

NOTICE IN ACCORDANCE WITH SECTION 57C OF THE RAILWAYS ACT 1993

10 August 2015

1. This is a notice, given in accordance with section 57C of the Railways Act 1993, (the Act), stating that the Office of Rail Regulation (ORR) proposes to impose a penalty of £2m on Network Rail Infrastructure Limited (Network Rail) for contraventions of condition 1 of its Network Licence.
2. The contraventions are in respect of Network Rail's delivery of its performance strategy targets in 2014-15 to the following operators:
 - a. Southern – PPM¹
 - b. Southern - CasL²
 - c. Govia Thameslink Railway (GTR) – CaSL

The acts and omissions which, in the opinion of ORR, constitute the contravention and justify the imposition of the penalty are more fully set out in paragraphs 9 to 21 of this notice.

3. In accordance with the Act, the penalty should be paid to the Secretary of State. ORR will specify the date by which the penalty must be paid in any final penalty notice given under Section 57C(6) of the Act.
4. Representations or objections with respect to the proposed penalty should be made by close of business on Tuesday 1 September 2015 by post to:

Alan Price
Director, Railway Planning and Performance
Office of Rail Regulation
One Kemble Street
London, WC2B 4AN
Or by email to: alan.price@orr.gsi.gov.uk

5. ORR will publish any representations or objections made in response to this consultation on its website and may quote from them. Anyone making representations or objections should indicate clearly if they wish all, or any part, of their submission to remain confidential to ORR. If such persons make a

¹ Public Performance Measure

² Cancellations and Significant Lateness

representation or objection in confidence, they should also send a statement, excluding the confidential information, which they are content for ORR to publish.

Relevant Legal Provisions

6. Under Section 57A of the Act, ORR may levy a penalty of such amount as is reasonable, if it is satisfied that the licence holder is contravening or has, within the last two years, contravened a licence condition. The amount may not exceed 10 per cent of the licence holder's turnover, defined in accordance with the Railways Act 1993 (Determination of Turnover) Order 2005 (SI 2005 No 2185.)
7. Section 57B(3) of the Act provides that, in deciding whether to impose a penalty, and in determining its amount, ORR must have regard to its statement of policy published at the time when the contravention occurred. For the purposes of this notice our Economic Enforcement Policy and Penalties Statement, published on 31 July 2012³, applies.
8. Under Section 57A(6) of the Act, ORR shall not impose a penalty if it is satisfied that the most appropriate way of proceeding is under the Competition Act 1998. In this case, ORR has no reason to believe that NR's failure to deliver performance regulated outputs could amount to an infringement of the Competition Act 1998.

The Contravention

9. The relevant condition of Network Rail's licence is condition 1. The relevant sections of condition 1 are set out in the attached annex.
10. ORR is satisfied that Network Rail has contravened condition 1 of its network licence by not achieving the purpose in condition 1.1 to the greatest extent reasonably practicable having regard to all the relevant circumstances, including the ability of the licence holder to finance its licensed activities.

³ [Economic Enforcement Policy and Penalties Statement](#) – the penalties statement starts on page 16

11. In particular, ORR is satisfied that Network Rail failed to deliver its performance strategy targets in 2014-15 to:
 - a. Southern – PPM
 - b. Southern - CaSL
 - c. GTR - CaSL
12. ORR's Periodic Review 2013 document set out a number of regulated outputs which NR is required to deliver in control period 5 (CP5). In England and Wales we agreed to take an input based approach for years 1 and 2, which includes intervening when delivery of performance strategy (PPM and CaSL) targets are outside of the agreed thresholds⁴.
13. At the end of 2014-15 the PPM Moving Annual Average⁵ (MAA) for Southern was 83.1%, 4.7pp worse than its Performance Strategy target, and a CaSL MAA of 4.8%, 1.9pp worse than its Performance Strategy target. GTR exited 2014-15 with a CaSL MAA of 4.3%, 1.3pp worse than its Performance Strategy target.⁶
14. ORR has identified that the most significant reason behind Network Rail's failure to deliver its performance strategy targets to Southern and GTR was the performance modelling, which resulted in a new timetable being implemented in December 2014-15 as part of the Thameslink programme works at London Bridge. In particular ORR has identified:
 - (a) Significant weaknesses in the process in terms of data quality: Network Rail has also stated that a number of the assumptions it made in the timetable modelling were incorrect. It identified that data used in the timetable modelling was flawed and that the data feeding the

⁴ Performance strategy targets: We will intervene in certain circumstances, for example if an operator's PPM Moving Annual Average (MAA) appears likely to fall more than two percentage points below its agreed PPM output or CaSL MAA appears likely to increase more than 0.2 percentage points above target.

