

Anna Walker
Chair

Telephone 020 7282 3696
Fax 020 7282 2043
E-mail anna.walker@orr.gsi.gov.uk



OFFICE OF RAIL REGULATION

8 May 2013

Richard Parry-Jones
Chairman
Network Rail Infrastructure Limited
Kings Place
90 York Way
London N1 9AG

Dear Richard

Network Rail's performance in 2012-13: year 4 of CP4

I am writing to set out the ORR Board's view of Network Rail's performance in 2012-13, as input to your Remuneration Committee's consideration of Network Rail's performance.

I have set out our detailed view under each area in the attached Annex A, looking first at any positives and then at any negatives. Annex B contains more detail on the evidence we have for our views.

There have been many areas of success during this year. Growth continues within the industry and during the year we can see that:

- the number of passenger journeys increased by 4%;
- the amount of freight moved increased by around 3%;
- national passenger satisfaction scores are at their highest level, currently standing around 85%; and
- train operators' overall satisfaction with Network Rail over the previous year is up by 25%. This is a major improvement.

In addition, we recognise that your joint work with First ScotRail led to a strong improvement in train performance in Scotland with the public performance measure reaching 93%, 2.3 percentage points up over the year and 1.1 percentage points up over the target. We congratulate all involved in this work and hope the lessons learnt can be applied to other routes.

Network Rail coped very well with the challenges of the 2012 London Olympics and the recent European Rail Study evidences the improvement and progress that has been made over the last two control periods stating that the UK network is the most improved in Europe.

Further progress includes signs of positive change in your safety culture where we welcomed your recent health and safety strategy as a positive step.

You are on course overall to deliver the substantial programme of enhancements in this control period including many which directly improve passengers' experience and also contribute to the expansion of the Strategic Freight Network.



You have done better than the targeted reduction in disruption from planned engineering works – achieving 12% in passenger services and 21% in freight.

However, our assessment of performance in 2012-13 shows that you have been unable to deliver consistently and there remain significant and persistent issues where Network Rail's performance falls short of what it was funded to deliver and therefore what we expected as the regulator. It is of concern, that this underperformance particularly affects the long distance and London and the South East routes.

While performance in Scotland was good, you missed all of your targets on punctuality and public performance measures for passenger services in England & Wales. We have had to specify a sliding-scale payment should you miss your commitments to the long distance passenger sector at the end of March 2014 and we are investigating whether you did everything reasonably practicable to deliver your targets in the London & South East sector last year. We acknowledge the adverse effects that poor weather brought and you will need to prepare for more frequent occurrences as a consequence of climate change.

Freight delays have improved, but you missed the regulatory target by 19%.

You will see from Annex A that we are concerned about the low levels of proactive maintenance and the growing backlog of work which are contributing to poor track quality in some areas. Further, we note that delay per incident is increasing despite fewer asset failure incidents and we are looking into this.

We also note that your asset stewardship indicator is behind your own target; asset data reliability is not as good as it should be; and we are examining closely the financial outperformance which you have reported.

Conclusion

As outlined above, Network Rail has achieved a lot in 2012-13 and has had some real successes. We welcome your successes and look forward to seeing sustained progress for the benefit of passengers and your customers. However, while train punctuality (PPM) overall is improving some aspects of both PPM and asset management fell well short of the improvements set out in the CP4 regulatory targets and we had expected Network Rail to be capable of achieving. We hope Network Rail will now redouble its efforts to achieve these agreed targets.

As you know, underperformance in CP4 will not result in adjusting downwards targets for CP5 – and we will be clear on this when we publish the draft determination on 12 June this year.

I am copying this letter to Patrick McLoughlin, Simon Burns and Norman Baker at the Department for Transport and to Keith Brown at the Scottish Government. I am also copying it to Philip Rutman, and Clare Moriarty (Department for Transport), David Middleton and Aidan Grisewood (Transport Scotland) and your members. It will be published on our website.

