Dear Alan

Possible breach of Condition 1 of Network Rail’s network licence with regard to its delivery of its enhancement programmes

Following your letter of 6 August 2015, I set out below Network Rail’s representations in response to ORR’s preliminary findings following your investigation into the delivery of Network Rail’s enhancement programmes.

We accept ORR’s preliminary view that Network Rail may not in the past have done everything reasonably practicable to comply with condition 1 of its network licence in relation to the delivery of its enhancements programme in 2014/15. We are pleased that the issues and actions highlighted in your letter accord with our own analysis and the key elements of our Enhancement Improvement Plan (EIP), a summary of which is attached to this letter. From our discussions it is clear that we have a common understanding of the root causes and you have acknowledged the positive way in which we have proactively responded to reach a consensus on the way forward. Similarly, there has been very positive engagement with DfT and other funders in responding to the current challenges. We believe it is also important that the wider context is clearly understood when considering the licence issues highlighted in your letter.

Although some projects have been delayed or paused, particularly those associated with electrification or where very little development work had been done before views were taken about cost, there are a large number of projects which are being delivered in line with expectations. These projects will bring about significant improvements for passengers and freight users. It is still true that once we have clarity about requirements and how this will be delivered the vast majority of our projects are delivered with outstanding professionalism. I am sure you will join with us in celebrating the successful delivery later this month of Birmingham New Street and the Borders railway, both of which will be transformational for passengers and the respective communities.

You refer to the missed milestones as the key failure. We accept this. And, of course we do not intend to imply that missing milestones is acceptable since this not only has important potential consequences for customers but also undermines the industry’s credibility. As highlighted in previous correspondence, however, we believe it is important to be explicit
about the different nature of the various milestones as well as the reasons for them being missed. We established 84 milestones for 2014/15 and, of these, we failed to meet the scheduled completion of 30. However, these included some relatively minor delays which will have little overall impact on delivery of the relevant projects and I understand you have acknowledged this. Also around half of our missed milestones were for development and one of the key lessons from recent experience is around the criticality of getting this front-end definition right before we progress to the delivery stages. I am sure you would agree that it would be inappropriate to require adherence to these milestones where the project is not ready.

In our view it is essential that everyone involved recognises the need for all parts of the industry to work together to address the issues identified between us. These system-wide issues have been highlighted in the discussions around Collette Bowe’s review and we are very pleased to be able to engage in this parallel review. It is important to be clear that we accept the need for improvements within Network Rail as highlighted in our discussions but we will also need your support, clarity from government and engagement from operators to address the root causes of the current affordability challenges. This is important, for example, so that we do not immediately repeat some of the mistakes of the past by creating expectations about the cost and timescale for new aspirations before sufficient development work has been completed. It is very good that there appears to be a consensus about the changes which are required and we hope that this will be taken into account in your assessment of the case to answer for Network Rail. For example, the recently constituted high level trilateral enhancement meeting involving me and Francis Paonessa from Network Rail, yourself from ORR and the DG and relevant Director from DfT has been an important step in improving the governance of, and future changes to, the programme as well as dealing with the issues arising from the lack of such a senior forum in the past. Equivalent arrangements have been in place in Scotland for some time.

We hope that you will be able to refer positively to the way Network Rail has proactively identified the issues and sought to address these issues in discussion with ORR, government and the rest of the industry. The thirteen issues identified in your letter have in the main been highlighted by Network Rail as a result of a series of lessons learned exercises across our portfolio and it is very pleasing that you see the same issues. For example, the ECAM process was put in place following discussions between us and we have been open about the challenges and emerging views on the costs of projects, many of which were at a very early stage in the development process during the periodic review. It is therefore disappointing that you comment in your letter in such general terms that we had been slow to respond to concerns arising. While we accept that some issues have taken too long to address, we are concerned that your letter could give a misleading impression of the overall position. Important changes have been driven proactively by the Executive team particularly following the arrival of Francis Paonessa, for example, with his appointment of a Development Director and an Engineering Director. More recently specific steps were taken to reinforce the governance and assurance arrangements around our plans and I comment further on these below.