⁵ The MAA reflects the proportion of trains on time or significantly late in the past 12 months. By taking an average of the last 13 periods we smooth out short term fluctuations or spikes and highlight longer terms trends in the data. Network Rail's performance is assessed against MAA targets.

⁶ ORR took into account any factors which affected Network Rail's performance which were in part, or completely, out of its control. Following such adjustment for traincrew and external issues, GTR was within the 2pp target threshold for PPM.

performance modelling was used before it had been fully validated and had '*multiple sub-optimal line assignments*'.

- (b) Over-optimism in its modelling and impact on performance: Network Rail's performance modelling had indicated a 1.06 percentage point (pp) impact on Southern's PPM and a 0.92pp impact on GTR's PPM in 2014-15 from the Thameslink programme. However, both operators believe the impact on PPM was underestimated and we found evidence that issues were exacerbated by lack of resilience in the timetable and significant reactionary delays.
- (c) Weaknesses in operator engagement: At a meeting on 13 May 2015, Network Rail stated that the timetable modelling was based on existing Timetable Planning Rules (TPRs) and that a number of assumptions fed into the timetable modelling were incorrect. Specifically that there were no allowances made for drivers and signallers to become familiar with the new layout, or Southern's Professional Driving Policy.
- (d) The results of the timetable modelling were made available in October 2014, just two months before implementation, which severely restricted the opportunity to make changes.
- (e) Risks to performance were underestimated in performance strategies: The significant and frequent changes to services from London Bridge suggest significant over-estimation of service reliability and incorrect timetable modelling outputs. GTR has additionally stated that they believe that the assumptions contained in the performance modelling were based on London Bridge operating 'normally' and that they did not see a clear link between the performance modelling and the performance trajectory contained in their 2014-15 Performance Strategy.
- (f) Impact on services: The performance modelling problems directly affected services to and from London Bridge, predominantly impacting on Southern services (GTR only run a limited service to and from London Bridge at present). However, the nature of service patterns

across the Sussex Area, where services to and from multiple London terminals are closely interwoven, means that delays to one service group quickly spread to others. Therefore, while Southern services to and from London Bridge have been directly impacted by the modelling, other Southern and GTR services have been significantly delayed through reactionary impact. The latest passenger satisfaction survey results reinforce this detrimental impact to services encountered by Southern and GTR services and its affected passengers.

(g) Underestimation and resulting detrimental impact of performance was likely the result of flawed assumptions and an approach which was construction led rather than operational.

15. ORR considers timetabling and modelling to be a key activity and, whether as part of a major project or renewal or maintenance, is part of Network Rail's core functions. Our findings show that Network Rail fell short of what is expected of a best practice operator.
16. The penalty which ORR proposes to impose on Network Rail relates to three past breaches of condition 1 as specified above. In assessing the penalty we have taken into account consequential impacts of these breaches.

Factors that justify the imposition of a penalty

17. ORR's penalties statement states that, in deciding whether to impose a penalty, we will take full account of the particular facts and circumstances of the contraventions, act in accordance with our Section 4 duties under the Act, and take into account the six Macrory principles and five principles of good regulation (proportionality, targeting, consistency, transparency and accountability).
18. ORR's primary objective in setting a penalty is to change the future behaviour of the licence holder and to incentivise it and others to comply with their obligations both specifically and in general.

19. Network Rail has already suffered reputational damage and additional costs as a result of the breaches and has taken effective action to mitigate and remedy specific failings.
20. ORR also notes that Network Rail's executive have acknowledged publically that it has not achieved its own performance targets and that bonuses under the Management Incentive Plan will not be awarded this year as a result. To some degree these factors will have already incentivised future compliance. However, a penalty could still provide an additional incentive to comply. We know from previous penalties that Network Rail is concerned about the effect penalties have on its reputation.
21. A penalty is appropriate in relation to Network Rail's delivery to Southern and GTR in 2014-15 because of the significant impact to performance and passengers during the year, most notably due to the issues associated with timetabling at London Bridge and its weaknesses in operator engagement. We also consider that a penalty would reinforce and incentivise Network Rail to ensure errors, and the operational impact of major projects, are managed more effectively in the future.