A handwritten signature in black ink, appearing to read 'Anna Walker', written in a cursive style.

Anna Walker

ANNEX A

Safety

1. Your continuing work to manage risk at level crossings is having a positive effect on risk, as measured by your level crossings risk indicator model. We note the package of measures in your level crossing programme, including level crossing closures, introducing new level crossing manager posts, improved training and the continued trial and roll-out of Automatic Open Crossings with flashing lights and barriers. We expect to see further work in this area to achieve your target of a 25% risk reduction by the end of CP4.
2. There has been a significant increase in train accident precursor scores in RSSB's Precursor Indicator Model. This is mainly due to the increase in the overall number and severity of structural failures, and also deterioration in track quality. There have been a number of occasions when trains have run into failed earthworks, including three in Scotland in June and July; nobody was seriously hurt but the potential for harm is clear. We served an improvement notice in Scotland in August, requiring you to assess the risks associated with failed earthworks in adverse weather and put in place appropriate control measures. Scotland Route devised an Adverse Weather Procedure; we will continue to monitor how the risk assessment framework and controls are rolled out to other Routes. We see the adverse weather procedures as an interim measure only; you should identify and manage the cause of earthworks failures to reduce the risks and the potential for train accidents *so far as is reasonably practicable*.
3. Our inspection work has found continuing resource issues in maintenance depots, with a potential impact on safety. We have found a reliance on inspection and reactive maintenance to maintain track safety, with little resource available for planned proactive maintenance work. This approach does not address effectively the underlying precursors to train accidents, such as increasing numbers of track faults. Although the numbers remain small, there has been an increase in the number of broken rails and an increase in the hazard rating associated with broken rails. Sussex is the worst performing route followed by LNE, Wessex, East Midlands and Anglia. We will continue to monitor your actions to manage the risks, but recognise that long-term improvement will only come by renewing the track.
4. We note that delay per incident is increasing despite fewer asset failure incidents and we have commissioned the independent reporter to look at this. Your work to develop asset information for the drainage and vegetation assets is taking longer than you planned; this has obvious effects on your ability to estimate workloads and robustly inspect and maintain these assets.
5. For last year the workforce fatalities and weighted injuries (FWI) was higher than your target (at 0.149 compared to 0.092) and higher than last year when you also missed your target. We think the introduction of close call reporting is a good idea and it should provide you with valuable information to better target workforce safety issues. We appreciate that you have some longer term programs in place to address behavioural and safety cultural issues, but you should ensure that suitable mitigation is in place in the

meantime. Our inspection work this year found that at a senior level, safety performance is seen as important but this is not always reflected by actions at supervisory-level.

6. Occupational health remains an area where you still have a lot of work to do, some progress has been made, but we continue to find examples of poor risk assessments, poor record keeping and control systems (where they had been identified) not being applied or monitored. We note that you have recently reinforced your management resource in this area and we expect you to make significant improvements next year, including the development of a comprehensive occupational health strategy.

7. Audit arrangements are improving, helped by the newly set up audit function, and consideration is being given to a risk-based approach as well as compliance with Network Rail standards, which is positive. Proactive monitoring is still heavily reliant on measuring compliance with standards rather than assessing risk and this area requires improvement.

8. We welcome your health and safety strategy set out in November; another positive step. We note the outcome, output and activity objectives and the early actions for completion by the end of CP4. If the strategy is implemented as intended it will ensure continuous improvement in the health and safety of passengers, the workforce and the public. In the next few months, we want to understand your overarching process for monitoring, auditing and reviewing health and safety performance across your business, as you assess your progress towards achieving your aim of no fatalities or major injuries and a 50% reduction in train accident risk by 2019.

9. In the last year we served eight enforcement notices, which is an improvement on the previous year, and you were prosecuted and convicted three times for breaches of health and safety legislation. These offences (largely) date from before the current Board terms of office. The fines totalled £4.5m and show that you need to keep focused on managing key risks to passengers and railway workers.

