

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
Chairman
Network Rail Infrastructure Limited
Kings Place
90 York Way
London N1 9AG

Dear Richard,

Network Rail's performance in 2014-15

I am writing to set out the ORR Board's view of Network Rail's performance in 2014-15, as input to your Remuneration Committee's consideration of your performance during the year.

Our comments are structured around the categories in your Management Incentive Plan (MIP). However, ORR's role is to assess your performance more widely set against the range of outputs in the CP5 Final Determination which you have signed up to - and for which you have been funded. This funding, which amounts to c. £38bn over the control period (including £21bn to maintain and improve the day to day running of the network and £12bn for enhancements) represents a significant national investment. It is therefore appropriate that we hold Network Rail to account for delivering the CP5 outputs. This is reflected in our comments, and is clearly an urgent issue.

We have provided a short summary of the key points we have considered below but they are discussed more fully in the Annex to this letter.

To provide some context, we recognise that there has been further growth in 2014-15 with passenger journeys up 4% during the first three quarters of the year compared to the same period in 2013-14. We also recognise the scale of the challenge the company faces in delivering a major enhancement and renewals programme in CP5 whilst at the same time ensuring the continued safe and efficient operation of the network.

There have been many positive developments and successes to note:

- **Health and safety** – While still in the early stages of implementation, the Business Critical Rules (BCR) programme demonstrates a more innovative approach to risk control. For example, the 'bow tie' analysis of risks and control measures has helped build a more robust understanding of the effectiveness of measures to control risk. The Tidy Railway programme is

another positive development that will enable further safety improvements. We have also seen evidence of further improvement in the management of risk at level crossings, including the closure of around 120 higher risk crossings.

- **Train performance** – This covers punctuality and reliability, which are measured using the Public Performance Measure (PPM) and the Cancellations and Significant Lateness¹ (CaSL) measure. Over the last decade there has been a significant improvement in performance and – although there are still some areas where it is unsatisfactory (these are set out below) there are indications that the overall downward trend seen since the latter part of 2011-12 has now been halted. Operators using the East Coast Mainline have seen performance for the last few periods of 2014-15 well above previous levels. Performance for the freight sector was also relatively strong.
- **Investing in the railway: enhancement programme** - You have delivered a number of significant infrastructure enhancements in the first year of CP5, all of which are providing or will provide tangible benefits to your customers and passengers. For example, upgrades to Reading and Edinburgh Haymarket stations and capacity improvements on the East Coast Mainline and Barry to Cardiff Queen Street corridor.
- **Asset management** – Your Composite Reliability Index (CRI) which measures the improvement in asset reliability weighted by asset type and the potential impact of failure, shows a reduction in the number of asset failure incidents. You have achieved all the 2014-15 milestones for the ORBIS programme which will deliver significant improvements in the way asset information is collected, stored and utilised. The number of unplanned temporary speed restrictions has halved since a high at the end of 2013-14.
- **Disruption** – Levels of disruption to passengers and freight users from planned engineering work during the year were consistent with your trajectories to meet the end of CP5 regulated targets.

However, you have fallen short of the targets you were funded to deliver in a number of areas.

- **Health and safety** - We have not yet seen evidence that the *Transforming Safety and Wellbeing* strategy is being delivered consistently. We have served 12 improvement notices and two prohibition notices during the year across a range of issues including drainage, track quality, vegetation management and occupational health. We also need more robust assurance that the renewals programme is delivering a safe and sustainable railway. Our RM3 analysis suggests that you still have some way to go in building safety management maturity.
- **Train performance** – Punctuality and reliability as measured by PPM and CaSL fell below the standards agreed in the performance strategies for key operators in England Wales and in the Final Determination for Scotland. We are investigating whether you have done everything reasonably practicable to achieve the levels of performance to which you committed and for which you were funded.

