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7 July 2014

Dear Mark

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

We are agreed that punctuality is important to passengers. It is therefore vital that Network Rail (NR) delivers on the performance outputs it is funded to deliver and provides the level of service that rail users expect. To this end, ORR has been closely monitoring NR's delivery of these outputs across Control Period 4 (CP4).

ORR wrote to NR on 25 March 2014 to confirm it intended to investigate NR's performance against its regulatory performance targets in 2013-14, the last year of CP4. The investigation covered all sectors and Scotland. At the end of 2013-14, no sector, or Scotland achieved its Public Performance Measure (PPM) Moving Annual Average (MAA) target. In addition the Long Distance and London and South East sectors failed to achieve their targets for Cancellations and Significant Lateness (CaSL) MAA.

This letter sets out the decisions made by the ORR Board on what regulatory action should be taken following the investigation. In reaching these decisions, the ORR Board had regard to its duties under section 4 of the Railways Act 1993. We also applied our competition primacy duty which obliges ORR to consider whether it would be more appropriate to proceed under the Competition Act 1998. In this regard, we are satisfied that NR's failure to deliver regulated performance outputs could not amount to an infringement of the Competition Act 1998 in any sector or Scotland in 2013-14. ORR has considered evidence, including NR's quarterly progress reports against its recovery plans, punctuality and delay data and correspondence and meetings between our organisations. This includes your public acceptance of the part NR has played in the under-delivery of the regulatory performance outputs in CP4. The ORR has also taken into account the views of NR's customers and the conclusions of the Independent Reporter (IR).

As part of its investigations ORR identified factors which were outside NR's control and meant that it was not reasonably practicable to deliver the performance targets in full in 2013-14. As a consequence ORR determined a number of adjustments to be taken into account in its assessment:

- the impact in 2013-14 of extreme weather incidents - during 2013-14 temperatures remained relatively mild throughout, but the year was characterised by periods of strong winds such as St Jude's storm on 28th October, heavy rain and associated flooding and prolonged wet and stormy conditions from 23rd December until mid-February. As is the nature of such events, these storms affected regions differently, but their effects were most pronounced in the South and West of England;
- train operating company (TOC) on self delays<sup>1</sup> (these include delays caused to an operator by lack of its traincrew or failures of its rolling stock); and
- external delays (such as delays caused by cable theft and suicides).

### **Regional sector**

The Regional sector achieved its CaSL (MAA) target in 2013-14. However the PPM (MAA) was 1.0 percentage point (pp) below target.

ORR's investigation and analysis showed that, taking into account the areas of adjustment identified above and in this case, particularly TOC on self delays and cancellations, NR would have achieved its PPM regulated target for 2013-14. On this basis, ORR's Board determined that no regulatory action was necessary in this sector.

### **Scotland**

In Scotland the regulatory target (PPM) was 92%, with the outturn at the end of P13 2013-14, 91.4%.

ORR's investigation found that performance following the December 2012 timetable change was disappointing. The timetable had a negative effect on performance, and, along with other issues such as on-going Temporary Speed Restrictions, meant that NR could not deliver the level of performance required to achieve its end of year targets.

However, NR's response to these issues was commendable. It worked proactively with First ScotRail to develop and implement a Further Improvement Plan. It addressed the issues generated by the December 2012 timetable change and it delivered an effective focus on non-track assets, weather resilience and externals. In the last three periods of 2013-14, it exceeded its PPM target but issues earlier in the year meant that the annual target was missed.

Overall, ORR's Board concluded that in 2013-14, NR did everything reasonably practicable to achieve its regulated performance outputs in Scotland. It failed to achieve its targets primarily as a result of the impact of the errors that occurred in the December 2012 timetable change. NR has learnt lessons from this incident to build on performance in the future.

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<sup>1</sup> LSE and Regional sectors only. In the LD sector no adjustment was necessary because operators performed better than JPIP (Joint Performance Improvement Plans) targets.