Factors that justify the amount of the penalty

22. In line with our penalties statement ORR has considered factors falling into three categories:
 - a. Proportionality;
 - b. Mitigating and aggravating features; and
 - c. Our financing duty

Proportionality

23. The penalty should be proportionate to the seriousness of the contravention, and this is our starting point in calculating the amount. In considering the seriousness looked at:

- a. The actual and potential harm caused to third parties including passengers and other railway users and to the public interest purpose of the obligation (including the effectiveness of the regulatory regime); and
 - b. The culpability of the licence holder including whether they have acted negligently, recklessly, knowingly or intentionally.
24. ORR sets out in its penalties statement, five levels of seriousness ranging from a technical or de minimis contravention to a very serious contravention, with corresponding financial ranges. To assist in determining the starting point for the penalty, we have assessed the level of harm, particularly the harm caused to passengers of Southern and GTR by Network Rail's failure to deliver its regulated targets in 2014-15, including the impact of the timetable modelling errors.
25. ORR estimated the value of passenger harm based on the total minutes of incremental delay caused to Southern and GTR passengers in 2014-15, as well as during the three periods affected by the Thameslink Programme at London Bridge. For each operator, the CaSL failures in excess of the threshold were allocated to one of four categories (e.g. full cancellations) in line with the distribution of all CaSL failures. An estimate of the delay incurred by passengers was calculated for each category, which in turn was multiplied by an estimate for the value of passenger time. For Southern, a similar process was undertaken for PPM failures in excess of the threshold, except those PPM failures allocated to CaSL categories were excluded from the calculation on the basis that they would be accounted for in the PPM calculation. These calculations enabled us estimate the value of the harm caused to Southern and GTR passengers by the excess CaSL and PPM failures.
26. The passenger harm analysis shows that Southern and GTR services and its passengers have been significantly impacted by Network Rail's non-delivery of performance, most notably as a result of the issues arising from the December 2014 timetable associated with the Thameslink programme at London Bridge.

27. Operational management and timetabling is a key process that underpins the running of the network and is essential for Network Rail and operators to plan their businesses and passengers to plan their journeys. There could be a significant impact if it goes wrong. In this case, we do not think that there was a risk of catastrophic failure as services continued to run after December 2014, although with revised timetabling, including a reduction in services and with operational delays. Passengers also had the option of alternative services because of the location and interconnecting service routes. Given the location of the works, the complexities of Thameslink programme and the level of services into London Bridge, it could potentially have been worse.
28. ORR does not think that Network Rail has benefited financially from the breach and we have no evidence that it cut corners to save money. We do not consider there is sufficient evidence to demonstrate that these breaches are of a 'systemic' nature. Therefore, overall, we consider Network Rail's behaviour was not knowing or intentional but was instead negligent and/or reckless.
29. The actual passenger harm to Southern and GTR was significant, but the train operators will have been compensated under Schedule 8 and the trains continued to run services for passengers, although some reductions to services were necessary. Passengers also had the benefit of choosing alternative service options (mainly London Overground) because of the location and interconnecting service routes.
30. However, ORR considers that NR bears some culpability in relation to its delivery of critical industry processes such as operational management; timetable modelling and planning and that there was a potential for greater harm.
31. ORR recognises from its analysis that whilst each operator was impacted, Southern services were impacted to a greater extent than GTR. Network Rail also missed the threshold we have set for both Southern's performance targets (PPM and CaSL) whilst our analysis has shown that GTR would only have been outside of the target threshold for CaSL.

32. However, the factors that caused Network Rail's non-delivery of these three separate performance targets in 2014-15 are very closely linked. In particular, a major contributory factor for both operators was the timetable issues associated with the Thameslink programme at London Bridge, which impacted on the performance and passengers of both, albeit to varying degrees in terms of passenger numbers.
33. Due to these commonalities it is appropriate to consider the three breaches together for the purposes of determining an overall or combined penalty.
34. Having considered the factors above, ORR has decided that this contravention falls into the moderately serious level in our penalties statement, which suggests a starting point in the range of £2-10m. Taking all relevant factors into account, we have decided that the significant actual harm caused to passengers, Southern and GTR, puts the starting point at the higher end of this range. ORR has therefore decided that the starting point should be £8m.
35. This compares with the starting point of £6m, also in the moderately serious range, for the Portsmouth resignalling penalty in 2007, where train services were restricted for a number of months affecting passengers in one location. Whilst this involved services in a specific geographical area the specific circumstances are different. Passengers were affected differently for Southern and GTR as they could use alternative services. However, the likely numbers affected in this case were significantly greater.