¹Trains fully or partially cancelled or more than 30 minutes late

- **Efficiency and financial performance** - Based on provisional information we have received, Network Rail's operating, maintenance and renewals (OMR) efficiency was around -2.2% in 2014-15 and you are now forecasting a cumulative efficiency of around 16% by the end of CP5 compared to the 22% that you forecast alongside your CP5 Delivery Plan. You are forecasting financial underperformance of £234m against your own budget and underperformance of around £430m against the regulatory measure for 2014-15. This means that you have spent more than was thought necessary to deliver what you have in 2014-15.
- **Investing in the railway: enhancement programme** - 39% of project completion outputs and 34% of project development regulated outputs were missed in 2014-15, (respectively, 13 of 33 GRIP 6 milestones and 13 of 38 GRIP 3 milestones). We have initiated an enhancements capability investigation and want to see the implementation of planned measures to deliver improvements in this area.
- **Overrunning engineering works** - On 27 and 28 of December 2014, passengers travelling into or out of King's Cross and Paddington stations were severely disrupted as a result of overrunning engineering works. In February, following an intensive investigation, the ORR Board concluded that you had breached your licence in that you had not done everything reasonably practicable in planning these engineering works and in the development and implementation of operational contingency plans.
- **Asset management: renewals and maintenance work** – You have under-delivered against the volumes of renewals work to which you committed in the CP5 Delivery Plan and we are concerned at the impact this may have on the sustainability of the network in the medium to longer term. We are discussing this issue with you.
- **Satisfaction** - Passenger satisfaction is of course the responsibility of both operators and Network Rail. The latest results of the National Rail Passenger Survey (published in January 2015) showed that nationally the percentage of passengers satisfied with their journey overall was 81% - down 2.0 pp (a statistically significant decline) compared to autumn 2013. As far as your customers (the TOCs and FOCs) are concerned, the proportion of passenger operators stating that they were "satisfied" or "very satisfied" with Network Rail's overall delivery to them decreased significantly from 58% in 2013 (and 66% in 2012) to 40% in your 2014 survey. However, freight operators reported increased satisfaction, with an improved score of 52% compared to 47% in the previous survey.
- **Data quality** – The quality of your data is critical to the understanding of underlying problems on the network and in this context we have seen some evidence of unsatisfactory data quality in a number of areas including asset condition, volumes data and financial reporting. We understand that your Audit Committee is reviewing data quality across all these areas. We have seen evidence of progress towards improving financial reporting but we now expect to see plans to improve data quality and management information across all areas of the business. This issue needs to be gripped urgently notwithstanding your estimate that it will take two years to get it under control.

In summary, despite a number of notable successes, you have fallen short of the targets you were funded to deliver during this first year of the control period. You have acknowledged the urgent need to address the underlying issues that have led to these delivery shortfalls. You recognise the key issues will be; clarifying the respective roles of the centre and the routes; strengthening accountability for all staff through clearer objectives and performance management; and improving your forecasting capability so you can generate clear and robust forecasts, setting out how and when you will achieve the required outputs. We know that Mark and his team are working on these issues and expect to see Network Rail address the underlying concerns and deliver the required improvements with a renewed focus on the core business. We look forward to receiving your updated delivery plan for CP5 over the summer.

I am copying this letter to Patrick McLoughlin, Claire Perry and Baroness Kramer, at the Department for Transport, Derek Mackay and Keith Brown at the Scottish Government and Edwina Hart at the Welsh Government. I am also copying it to Philip Rutnam and Clare Moriarty (Department for Transport) David Middleton and Aidan Grisewood (Transport Scotland), Gareth Morgan (Welsh Government) and Michael O'Higgins at Network Rail. Our intention is to publish it on our website in mid-June alongside our next Network Rail Monitors.

A handwritten signature in blue ink that reads "Anna Walker". The signature is written in a cursive, slightly informal style.

Anna Walker

ANNEX

Health and Safety

ORR Inspectors have seen evidence that Network Rail has taken a more critical approach to the evaluation of performance in relation to Health and Safety. For example, the use of deep dives, corporate health and safety audits and the 'bow tie' analysis of risks and control measures have all helped build a more robust understanding of the effectiveness of measures to reduce risk. While still in the early stages of implementation, the *Business Critical Rules (BCR) and Planning and Delivering Safe Work (P&DSW)* programmes, demonstrate a more innovative approach to risk control.

