



OFFICE OF RAIL REGULATION

**NOTICE, IN ACCORDANCE WITH SECTION 57C OF THE RAILWAYS ACT 1993 AS AMENDED, OF THE OFFICE OF RAIL REGULATION'S DECISION TO IMPOSE A PENALTY ON NETWORK RAIL INFRASTRUCTURE LIMITED**

**12 APRIL 2006**

1. This document constitutes a notice, given in accordance with section 57C(6) of the Railways Act 1993 as amended (the "Act"), stating that:

- (a) the Office of Rail Regulation ("ORR") has imposed a penalty of £250,000 on Network Rail Infrastructure Limited ("Network Rail");
- (b) the penalty is in respect of a contravention by Network Rail of Condition 7 of its network licence;
- (c) the acts and omissions which, in the opinion of ORR, constitute the contravention and justify the imposition of the penalty are set out in paragraphs 9 to 12 of this notice. They relate to Network Rail's failure to publish accurate information about the capability of the network in documents which are used to define the network available for train operators and its failure to take a more proactive and timely approach, prior to the adoption of an appropriate recovery plan, to rectifying the discrepancy between actual and published capability. These amount to a failure to take such steps as are necessary or expedient to achieve the purpose set out in paragraph 1 of Condition 7 to the greatest extent reasonably practicable including meeting the reasonable requirements of customers and funders, as more set fully out in paragraphs 9 to 12 of this notice;
- (d) the other facts which, in the opinion of ORR, justify the imposition of the penalty are set out in paragraphs 20 to 34 of this notice; and
- (e) ORR's decision that it is satisfied that Network Rail has contravened and is contravening Condition 7 is explained further in the notice served and published under section 55(6) on 2 March 2006. The penalty ORR has imposed on Network Rail does not relate to the continuing contravention of Condition 7 and is solely in relation to the past conduct of Network Rail prior to the adoption of an appropriate recovery programme; and
- (f) in accordance with the Act, the penalty should be paid to the Department for Transport. The penalty must be paid by 12 May 2006 to the Department for Transport by BACS transfer to account number 19761000 (sort code 10-14-99).

2. This notice follows publication of a notice under section 57C on 2 March 2006 describing ORR's intention to impose a penalty on Network Rail. Representations on this notice were received from Network Rail on 17 March 2006. No other representations were received. ORR has taken account of Network Rail's representations. ORR considers that its assessment of the position, and, in particular, Network Rail's failure to produce a recovery plan until

30 August 2005 and the adverse effect on train operators remain as stated in its earlier notice. Furthermore, ORR has already considered the mitigating effect of the circumstances of this case in arriving at the sum of £250,000.

3. ORR has therefore decided to confirm the penalty of £250,000 described in the notice published on 2 March 2006.

#### **Relevant Legal provisions**

4. 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 contravened a licence condition. The amount may not exceed 10 per cent of the licence holder's turnover determined in accordance with the Railways Act 1993 (Determination of Turnover) Order 2005 (SI 2005 No 2185). In broad terms, the Order defines applicable turnover as turnover on regulated activity in Great Britain in the business year preceding the penalty notice under section 57C, plus, where the contravention lasted for more than a year, an additional sum for such additional period (provided that the total sum is not more than double the preceding business year's turnover). Network Rail's turnover for 2004-05 on regulated activity was £3.8 billion.

5. No penalty may be imposed in respect of a contravention unless a notice is served on the licence holder within two years of the time of the contravention.

6. 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 received complaints about a breach of a specific licence obligation and is not satisfied that it is most appropriate to proceed under the Competition Act 1998.

7. The relevant condition of Network Rail's network licence is Condition 7.

8. Condition 7 requires Network Rail, by virtue of paragraph 2, to:

"take such steps as are necessary or expedient so as to achieve the purpose to the greatest extent reasonably practicable having regard to all relevant circumstances including the ability of the licence holder [Network Rail] to finance its licensed activities."

"The purpose" referred to in paragraph 2 of Condition 7 is defined in paragraph 1, and is:

"to secure:

- (a) the operation and maintenance of the network;
  - (b) the renewal and replacement 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 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.”

