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OFFICE OF RAIL REGULATION

2 May 2012

Rick Haythornthwaite
Chairman
Network Rail Infrastructure Limited
Kings Place
90 York Way
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Dear Rick

Network Rail's performance in 2011-12: year 3 of CP4

1. I am writing to set out the ORR Board's view of Network Rail's performance in 2011-12, as input to your Remuneration Committee's consideration of Network Rail's performance.
2. I have summarised our view under each area below, where applicable starting each area with what we see as the positives then moving to any concerns. The annex contains more detail on the evidence for our views.
3. The overall railway context is positive. The industry continues to expand and there is strong passenger revenue growth. Passenger rail travel increased by over 7% during the year and freight moved by 1%. Train miles increased by around 3%.
4. We see some real progress by Network Rail in a number of areas. We welcome the strong commitments, led by David Higgins, to improving health and safety. We also welcome your plans to improve your asset condition knowledge, your management of civil structures (e.g. bridges) and the handling of level crossing risk. These plans now need to be delivered. You have made very good progress on the significant enhancement programme and on reducing disruption to railway users from engineering works. However you have fallen short of agreed targets in 2011-12 on passenger and freight service performance, on progress towards agreed improved asset management, and - in our view - fallen short in terms of a continued reliance on us to force progress in specific safety and asset management related areas.

Safety

5. Looking at broad safety trends, your *Safety & Environment Assurance Report* (SEAR) shows that you achieved your passenger safety target for 2011-12 (measured in terms of fatalities and weighted injuries).



INVESTOR IN PEOPLE

6. Specifically on level crossings, following our high level of enforcement activity in recent years, and the arrival of a new CEO, we believe you now have in place a robust plan which should ensure you manage the risks to as low as reasonably practicable at all 6,500 crossings. You will now need to ensure the plan is delivered in a credible and timely manner.
7. However SEAR also shows that your workforce safety target finished behind trajectory.
8. Moreover, there continue to be problems with getting some of the basics right. We served a national improvement notice on Network Rail in May last year to secure timely bridge examinations and we are concerned that your internal processes did not pick up an issue of this magnitude. Both our inspections and your own review processes have shown some under-resourcing of maintenance work and your progress on implementing the Grayrigg recommendation No.2 on switches and crossings was too slow - we had to intervene to speed this up. Looking at aggregate data we have served you 14 notices; the same as last year.
9. At this stage we do not have the final findings in relation to progress against the agreed trajectory towards excellence in health and safety using the railway management maturity model (RM3).
10. Overall, progress has been made during the year and we believe you are now in a better position than at the start of the year, but we are concerned about progress in specific areas being dependent on pressure from us.

Asset management

11. You have made some improvements in your asset management capability (for example you have improved your risk assessment and management processes through early implementation of a new integrated risk management standard) and some progress in the development of your asset policies (for example, the move towards using a standardised and consistent approach for all asset groups).
12. You have developed the 'ORBIS' project which will drive progress in your asset condition knowledge and we support this project (although we are having further discussions with you on future pace, funding and the level of benefits). We are pleased that, to date, ORBIS has met its deadlines.
13. You have developed a transformation plan to improve the management of your structures assets (e.g. bridges), which has been an issue for us. We believe this is a good plan and you are working as quickly as possible to deliver it.

14. Set against these positive developments, we have a number of concerns which we have already published in our *Network Rail Monitor* and raised at Chief Executive level with you. The issues are:

- you are not delivering against some of the agreed asset management improvement trajectories. Specifically in 2011-12, you are well behind the target capability in maintenance planning, which is a key area of whole life cost justification;
- despite the progress noted above, your asset policies do not yet meet the required standard and we are concerned whether you will reach the required standard by the time of your strategic business plan in January 2013. This is important as it provides the basis for planning for CP5;
- that - although you have the ORBIS plans - your asset condition knowledge is currently not where it needs to be. We are carrying out an audit of this so we can establish a new baseline against which to measure your progress;
- on structures, although you have the transformation programme plan agreed following Arup's very critical review of your management of your civil structures, you should not have got into this position.

15. Getting asset management right is a fundamental for your business and all who use the railways and you must see it as such. Although you have made good progress in some areas, your progress overall is not as fast as it needs to be and this is reflected in issues identified elsewhere in this letter, for example on train service performance.

Train service performance

Passenger trains

16. We recognise that passenger train punctuality has improved greatly over the last decade and the most recent Passenger Focus survey reflects this with overall passenger satisfaction remaining at a high of 84%. Overall satisfaction with punctuality/reliability is at 81%.

