

John Larkinson
Chief Executive



Alex Hynes
Managing director, Scotland's Railway
By email

13 December 2019

Dear Alex,

Preparations to deliver efficiently in Scotland in CP6

As a follow up to my March 2019 letter, I set out below our views about Network Rail's preparations to deliver efficiently in Scotland in CP6¹.

Our PR18 determination required Network Rail to make £385m of efficiency improvements in its Scotland route ('Scotland') in CP6 (covering its core operations, support, maintenance and renewals activities). This was against a backdrop of poor efficiency and renewals delivery in CP5².

As you are aware, as part of Network Rail's ongoing internal reorganisation, the Scotland route has been replaced by the Scotland region³. This has not affected Network Rail's CP6 efficiency plans for Scotland. Scotland has reported £13m of efficiency improvements during the first six periods of 2019-20, and £35m forecast for the full year, slightly behind its £39m internal target, though ahead of the PR18 assumption. We expect an increased focus to meet the target⁴.

¹ See https://orr.gov.uk/_data/assets/pdf_file/0005/40847/network-rails-preparedness-for-rail-control-period-6-2019-03-28.pdf.

² We reported on Scotland route's efficiency in CP5 in our July 2019 annual efficiency and finance assessment. See <https://orr.gov.uk/rail/economic-regulation/regulation-of-network-rail/monitoring-performance/efficiency-and-finance-assessment>.

³ Because most of the recently available information has been for routes rather than regions, I generally refer to routes in this letter. I recognise that responsibility for these matters has transferred to regions. This letter only considers efficiencies being delivered by Scotland, not those being delivered by Network Rail's central functions that are allocated to Scotland.

⁴ This excludes Scotland's allocation of efficiencies being delivered by Network Rail's central functions. Network Rail's CP6 delivery plan is to deliver £339m of efficiency improvements in Scotland in CP6. The PR18 number (£385m) included an allocation of efficiencies to be delivered by Network Rail's central functions. I have separately written to Andrew Haines about the GB position.

The region's efficiency challenge more than doubles in year 2 (see chart below) and in this respect more still needs to be done over the next few months, particularly in relation to the quality of a number of renewals efficiency plans, as these are critical to delivering the increasing efficiency challenge in year 2 and later years of CP6. Specific areas requiring improvement include work bank planning and optimisation of access.

PR18 assumed efficiency profile for Scotland in CP6 (excluding central functions efficiencies)



As at Period 7, renewals volumes in Scotland were 22% behind plan. Network Rail intends for this to recover to 7% under-delivery by year-end. This mainly comprises deferral of planned signalling works due to, amongst other things, the uncertainty of the deliverability of the unremitted workbank⁵, partially offset by work accelerated from future years. This represents a risk to delivery of required volumes that could also affect efficient delivery in later years of CP6. The renewals delivery challenge will also be increased by the deferral of enhancements from year 1 and the current intention to defer some year 2 renewals (particularly in signalling) to later years of

⁵ Unremitted projects are those which have not been shared with Network Rail's supply chain to develop the detailed scope and design of the work.

CP6⁶. Network Rail's supply chain has also expressed concerns about lower than anticipated work orders which we are currently investigating.

Progress since March 2019

There can be no let-up in the focus that Network Rail needs to put on delivering efficiently in Scotland in CP6. This is why in my March 2019 letters I expressed concern about the different levels of maturity and uncertainty in routes' CP6 efficiency plans and the robustness of reporting on efficiency improvements. Our concerns applied to all routes, not just Scotland.

In response to these concerns, Network Rail developed an efficiency improvement plan and agreed to support an independent reporter review of routes' renewals and efficiency plans for years 1 and 2 of CP6. From this work and our own engagement, we have seen a continuing effort to improve efficiency plans and delivery. However, substantially more still needs to be done over the next few months, particularly in relation to the quality of renewals efficiency plans, as these are critical to delivering required renewals volumes and the increasing efficiency challenge in later years of CP6. These matters are set out in an annex to this letter, together with an update on Scotland's wider leading indicators of readiness for year 2 of CP6.