### **The Contravention**

9. ORR is satisfied that Network Rail has contravened and is contravening Condition 7 of its network licence by not taking such steps as are necessary or expedient, to achieve the purpose in paragraph 1 of Condition 7 to the greatest extent reasonably practicable, in that it:

- (a) has not, and is not, adopting best practice in the operation of the network in ensuring that the capability of the network is accurately described;
- (b) has not, and is not, securing the operation of the network in a timely, efficient and economical manner because it was not and is not making available accurate information on capability; and
- (c) is not therefore satisfying the reasonable requirements of its customers and funders, which include having timely and accurate information.

10. ORR considers that a best practice operator of the infrastructure, acting in a timely, efficient and economical manner should make available accurate information about the capability of the network. Network Rail should provide to users, in a timely manner, accurate and up to date information on the capability of the network (including such matters as gauge, line speed, and route availability). ORR's reasons for the decision are set out in full detail in the notice served and published under section 55(6) on 2 March 2006.

11. Following the decision that Network Rail is contravening Condition 7, ORR is further satisfied that it is not appropriate, given the recovery programme put in place by Network Rail, to make a final order, or to make or confirm a provisional order, in respect of continuing contravention. This is for the reasons set out in detail in the notice served and published under section 55(6) on 2 March 2006.

12. This penalty does not relate to the continuing contravention and is in relation to the past conduct of Network Rail prior to the adoption of an appropriate recovery programme.

### **Background**

13. In response to an investigation by ORR, launched after a freight customer of Network Rail's had submitted a complaint to ORR in November 2004, Network Rail has, so far, identified up to 40 routes across its network where the published capability of the route does not match the actual capability.

14. We understand that an initial complaint about a particular route had been made to Network Rail's predecessor, Railtrack Plc, in October 2001. However, the matter was not drawn to ORR's attention until November 2004, when a freight customer wrote to ORR, complaining about capability and forwarding a letter from Network Rail dated 5 October 2004 which acknowledged that there were lines where the capability of the network was less than that contained in published documents. Network Rail admitted in a letter to ORR of 10 January 2005 that it had been aware of the discrepancy between actual and published capability for some time.

15. It is not entirely clear from the correspondence when Network Rail first became aware of this issue. As noted above, Network Rail acknowledged in October 2004 that there were routes on the network that were not sufficiently robust to deal with potential flows of freight traffic. However, it did not provide an assessment of this, as requested by ORR, until 17 February 2005 ("the February list"). The February list indicates that, prior to ORR's request, it had not done sufficient work to ascertain the extent of the problem for itself. ORR considered that the February list was inadequate and needed to be quantified. In addition, ORR required Network Rail to develop a work plan to address the discrepancies. Despite interim meetings and exchanges of letters, Network Rail did not provide a quantified assessment of the February list for a further three months and did not produce an acceptable plan to address the discrepancies until the end of August 2005. This plan was subsequently updated and expanded in January 2006.

#### **Network Rail representations on penalty**

16. Network Rail's response to the notice of 2 March 2006 proposing the penalty, which was received by ORR on 17 March 2006, states that it does not agree that any penalty is appropriate and, in any case, considers that the size of the proposed penalty is disproportionate in the circumstances.

17. Network Rail's view is that:

- (a) this is an issue inherited from Railtrack Plc and part of a wide range of legacy issues which Network Rail believes that it is prioritising appropriately;
- (b) the decision to impose a penalty is inconsistent with ORR's draft enforcement policy and penalties statement, particularly in so far as it relates to incentivising compliance. Network Rail is of the view that the penalty is punitive and does not seek to incentivise compliance;
- (c) if a financial penalty were to be considered appropriate, Network Rail considers that ORR should take into account the recovery plan undertaken by Network Rail and recognise that Network Rail engages openly with its customers and ORR. Network Rail considers that this should significantly mitigate the level of the penalty;
- (d) there was a degree of uncertainty on the part of Network Rail as to whether it was funded for actual or published capability that contributed to its inability to develop a remedial plan;
- (e) it has not profited from the breach and has expended significant resource in addressing the position; and
- (f) the contravention only relates to a relatively small number of routes for which there is a limited known potential use. Network Rail does not consider there is evidence of significant detriment across the network.

18. ORR also notes Network Rail's statement that it has been "difficult to make progress on this issue but that relevant train operators are now engaging more constructively in this process". ORR has not received any information indicating that train operators were obstructing Network Rail from performing its obligations in relation to published capability. ORR also notes that Network Rail has made

some further comments about the *Enforcement Policy and penalties statement – draft for consultation* (“the draft penalties statement”) which it will take into account in finalising its policy.