Network Rail received over £100m of ring-fenced funding for CP5, to reduce the risk at level crossings. Over the last 12 months, you have closed 25 level crossings using this funding and a further 93 crossings using your own funding. There has also been good progress on developing a level crossing strategy to describe the management of risk at passive level crossings. The level crossing manager role has been embedded across the routes, resulting in a better understanding of crossing risks.

We also note good progress on occupational health with the appointment of specialists to each route, improved data collection and management and the initial implementation of the strategy on occupational health.

However, progress on delivering the *Transforming Safety and Wellbeing* strategy has been slower than we would have expected and early deliverable dates have been missed. ORR Inspectors identified a number of instances where the management of health and safety risks was inadequate. During the year we served Network Rail two prohibition notices to prevent immediate harm. These related to instances of inadequate risk assessments and unsafe working practices for working at height and the manual handling risks associated with concrete troughing. Inspectors also served 12 improvement notices. These included where the implementation of *Safety by Design* was not as effective as it could have been, for example on the Swindon and Reading resignalling projects. Improvement notices were also served to address weaknesses in asset management - drainage, track quality and vegetation. These problems have been exacerbated by underdelivery of maintenance and renewal volumes.

Despite the good progress on occupational health at a strategic level (noted above) we have served improvement notices relating to occupational health risks on the ground. These covered: Control of Substances Hazardous to Health (COSHH), ballast dust, asbestos management, hand arm vibration, and manual handling.

Network Rail's monitoring and assurance is not yet robust end to end. Although there are examples of powerful audits, for example on compliance with the Electricity at Work regulations, there are too many examples of audits and monitoring at lower levels of the organisation which are only paper-based and do not fully test conditions on the ground.

Finally, we see a significant amount of change being directed to the Delivery Units, for example BCR and P&DSW. We have not seen evidence of a coherent overall programme approach allowing robust decisions on priorities to be made. As a result

there is a risk that the Delivery Units will struggle to manage the changes at the same time as continuing to deliver on the core business commitments.

Train performance

In England and Wales, there are signs that the steady downward trend in punctuality as measured by the Public Performance Measure (PPM) moving annual average (MAA) since P10 of 2011-12 may have been halted. For example, the East Coast Mainline, a key economically important route, has seen performance for the last few periods of 2014-15 well above previous levels.

Detailed analysis of actual train arrival times shows that trains arriving early constitute the largest single category for almost every operator. We also note that nationally, around half of trains that failed PPM in 2014-15 missed their PPM threshold by less than five minutes and there is some cause for optimism that performance can reach the required regulatory targets in the coming years, even allowing for passenger growth. The recovery of performance has been helped by the fact that most routes have seen less than half the total of delay minutes attributable to Severe Weather category seen in 2013-14.

Performance for the freight sector was relatively strong and the Freight Delivery Metric (FDM) target of 92.5% for the year was exceeded.

However, PPM MAA for England and Wales at the end of 2014-15 was 89.6%, 1.4 percentage points (pp) below the CP5 Performance Plan target. Reliability as measured by Cancellations and Significant Lateness (CaSL) was 2.9%, 0.5 pp above (i.e. worse than) target.

For clarity, we agreed during the periodic review process for CP5 that we would not hold you to account directly for the delivery of the above national level numbers in the first two years of the control period. But we are continuing to hold Network Rail to account for the commitments agreed with operators in the performance strategies. In the CP5 Final Determination we set a shortfall threshold of 2.0 pp for PPM and 0.2 pp for CaSL at which point we would consider whether to intervene. The following operators were outside these thresholds:

- *PPM* – Southern by 4.7 pp², First Trans Pennine Express (FTPE) by 2.4 pp, and Govia Thameslink Railway (GTR) by 2.8 pp.
- *CaSL* – Southeastern by 0.26 pp, First Great Western by 0.42 pp, South West Trains by 0.56 pp, Virgin Trains (West Coast) by 0.96 pp, Abellio Greater Anglia by 0.87 pp, FTPE by 0.77 pp, GTR by 1.29 pp and Southern by 1.88 pp.

