

Office of Rail Regulation

Minutes of the 88th Board meeting on 22 October 2012

(9:30 – 16:45) in Room 1, ORR offices, One Kemble Street, London

Board present:

Non-executive directors: Anna Walker (chair), Tracey Barlow, Peter Bucks, Mike Lloyd, Stephen Nelson and Steve Walker.

Executive directors: Richard Price (chief executive), Michael Beswick, Ian Prosser, and Cathryn Ross.

In attendance, all items: Dan Brown (director, strategy), John Larkinson (acting director, RPP), Juliet Lazarus (director, legal services), Ken Young (director, external affairs), Alastair Gilchrist (director of corporate operations), Sam McClelland Hodgson (Board secretary), Gary Taylor (asst. board secretary).

In attendance, specific items: Carl Hetherington (RME) (item 6, 7 & 8), Jonathon Hulme (RME) (item 6)

Item 1: Welcome and apologies for absence

1. Anna Walker welcomed everyone to the meeting. We noted apologies for absence had been received from Mark Fairbairn and Ray O'Toole.

Item 2: Declarations of interest

2. There were no interests declared relevant to the agenda.

Item 3: Monthly Safety report / issues to advise the Board

3. We noted Ian Prosser's update provided via the CE's report. He highlighted the ongoing issues with structures, maintenance and workbanks and we discussed the leading and lagging indicators. We also noted the progress being made on level crossings by Network Rail

4. We noted that we would receive the full Health and Safety report for discussion at our January meeting, and this would provide a better view of the data indicators. We would then have a clear idea of the direction of the Precursor Indicator Model (PIM).

Board 23.10.2012 Action A: 6 monthly health and safety report to highlight trends in the Precursor Indicator Model to ensure Board focuses on 'big picture' issues.

Item 4: Preparation for the Network Rail and ORR Joint Board meeting – 14 November 2012

5. An additional item to the agenda, we received an update on the planning for our bi-annual joint session with Network Rail. We noted that agenda which was being developed with Network Rail for the session and would follow a similar format to our previous sessions, with a mix of presentations and table discussions. It was a very important session as it would enable both Boards to explore PR13 issues.

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6. We also discussed the briefing we would require to prepare us for the meeting. We noted that we would also receive a briefing on the day in relation to the latest position on performance from Michael Beswick. It was agreed that the November session should be followed by another in March when Network Rail's Strategic Business Plan was available.

Item 5: Six Monthly assessment of NR performance (economic and safety)

7. We considered a paper providing an assessment of Network Rail's overall performance at this mid-year point. We noted that Network Rail has made progress in many areas, including developing its safety strategy, improving freight performance and good delivery of enhancement projects (with one concern). However there were broader concerns with some important aspects of passenger train performance and more work was being done to clarify and address underlying issues and risks in its asset management.
8. John Larkinson also provided us with a detailed update on the progress on performance, concessions and asset management. We noted a number of key new developments were highlighted including:
 - Improvements on specific aspects of safety -
 - we now had a number of new studies to assess Network Rail's asset management, which have allowed us to be more specific and focussed in our challenge. There has been progress in trying to get to a shared view of the issues with Network Rail, but there was still more to do in this area
 - From our monitoring work we noted potential issues about progress on the Great Western electrification project which we were currently investigating further
9. In particular reference to concessions, although Network Rail had made good progress analysing potential infrastructure concessions, further progress depended on multi party agreement on some key issues. There was work ongoing with Network Rail and DfT on potential options for concessions and we asked that a paper be brought to our November meeting on this issue. It was important for the Board to consider the public interest business case and policy implications for concessions drawing on experience from other sectors.
10. We discussed the progress of Network Rail's projects and issues relating to workbanks where there was a potential backlog. This included both track renewals and track maintenance at least in some part of the country. Network Rail devolution meant that the geographical distribution of work was also now a relevant issue; previously the picture had been solely a national one. We agreed that we should highlight these issues in the Monitor publication.

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11. We noted the report and agreed the key messages on overall performance within it. We understood that these messages would inform our engagement with Network Rail and other stakeholders over the next few months, including our next *Network Rail Monitor* in early December.

12. We agreed it was important to have consistent key messages for Monitor and other publications and for our briefing for the Network Rail / ORR joint board meeting in November.

13. We noted that there was still further work needed on FVA issues (though this was not an area which was part of the Monitor publication) and Richard Price agreed to give this further thought with the executive team and come back to the Board on it.

Board 23.10.2012 Action B: Executive to reflect on Board comments and produce briefing for ORR/NR Board workshop on 14 November.

Board 23.10.2012 Action C: Following a discussion on concessions we agreed that a further discussion would be scheduled for the November Board meeting.

Board 23.10.2012 Action D: Paper to focus on concessions in the wider context of governance of risk.

Board 23.10.2012 Action E: We agreed that John would highlight issues around work banks for the monitor document

Board 23.10.2012 Action F: Richard, John and Cathryn to consider comments on FVA and establish clear handling strategy.

Board 23.10.2012 Action G: Important to ensure consistency around the Annual efficiency assessment, monitor and handling of FVA.