Train service performance

Passenger trains

10. The most recent Passenger Focus survey showed national satisfaction overall increasing to a high of 85%. We are pleased to see this, especially in relation to the provision of information during journeys and in the perception of how well the industry deals with delays.

11. Scotland has had an exceptional year, despite experiencing some extreme weather and we recognise the strong performance gains there, with First ScotRail's public performance measure (PPM) rising 2.3 percentage points over the year to finish at 93%; 1.1 percentage points better than the 2012-13 target profile. This reflects the benefits of your joint work with First ScotRail, including a re-timetabling exercise to address many train path conflicts, and robust seasonal preparation. There are indications that the Scotland route is also benefitting from the early implementation of remote condition monitoring equipment, allowing an improved approach to the maintenance of critical assets. We congratulate everyone involved in these achievements and look forward to see the lessons learnt rolled out to other routes.

12. However, Network Rail is failing to achieve its commitments in England and Wales. The PPM in each of the three sectors (long distance, London & South East and regional) has deteriorated over the year and each is worse than its end-of-year target. This is not acceptable and needs to be addressed by you as a matter of urgency in the final 12 months of CP4. While we acknowledge the impact that poor weather has had on the industry, we are more concerned with issues that are in your own control such as operational planning errors, poor condition of track assets and the robustness of earthworks and structures. We also expect you to prepare for the possibility that adverse weather events may become more frequent as a consequence of climate change.

13. There is now a real likelihood that Network Rail will not hit the England and Wales sectoral targets for PPM and Cancellations and Significant Lateness (CaSL) that you were funded to deliver at the end of CP4. The positions at the end of this year were:

- *Long distance:*

PPM - At 87%, the sector finished well below the 2012-13 target of 91.5%. Our July 2012 order specified that non-delivery of the long distance CP4 PPM target will result in a financial penalty (although it may be reduced to the extent we think that achieving the target was not reasonably practicable). It will also bring reputational damage for the entire industry. We will consider our position in relation to 2012-13 performance once we have reviewed your update on your Q4 long distance recovery plan.

CaSL - The regulatory target of 4% was missed, ending at 4.9%, and is worse than last year.

- *Regional sector:*

PPM - The 2012-13 regulatory target of 91.9% was missed. This sector started the year well but deteriorated following some months of good performance and finished at 91.1%. You have recently provided us with a plan to recover performance and we are considering it.

CaSL - The regulatory target of 2.3% was missed, finishing at 2.5%, and is worse than last year.

- *London & South East:*

PPM - We recognise the important contribution of the additional resources you have brought to bear in support of your plan. However, your recovery plan to address PPM underperformance has not yet produced the expected results and the 2012-13 regulatory target of 92.7% was missed, finishing at 91%. You expect this sector to finish the control period below target. We will investigate your 2012-13 performance in this sector in May and, once completed, tell you what we intend to do.

CaSL - The regulatory target of 2% was missed and at 2.5% is marginally worse than last year.

14. You need to be clear that failing to achieve your targets at the end of this control period will have implications for the next: we will not adjust downwards targets for CP5 because of shortfall in CP4.

15. The regulatory limit of 5.2 million minutes of delay caused by Network Rail to passenger services in England and Wales was exceeded by 1.9 million minutes, and the 386,000 delay minutes target for Scotland was exceeded by 7,600. We have already said that we are focusing on the PPM and CaSL targets, which are closest to your customers' interests, rather than delay minute targets, so we have not taken any action in this area.

Freight

16. Freight delays missed the regulatory target by 19%. However, we are encouraged that performance in this sector is significantly better than last year, due in no small part to the work of the Recovery Board which has been viewed across the industry as a major success. We would welcome your support in bringing pressure to bear on freight operators to ensure that not only are Network Rail delays on freight services reduced, but the impact of freight failures/late running on passenger services are reduced also.