19. Network Rail’s full representations can be viewed on the ORR website.

#### **Whether to impose a penalty**

20. Section 57B(3) of the Act provides that, in deciding whether to impose a penalty, and in determining the amount of any penalty, ORR must have regard to any statement of policy published at the time when the contravention occurred. No such statement of policy has been published to date. On 17 November 2005, ORR published for consultation a draft of a statement of policy, in chapter 4 of its draft penalties statement<sup>1</sup>. The consultation closed on 9 February 2006. The validity of any decision to impose a penalty or any determination of the amount of any such penalty is not effected by a final policy not being published<sup>2</sup>, and ORR considers that in the circumstances it is appropriate to have regard to the draft penalties statement in reaching a decision on whether to impose a penalty, and the amount of that penalty.

21. ORR has stated in its draft penalties statement that, in deciding whether to impose a penalty, it will act in accordance with its duties under section 4 of the Act and will take account of five principles of good regulation: proportionality, targeting, consistency, transparency, and accountability.

22. ORR has also said, in the draft penalties statement, that the penalty should be proportionate to the nature and severity of the contravention. In paragraph 7 of the draft penalties statement, ORR has stated that it will consider, in particular:

- (a) the seriousness of the contravention;
- (b) whether the contravention or possibility of the contravention would have been apparent to a diligent licence holder;
- (c) culpability;
- (d) the extent to which a penalty or reasonable sum would provide additional incentives on the licence holder to remedy the contravention;
- (e) the impact the contravention has had on third parties;
- (f) whether the licence holder has profited from the contravention; and
- (g) the licence holder’s record of compliance or non-compliance with this and other obligations.

23. On this basis, following the decision that it is satisfied that Network Rail has contravened and is contravening Condition 7, ORR has decided that it should impose a penalty on Network Rail. This penalty notice does not relate to the

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<sup>1</sup> *Enforcement policy and penalties statement - draft for consultation*, ORR November 2005, can be found at <http://www.rail-reg.gov.uk/upload/pdf/259.pdf>.

<sup>2</sup> Railways Act 2005, Schedule 1, 24(2).

continuing contravention and is in relation to the past conduct of Network Rail prior to the adoption of an appropriate recovery plan.

24. In reaching this decision, ORR has had regard to the factors listed in paragraph 22 above, which are considered in turn below.

25. As far as the seriousness of the contravention is concerned, the discrepancy, between the route capability as published by Network Rail and as it is (or was) in reality, applied to a significant, but relatively small, number of routes across the network. Network Rail has reiterated this point in its representations. ORR considers that it has recognised this issue in considering the appropriate penalty. ORR also notes that Network Rail has yet to gauge the full extent of the discrepancy. As a matter of principle, ORR considers that this cannot be classed as trivial as even a relatively limited discrepancy of this type has a number of serious implications for the industry:

- (a) freight train operators have rights under their access contracts to use the network, subject to the capability of the network set out within the sectional appendices (which are the industry documents that Network Rail currently uses to describe the capability of the network). Accurate information on capability would therefore have been important for the operators to be able to plan the future of their businesses with a reasonable degree of assurance, such as in seeking and agreeing new haulage contracts;
- (b) Network Rail needs to understand and document the nature of its network, including the capability of its assets, to secure the efficient operation and maintenance of the network, to plan renewals of the network efficiently, and to plan the future use and development of the network. Furthermore, accurate information on capability is needed to give assurance to its customers in negotiating new access rights, and greater confidence to ORR when approving or directing access applications, that the infrastructure described is available to meet the applicant's reasonable requirements;
- (c) in addition, accurate information about network capability is an important input to periodic reviews, and therefore is a reasonable requirement of funders and users.