Next steps

We will continue our work reviewing Scotland's efficiency plans and wider leading indicators of readiness over the next few months and we will directly engage with your team and Transport Scotland on this. We will report publicly on these matters. I have invited Andrew Haines and Jeremy Westlake to present Network Rail's CP6 efficiency plans at the ORR Board meeting in January 2020. This will provide an opportunity for our Board members to engage directly about Network Rail's CP6 efficiency plans and the challenges to delivering them.

Yours sincerely



John Larkinson
Chief Executive

Copied to:
Andrew Haines, Chief Executive, Network Rail
Bill Reeve, Director of Rail, Transport Scotland

⁶ See my 3 December 2019 letter to Bill Reeve at Transport Scotland for further details.

Annex

Progress of Network Rail's efficiency improvement plan

Network Rail developed an efficiency improvement plan in April 2019. This incorporated a number of specific actions grouped into six themes:

- a) improve external communication of business changes improving efficiency;
- b) completion of efficiency calculators for reporting;
- c) strengthen assurance of routes' plans;
- d) improve milestone reporting for process delivered efficiencies;
- e) launch CP6 tracker; and
- f) a new leading indicator framework.

We have seen good progress on most of the actions in Network Rail's efficiency improvement plan. Network Rail has increased the size of the central team managing the process for routes' reporting of efficiencies. It has revamped its periodic efficiency report and it is continuing to develop this report, including taking on board our feedback. The team continues to work with us on how efficiencies and headwinds should be calculated as part of the fishbone framework for explaining changes to routes' expenditure⁷. This framework needs to be embedded before 2019-20 year-end reporting.

However, Network Rail needs to make further progress in some areas. The documentation of some planned business changes remains poor, although it continues to improve. Network Rail also needs to improve milestone reporting for process delivered efficiencies⁸. As explained below, Nichols has confirmed our concerns about these matters.

Independent reporter review of renewals and efficiency plans

In May 2019, ORR and Network Rail commissioned Nichols to undertake an independent reporter review of Network Rail's renewals and efficiency plans for years 1 and 2 of CP6. The scope of Nichols' review was in two parts:

⁷ Network Rail is implementing a fishbones visualisation approach to show more clearly the separate drivers of changes to regions' costs over time.

⁸ Some of Network Rail's planned efficiencies result from changes to business as usual processes, as opposed to discrete projects. Network Rail refers to these as 'process-led efficiencies'. The most significant of these is 'Better Every Day' – the adoption of LEAN techniques to deliver multiple local improvements and to develop a culture of continuous improvement. Whilst we accept that it is harder to evidence such business changes, we expect more robust planning than we have seen.

- Part A – Renewals: To assess the preparedness of each route to deliver its renewals plans. The scope included workbank planning data; reasons for variances; workbank maturity and opportunities to improve reporting of preparedness.
- Part B – Efficiency: To assess the preparedness of each route to deliver its planned efficiency savings. The scope included routes' overall approach to and quality of efficiency plans; description of business changes and how they will generate efficiency; calculation forecasts; progress monitoring; approach to risk management and identification/documentation of limitations.

Nichols completed a Phase 1 report, covering the Wessex and Scotland routes in July, which we have published⁹. Nichols completed its Phase 2 (final) report earlier this month, which we are putting on our website. The Phase 2 report covers all other Network Rail routes.

Part A – Renewals

In Scotland, Nichols found evidence of a generally good level of progress in authorising work for year 1 of CP6 with timely plans to complete this. Workbank planning for year 2 is progressing and is ahead of the equivalent point in year 5 of CP5. A notable exception to this was work on the signalling portfolio where, due to a combination of factors, only 33% of year 1 work was authorised at the end of period 1. Nichols considered this to be a significant issue. We will continue our work of reviewing Scotland's renewals plans and delivery over the next few months. We will publicly report on these matters.