Disruption to passengers and freight from planned engineering work

17. Levels of disruption to passengers and freight trains from planned engineering work are better than target with measures beating our regulatory targets by some 12% and 21% respectively. The number of rail replacement bus services has reduced for the third year in succession and disruption to freight services has again fallen overall. We welcome this. Although there has been some increase in the amount of passenger disruption compared to a year ago this is still a good achievement considering that the enhancement programme has increased also in the year, and we are looking for this progress to be sustained.

Asset management

18. We recognise that you have made some improvements in your asset management capability since the publication of the Initial Industry Plan, which is borne out by the latest assessment of the *Asset Management Excellence Model*, the draft of which we have received recently. There has been real progress in the area of whole-life cost justification. Whilst we note that you have closed the gap to the agreed trajectory, four of the six categories are still behind target based on the latest assessment. Much of the good work has been done as part of the central team and we expect this to be embedded in the routes. We strongly support the move to route asset management teams who are co-located with the maintenance and operational route teams.

19. Your 'ORBIS' project also progresses. It is a key enabler to unlocking efficiency savings through programmes such as LADS (the linear asset decision support tool) and will provide a step change improvement in maintenance and renewals activities using a systematic approach. Improving asset knowledge is a fundamental step to better asset management decisions and we are pleased that you are continuing to make progress in this area. But the pace of improvement needs to be faster in asset areas other than track, to unlock the key benefits and so we are considering setting regulated outputs in this area in CP5.

20. Your plan to transform your management of structures and earthworks assets is being delivered largely as forecast. We require evidence from you that the transformation

is being embedded effectively in the routes as the programme progresses to ensure that civil assets are delivered and managed safely, efficiently and sustainably. This is a long-term programme which will remain on our regulatory escalator until we have evidence that no issues remain.

21. Set against these generally positive developments, there remain a number of significant issues. These have already been published in our *Network Rail Monitor*:

- Progress in other key asset management areas is behind the agreed improvement trajectory and we require robust reassurance from you regarding opex planning, competence and network resilience;
- Data reliability is not as good as it should be; there is variability in your data quality on civil assets, electrification assets and points. You need reliable data to both run and plan network operations and we need to understand the robustness of the asset information which underpins your strategic business plan, particularly as you are proposing a substantial increase in civils structures funding in CP5. Structures examinations remains an issue and your progress catching up bridge strength assessments, although improved, is still too slow;
- Your July 2012 annual return reported a declining trend in track quality across the network. Your own Asset Stewardship Indicator (ASI) is currently behind target in the latest information you have sent us. Our inspection and investigation work has raised issues about track maintenance on the Sussex route, where the highest number of faults is located and we are assessing your plans to address these. We have asked you to address as a matter of urgency the number of rail breaks in the London North Eastern route which were found to be at a four-year high. Additionally the number of significant OLE asset failures that have disrupted the network in recent months is an issue which you must address.

22. Further, as detailed in your own Financial Report for period 13 of 2012-13, plain line track renewal volumes are under-delivered by 18%, earthworks by 21%, underbridges by 24% and some electrification asset areas by up to 94%. Given the recent high profile OLE failures, a 59% under-delivery in wire run renewals is particularly disappointing. Despite these shortfalls in volumes, renewals expenditure is close to budget, implying that works have cost considerably more than you anticipated (potentially by about 20%). This level of under-delivery will clearly affect the deliverability of both CP4 outputs and those in future years.

23. Establishing and embedding good asset management practice is fundamental to a large infrastructure organisation such as Network Rail. Our route visits have revealed varying degrees of capability across the network. We need to be confident that strong governance and assurance processes are in place to achieve compliance with your own asset policies to deliver a reliable and efficient service for the customers across the network. Until your plans to improve asset management are delivered substantially, reliability for train operators will continue to be an issue and asset-related safety issues will continue to arise.

Financial performance

24. Network Rail's latest Finance Report shows forecast cumulative operation, maintenance and renewal (OMR) savings of 15.7% in 2012-13. This is 2.9 percentage points worse than the trajectory to deliver our PR08 efficiency improvement.

