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Sir David Higgins  
Chief Executive  
Network Rail Infrastructure Limited  
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31 July 2013

*Dear David,*

**BREACH OF CONDITION 1 OF NETWORK RAIL'S NETWORK LICENCE WITH REGARD TO NETWORK RAIL'S OPERATIONAL PERFORMANCE**

Alan Price wrote to Network Rail (NR) on 28 June to advise that, following ORR's investigation, we were considering whether the company was in breach of its network licence for failing to meet regulatory performance targets in the Long Distance (LD) and London and South East (LSE) sectors in 2012-13. We received a response from NR on 10 July 2013 and we have taken these representations, those from Train Operating Companies and our Board's recent dialogue with your Chairman Richard Parry-Jones into account.

I am now writing to advise you that our Board has found that Network Rail breached condition 1 of its network licence in respect of failure to meet Public Performance Measure (PPM) targets for both the LD and LSE sectors in 2012-13.

In reaching these decisions, we have had regard to our duties under section 4 of the Railways Act 1993, in particular our duties to promote improvements in railway service performance and to protect the interests of users of railway services. We have also considered evidence including NR's quarterly progress reports against its recovery plans, punctuality and delay data and correspondence and meetings between our organisations. We have also taken into account the views of NR's customers and the conclusions of the Independent Reporter, following its assessment of delivery of the recovery plans for both the LD and LSE sectors.

Having reviewed the available evidence, we are satisfied that NR did not do everything reasonably practicable to achieve the 2012-13 PPM targets in either the LD or LSE sector. We are therefore satisfied that NR breached condition 1 of its licence in those sectors in 2012-13. In coming to that conclusion, we noted, in particular that:

- a. even with adjustments to reflect days of extreme weather, neither the LD nor LSE sectors would have achieved their targets for 2012-13;
- b. by NR's own admission, weather resilience is inadequate and you could have managed the impact of weather more effectively;
- c. NR's day to day maintenance of the network in 2012-13 fell below what we would expect of a best practice operator. There were, for example, instances where delays arising from infrastructure problems could have been avoided had preventative measures been taken. Furthermore in 2012-13 the volume of renewals delivered by NR was below its own plan in most asset areas. In our view it is very likely that this contributed to the performance problems.
- d. NR did not complete all the deliverables or deliver the delay minute savings and PPM benefits committed to for 2012-13 set out in the LD Recovery Plan (LDRP) or the LSE Plan (LSEP).
- e. the Independent Reporter found that benefits which had been predicted to be delivered by remote condition monitoring initiatives had been overstated in the LDRP and LSEP (though the issue was not as pronounced in the LSE sector as in the LD sector);
- f. the Independent Reporter also found that progress in setting up the Weather Resilience and Climate Change Steering Group had been slow;
- g. even though some good work had been undertaken, delays attributed directly to train planning remained high in 2012-13;
- h. there were problems relating to operational planning over the Christmas and New Year period in 2012; and
- i. NR could have had clearer vegetation strategies in place.

A more detailed assessment of the evidence we have used to reach our decision has already been provided to NR and will also be published with this letter on our website.

### **Consideration of penalties**

The Railways Act 1993 gives ORR a power to impose a financial penalty where we find a past or current licence breach. The Act also requires us to have a policy in relation to the setting of penalties and reasonable sums. That policy is part of our enforcement policy statement and, broadly, says that we will first consider whether a penalty is appropriate, then consider the starting point for a penalty and any aggravating and mitigating features before finally deciding the proposed sum.

ORR's primary objective is to ensure that NR takes all practicable measures to exit the current control period (CP4) as close to its regulatory targets as possible on behalf of passengers. Taking that into account, our Board has concluded that,



although NR breached its network licence in both sectors in 2012-13, we will not impose a penalty for either breach because:

**In respect of the Long Distance sector:**

- a. NR's acknowledgement of its failings and the firm commitment we have received from your Board to hold its executive to account in delivery of performance improvements;
- b. recently, NR has taken further steps and been able to establish funding of £50m to date for further performance improvement to improve LD and LSE performance in 2013-14;
- c. there is already an enforcement order and associated reasonable sum which remains in place for the end of the control period (March 2013-14). The purpose of that reasonable sum is to incentivise you to comply with your obligations for the rest of the control period. This penalty is potentially substantial and if current performance levels are sustained to the end of this control period will amount to £72 million (based on 2013-14 period 3 data);
- d. in quarter one of 2013-14 there were some signs of improving performance, though until improvements are sustained over a long period, it is difficult to draw any solid conclusions;
- e. we have noted the recent good progress you have made in reducing external delays, particularly from cable thefts;
- f. the slow but positive steps being made against the recommendations of the November 2012 West Coast South reliability programme report (known as 'the Gibb report') and the work in recent months of the West Coast South Joint Board; and
- g. the majority of operators believe that an additional penalty would potentially reduce resources available to NR to deliver their target performance for passengers in 2013-14; and that financial penalties for licence breaches remove funds from the industry. Most operators are supportive of action that requires NR to spend the money instead to deliver performance improvement, including where necessary further funding and effort to deliver performance improvement initiatives.