17. However, committed PPM (public performance measure i.e. percentage of trains on time) targets for CP4 are still generally not being met. Performance for the regional sector is good - above the year-end target - but the London & South East sector is still behind target, and the long distance sector and Scotland continue to be well below target. We took enforcement action in January, concluding that you would be likely to miss both the 2011-12 and 2012-13 performance targets for long distance passenger services. Some of the problems on long distance sector performance link to our concerns on asset management, for example your reported slow deployment of remote condition

monitoring, and insufficient progress in your maintenance capability. Year-end data shows the long distance sector is at 89.1%, compared with the year-end target of 90.9%.

18. Your end-of-year cancellation and significant lateness targets for the regional sector and long distance sector were met, but the target for the London & South East sector was missed, with the end-of-year figure at 2.4% compared with the target of 2.1%.

19. Although we have focused on the PPM targets, which are closest to your customers' concerns, we note that you still missed your CP4 delay minute targets in both England & Wales and Scotland, by 19.9% and 21.0% respectively.

Freight

20. In January we issued an enforcement order in respect of continued delay to the freight sector given your poor performance - you ended the year 11% worse than the regulatory target. However, we are encouraged by the positive engagement within the Recovery Board from both you and the freight operators and we can see that there is real commitment to understanding the causes of poor performance and finding sensible solutions. Taken with other factors, we decided that a penalty was not appropriate in this case but we are looking for improved performance in this sector.

Disruption to passengers and freight from planned engineering work

21. Disruption to passengers and freight trains from planned engineering work has been well below the regulatory target and, as a result, there have been real improvements, for example in terms of fewer buses running instead of trains. This is a good achievement considering that expenditure for enhancements and renewals was, overall, almost 20% higher than last year.

Delivery of the enhancement programme

22. Overall, you have made good progress on the £1.6bn PR08 enhancement programme and are within budget. Passengers and freight customers are starting to see real benefits from these works: Southern are running longer trains because you extended platforms on time, and more trains are running on the North London Line as a result of your works. Progress has also been generally good on enhancements funded outside PR08, for example the north west electrification programme.

23. During the year you were asked to progress further enhancement projects (and renewals) as part of the Government's growth review. These included electrification of the north trans pennine route and increased spend on bridges. We will be monitoring your progress on these.

24. The concerns we have had about enhancements have been with a small number of your projects, such as southern power enhancements.

Expenditure and efficiency

25. Our PR08 determination challenged you to make efficiency improvements of 21.0% across controllable operating, maintenance and renewals expenditure (OMR) by the end of 2013-14. This equates to a required efficiency improvement of 23.5% on a REEM basis¹. The 23.5% covers both your CP4 efficiency target and “catch up” from CP3. Your *Period Finance Report* for period 13 shows cumulative OMR savings of 16.9% in 2011-12. This is 0.8% better than your 16.1% target for this point in CP4.

26. We welcome the efficiencies that you have achieved in CP4 and the fact that this has enabled you to make payments of £100mn to DfT and £12.5mn to TS in 2010-11, and £40mn to DfT in 2011-12, with the potential for further payments in future. However, we had serious concerns about Network Rail’s reporting of renewals efficiencies in 2010-11. Many of these appear to have been addressed, and we are confident that the payments you have made to the governments to date will be within the outperformance you make in CP4. But some issues remain.

27. Issues regarding Network Rail’s civils asset policy and reporting of renewals activity will need to be considered as part of our annual efficiency and finance assessment in July 2012 when we will be deciding on what OMR efficiencies you have delivered for both 2010-11 and 2011-12.

28. There is another wider issue for our efficiency assessment in 2011-12 which is that you are reporting efficiency outperformance while failing to deliver CP4 train performance outputs. We said in our PR08 determination that Network Rail should not benefit from a material failure to deliver its regulatory outputs and we are discussing with you what adjustments may be needed to your efficiency forecasts in these circumstances. We are working towards resolving these issues by July.

Customer satisfaction

29. Although this is not a formal regulatory target, we were disappointed to note the overall satisfaction of Network Rail’s customers declined by 5 percentage points from the 2010 survey (to 43%) and that there was a 5 percentage point increase in their

¹ The real economic efficiency measure (REEM) is the primary measure agreed between Network Rail and ORR for reporting efficiency savings in CP4.

dissatisfaction. The most significant factor in this decline related to overall train service performance.

Stations and depots condition

30. Your March 2012 delivery plan update indicates that you expect to achieve your targets in all stations categories nationally. We note there have been issues with the reliability and accuracy of the data itself following Arup's report in 2011, but you have worked to address the shortcomings. Arup will report on your progress in early May.