25. We are looking at the savings you have reported to us to identify whether there is evidence to support them, or whether some of these savings have been achieved through failing to deliver sustainable volumes of work or required outputs. If you have incurred lower costs while not delivering the required outputs, we need to consider how much of the cost reduction resulted from genuine efficiencies and how much resulted from the failure to deliver outputs. At the end of 2011-12 we adjusted our assessment of your financial performance by £172m because of the failure to deliver train punctuality and reliability targets. Train punctuality and reliability has further deteriorated in 2012-13 and we expect our adjustment of Network Rail's financial performance will increase very substantially.

26. We also need to consider whether you done what is necessary to improve your company's capability (and therefore the potential to deliver efficiency) including over the long term. In your strategic business plan you proposed to increase spending on civil assets by around £800m. Our initial review has highlighted issues on the sustainability of work to renew civil structures, drainage and fencing in CP4. At this stage we consider that financial underperformance could be significant.

27. You achieved £953m of Financial Value Added (FVA) across all items of income and expenditure on a 'gross' basis at the end of 2012-13. However, it is not clear to us that you have outperformed financially because of your failure to deliver required outputs, bearing in mind our view on the sustainability of your renewals work and other possible considerations such as the effect of input prices and the components of interest outperformance. Our assessment of your financial performance may need to be adjusted accordingly. We will consider these matters as part of our annual efficiency and finance assessment this autumn.

Delivery of the enhancement programme

28. You are generally on course in delivering the substantial programme of investments agreed for CP4. Notable milestones this year were the achievement of Thameslink Key Output 1 (with the completion of the bay platforms at Blackfriars station), completing works at Nuneaton (allowing container trains from Felixstowe to the North West to avoid London), and completing your part of the East London Line work (allowing new trains to run between Highbury & Islington and Clapham Junction). Electric trains are now running on the Paisley Canal branch line after this project was completed to challenging timescales.

29. Passengers are also beginning to see improvements from other enhancement programmes, such as longer platforms at the southern end of the East Coast main line and you have increased the gauge clearance for freight trains on the Southampton-Basingstoke diversionary route - a key step for the Strategic Freight Network.

30. We are focusing on monitoring a small number of schemes we judge to be at higher risk, for example the Great Northern/Great Eastern upgrade project and the Great Western main line electrification project. Although there have been issues with delivery elsewhere, your early design and development phases slipped by 18 months and we need to be sure that your plans are realistic and efficient.

Customer satisfaction

31. Although 'customer satisfaction' is not a regulatory target we welcome the results of your latest annual customer survey. This showed a 23 percentage point increase in train operators' overall satisfaction (with Network Rail) over the previous year. This reflects the generally positive views of passenger train operators following devolution - improved working relationships, quicker resolution of issues and decision making being the factors noted. However, we note that around 20% of your customers remain dissatisfied overall, with much dissatisfaction in the Sussex route.

Stations and depots condition

32. Your Strategic Business Plan showed that you are on target to exceed your station condition target and your provisional data for light maintenance depots indicates that their overall condition is better than expected. You have been working on your data input and collection processes supporting the station stewardship and light maintenance depot stewardship measures and we expect to see further improvement when the independent report looks at this again next year.

Environmental sustainability

33. There is no CP4 regulated output requirement in this area but you have committed to improvements. We note that you are mainly on track with your own targets and this shows, overall, a good start to putting in place plans and processes that will be needed to achieve further reductions in CP5 and beyond. We were however disappointed with the quality of information in the SBP regarding your approach to improving the resilience of the network in the face of climate change.