Item 6: Annual efficiency assessment

14. Further to recent considerations and discussions in correspondence regarding our Annual efficiency assessment document, we considered a paper which summarised the policies underpinning the CP4 Efficiency Benefit Sharing Mechanism (EBSM), the calculation of EBSM payments to train operators for 2011-12, and considerations and judgements that are required to conclude on whether payments should be made by Network Rail to TOCs.

15. The assessment showed that in applying the EBSM policy that we put in place in PR08, EBSM payments should be payable for 2011-12. We noted that train operators had provided examples of how they have contributed to Network Rail's efficiency improvements and we had seen improved industry collaboration in CP4. In

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developing the EBSM policy we knew that there would be uncertainties in the calculation. Recognising these uncertainties we considered the recommendations that payments should still be made.

16. Taking into account all of the information and evidence provided, we approved the proposed EBSM pay-outs for 2011-12; on the basis of the policy established for CP4, the adjustments that had been made to the calculations (eg on costs) and the train operator contribution to the savings. We agreed it was important to publish this document in early November 2012.

17. We also agreed to delegate sign off of the final annual efficiency assessment document to the Chair and Chief Executive; and noted that comments received by Board members on the annual assessment document to date were being taken into account in the drafting of the final document. We agreed that the Board should consider a lessons-learnt exercise from the handling of the CP4 EBSM in designing similar proposals for CP5.

18. The Executive confirmed it would take on board the comments regarding handling and ensure a clear and robust handling plan for this document in addressing stakeholders, Governments, including the PAC.

Board 23.10.2012 Action H: We agreed that the Board should consider any lessons learnt from the handling of the CP4 EBSM in developing principles for CP5

Board 23.10.2012 Action I: We agreed with the proposed EBSM pay-outs for 2011-12. We agreed that we would delegate sign off of the document to the Chair and Chief Executive.

Board 23.10.2012 Action J: We agreed that a handling pack – including the Executive Summary to the annual assessment document would be prepared and circulated to NEDs for comments.

Board 23.10.2012 Action K: We agreed that the document should be published in early November (in advance of the Transport Select Committee meeting on 12 November).

Item 7: PR13 proposals for aligning incentives

19. Further to the discussion at the September Board, we considered a paper setting out the policy options and our proposed decisions for regulatory tools to improve the alignment of incentives between Network Rail and train operators, in CP5 and beyond, to reduce industry costs and improve efficiency.

Paragraphs 20-24 and resulting actions have been redacted because they relate to policy development.

Item 8: Track access charges – the road to normalisation

25. We noted the presentation provided on our proposed policy in relation to track access charges for PR13 and our proposed principles to re-consider certain of the design features of the Volume Incentive as part of PR13 with the aim of improving its effectiveness.
26. We confirmed we were generally supportive of the proposed direction of travel. The Board would consider this work in greater detail and its recommendations at its next meeting.

Item 9: Conclusions on financial framework consultation for decision document in December 2012

27. In May 2012 we took decisions on high level financial framework issues, e.g. the adjusted WACC approach following while in August we consulted on detailed financial framework issues, such as indexation of allowed revenue. We considered a presentation which set out the findings of the consultation, including the views of stakeholders; NR, industry operators and Governments.
28. Taking these into account we considered the executives' recommendations on approach set out in the slides on a range of financial framework issues; including in-year risk buffer, P&L volatility and importance of profit, embedded debt and FIM fee, Network Grant, Adjusted WACC calculation, level of financial indebtedness, handling of industry reform initiatives and adjusted WACC approach, in year risk buffer, reactive maintenance and long-run renewals, corporation tax, de-minimis activities, outperformance, opex memorandum account, re-openers, BT Police and RSSB.
29. We agreed all aspects of the framework issues set out in the slides provided, except in relation to indexation. We had significant discussion particularly in relating to the complexities, trade-offs and options around efficiency, inflation, indexation, and *ex post* adjustment and analysis around the likely movement of RPI over the next 5 years and comparisons with other indices. We asked the Executive for a further short paper in order to reach agreement on indexation. We thought it would be helpful for the paper to also cover forecasting for inflation, possible scenarios and the assessment criteria.
30. We would arrange a Board conference call to conclude this matter prior to our next Board meeting. The timing of this follow up meeting was particularly important as we noted we had publicly committed to publish our financial framework decisions by the end of this year and our document was currently planned for publication on 13 December.

Board 23.10.2012 Action P: Paper to be produced which captures the options around ex post and non ex post adjustments for indexation.

Board 23.10.2012 Action Q: Paper to include analysis around the likely movement of RPI over the next 5 years and comparisons with other indices.

Board 23.10.2012 Action R: Schedule potential conference call to discuss paper.

Board 23.10.2012 Action S: Following discussions around the BTP, Anna agreed to speak to Millie Banerjee (Chair of BTP).

