

Anna Walker

Chair

Telephone 020 7282 3696

Fax 020 7282 2043

E-mail anna.walker@orr.gsi.gov.uk

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Richard Parry-Jones

Chair

Network Rail

1 Eversholt Street

London

NW1 2DN

**NETWORK RAIL'S CP5 DELIVERY AND ISSUES FOR CP6**

I am writing to you following our recent Board to Board session in November, at which we discussed performance in the first six months of CP5 and how we are beginning to draw out our emerging thinking for the next periodic review (PR18).

Delivery in CP5

We discussed the importance of the delivery of the CP5 programme (maintenance, renewals and enhancements) if our rail network is to have the resilience it needs to deliver reliably for users and to cope with future expected growth in both passenger and freight traffic. The CP5 final determination funded Network Rail significantly in all three of these areas.

In the final determination for CP5 we all recognised that performance during the last two years of CP4 meant that Network Rail was likely to be below the performance targets (public performance measure (PPM) and cancellations and significant lateness (CaSL)) in England and Wales during the first two years of CP5. We agreed a performance plan,

proposed by your team, which set out how Network Rail was going to recover performance over that period to get back on trajectory to achieve the CP5 regulated performance outputs by the end of 2015-16. ORR's analysis, set out in the Network Rail Monitor published on 20 November shows that Network Rail has fallen short of the performance trajectory you specified in the plan. Although the company is largely delivering on the milestones outlined in the plan it would appear that these are not having the anticipated effects on performance.

I know that both you and your Board share our concerns about current performance. We discussed what was needed to recover the position. This is a very important issue because, if performance does not recover, the end CP5 targets will be at risk.

While recognising that each route has its own issues, Mark Carne advised us of the five core strategies which the company is adopting to recover performance:

- increased asset reliability (track and train);
- elimination of temporary speed restrictions;
- increased weather resilience;
- improved operation to the timetable and improvements in the timetable themselves; and
- a reduction in the impact of reactionary delay.

We recognise that there are areas where performance has been strong: for example some long distance operators are exceeding punctuality targets in terms of PPM and CaSL (CaSL is of particular importance to long-distance passengers). Network Rail has also taken positive steps such as filling maintenance vacancies to ensure backlogs are tackled, simplifying business critical rules, improving leadership in platform/train interface and the roll out of the safe work leaders' initiative to ensure improvements in worker safety – something Mark has championed strongly and personally.

We also recognise that there are elements of the five core strategies where Network Rail needs the co-operation and joint ownership of the train operators to deliver. These include increasing rolling stock reliability and improving the operation of the timetable which can also contribute to reducing reactionary delay. We understand discussions are progressing

on these issues in the Rail Delivery Group and we are ensuring our views are clearly represented through our participation in the National Task Force.

Nevertheless, of your five core strategies, three (increased asset reliability, the elimination of temporary speed restrictions and better weather resilience) depend on Network Rail's delivery of the maintenance, renewals and enhancement work it committed to and was financed for, as part of the CP5 settlement. The delivery of this work is crucial for delivering the asset reliability needed for the growth in the use of the rail network.

Richard Price's letter of 9 December to Mark sets out the details of our concerns. On renewals, there are major discrepancies between the volumes in the delivery plan and what has been delivered in practice. We also have real concerns about maintenance volume reporting where the data is not good enough for either ORR or Network Rail to rely on its accuracy and assess progress with the maintenance programme. On enhancements, we are still at an early stage in CP5 but some critical milestones have been missed. The enhancement programme is crucial to delivering new electrified parts of the railway, as well as providing extra capacity to reduce crowding, and improvements to service reliability and journey times.

I know that Mark and your team share these concerns and are acting on them. These are all crucial issues for users of the railway. Our teams are in touch to monitor progress.

I am sure Network Rail's Board will also be reviewing progress against the agreed targets and milestones for CP5. I suggest we meet again at the end of the first year of CP5 (in April or in May 2015) to hear your assessment of progress in the crucial areas.