ANNEX B: Evidence for assessment of Network Rail's performance in 2012-13

Statement	Source																											
Introduction																												
<p>Passenger journeys increased by some 4% during the year, the amount of freight moved increased by 3%; Network Rail coped well with the challenges of the London Olympics.</p> <p>European Rail Study notes improvement and progress with the network.</p>	<p>Sources: LENNON database + train operators (latest figures), with Network Rail data for train miles; <i>Network Rail Monitor</i> (Q2, 2012-13) recognition of engineering work being brought forward before the Games and a general reduction in work during the Olympics and Paralympics.</p> <p>Source: Europa.eu</p>																											
Safety																												
Workforce safety was higher than target.	Source: Network Rail's <i>Safety, Health and Environment Performance Report</i> , period 13, 2012-13.																											
Six prosecutions concluded in 2012-13.	<table border="0"> <tr> <td>Wiltshire level crossing</td> <td>£356,250</td> </tr> <tr> <td>Thames Valley workers</td> <td>£150,000</td> </tr> <tr> <td>Grayrigg</td> <td>£4,000,000</td> </tr> <tr> <td>Cheshunt track worker</td> <td>£100,000</td> </tr> <tr> <td>Stoneblower*</td> <td>£200,000</td> </tr> <tr> <td>Total</td> <td>£4,806,260</td> </tr> </table> <p>*includes joint prosecution with GT Railway maintenance</p> <p>Source: ORR website.</p>	Wiltshire level crossing	£356,250	Thames Valley workers	£150,000	Grayrigg	£4,000,000	Cheshunt track worker	£100,000	Stoneblower*	£200,000	Total	£4,806,260															
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ORR served 10 notices on Network Rail.	Source: ORR website.																											
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Non-delivery of the CP4 PPM target for long distance will result in a financial penalty.	ORR letter to Network Rail, 23 July 2012.															
Passenger satisfaction: overall passenger satisfaction remains at 85%, still at a record high.	Source: <i>Passenger Focus' National Passenger Survey</i> , Autumn 2012.															
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Disruption to passengers and freight trains from planned engineering work beating our regulatory target.	<p>Passenger disruption: PDI-P is 0.60 - measure lags by 1 period. (2012-13 target is 0.68 maximum).</p> <p>Freight disruption: PDI-F is 0.79 (2012-13 target is 1.00 maximum).</p>															
Enhancements and renewals expenditure was, overall, 3% higher than last year.	Source: Network Rail's Strategic Business Plan (file SBPT3338)															
Asset management																
Progress with asset management areas: - capability; - development of asset policies; - whole-life costing/maintenance planning; and - asset condition and ORBIS.	Source: AMCL Draft A report <i>2013 SBP AMEM Assessment</i> , March 2013															
The Asset Stewardship Indicator (ASI) is currently showing as behind target.	Source: Network Rail's <i>Infrastructure Condition Report</i> , period 11, 2012-13.															
Expenditure and efficiency																
Commentary on FVA and OMR.	Source: Network Rail's <i>Financial Report</i> , period 13, 2012-13.															
Delivery of the enhancement programme																
Commentary on progress and milestones.	Source: ORR's <i>Network Rail Monitor: 2012-13 Q1, Q2, Q3.</i>															

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Light Maintenance Depots: All network	Minimum average at 1 Apr 2014	2012-13 forecast																																			
England & Wales	2.52	-																																			
Scotland	2.56	-																																			
All LMDs	2.52	2.39																																			
Environmental sustainability																																					
Network Rail is broadly on track to committed improvements.	<p data-bbox="839 1514 1337 1543">Network Rail's forecasts for end 2012-13:</p> <ul data-bbox="858 1552 1461 1839" style="list-style-type: none"> Operational recycling at 55% (target 55%) Infrastructure recycling at 95% (target 95%) 6 environmental incidents causing serious damage (forecast was 6) Proportion of SSSIs rated favourable or recovering was 100% (forecast was 95%) 14% reduction in CO₂ emissions (on 2006-07); not meeting the original forecast of 17% <p data-bbox="839 1845 1458 1906">Source: Network Rail's Strategic Business Plan (file SBPT3338).</p>																																				