We are investigating whether Network Rail has done everything reasonably practicable to achieve its targets and the ORR Board will consider this in the summer.

In Scotland, PPM at the end of 2014-15 was 90.5%, 1.5 pp below the regulated target. We estimate the impact of the Commonwealth Games on performance was approximately 0.6 pp on the MAA. There is no regulated target for CaSL. We are

² The impact of London Bridge has been really severe on Southern services which were 10% below the period 13 plan for PPM.

investigating whether Network Rail has done everything reasonably practicable to achieve this target in Scotland and as above, the ORR Board will consider this in the summer.

Efficiency and financial performance

Based on the provisional information we have received, Network Rail's operating, maintenance and renewals (OMR) efficiency was around -2.2% in 2014-15 and you are now forecasting a cumulative efficiency of around 16% by the end of CP5 compared to the 22% that you forecast alongside the CP5 delivery plan.

You are forecasting financial underperformance of £234m against your own budget for 2014-15³. However, this internal budget is itself £91m higher than our PR13 financial assumptions, mostly due to higher budgeted track renewals and Schedule 8 costs. Our regulatory financial performance measure also takes into account any under delivery of PR13 output requirements (e.g. in relation to train performance) and our indicative assessment is that these adjustments may be £100m or higher for 2014-15. Therefore, the provisional regulatory financial performance measure is adrift of target by £430m (or around 4% of relevant income and expenditure), though much work remains to be done to finalise this.

Key drivers of this financial underperformance include:

- higher than expected track renewals costs;
- overspend across a number of enhancements projects, including a significant contribution from Thameslink;
- higher than expected operations and maintenance costs due to difficulty in achieving planned efficiencies and the introduction within the year of the Tidy Railway and Vegetation Management programmes;
- higher Schedule 8 costs reflecting worse than expected train performance; and
- lower than expected property income.

Whilst not directly affecting financial performance, it is relevant to note the £1.2 bn (18%) forecast underspend against your own budget on renewals and enhancements. This is largely due to under-delivery of planned track, signalling and electrification work (considered in the asset management section below).

Recognising our concerns regarding regulatory financial reporting in 2013-14, you developed a regulatory financial statements improvement plan in 2014. There are clear indications that progress is being made to deliver these improvements though there is still more to do in this area before we can be comfortable that information quality is at an appropriate level.

³ This is not a simple measure of overspend or underspend but a measure of the variance between actual income and expenditure and budget adjusted for variances to planned work. The measure excludes some 'non-controllable' items such as electricity for traction and 25% of any capex (over)/under spend is retained by Network Rail to reflect the incentive treatment in the regulatory asset base.

Investing in the railway: enhancement programme

Despite some considerable challenges and difficulties, you have delivered a number of significant infrastructure enhancements in the first year of CP5, all of which are or will provide tangible benefits to your customers and passengers. These include:

- upgrades to Reading and Edinburgh Haymarket stations;
- power supply upgrades and works to facilitate longer trains in Wessex;
- electrification projects in the North West of England and Scotland; and
- capacity improvements on the ECML and Barry to Cardiff Queen Street corridor.

You have acknowledged shortcomings with the delivery of the enhancements programme and have developed an improvement plan to address these. 39% of project completion outputs and 34% of project development regulated outputs were missed in 2014-15, (respectively, 13 of 33 GRIP 6 milestones and 13 of 38 GRIP 3 milestones). Slippage in the project development programme has contributed to delays in your ECAM submission plan, with 20 submissions delayed against plan. We have also seen a general trend of cost escalation across the enhancements programme, with costs submitted for ECAM often significantly higher than those proposed in the Strategic Business Plan (SBP). We have initiated an enhancements capability investigation and want to see the implementation of planned measures to deliver improvements in this area. The ORR Board will consider the results of this investigation in the summer.