Mitigating and aggravating factors

36. ORR's penalties statement also states that we will adjust the penalty up or down from the starting point to take account of any relevant mitigating or aggravating factors.
37. ORR has identified the following mitigating factors that apply to Network Rail:
 - a. It has been proactive in identifying the problems and worked hard to ensure impact was managed and mitigated where possible, including making further timetable changes. It has also stated that during the

course of the year, it made several changes, all of which were aimed at improving the customer experience. This includes an increased number of visible frontline employees on the station concourse throughout the day, more customer information screens and improved Wi-Fi around the station. As a result, in recent months, there has been considerable improvement in the customer experience at London Bridge.

- b. It now has an understanding of, and focus upon, managing the impact of major enhancement programmes on operational performance and is working very closely with its customers to ensure that information is shared as early as possible.
- c. Its Internal Audit function has undertaken separate reviews of operational performance in recent months and Network Rail is committed to the implementation of the observations and recommendations that these reviews have made. These reviews have been shared with us, and we consider that they are detailed and identify appropriate steps for improvement. Network Rail is also examining how it can improve its performance modelling capability.
- d. It has publically admitted its failings for the unacceptable performance delivered to Southern and GTR services in 2014-15 and it will have had additional resource costs to manage and mitigate the issues. It has been carrying out additional work to review of the causes of poor performance and service impact which will have required additional time and resource (Jane Simpson's South East [route] Review). There will also be additional costs associated with increased station resource and WiFi and screen improvements to assist the customer experience at London Bridge.
- e. It has co-operated fully with our investigation, providing staff when required, and was open and forthcoming with its responses.

38. In relation to aggravating features, ORR considers there is evidence of relevant previous contraventions and a failure to learn from previous mistakes such as:
- a. Previous failures to fully consider the impact of its actions on its customers and rail users has been an element in previous breaches such as the Portsmouth signalling project in 2007.
 - b. Following the breach caused by the December 2014 possession overruns, Network Rail made a commitment to put passengers at the heart of its planning.
39. ORR has noted that Network Rail has not told us of any plans to make ex-gratia payments over and above its contractual commitments (including Schedule 8 payments) or to make any other types of reparations.
40. On balance ORR considers that the mitigating factors significantly outweigh the aggravating factors in this matter. Ultimately we consider that, having taken into account the factors above, any decision on a proportionate penalty is a matter of judgment and not arithmetic. Considering Network Rail's public admission to its failings and significant improvements, ORR considers that the penalty should be reduced to £2m.

Financing duty

41. ORR has a duty under Section 4 of the Act not to make it unduly difficult for a licence holder to finance those activities in relation to which ORR has functions. In the case of Network Rail, this duty might have a bearing on the level of penalty ORR might impose. In this case, ORR does not consider that the proposed penalty would make it unduly difficult for the licence holder to finance its activities. ORR also considers it consistent with its duties in general, in particular those under Sections 4(1)(a) (to protect the interests of users of railway services), 4(1)(c) (promoting efficiency and economy) and 4(1)(g) (enabling persons providing railway services to plan their businesses with a reasonable degree of assurance.)

Conclusion

42. Having regard to ORR's duties in Section 4 of the Act, the factors listed in ORR's penalties statement and for the reasons set out above, ORR has decided that it should propose a penalty of £2m in respect of Network Rail's contraventions of condition 1 as described in this notice.

Yours sincerely,



Richard Price
Chief Executive

Annex – Section 1.1 of Network Rail’s licence

Purpose

1.1 The purpose is to secure:

- (a) the operation and maintenance of the network;
- (b) the renewal of the network; and
- (c) the improvement, enhancement and development of the network,

in each case in accordance with best practice and in a timely, efficient and economical manner so as to satisfy the reasonable requirements of persons providing services relating to railways and funders, including potential providers or potential funders, in respect of:

- (i) the quality and capability of the network; and
- (ii) the facilitation of railway service performance in respect of services for the carriage of passengers and goods by railway operating on the network.