CP6

We also discussed a number of issues ORR has been considering in relation to CP6 and therefore need to be explored with you and the sector.

We explained that, from our experience on consultations for CP5, policy development is complex and time is needed to explore options fully given the importance of robust evidence and analysis and the range of organisations which need to be involved. With this in mind, we are scoping and carrying out work in a number of areas in advance of publishing our first PR18 consultation document in early 2016.

First, we will focus on how we set your price control as a monopoly company, learning from PR13 and other regulatory experience. We have started two forward-looking pieces of work to improve how we regulate Network Rail in the next control period:

- to understand better what role comparison within Network Rail (e.g. by route or activity) could play at the next price control (recognising that we already expect more to be made of comparison in our monitoring of CP5). Comparisons are widely used in water, energy and healthcare regulation; and
- to understand whether there are lessons which can be learnt more generally from the experience of different approaches to cooperative working between Network Rail and TOCs in the operation or enhancement of the railway.

Secondly, following on from our initial thinking in PR13 and working closely with the Rail Delivery Group, we are looking at how the structure of Network Rail's charges can be reformed to improve incentives on the company, and the wider industry. This could begin to address in a number of possible areas, including:

- incentivising TOCs and FOCs to reduce network costs;
- incentivising TOCs and FOCs to use the network efficiently;
- incentivising Network Rail to deliver more of what its customers want, for example capacity, journey time; and
- improving transparency so funders who provide about £4 billion a year in network grant have a better understanding of what the grant funds.

Finally and closely linked to the two other areas – we mentioned that we are starting to think about the different functions which make up Network Rail and specifically whether our regulation could provide better incentives and a clearer focus on Network Rail's role in operating the system as a whole ("system operator") including:

- making better use of the constrained network (incentivising Network Rail to identify opportunities for additional services); and
- as Network Rail develops its ideas in relation to the digital railway, whether the regulatory framework exists to ensure that the additional capacity created is utilised efficiently and trade-offs between capacity and performance are explicitly understood.

I hope you find this letter helpful both in providing an update on how we want to see Network Rail meet the delivery challenge in CP5 and setting out some of our initial thoughts on the key areas which we think should form the basis of a broader discussion in starting to prepare for PR18. ORR's Board will look forward to progressing both important issues with you.

Yours

A handwritten signature in black ink, appearing to read 'Anna'.

Anna Walker



OFFICE OF **RAIL REGULATION**

Richard Price
Chief Executive

Mark Carne
Chief Executive
Network Rail
1 Eversholt Street
London NW1 2DN

9 December 2014

Dear Mark,

NETWORK RAIL'S DELIVERY IN CP5

We met on 18 November to take stock of Network Rail's performance against the regulatory outputs for the first six months of CP5. We also discussed some of these issues when our Boards met recently, and you and I had a further discussion on this last week.

Overall, the first six months of the control period have proved very disappointing, even against the revised performance plan agreed after for the first two years of CP5. You have acknowledged this. This letter sets out our key points of concern. There are areas in which we need to see focussed action to improve your planning and delivery in CP5 so that the railway's customers and taxpayers get the service and improvements they are paying for.

Performance

It is clear that train performance is not where it should be against the revised plan, whether using the public performance measure (PPM) or on cancellations and significant lateness (CaSL). It is also clear from the data that the causal factors vary across Network Rail's ten routes, but a common feature is higher-than-expected rates of asset breakdowns. Although the overall number of infrastructure asset failures has declined (measured by your composite reliability index), it remains higher than the level that Network Rail indicated was needed to underpin the recovery in service reliability and punctuality committed to in the agreed CP5 delivery plan and the subsequent performance plan.