Item 10: Audit Committee – report to the Board

31. As part of the Board committee review work being carried out, we had agreed to pilot a formal report from the Audit Committee to the Board following each meeting, to provide a summary of the issues discussed and work being done by the committee to look at risk, assurance, internal audit and finance. The purpose of this report was to ensure the Board as a whole was aware of the committee's work and any issues of concern. We noted the audit committee's discussions of the draft refreshed high level risk register.
32. We were informed of the discussions on recent internal audit reports which had provided the committee and the office with a number of areas for improvement in relation to procurement. The Board noted recent comments in the papers on some aspects of our procurement policy and the need to ensure we had appropriate policies, that there were being applied, and we had an appropriate handling strategy in the light of our policies. We also noted the discussions relating to a draft report on inspections which was subject to further discussion and review between the executive and Internal Audit to finalised this internal audit report ahead of the next Audit Committee in December.
33. There was positive support for this style of feedback from the Committee and it was thought to be a useful summary in addition to the committee minutes circulation.

Item 11: High Level risk register

34. Following the Board's annual risk workshop on 23 July 2012 in which we looked to identify the key risks facing ORR over the next year or so, along with possible control actions which will help us to mitigate these risks, the executive had worked up refreshed high level risks and an associated register which was considered by the Audit Committee in September.
35. Tracey Barlow, Chair of the Audit Committee highlighted the areas of discussion and input it had had to the development of the final Risk Register which was considered to be a good reflection of not only the outputs from the initial workshop but provided the appropriate control actions and level of risks which were being mitigated against.

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36. We noted the progress made following the risk workshop and the Audit Committee review and agreed the high level risk register, we were content that the Executive has captured the right high level risks; and put in place the right mitigation strategies sufficient to satisfy our appetite for risk in this control period and the next.
37. We noted that this was a living document and it was important for the executive to review the risks and the control actions effectively in order to help us to manage our risk profile and appetite effectively. We also noted that the Audit Committee regularly discussed risks with the lead directors and that there were directorate level registers which flowed from this high level risk register, which were also periodically reviewed.

Item 12: Assurance to the Board – Quarter 2

38. We discussed the 2nd of these ‘Assurance to the Board’ reports which set out for the Board our progress against our business plan and managing resources.
39. We thought this information was very useful in setting out for us the progress of the office in delivery of our strategic outputs and how we were managing our resources, particularly the activities table in charting progress being made. It was agreed we needed to be more ambitious on improving the passenger experience and transparency issues and proposals should come back to the Board on these in January for 2013/14.
40. We noted that it had been agreed that there should be a mid-year review of resource and allocation which had not occurred. This was because of the focus on the new Business Planning process for 2013/14. We noted that whilst there was a current underspend, (including after following the reforecast in September), there was a number of workstreams coming on line in the coming months.

Item 13: Chair’s report

41. We noted the Chair’s report (circulated via email), which provided details of Anna Walker’s recent meetings with Government, industry and stakeholders over the course of the past month.
42. We noted that annexed to the Chair’s report this month was the Quarter 2 assessment of the Board’s progress against its objectives. We agreed to provide any comments on the assessment table in correspondence.

Board 23.10.2012 Action T: Board objectives to be circulated to NEDs for comments

Item 14: Chief executive’s overview and monthly data pack

43. We noted the recent issues highlighted in the Chief Executives monthly report and management data pack. In particular we noted the latest position in relation to performance issues and the meetings scheduled in the coming weeks to discuss long distance performance and London and the South East performance with Network Rail and TOCS. An update on the latest developments would be provided to the Board ahead of the Joint Board meeting on 14 November 2012.

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44. We also noted the recent discussions on Scotland and the potential for independence and the role of regulation. We agreed that it would be useful for the Board to consider the issues in more detail in the near future. We agreed that a discussion would be scheduled on the Board agenda to take place within the next six months.

Board 23.10.2012 Action U: Michael to provide Board with an update on LSE performance issues in advance of ORR/NR Board workshop on 14 November.

Board 23.10.2012 Action V: Issue of Scottish independence to be discussed at the Board within the next six months.

Item 15: Committee meetings: SRC (July)

45. We noted the draft minutes of the safety regulation committee meeting held in July. We had received an oral update at our September meeting.

Item 16: Board forward programme

46. We confirmed our board dates for November as 28 November for our formal Board meeting and 29 November for our Periodic Review and Remuneration committee meetings.
47. We also noted the board stakeholder events in November and our activities in December 2012.

Item 17: Approval of minutes of Board meeting 18 September 2012

48. The minutes of our meeting held on 18 September were confirmed without amendment subject to the Chairs final review.

Item 18: Matters arising (not taken elsewhere on the agenda)

49. We noted the effort made over the past month to significantly reduce the volume of actions, we had reduced this down to only 10 outstanding actions. We suggested for the future using a red, amber, green, rating to highlight the length of time of outstanding actions.

Item 19: Any other business

50. There was no other business raised on this occasion.

Item 20: Meeting review, including awayday feedback

51. We thought we had had very positive sessions and discussions over the past two days. The quality of papers and slide packs continued to improve and with clear executive recommendations.
52. We thought there were still some lessons for all Board members in helping our chair move business on and in developing board papers at executive level with NED involvement.

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Anna Walker

Chair

Draft minutes approved by the Board in 28 November 2012