Part B - Efficiency

Nichols' review has been positive about a number of aspects of efficiency planning in Scotland including clear route ownership of plans, dedicated resources and robust governance arrangements. Nichols has also been positive about the engagement and support that it received throughout its review. However, Nichols has confirmed some of the concerns that we set out in our March 2019 letter regarding the quality of a number of efficiency plans. Nichols' findings for Scotland are summarised below:

- more complex renewals efficiencies require a greater level of documentation and evidence of planning including a better specification of 'what' and 'how' efficiencies will be delivered;

⁹ See https://orr.gov.uk/data/assets/pdf_file/0013/41602/interim-nichols-review-of-network-rails-renewals-and-efficiency-planning.pdf.

- Scotland should improve its documentation of the business changes leading to efficiency improvements and ensure that there is a clear record of assumptions and calculations of forecast efficiencies;
- Scotland should enhance milestone planning, and the monitoring of enabling and implementation actions to deliver renewals efficiencies. This needs to be resourced and driven as a change programme which some routes have already done; and
- Scotland needs to strengthen its change management office resources to provide greater coordination and oversight of the delivery of efficiency initiatives.

We have seen some progress since Nichols' Phase 1 report in the Scotland region. Scotland has appointed KPMG to support the development of a change management office to oversee the delivery of efficiency plans (as some routes have already done), although the route is of the view that this will take time to bed in. From my team's regular review meetings with Network Rail's central efficiency reporting team, we have seen a strengthening of internal assurance of region's planned and reported efficiencies and a pragmatic approach to reduce forecast efficiencies where there are uncertainties about the quality of routes' plans.

However, the variability in the quality of Scotland's efficiency plans and forecast calculations remains a concern for us. It is a particular risk to delivery of efficiencies linked to major renewals projects, with far higher efficiency targets in years 3 to 5 of CP6. Scotland needs to do more now to develop and implement those plans to improve preparedness for these years.

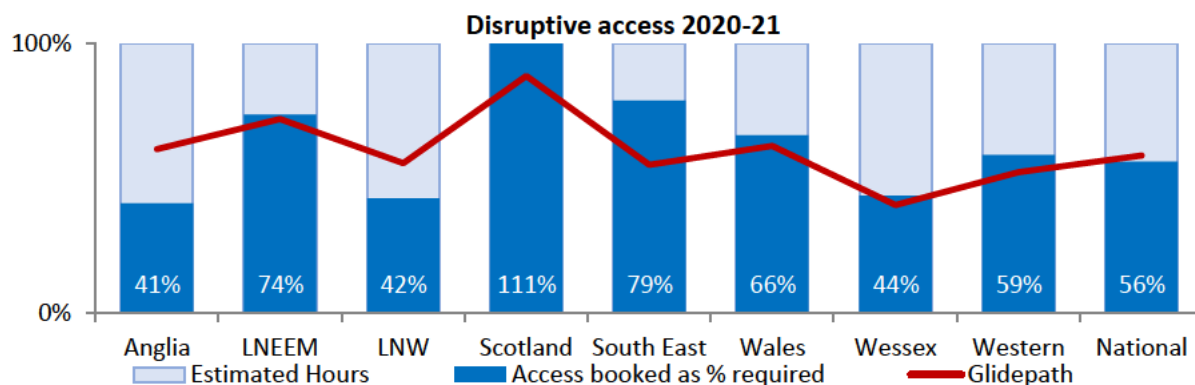
We will continue our work reviewing Scotland's efficiency plans and delivery over the next few months. We will publicly report on these matters.

Wider leading indicators of CP6 readiness

Alongside our PR18 determination we required Network Rail to show that it is better prepared to deliver efficiently from the start of CP6. Network Rail developed a periodic leading indicators report, which, in consultation with us, has improved over time. We have reported on these indicators of year 1 readiness in our 2018 and 2019 Network Rail

Monitor publications. This section provides a short summary of Scotland's year 2 readiness based on some of the key indicators in Network Rail's latest (period 7) report¹⁰.