### **Long Distance (LD) sector**

In July 2012, in line with ORR's enforcement policy, we made a final order requiring NR to take all necessary steps to ensure it delivered its performance (PPM) targets for 2013-14 to the greatest extent reasonably practicable. This involved delivering the plan NR had agreed with operators and adjusting it to meet emerging circumstances. The order provided that if NR didn't meet those targets, it should pay a reasonable sum. This reasonable sum could be adjusted to the extent that ORR considered it was not reasonably practicable for NR to achieve its PPM targets having regard to all relevant circumstances. On that basis we took no further action for 2012-13.

The LD sector operated around 548,000 trains in 2013-14. At the end of the year the sector recorded a variance to target of PPM of 5.1pp. This means that 28,000 more trains were late than would have been the case had NR achieved its PPM target.

Having reviewed all the evidence, ORR's Board is satisfied that NR did not do everything reasonably practicable to achieve the 2013-14 PPM target in the LD sector. In coming to that conclusion the Board noted that, even with adjustments as set out in this letter, the LD sector would not have achieved its targets in 2013-14.

### **Final reasonable sum amount**

The final LD enforcement order stated that the reasonable sum should be calculated on the basis of a monetary penalty of £1.5m for each tenth of a percentage point by which NR failed to achieve the CP4 PPM output and reduced to the extent to which it was not reasonably practicable to achieve the target having regard to all relevant circumstances. The gross fine for the 5.1% shortfall therefore amounts to £76.5m. However applying this methodology, the ORR Board has determined that the final sum payable is **£53.1million** (calculated as set out in annex 1).

NR is required under the order to pay this sum to the Secretary of State for Transport within a month of the issue of this decision letter.

ORR expects NR to treat the imposition of this reasonable sum as a very clear signal of the importance of performance delivery for passengers and that ORR expects NR management to address the issues raised by its investigation.

### **London and South East (LSE) sector**

The LSE sector actual PPM performance was 3.4pp below target. The CaSL MAA performance was 1.1pp worse than target.

The Board took into consideration the adjustments set out earlier in this letter. Even having done so, ORR believes the LSE sector still missed the 2013-14 regulated PPM target by 1.6pp.

ORR's investigation found evidence that NR had not done everything reasonably practicable in delivering its PPM regulated targets in 2013-14.

Alan Price wrote to Robin Gisby on 6 June to set out ORR's investigation findings and to ask for any representations. ORR received NR's response on 13 June 2014 which included an offer to establish a new resilience fund for routes in the LSE sector. This fund would deliver better outcomes for users by focusing on the resilience of routes coming in to London and would be directed at improvements not otherwise funded within the CP5 settlement which would make the infrastructure more resilient to future adverse weather.

The ORR Board concluded that NR had not done everything reasonably practicable to achieve its regulatory targets in this sector and therefore had been in breach of Condition 1 of its network licence in relation to the PPM regulated targets for the LSE sector in 2013-14.

### **Consideration of penalties**

Having identified a breach, the Board then had to consider whether a penalty was appropriate. ORR's policy is clear that our primary objective in setting a penalty is to change the future behaviour of an offender so as to deter non-compliance with its obligations (both specifically and in general).

The Board took account of all the evidence, our policy, and our section 4 duties and determined that the imposition of a penalty would not be appropriate in respect of the LSE sector. In particular, the Board felt that a penalty was not necessary to change NR's behaviour in order to deter non-compliance in light of the following factors:

- NR acknowledged publically its responsibility for not achieving performance targets in CP4;
- NR has agreed a CP5 performance plan and delivery plans which should ensure that it takes all necessary steps to ensure performance recovers;
- NR has committed to provide an LSE resilience fund (as set out in NR's response of 13 June 2014 (Annex 2) for the benefit of LSE passengers.

In relation to the third factor listed above, we will hold NR to account in delivery of an LSE resilience fund plan of £25 million in order to deliver additional resilience in the routes in this sector.