Environmental sustainability

31. There is no CP4 regulated output requirement in this area but you have committed to improvements. You are broadly on track with the exception of CO₂ emissions relating to stations, offices and depots where you have achieved around half the originally forecast reduction.

Your change programme

32. Overall, we welcome the progress you have made in terms of devolution and train operator alliances.

33. By November 2011 you had put in place your plans to devolve responsibilities to your operating routes and your Project DIME should introduce more contestability in the delivery of capital projects. These changes should lay the foundation for improved delivery at a lower cost.

34. You also progressed your approach to alliancing and again we support this approach as better aligned incentives should deliver improvements to customers and reduce costs to taxpayers. These alliances will need to be transparent and non-discriminatory.

35. While we support your work on developing infrastructure concessions, there was little visible sign of progress until the end of the year, although we have now agreed new milestones with you to move this faster.

36. I am copying this letter to Justine Greening, Theresa Villiers and Norman Baker at the Department for Transport and to Keith Brown at the Scottish Government. I am also copying it to Philip Rutnam, Steve Gooding and Nick Bisson (Department for Transport), David Middleton (Transport Scotland) and your members. It will be published on our website.

Yours

Anna Walker

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Annex: Evidence for assessment of Network Rail's performance in 2011-12

Statement	Source
Introduction	
<p>Passenger rail travel increase; freight moved increase</p> <p>Train miles increase.</p>	<p>Source: LENNON database + train operators (latest figures);</p> <p>Source for train miles: Network Rail 2011-12 data.</p>
Safety	
<p>Network Rail achieved its (internal) passenger safety target for 2011-12 (measured in terms of fatalities and weighted injuries).</p>	<p>13-period average is 0.227 (beating the 2011-12 internal target of 0.244).</p> <p>Source: Network Rail's <i>Safety & Environment Assurance Report</i>, period 13, 2011-12.</p>
<p>Workforce safety target finished behind trajectory.</p>	<p>13-period average is 0.136 (behind the 2011-12 internal target of 0.094).</p> <p>Source: Network Rail's <i>Safety & Environment Assurance Report</i>, period 13, 2011-12.</p>
<p>We served a national improvement notice on Network Rail in May 2011 to secure timely bridge inspections.</p> <p>(NB: also an asset management issue.)</p>	<p>Improvement notice ref: I/303293339/JPMcG, served 20/05/2011.</p> <p>Source: ORR website.</p>

Statement	Source
<p>ORR and Network Rail have found under-resourcing of maintenance work. (NB: also an asset management issue.)</p>	<p>Our inspections found under-resourcing of track and off-track following the 2bc reorganisation, creating workload problems and putting pressure on the management of maintenance workbanks, particularly in rural areas. Network Rail's own post-implementation review also found under-resourcing. Network Rail has begun to put back in place around 200 posts.</p>
<p>Progress on implementing the Grayrigg recommendation No.2 on switches and crossings was too slow: we had to intervene to speed this up. (NB: also an asset management issue.)</p>	<p>It's now 3½ years since RAIB's Grayrigg recommendations. ORR escalated the issue with Network Rail last year to give the matter more priority.</p>
<p>ORR served 14 notices on Network Rail - the same as last year.</p>	<p>Source: ORR Regulatory Management Team.</p>
Asset management	
<p>Some improvements in asset management capability.</p>	<p>'Risk and Review' improvement better than planned. Source: AMCL's 2011 AMEM Assessment, published 6 Dec 2011, on ORR website.</p>
<p>Some progress in the development of Network Rail's asset policies.</p>	<p>Source: Arup report <i>IIP 2011 Review</i>, published 16 Dec 2011, on ORR website. From Arup report: "<i>It is of particular note that they have produced additional specific policies for the management of Drainage and Earthworks, and that all the policy documents follow a standardised "10 Step" format as set out in their Asset Management Strategy</i>".</p>