The long delay in submission and poor quality of the technical files provided to us for authorisation of new infrastructure into use has also been a problem, with specific concerns in respect of both Rutherglen and Coatbridge Electrification and NW Electrification Phase 2.

Asset management

The ORBIS programme (Offering Rail Better Information Services) is a major investment in asset management which is set to change the way asset information is collected, stored and utilised. A number of important programme milestones were achieved on time during the year. For example, the linear asset decision support tool (LADS) was rolled out as planned in May 2014 and in August a new app was rolled out allowing maintenance staff to enter fault data into handhelds and for this to be transmitted electronically to control centre staff.

However, we need to see further progress in your maintenance strategy towards implementing a risk-based approach which will allow you to move from a primarily “find and fix” approach to one which is based on “predict and prevent”.

The number of unplanned temporary speed restrictions has halved since a high in period 12 of 2013-14 and your Composite Reliability Index has shown a reduction in the number of asset failure incidents. However, we remain very concerned about underdelivery of both maintenance and renewals volumes and the impact this may have on the sustainability of the network. For example, at the end of period 13 renewals volumes had fallen short of the delivery plan commitments as set out in the table below. We are discussing this with you.

Asset category	Metric	Actual	Budget	Variance (%)
Track – Plain Line	Linear km	1,197	1,401	(15)%
Track – S&C	Point ends	696	1,095	(36)%
Signalling	SEU	691	1,885	(63)%
Civils – underbridges	Sq M	65,857	121,031	(46)%
Civils - earthworks	5 chain	2,208	3,178	(31)%
Electrification – OLE rewire/refurb	Number	58	93	(36)%

Problems in this area have been exacerbated by poor quality data with clear examples of errors and misreporting, something we have raised with you on a number of occasions.

There have been some aspects of the civils and operational property portfolios which have caused concern during the year. These include (as mentioned above) the quality of information on drainage assets and the condition of those assets, a backlog of structures examinations and the discovery of a backlog in operational property assessments.

Customer satisfaction

Although passenger satisfaction depends on TOC as well as Network Rail performance, the latest (Autumn 2014) results of the National Rail Passenger Survey (published in January 2015) reflect our concerns about your non-delivery of some regulated outputs. These results showed that nationally the percentage of passengers satisfied with their journey overall was 81%. This is down (- 2.0 pp – a statistically significant decline) compared to autumn 2013 when 83% of passengers were satisfied. It is also lower than the spring 2014 result of 82%.

At a national level, the proportion of passengers satisfied with punctuality/reliability was 77%. Again, this was significantly down compared to autumn 2013 when 79% were satisfied. Satisfaction with punctuality/reliability by individual TOC varied between 68% (Southern) and 96% (Grand Central). Nationally, satisfaction with the provision of information during the journey also declined, with 69 per cent satisfied (a statistically significant 2.0 pp down on the autumn 2013 result).

As far as Network Rail's TOC customers are concerned, the proportion stating that they were "satisfied" or "very satisfied" with Network Rail's overall delivery to them decreased from 58% in 2013 (and 66% in 2012) to 40% in the 2014 survey. For the first time since the survey was introduced the number of "dissatisfied" or "very dissatisfied" customers was greater than those satisfied (41%). This is a striking result given that satisfaction with train performance in fact increased by 4% compared with 2013. Your own analysis suggests that this is due to deterioration in the relationship with TOCs and this is something you will doubtless want to address.

More positively, freight customers reported increased satisfaction with Network Rail, with an improved score of 52% compared to 47% in the previous survey.

Disruption

Levels of disruption to passengers and freight users from planned engineering work during the year were consistent with your trajectories to meet the end of CP5 regulated targets. The measure for passengers (PDI – P) was 4.3% worse than the 2013-14 figure but 8.0% better than your 2014-15 forecast. Similarly, for freight users PDI – F was 1.7% worse than for last year, but 12.3% better than your 2014-15 forecast.