Our decision not to impose a penalty for the LSE breach is on the basis that:

- NR provides a public commitment to the establishment of this fund which will be added to the delivery plan in September;
- the fund amount is confirmed as £25 million in agreement with ourselves, NR and DfT by the end of July 2014;
- NR works with ORR, the Department for Transport (DfT), Industry and passenger groups in developing its fund plan between now and the final plan, to be agreed with ORR no later than 31 December 2014, based primarily on the Climate Change Resilience Plans described in the Final Determination and due by September 2014; and
- the agreed fund and plan are monitored through quarterly enhancement delivery plan reviews and enforced, if necessary, by ORR under our existing delivery plan regulatory framework in CP5.

In light of the above, ORR believes that the resilience fund will provide long term benefit and improvements for passengers and NR customers in the routes within the LSE sector and enhance the existing commitments of delivery of asset performance in CP5.

## **Freight**

In December 2011 the Board found NR in breach of condition 1 of its network licence and placed a freight performance order on the company on 19 January 2012 (later amended on 23 April 2012). The order required NR to establish a recovery board of its freight customers with a remit to agree reasonably practicable steps NR should take to remedy the licence breach. ORR was pleased with the progress of this board as a remedy and there was an improvement in performance. We therefore confirmed that NR had complied with the order in September 2012.

We have continued to keep the sector under review and expected and encouraged freight operators to alert us to any serious delivery concerns. We have received no formal complaints from the industry regarding delivery of this CP4 output.

However, NR did not achieve its target for freight performance at the end of CP4, recording 3.70 delay minutes/100km. This is a variance to target of 25.9%., Separately to the passenger performance investigation, we wrote to the Freight Joint Board (FJB) and received a comprehensive response in March 2014, in which the Board's Chair stated that he did not consider that we should investigate freight performance.

The FJB stated that the below target freight performance had not caused serious customer issues. Amongst other points, it was acknowledged that the picture regarding freight is complex and the FJB pointed out that performance as measured



by the new Freight Delivery Metric put in place for CP5 appears more positive. This measure is more relevant to the freight community as it measures arrival time at destination, which is more important than delay minutes accumulated en-route.

In addition, we understand that performance in this sector was affected by adverse weather and the residual impact of Hatfield Colliery landslip which closed a main freight artery for almost five months in 2012-13 and 2013-14.

In light of all the circumstances, the ORR Board decided not to take any further regulatory action in relation to NR's failure to meet its regulated CP4 output for Freight.

### **CP5**

We will take a more forward looking approach to monitoring in CP5 and will monitor very closely delivery of NR's CP5 performance plan. ORR will initiate an investigation which could result in enforcement action should there be evidence of NR not doing everything reasonably practicable to deliver its performance plan or its bilateral performance agreements with operators in the first years of CP5 or its regulated performance outputs thereafter.

A more detailed assessment of the evidence ORR has used to reach these decisions has already been provided to NR and will also be published with this letter on ORR's website.

I am copying this letter to Patrick McLoughlin MP, Secretary of State for Transport, Stephen Hammond MP, Parliamentary Under-Secretary of State for Transport and Philip Rutnam, Clare Moriarty and Nick Bisson, DfT, Keith Brown MSP, minister for transport and veterans, David Middleton and Aidan Grisewood at Transport Scotland, Edwina Hart Minister for Business, Enterprise, Technology and Science in the Welsh Government, Richard Parry-Jones, Robin Gisby and Paul Plummer at Network Rail and to the other parties on the attached list.

