss these with ORR. Before the start of the control period we will provide a summary performance plan which takes account of their views. We will use this to monitor progress over the early years of the control period.

Given that we do not expect to meet all the train performance targets in the early years of CP5, we assume based on discussions with ORR that delivery of our plans combined with evidence of a continuous and balanced improvement, would be regarded as evidence that we are doing everything reasonably practicable to meet the reasonable requirements of customers and funders in this area. Once we have reached the performance targets in the Final Determination we would expect to revert to a more conventional output-based approach to compliance with our licence.

Climate change and extreme weather could create further challenges for the industry. In the long term, we clearly recognise the need to improve the resilience of our network through the application of our asset policies. Similarly, we recognise the need for us to manage the impact of extreme weather conditions including through our operational response together with operators. When we do experience extreme conditions, our focus will continue to be on doing the right thing for passengers and freight users rather than managing to targets. We will use the proposed review of our structures renewal requirements in years 3-5 of CP5 to consider whether our current plans are robust to climate change. Similarly, we are due to produce climate change resilience plans for each route and although this could have implications for our asset policies and our longer term renewal plans we have not incorporated additional requirements into our plans for CP5.