**In respect of the London and South East sector:**

- a. NR's acknowledgement of its failings and the firm commitment we have received from your Board to hold its executive to account for the delivery of performance improvements;

- b. recently, NR has taken further steps and been able to establish funding of £50m to date for further performance improvement to improve LD and LSE performance in 2013-14;
- c. there are positive signs in the sector, notably the leadership being given to performance which is beginning to bear fruit;
- d. in quarter one of 2013-14 there were some signs of improving performance, though until improvements are sustained over a long period, it is difficult to draw any solid conclusions;
- e. we have noted the recent good progress you have made in reducing external delays, particularly from cable thefts; and
- f. the majority of operators believe that a penalty would potentially reduce resources available to NR to deliver their target performance for passengers in 2013-14; and that financial penalties for licence breaches remove funds from the industry. Most operators are supportive of action that requires NR to spend the money instead to deliver performance improvement, including where necessary further funding and effort to deliver performance improvement initiatives.

### **Next steps**

Rail customers are entitled to expect what they have paid for – safe, punctual, and reliable train services. We will need to see significant improvement and momentum throughout the remainder of CP4 and going into CP5. The network's resilience and performance must improve. Noting there are only eight months left in this current control period, we would like to continue regular dialogue with the NR Board on these critical performance issues.

As part of this dialogue, we will expect to receive details of what additional funding and resourcing (beyond that which you have already committed to) NR is going to implement to recover its performance in these sectors between now and the end of the control period and to ensure it enters the next control period on a positive trajectory.

We will want to see evidence that NR is taking steps to remedy all of the issues we have identified as part of our investigation. These include:

- undertaking better weather mitigation and ensuring the resilience of the network in adverse and extreme weather;
- delivering day to day maintenance of the network consistent with that of a best practice operator;
- delivering planned volume of renewals by the end of the control period; and



- Demonstrating clear evidence that senior management and Board members are committed and focused on addressing the underlying issues and doing everything reasonably practicable to achieve the regulatory targets.

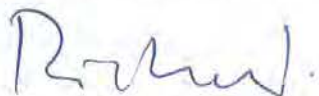
In order to give us assurance that Network Rail is providing the necessary level of focus on achieving its regulatory targets we require delivery of the remaining quarterly reports covering 2013-14. We expect that these reports should, from quarter 2, review all aspects impacting on performance in the quarter and the response you have made to these issues. The quarter 4 report should also include an end of year assessment. I expect our teams to agree the appropriate format and content in due course. We will also expect NR to provide assurance of its commitment to delivery through engagement with ORR including, at our September Board, presenting its additional investment proposals to address performance during 2013-14.

In summary ORR expects Network Rail to commit the necessary resources to comply with your obligation to do everything reasonably practicable to deliver your regulatory targets in 2013-14 for passengers, thereby reducing any penalties you pay. I remind you that the LD order we made in July 2012 provides for the reasonable sum to be reduced if NR can convince ORR that it did everything reasonably practicable to achieve the target. We will continue to closely monitor NR's performance in both the LD and LSE sectors and will not hesitate to raise issues and, where appropriate, take further regulatory action if we consider NR is not recovering performance.

In parallel with this, it is important that poor performance is not rewarded. As you know the objectives ORR set under Network Rail's licence require the company's Management Incentive Programme to incentivise proven long-term sustainable delivery of all of Network Rail's performance and output obligations. In line with this, your remuneration committee's guidelines for its assessment of payments under the Plan attach substantial weight to delivery of your PPM targets. In addition we are examining the size of adjustments that should be made to NR's measure of Financial Value Added in respect of missed performance targets, and this will also impact on the amounts which can be paid under the Management Incentive Plan.

I am copying this letter to Patrick McLoughlin, Secretary of State for Transport, Norman Baker MP and Philip Rutnam, Clare Moriarty and Nick Bisson at the DfT, Keith Brown SMP, David Middleton and Aidan Grisewood at Transport Scotland, Richard Parry-Jones, Robin Gisby and Paul Plummer at Network Rail and to the other parties on the attached list. A copy will also be placed on our website.

Yours sincerely

A handwritten signature in blue ink, appearing to read 'Richard Price', written in a cursive style.

**Richard Price**



**cc:**

Train Operating Company MDs  
Owner Group MDs  
Welsh Government  
Transport for London  
ATOC  
Passenger Focus  
London TravelWatch  
Rail Delivery Group  
NTF