Securing engineering access to the railway

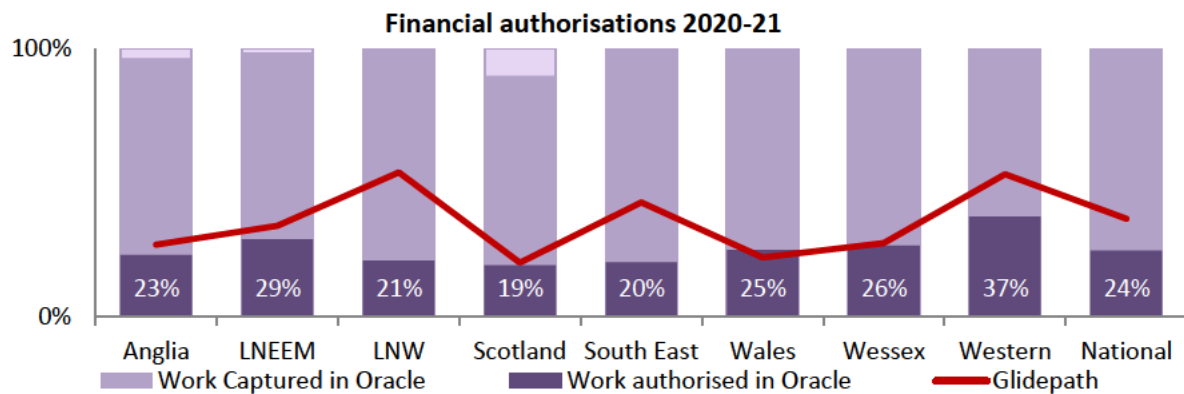


Scotland appears to be on track for booking disruptive access to the network for planned engineering work in 2020-21. It is significantly ahead of its internal target compared to other routes¹¹.

¹⁰ We agreed with Network Rail that as good progress had been made with year 1 planning, the focus of the leading indicators report should be year 2 from Period 6. Network Rail has implemented these changes.

¹¹ Network Rail uses the term 'glidepath' for its internal targets for leading indicators. We note that the current level for Scotland is over 100% of forecast renewals. This partly reflects Network Rail's uncertainty about renewals volumes in year 2 (deferral of work from year 1 and possible acceleration of work from later years). We intend to review the effectiveness of Network Rail regions' possessions planning and use over the next few months.