26. As regards culpability, although Network Rail inherited this problem from Railtrack, it has had more than three years to address it. ORR has considered Network Rail's comments that it has been addressing a wide range of legacy issues since it acquired Railtrack Plc and has been focusing on key priorities identified in conjunction with customers and industry parties. However, ORR considers Network Rail must carry the responsibility for the information it publishes and the consequences where this is inaccurate or misleading. Furthermore, ORR is not of the view that addressing this issue proactively would have affected the key priorities. In June 2002, the then Rail Regulator said, in regard to network stewardship problems on the network which Railtrack had bequeathed to Network Rail and which related to compliance with Condition 7,

"The Regulator will require Network Rail to take action as soon as practicable to address these issues and other shortcomings which it inherits,

in a timely and efficient and effective manner. This should build, where appropriate, on the progress made by Railtrack.”<sup>3</sup>

27. ORR considers that a diligent licence holder would have identified the contravention earlier and either started to resolve the problem immediately or stated when and how it proposed to do so. Although concerns were first raised with Network Rail’s predecessor, Railtrack Plc, in 2001, it is not entirely clear when Network Rail first became aware of this issue. For the purposes of this notice, the financial penalty relates to Network Rail’s conduct in the period from December 2004, when ORR first wrote to Network Rail, until an appropriate recovery plan was adopted.

28. ORR has considered Network Rail’s representations in relation to funding for the network and the progress that has been made to address this issue. ORR does not accept the view that discussions about funding prevented Network Rail from publishing accurate capability information. Network Rail should have ensured that it had the information it needed to ascertain whether it could meet its contractual obligations.

29. As indicated in paragraph 27, ORR considers that the breach or possibility of the breach would have been apparent to a diligent licence holder. Network Rail publishes information on the capability of the network principally through the sectional appendices. These are used in the “operating constraints” in freight track access contracts to describe the network that the freight train operators have rights to use. ORR considers that a diligent licence holder would ensure that the infrastructure it had to make available under these contracts was described accurately.

30. In terms of additional incentives to remedy the contravention, ORR’s decision not, at this stage, to make an order under section 55(7) of the Act (as described in ORR’s notice under section 55(6) of 2 March 2006 in relation to the continuing contravention recognises that there is a suitable recovery programme in place and that Network Rail is working to deliver that programme to remedy the contravention.

31. ORR has considered Network Rail’s view that the imposition of a penalty is inconsistent with the draft penalties statement - that is, where ORR has accepted that it is satisfied that Network Rail is currently taking all steps to ensure compliance, ORR should not impose a financial penalty. Network Rail’s position is that to impose a penalty in these circumstances is not consistent with the stated principal purpose of a penalty which is to incentivise further compliance. Network Rail considers that no further incentivisation is required if the Network Rail is now taking the necessary steps and that therefore the penalty is punitive. ORR does not accept this position. ORR considers that this takes a very restrictive view of incentivisation. ORR also considers that it misunderstands the draft policy and the distinction to be made between considering whether a penalty should be levied and how much any penalty levied should be. ORR does not consider it

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<sup>3</sup> The proposed acquisition of Railtrack PLC by Network Rail Limited; a statement by the Rail Regulator and proposed licence modifications. ORR, June 2002. <http://www.rail-reg.gov.uk/upload/pdf/146.pdf>.

appropriate, for the industry as a whole, for it to adopt an interpretation that would result in no financial penalty where an appropriate recovery plan is accepted, regardless of the seriousness of the prior breach or the length of time that was involved or other factors. Taking appropriate steps to remedy the current breach is vital for the licence holder and other parties affected by an issue. However, ORR considers that it would send the wrong signals to licence holders if ORR adopted a policy that meant that licence holders would never receive a penalty, despite, for example the seriousness or longevity of the past conduct, by submitting a recovery plan. ORR does not believe such a policy would incentivise timely or proactive compliance by licence holders. In relation to the level of the penalty, ORR has considered the factors set out in paragraphs 35 to 41.

32. As noted in paragraph 25 above, the contravention has had an effect on the ability of freight train operators to plan their businesses, as inaccurate and unreliable information on network capability may create uncertainty and risk when seeking new opportunities in the market place. ORR understands that, although there may be a breach of access contracts with freight train operators, the latter are unlikely to be in a position to claim damages, because the discrepancy relates largely to potential use and it is therefore difficult to quantify relevant losses.

33. As regards whether the licence holder has profited from the breach, ORR is not currently able to assess whether Network Rail has profited materially from the failure to describe accurately the capability of the network. Network Rail has stated in its representations that it has not made a profit. ORR does not expect Network Rail to incur unnecessary expenditure where there is no expectation of traffic, but it must be able to comply with access agreements, and must follow industry processes and be proactive in suggesting any necessary changes to them. ORR will assess the effect of failure to deliver published capability on present value of costs as part of the Periodic Review 2008 and will claw back any savings which have not been incurred efficiently.