You pointed to 'reactionary delay' as the largest single contributor to the worsening PPM (ie: a growing impact of knock-on delays, whatever the initial problem, reflecting things like more congestion on the network). We recognise that franchised passenger journeys have risen by 4.4% in quarter 2 of 2014-15 compared with the same period

a year earlier, and that this presents challenges on a congested network. We understand that the further decline in performance since CP4 contains an increase in reactionary delay, however reactionary delay is a multiplier on primary delay, and is therefore a function of where and when the delay occurs, not just the ability of the train operators to recover.

The impacts on passengers of long delays can be more serious than the 5- and 10-minute thresholds in the PPM statistics imply. We are therefore particularly concerned by year-end forecasts for CaSL for a number of operators which show that their outturn position is likely to be worse than the threshold of 0.2percentage points below the individual TOC Performance Strategy we specified in the Final Determination as the point at which we would investigate. We are keen therefore to see the outcome of your Q2 Performance Strategy reviews with each of the TOCs and the updates these will require to your plan.

As we discussed, I want to be assured that Network Rail is meeting its commitments on the things which are substantially under your control – notably the condition, reliability and operation of the network. We are under no illusions that the solutions to poor punctuality require cooperation across the whole industry, but it is incumbent on Network Rail to meet its commitments on asset condition and reliability. We need to see harder evidence that you are putting in place effective plans which will achieve this – and this leads on to our observations on renewals and maintenance.

Renewals and maintenance

Though performance of the network is a complex issue, improving the condition and reliability of your assets is at the heart of your role in managing risks to service reliability and punctuality across the network. As noted above, asset reliability is improving but not at the rate needed to sustain improved service reliability, and for which you were funded to deliver.

You have proposed a five-point whole-industry strategy for addressing performance, and this is welcome. However as we discussed, three of the five points - increased asset reliability, 'eliminating' temporary speed restrictions (without compromising safety) and improved weather resilience - are wholly or very largely dependent on the integrity and delivery of your maintenance and renewals plans; and a fourth – reactionary delay – is a function of primary delay, which is also dependent on asset reliability. That is why we are so concerned about Network Rail's under- delivery of key volumes, the lack of clarity that work is being done at the critical points in the network which make the biggest difference for customers, and indeed whether the data you use to plan and monitor progress is adequate for the task.

At the end of CP4, Network Rail's performance on punctuality and service reliability was below target, and worse than the company had projected in its strategic business plan (SBP) for CP5. You proposed in January to revise the CP5 England and Wales year 1 performance trajectory downward from 91.9% to 91.1% for 2014-15. We agreed not to hold NR to account to the regulatory targets in years 1 and 2..

Instead we said that we would focus on the delivery of your plans to restore performance to the committed level during CP5 – taking into account delivery of your performance plan as well as your maintenance and renewal plans as evidence that you are doing everything reasonably practicable to give passengers the levels of service to which you committed. It is with this in mind that we express our concerns below on your maintenance and renewal delivery.

Renewals

Reflecting the problems with delivery in CP4, we are monitoring a range of inputs in CP5 in addition to the regulated outputs. Having scrutinised the data, we raised our concerns around renewals volume reporting in my letter of 30 October on data quality. Among other things we were surprised to see large fluctuations both up and down in the cumulative volumes.

Network Rail's SBP submitted to the ORR in January 2013 was route based. Therefore we met with every route managing director at the start of 2014 to challenge them on issues such as:

- whether they owned and were committed to implementing the SBP (particularly in the first 2 years)
- whether they had the network access to deliver the SBP
- whether the supply chain contracts and Network Rail resources were in place and scheduled to deliver the SBP.

All routes confirmed that they owned the plan, were committed to the plan and could deliver it. When the revised plan (delivery plan) was finalised early this year there were some significant differences from the SBP which your team were able to explain and again give us assurance that you could deliver your new plan.