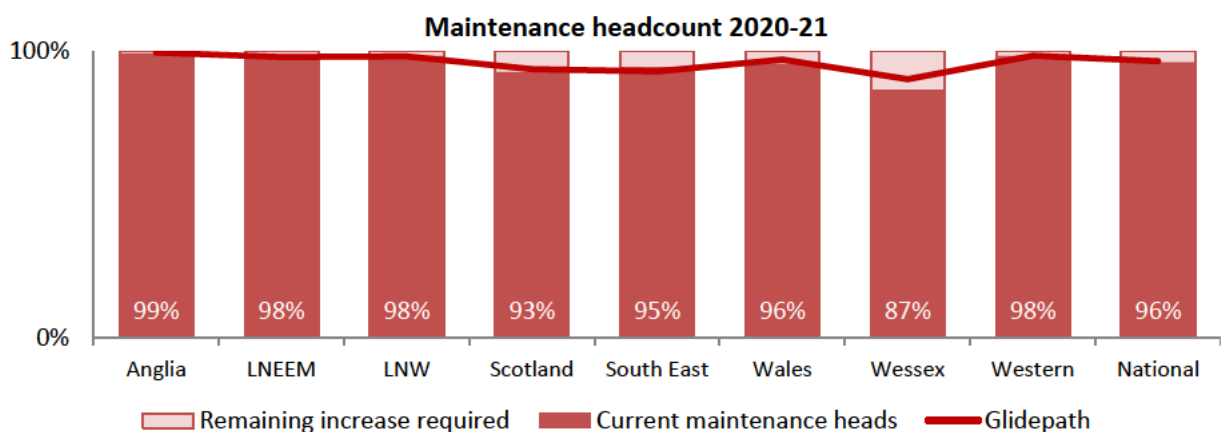
Renewals workbank planning



Similar to most regions, Scotland has only a low level of financial authorisations, although this is consistent with its internal target. Only 19% of renewals projects for 2020-21 (by value) have completed detailed designs and received financial authorisation for delivery. This suggests that Scotland has substantial work to do to finalise its renewals workbanks for 2020-21.

As we have previously reported, financial authorisation is not a particularly useful indicator for understanding the progress of earlier stages of renewals planning. We welcome Network Rail's current work to develop a consistent measure across routes/regions of renewals remits issued and accepted. This should provide a better understanding of the progress of earlier stages of renewals planning. I also recognise the work that Network Rail has done to disaggregate the financial authorisations indicator by asset type to help better understand where key risks may reside.

Maintenance capacity



Scotland's maintenance headcount is currently around 7% lower than planned for 2020-21. Although this is in line with target at this point, it is below most routes.

Efficiency plans for year 2

| Key | Anglia | LNEEM | LNW | Scotland | South East | Wales | Wessex | Western | Total |
|-----|--------|-------|-----|----------|------------|-------|--------|---------|-------|
| (1) | 32% | n/a | 2% | n/a | 0% | n/a | 28% | n/a | 8% |
| (2) | 47% | 69% | 63% | 53% | 69% | 39% | 24% | 64% | 59% |
| (3) | 17% | 16% | 31% | 47% | 22% | 60% | 46% | 35% | 31% |
| (4) | 1% | 5% | 4% | n/a | 8% | 1% | n/a | n/a | 3% |

Key: (1) Projects that have been delivered and waiting for benefits to materialise; (2) Projects in place with delivery date and milestones, business confident in delivery; (3) Strategic theme assigned but no plan in place, or plan in place but low confidence in delivery; and (4) Commitment to deliver, but no strategic theme assigned. 'n/a' means that no value has been assigned, i.e. 0%.

Network Rail uses a colour coding approach in the above table to show the maturity of routes' efficiency plans. Overall, Scotland considers that 53% of year 2 planned efficiencies have projects in place with delivery plans and milestones and 47% have been assigned to strategic enabling themes with routes' commitment to deliver, but no plan in place. Given our concerns about the quality of some renewals efficiency plans and the increased scale of efficiencies that need to be delivered, we consider that the current level of confidence in year 2 efficiencies could be overstated.

Readiness assessment for year 2

| | Anglia | LNEEM | LNW | Scotland | South East | Wales | Wessex | Western |
|-----------------------|--------|-------|-----|----------|------------|-------|--------|---------|
| Disruptive Access | 4 | 3 | 4 | 4 | 4 | 4 | 5 | 5 |
| Workbank Planning | 4 | 3 | 3 | 4 | 4 | 5 | 4 | 3 |
| Maintenance Headcount | 4 | 3 | 3 | 4 | 4 | 5 | 3 | 4 |
| Efficiency | 3 | 3 | 3 | 3 | 3 | 3 | 3 | 3 |

Key: A 5 indicates a high level of readiness and a 1 indicates a low level of readiness.

Network Rail has recently developed a combined readiness assessment based on the indicators reported above. We welcome this as a useful high-level summary of where the greatest risks reside. I also acknowledge Network Rail's ongoing work to improve regions' explanations of their year 2 readiness, although we have yet to see the outcome of this work. We will continue to engage with Network Rail's business review team and Scotland on this, for example, about the quality of the plans to deliver substantially higher renewals volumes and efficiencies in the later years of CP6.