Yours sincerely

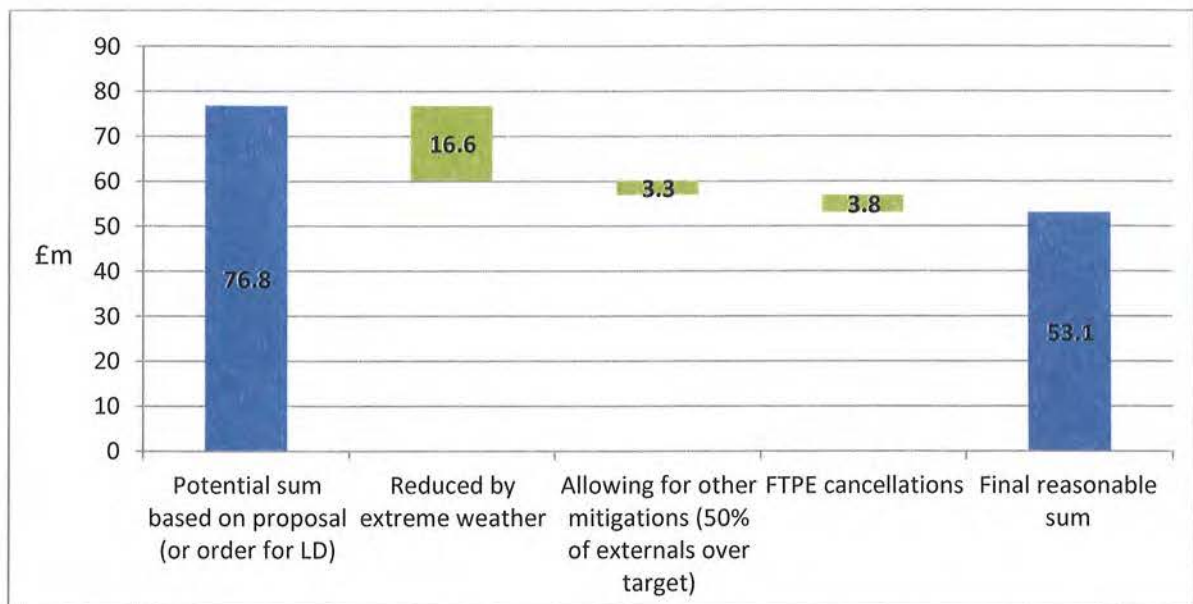
A handwritten signature in blue ink that reads 'Richard Price'.

**Richard Price**

**cc:**

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

### Annex 1: Final LD reasonable sum calculation





Annex 2 – Network Rail letter dated 13 June 2014



Alan Price  
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Robin Gisby  
Managing Director, Network  
Operations

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N1 9AG

13 June 2014

Dear *Alan*

**RE: Possible breach of condition 1 of Network Rail's network licence with regard to its operational performance in the London and South East sector**

I am writing to you in response to your letter of 6 June. First let me thank you for acknowledging the considerable efforts of Network Rail front line staff to maintain the train service despite the impact of extreme weather and other factors outside our control. However, I note you have concluded that after taking account of these external factors, the LSE sector still missed its 2013/14 target by over one percentage point.

We have previously acknowledged our responsibility for missed performance outputs in Control Period 4. Moreover Mark Carne acknowledged this week at the Transport Select Committee that the company had failed to do a good enough job in improving operational performance since 2009 citing specifically the impact of congestion and unsatisfactory asset reliability (while also managing record growth). On top of this, passengers have faced disruption from extreme weather conditions which have affected the nation as a whole.

Our focus now is on looking forwards to deliver our plans - we share your desire to draw a line under CP4. In our view, our plans for CP5 are based on much more robust information and analysis than ever before and they include a series of very useful milestones by which we will be able to measure progress across the industry.

A consequence of the past performance is that we start CP5 significantly behind the regulatory train performance targets set out in the final determination. Despite this, our commitment is to move as quickly as possible towards these targets and then to drive continuous improvement in this and all other aspects of business performance.





In making this commitment we clearly recognise the criticality of our role in managing the impact of extreme weather conditions and other external factors. The climate change resilience plans which are being developed for each route will help to make sure we are prioritising existing funding as well as informing the debate about whether funding should be provided for investment in further climate change resilience.

We also remain committed to continued growth in rail services. However, I am sure everyone recognises that actual performance will continue to be influenced by further increases in passengers and trains to some extent and that in some cases additional growth can result in further performance challenges. We are now much more able to articulate these trade-offs between capacity, performance, cost and revenue.

We are very conscious that success depends upon continued and close collaboration locally between our routes and train operators as well as nationally. The franchising programme presents significant challenges as well as opportunities in this context and your support for improved alignment between regulation and franchising is very welcome. We look forward to seeing some real progress in this important area.

You acknowledge that we have already provided a great deal of data to the ORR. Given the above, we do not propose to make further representations on whether there has been a licence breach. If you conclude that there has been such a breach we understand that you will need to consider whether or not any penalty is appropriate.