With regard to governance, at the end of January 2015, the Board established two temporary Committees with a focus on enhancements. One, chaired by our Senior Independent
Director Janis Kong, focused on the immediate learnings from the Christmas 2014 project delivery problems to ensure the Easter works were delivered smoothly. The other is the Major Projects Delivery Committee (MPDC) chaired by Malcolm Brinded, a non-Executive Director of Network Rail. This latter Committee's remit is to look in more detail at Network Rail processes and performance in regard to enhancement project scope definition, cost estimation, and delivery, as well as the process by which project funding is sought, approved and revised, and how project and portfolio performance is monitored and communicated internally to the Board and externally. As you know, the MPDC is convened every two weeks, with Network Rail Executive and Non-executive membership and, since March, attendance by a representative from both the Shareholder Executive and ORR (typically by yourself). It was helpful that our most recent meeting was attended by our Chairman, Sir Peter Hendy and Richard Brown, our Special Director appointed by the Secretary of State. A key output of this Committee will be the Enhancements Improvement Programme (EIP) which is a programme plan to deliver multiple improvements, over the coming 12-24 months, to address the issues identified by the MPDC and separately by ORR and also in the DIT Bowe Review.

As you know we have instituted a series of internal peer reviews of the largest and most challenging projects and a number of changes have been made as a result of these reviews. With regard to independent assurance, you will be aware that we commissioned an independent view of the Western Programme. In July 2015, Nichols were appointed to carry out a deliverability review of the CP5 enhancements portfolio following a requirement for assurance by ORR on the profile and deliverability of both cost and programme of the portfolio proposed by Network Rail. Following Sir Peter Hendy's appointment as Chairman of Network Rail, the scope of this review has been expanded throughout July and August 2015 to provide assurance of the CP5 enhancements re-plan in line with the Terms of Reference from the Secretary of State to Sir Peter Hendy. The scope of the Nichols work includes a review of Infrastructure Project's Deliverability Reviews and also of Group Strategy's affordability process. This scope includes not only a review of programme deliverability and affordability but also a review of the capacity for enhancements by examining resourcing levels and constraints, signalling delivery capability and consent requirements. The draft report from Nichols is due on 7 September 2015. Following a requirement identified by ORR for ongoing assurance that Network Rail is on plan to deliver its regulated milestones and that the industry is informed as early as possible of any changes to programmes to allow effective planning, Arup were also appointed in July 2015 to provide us and ORR with independent assurance of Network Rail's reporting accuracy.

While we have accepted that there may have been a past breach we consider that we have since been and are doing everything reasonably practicable to address these issues in compliance with Condition 1 of our licence. Your support in the development of our EIP has been helpful. Of course the detailed actions required to implement some elements of the EIP are still being developed but we are keen to do this in a way which truly embeds the changes, not just in Network Rail, but across the industry and in our dealings with government so this should not be regarded as a failing at this stage. It is also important that we challenge and test the detail of the EIP fully at our MPDC before discussion at the Board.

Following discussion of the EIP at the 27 August MPDC it was agreed that the seven workstreams will be reviewed in tranches at subsequent meetings. The final review by this
committee is likely to be on 7 October with subsequent authority at the Network Rail Board on 22 October. In parallel, we plan to discuss further with DfT at our forthcoming Enhancement High Level Trilateral and we hope this will be followed by further detailed discussions particularly to make sure that our plans fully address any concerns identified by Collette Bowe. We are also keen to discuss with Transport Scotland and with the rest of the industry. We will therefore submit the final version of our EIP to you by the end of October. This will comprise the EIP integrated programme plus the developed list of EIP deliverables or assurance activities and a mapping of these actions against the points raised in your letter.

In our view, delivery of the established EIP should be regarded as a reasonable requirement of customers and funders such that no further regulatory action is required other than to monitor our delivery of the key milestones in this plan. We suggest that this monitoring should be done primarily through our Director Level Meetings and the High Level Trilateral with DfT and should make use of the milestone reporting processes being established within Network Rail. There can be no doubt that we are strongly incentivised to deliver these improvements as part of our drive for continuous improvements and the EIP will therefore be fully embedded in our performance management framework so that we can report clearly on progress. Whilst recognising that any decision on a financial penalty is the responsibility of ORR’s Board, taking into account the mitigating factors outlined above and having regard to ORR’s economic enforcement policy, we submit that further reparations or a fine would not help to achieve any additional focus on addressing the challenges which have been clearly understood between us.

I am copying this letter to Patrick McLoughlin, Clare Perry, and officials at the Department for Transport, Derek Mackay and officials at Transport Scotland, Mark Carne and Francis Paonessa at Network Rail.

Yours sincerely

[Signature]

Paul Plummer
Group Strategy Director