However, after seven periods, there are major discrepancies between the volumes in the delivery plan and what has been delivered in practice, across all asset groups. The commentary on volumes in your Period 8 Finance Pack shows that so far this year you have delivered the following percentages of your delivery plan:

Asset category	% of renewals plan delivered by 2014-15 Period 8
Track Plain Line	90%
Track Switch and Crossing (S&C)	51%
Signalling	53%
Civils -Underbridges	45%
Civils -Earthworks	39%
Overhead line Equipment (OLE)	80%
Conductor Rail	44%

Renewing the assets is a very large part of your core role as the manager and operator of the railway infrastructure, and the credibility of your plans is key to demonstrating whether you are likely to deliver the commitments in the Final Determination. We therefore need your assurance that your recast plans are credible across all routes, based on a robust assessment of what is possible and how it will be achieved. You are undertaking a 'deep dive' on renewals and I would like to understand what you have concluded from that and the improvement plan you propose, including how you plan to ensure that your management information and local delivery planning is coherent and robust.

Maintenance

We also expressed real concerns around maintenance volume reporting where, on the basis of what you have reported; we cannot distinguish between deviations from your planned volumes and inaccuracies in your data. It is fundamental to any company to understand what it is buying for the money it spends. To ensure both effective delivery and to demonstrate efficiency it is imperative that the industry is able to clearly back up its expenditure and delivery projections with robust data. It is impossible to truly demonstrate the progress you have made in terms of financial efficiency without being able to track unit rates. If you cannot rely on your volume data then the unit rates become invalid.

I know you personally share these concerns. We consider that you need this information as a business in order to make informed asset management decisions and I am therefore pleased to see your commitment to improving this area in your letter of 3 December. I would be grateful if you could confirm when we will be able to see a comprehensive plan with dates and milestones that can be tracked in order to progress this issue once and for all.

Enhancements

Our Monitor reports on a number of milestones not being met in the first six months of CP5. I recognise that we are still at an early stage in CP5, but as we have discussed, slippage on critical milestones jeopardises the delivery and timing of important benefits to passengers and freight customers, including extra capacity to reduce crowding, and improvements to service reliability and journey times. We will continue to monitor these projects closely and will continue to seek clarity on how you are managing delivery risks. Our trilateral discussions with the DfT are helping to make sure the impacts of these risks on passengers are well understood, and we expect you to manage these so that inconvenience to rail users and deferral of benefits is minimised.

Your Enhancement Cost Adjustment Mechanism (ECAM) submissions are not as accurate as would be expected. For example the most recent East Coast submission contained a 40 per cent error in employer costs and omitted Schedule 4 costs for a particular activity.

We understand that you are changing your internal governance to address our concerns, which you share, on the cost escalation and missed delivery milestones for the enhancement portfolio. We agreed that you would come and present these new arrangements to our senior team shortly.

Conclusion


Though we are still at an early stage in CP5, the data do not yet show that the planned recovery in service reliability and punctuality for customers is happening, and that there are significant gaps in the work Network Rail had planned to underpin this recovery.

Specifically we will need to see:

- the outcome of the Q2 Performance Strategy reviews with each of the TOCs and the implications for changes required to your plan;
- evidence that you are putting in place effective plans to achieve your commitments on asset condition and reliability and clarity on how you will recover and prioritise your plans for delivery of key maintenance and renewal volumes;
- assurance that any recast plans are credible across all routes, based on a robust assessment of what is possible and how it will be achieved;
- improvements in data quality for monitoring progress of delivery through a comprehensive plan with dates and milestones that can be tracked; and
- your revised internal governance arrangements to show how you are addressing cost escalation and missed delivery milestones for network enhancements.

It is essential for your company's credibility as an infrastructure manager that this is put right. I know you share many of these concerns and I believe that, with your sustained focus on strengthening the organisation and improving delivery, Network Rail is capable of addressing them. It is essential that these issues are resolved quickly, and that rail users see the improvements to the standard of service they expect and have paid for.

Yours sincerely

A handwritten signature in black ink, appearing to read 'Richard Price'.

RICHARD PRICE