

Bill Emery
chief executive
Telephone 020 7282 2006
Fax 020 7282 2043
Email bill.emery@orr.gsi.gov.uk



Steve Russell
Chairman – remuneration committee
Network Rail Infrastructure Limited
Kings Place
90 York Way
London
N1 9AG

3 March 2011

Dear Steve

High level objectives for your management incentive plan

1. Many thanks for keeping us regularly updated on the progress you are making with your review of your management incentive plan and (although we are yet to see all the detail on the hurdles, performance goals and structured discretion rules) we broadly welcome the direction of your proposals. As you are aware we intend to specify a series of high level objectives for your new management incentive plan as provided for in your network licence.

2. Our general position remains as we set out in my letter to you of 30 April 2010, namely:

... We remain of the view that a properly constructed management incentive plan plays a part in driving your senior managers to achieve and out-perform both your regulatory and business requirements which are aligned with the progress needed to achieve a successful railway. Such a plan must work from three different perspectives – incentivising current year performance, but also in supporting delivery in the medium term (this control period) and in laying the foundations for sustainable, improving performance longer term (later control periods).

3. We have been considering your management incentive plan licence condition (condition 16 in part E - corporate matters - of your network licence). Clauses 16.4 & 5 require you to establish a framework of incentives to comply with licence and contractual obligations, and with any objectives that ORR may specify from time to time, after consulting with you.



Three high-level objectives

4. We have now reviewed the position and in the light of all the circumstances we consider that we should specify objectives for your framework of incentives for your executive directors. We are very clear that in setting high level objectives we must not engineer by design or default removal from you and your colleagues responsibility for the remuneration of your executives and that is it for you to fully explain and justify the decisions you take to all interested parties.

5. Under your licence it is for us to set the objectives after consulting with you, for you to design a management incentive plan framework that aligns with the objectives and for us to decide if that has been achieved. Within a framework that complies with the objectives, the setting of targets (and their justification) is a matter for you and your board/remuneration committee colleagues overseen by your members.

6. After careful consideration we have decided to consult you on us specifying **three high level objectives**, these being:

- (1) ***Delivery objective*** - that the primary focus of your framework should be to **incentivise proven long-term sustainable delivery of all of Network Rail's performance and output obligations** coupled with a requirement to give full weight to the improvement trajectories agreed between us to ensure progress on **efficiency, service culture, excellence in health & safety culture / risk control and asset management excellence**¹
- (2) ***Out-performance objective*** - the rewards within your framework should be so proportioned that they **strongly incentivise significant out-performance** of the efficiency assumptions established at the 2008 periodic review
- (3) ***Accountability and transparency objective*** - that you seek the views of your principal funders and members and do so openly and transparently:
 - initially on your full rationale and justification for your overall framework and its potential implications for your executives' remuneration (in aggregate terms), and
 - annually on the data and information you are using for the decisions you intend to take under your management incentive plan year by year (again in aggregate terms) and
 - in both cases have regard to the information and views expressed in your published final decisions which will need to include a full explanation of your reasons and how you have dealt with the views.

7. We consider the first two objectives focus on some of the weaknesses with the previous arrangements without unduly constraining your flexibility to set incentives which encourage your executives to respond to your customers' needs and continuously improve efficiency.

¹ An agreed summary of the control period regulatory obligations and improvement trajectories is set out in an annex to my letter to David Higgins of 1 March 2011

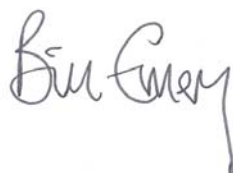
8. We see the third objective as a means to address the accountability issues that have beset decisions you have taken in recent years. Open and transparent dialogue with both principal funders and your members will enable you to explain how your new management incentive plan and decisions you intend to take each year reflects the market you are in for executive talent and in particular the additional value created for the taxpayer and users of the railways (the wider public interest) that you are incentivising and ultimately rewarding.

9. Your proposed decisions on remuneration must also demonstrate how you have taken account of ORR's assessments of the company's performance (early June each year) and efficiency improvement (in mid July each year) and how any underperformance has been reflected in your decisions. You must set out how your management incentive plan and your decisions have reflected any penalties imposed on the company by ORR or the courts.

10. Please could you consider the above objectives and provide me with any representations you may have on them by 11th March so that we can take them into account in our final decision on the appropriate objectives we should specify.

11. I am copying this letter to Steve Gooding and Nick Bisson (Department for Transport), David Middleton (Transport Scotland) and your members (via Hazel Walker). We will consider carefully any comments we receive on our proposals. I am also publishing this letter on our website.

Yours sincerely

A handwritten signature in blue ink, which appears to read 'Bill Emery', is positioned below the 'Yours sincerely' text.

Bill Emery