Statement	Source
We have raised concerns at Chief Executive level about Network Rail's asset management.	Executive director level meeting between ORR and Network Rail (chaired by Richard Price, David Higgins present). Subsequently CEOs discussed position on civil structures.
Network Rail is not delivering against the agreed asset management improvement trajectories.	<p>Source: AMCL's <i>2011 AMEM Assessment</i>, published 6 Dec 2011, on ORR website. The April 2012 update, as yet unpublished, shows only slight improvement.</p> <p>Network Rail has missed 14 out of 23 of the activity level targets.</p> <p>Key areas such as maintenance planning maturity/capability ('Opex Evaluation') are well short of target (42%, target 51%).</p>
Asset policies do not meet the required standard.	<p>Sources: Arup report <i>IIP 2011 Review</i>, published 16 Dec 2011, on ORR website; and</p> <p>AMCL report <i>Initial Industry Plan 2011 Review</i>, published 16 Dec 2011.</p> <p>From Arup report: "We have had difficulty for many of the assets in identifying a clear relationship from NR Business Objectives (performance, demand, capacity etc) through Asset Policy down to specific asset outputs that can be reflected in the Route Management Plans"; and</p> <p>From AMCL report: "The strategic framework that defines how the different tiers of models and the Asset Policies are integrated as part of a holistic Asset Management process is still not fully developed and the interfaces between the models and the Asset Policies are not yet fully effective".</p>

Statement	Source
Asset condition knowledge is not where it needs to be.	Sources: AMCL's <i>2011 AMEM Assessment</i> , published 6 Dec 2012; and <i>Arup's Review Asset Policy, Stewardship and Management of Structures</i> , Mar 2011. Both on ORR website.
Train service performance	
Passenger satisfaction: overall passenger satisfaction remains at 84%, still at a record high.	Source: Passenger Focus' <i>National Passenger Survey</i> , Autumn 2011.
We took enforcement action in January 2012, concluding that NR would be likely to miss both 2011-12 and 2012-13 performance targets for long distance passenger services.	Final Order issued 19 Jan 2012 requiring a recovery plan. (Network Rail submitted its long distance recovery plan 30 March, with further 'management plan' on 26 April.)
We also issued an enforcement order in January in respect of continued delay to the freight sector.	Final Order issued 19 Jan 2012, setting up a freight recovery board to find solutions. (ORR Board decided in March that a penalty was not appropriate.)
Disruption to passengers and freight from planned engineering work	
<p>Disruption to passengers and freight trains from planned engineering work is well below our regulatory target.</p> <p>Enhancements and renewals expenditure was, overall, almost 20% higher than last year.</p>	<p>Passenger disruption: PDI-P is 0.53 at period 12. (CP4 target is 0.83). (Measure lags by 1 period)</p> <p>Freight disruption: PDI-F is 0.85 at period 13 (CP4 target is 1.00).</p> <p>Source: Network Rail's <i>Control Period 4 Delivery Plan update 2012</i> (for spend figures).</p>

Statement	Source
Delivery of the enhancement programme	
<p>During the year Network Rail was asked to progress further projects as part of the Government's growth review.</p>	<p>Issues will include:</p> <p>Access for All extra funding: we are concerned at NR's ability to achieve a step-change in delivery rate. We are reviewing in April.</p> <p>NR discretionary fund increase: we will use reporters to check benefits are delivered efficiently.</p> <p>Network Rail also received more money for bridges work and we will check this is spent efficiently.</p>
Expenditure and efficiency	
<p>We had serious concerns about Network Rail's reporting of renewals efficiencies in 2010-11.</p> <p>We asked Arup to review how Network Rail was improving its reporting for 2011-12</p>	<p>Source: as reported in our annual efficiency and finance assessment of Network Rail 2011, on ORR website.</p> <p>Source: Arup's Regulatory Accounts interim review.</p>
Customer satisfaction	
<p>The overall satisfaction of Network Rail's customers declined.</p>	<p>Source: Network Rail/GfK's <i>Customer Satisfaction Survey 2011</i></p>
Stations and depot condition	
<p>There have been issues with the reliability and accuracy of the stations and depots condition data.</p>	<p>Source: Arup's <i>2010-11 Q3 Data Assurance Report</i> (published Feb 2011, on ORR website).</p>

Statement	Source
Environmental sustainability	
Broadly on track to committed improvements, with exception of CO ₂ .	<p>Source: Network Rail's <i>Control Period 4 Delivery Plan update 2012</i>.</p> <ul style="list-style-type: none"> • Operational recycling 49% versus original forecast of 50% • Infrastructure recycling at 90% versus original forecast of 95% • Number of environmental incidents causing serious damage 6 versus forecast of 6 • Proportion of SSSIs rated favourable or recovering 100% versus forecast of 95% • NR CO₂ emissions down 8% versus original forecast of down 15% (from an 06/07 base)
Change programme	
We support Network Rail's work on developing alliancing initiatives.	<p>Policy statement of 6 Mar (on ORR website) supports aims of alliancing.</p> <p>On 28 Mar we consented to NR becoming involved with train operations in the Wessex Alliance, and confirmed that the ring-fencing <i>de minimis</i> facility should be used for alliancing business.</p>

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