It is our view that a penalty for LSE performance would not further incentivise performance and would not result in any benefit to passengers. For the same reasons we would support proposals for any Long Distance penalty to be used for improvements in railway services.

Your letter asks us to provide details of the actions Network Rail proposes to take by way of mitigation or reparation to help safeguard future performance and resilience of the railway.

With regard to mitigation, the company has obviously incurred substantial additional costs to deal with the performance challenges in London and the South East on top of the significant levels of compensation already provided to operators. Managing improvements in performance is core to our ongoing responsibilities so it is not possible to clearly separate these incremental costs. It is possible, however, to



identify specific areas for investment which we have made to improve climate change resilience which are clearly on top of what might reasonably have been envisaged at the start of CP4. Examples include the further improvements we made for winter, protection against lightning strikes, enhanced cooling of equipment rooms, raising signalling above groundwater levels, additional drainage works and many others. Much of this was funded from the additional funds we allocated to the LSE Recovery Plan. In addition of course we have made significant improvements to the management of the service during extreme weather when we necessarily prioritise capacity above performance.

With regard to reparations, we are very mindful that any additional commitment which Network Rail makes has implications for taxpayers as well as passengers. The company must therefore consider such commitments with reference to our ultimate purpose which is to deliver outstanding value for both of these groups. As noted above, however, we do not consider that a penalty would improve matters for either group.

We therefore propose to establish a fund specifically for further investment in resilience of the LSE network over the next few years. Subject to the discussion at your Board, we propose to discuss the size of the fund with you and DfT and agree this in the next few weeks. Our current view is that this amount should be in the region of £20-25m, spread across the routes coming into the London conurbations, focussed on those service groups that affect the LSE performance and directed improvements not otherwise funded within the CP5 settlement.

The use of this fund would be informed by our ongoing work on climate change resilience. However we have done some initial analysis of the potential areas for investment and we would agree a programme with you by the end of December 2014. Typical investments might be as follows:

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- enhancing drainage in flood areas or on diversionary routes for other vulnerable sections of the line where this may not be captured by our current policy and prioritisation
  - further enhancements to earthworks in flood areas
  - raising track in an area that is at a high risk of flooding
  - raising track side cabling in flood areas and relocating equipment such as Pangdean Sub HV Switchgear
  - developing traction cables specifically to survive extended periods under flood water without deterioration
  - an enhanced approach to tree management for trees outside our boundary



- further flood alleviation in areas that have recently flooded
- enhanced weather forecasting accuracy and decision support tools that enable the tailoring of operational restrictions to match local conditions

Based on the penalty proposed for Long Distance performance of £1.5m per 0.1 percentage point of PPM a residual gap of one percent would imply a penalty of at least £15m but we recognise that there are more passengers involved in the LSE sector and that this could imply a significantly higher value. As a sense-check, we note that ORR's guidance on penalties would imply a range of £2-10m for a moderately serious breach and £10-25m for a serious breach.

In this context we consider that our proposal of a fund as reparation on top of the mitigations already committed to be a proportionate and appropriate response to the performance issues faced by passengers in London and South East.

In parallel we have been discussing with ORR the way in which our financial performance and RAB in CP4 should be adjusted for missed train performance outputs. This is particularly important to us in the context of the need for clarity about how any equivalent adjustments would be made in CP5. As you know, we consider it is important that these adjustments take account of the impact of unusual weather or other external events in the same way as adjustments would be made in the context of licence breach or penalties. Similarly, we believe it is important that any penalties or reparations are taken into account when considering the need for any further adjustments to financial performance. Taken together, any adjustments or penalties for missed outputs should help drive continuous improvement and not perverse outcomes. We are equally clear, however, that these parallel discussions will not be concluded until after the conclusion of the issues raised in your letter.

~~I understand that you will be discussing the questions around licence breach, penalties and reparations at your Board on 24 June. Please let us know if you would like to discuss further in advance of your meeting.~~

Yours sincerely

**Robin Gisby**  
Managing Director, Network Operations