34. In terms of the licence holder's record of compliance or non-compliance, within the last two years Network Rail has been in contravention of paragraph 2 of Condition 9 of its network licence in respect of timetabling (the so-called "T-12" obligations). In that case, ORR decided not to make an enforcement order, but to rely on a recovery plan in accordance with section 55(5B) of the Act, and not to impose a penalty. ORR considers that a penalty is appropriate in this case as this is the second time, in a relatively short time period, that Network Rail has been found in breach of its licence. ORR considers it important to incentivise proactive compliance with licence obligations. ORR has also considered Network Rail's comments about stewardship generally and its performance overall. ORR acknowledges Network Rail's general performance, but considers that this second breach of the licence indicates a failure proactively to address its licence obligations. On balance, having regard to the factors listed in paragraph 7 of the draft penalties statement, ORR has decided to impose a penalty in respect of the past conduct of Network Rail in relation to breaching Condition 7 of its network licence.

#### **Calculation of the amount payable**

35. In calculating the amount payable, ORR has stated in the draft penalties statement that it will consider:



- (a) proportionality;
- (b) mitigating and aggravating factors; and
- (c) financing issues.

#### *Proportionality*

36. ORR has stated, in paragraph 10 of the draft penalties statement, that its principal objective in determining the amount or level of a penalty will be to incentivise compliance with the relevant condition or requirement. In paragraph 12 of the draft penalties statement, ORR states that the principle it intends to use would result in a penalty set at the minimum level required to incentivise compliance. In ORR's view, although ORR considers that this contravention has certain serious implications justifying the imposition of a penalty - as described in paragraph 25 above - the impact on Network Rail's costs and its users is difficult to quantify.

37. In setting the penalty, ORR has had regard to the cost of compliance, and to any benefit from non-compliance enjoyed by the licence holder. The cost of compliance, and the benefit from non-compliance, are not clear. As noted in paragraph 33 above, ORR is currently unable to assess whether Network Rail has profited materially from savings on maintenance and renewal costs. As noted above Network Rail has stated categorically that it has not profited from the breach.

38. ORR has also had regard to potential costs incurred by third parties as a result of the contravention. Freight train operators have incurred costs in raising the issue with Network Rail, and the uncertainty created by the breach may have caused damage to their ability to attract freight and compete with other modes of transport.

#### *Mitigating and aggravating factors*

39. There is a mitigating factor. Network Rail has taken steps to rectify the contravention. ORR has accepted this in deciding not to make, at this stage, an enforcement order under section 55 of the Act in relation to the continuing contravention.

40. There are no material aggravating factors.

#### *Conclusion on the amount of the penalty*

41. For the reasons set out above - in particular, the fact that the breach relates to the discrepancy between actual and published capability, rather than failure to maintain capability, the limited benefit from non-compliance enjoyed by Network Rail, and the mitigating factors -, and having taken account of representations duly made and not withdrawn on the notice published on 2 March 2006, ORR has decided that the amount of the penalty should be £250,000.

#### **Financing issues**

42. In ORR's draft penalty statement, ORR notes that it has a duty under section 4 of the Act not to make it unduly difficult for a network 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 level of the proposed

penalty would make it unduly difficult for the licence holder to finance its activities and considers it consistent with its duties under sections 4(b) (to promote the use of the network for the carriage of goods), 4(c) (promoting efficiency and economy) and 4(g) (enabling persons providing railway services to plan their businesses with a reasonable degree of assurance). ORR notes Network Rail's comment that the proposed penalty would not have any impact on its ability to finance its relevant activities.

### **Conclusion**

43. Having regard to ORR's duties in section 4 of the Act, the factors listed in paragraph 7 of ORR's draft penalties statement, representations received, and for the reasons set out above, ORR has decided that it should impose a penalty in respect of Network Rail's contravention of Condition 7 as described in this notice. In particular, ORR considers that a diligent licence holder would not have allowed itself to be in this position, that the contravention has had an adverse effect on third parties, and that it is relevant that this is not the first time that Network Rail has been in contravention of its licence obligations.

44. ORR has considered Network Rail representation that a penalty of £50,000 would be proportionate in the circumstances. However, for the reasons set out above, and having regard to Network Rail's turnover, which was approximately £3.8 billion in 2004-05, ORR has imposed a penalty of £250,000.



**Bill Emery**

**Chief Executive of the Office of Rail Regulation**