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Chief Executive

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Sent by email
cc DfT, Transport Scotland and Welsh Government

24 May 2019

ORR opinion (under our Managing Change Policy) on Network Rail's "Putting Passengers First" programme

This letter is ORR's Opinion (under our Managing Change Policy) (our Opinion), on Network Rail's "Putting Passengers First" programme.

In 2018, Network Rail undertook an extensive review (the "100-day review") to identify potential improvements in the way it operates. We wrote to Network Rail on 21 January 2019, giving our initial views on the programme and seeking assurances around continued delivery and accountability.

Since then, Network Rail has provided us with some further information. However, it has not provided us with a full description of the programme. This has made it difficult for us to form a view of the programme in its entirety. As such, our Opinion is based on the information provided to us by Network Rail to inform our 21 May Board meeting that discussed our Opinion, including its confirmation that the:

- changes being implemented will not have an adverse effect on its ability to safely deliver the 2018 periodic review (PR18) requirements for control period 6 (CP6[1]), particularly during the implementation period; and
- regional managing directors will be accountable for the delivery of the requirements for CP6 and that it will take steps to ensure it can measure its delivery.

When implementing changes of this nature it is important that Network Rail engages with us, passenger and freight operator representative groups[2], customers (both passenger and freight operators), funders and other stakeholders in an open and transparent manner and takes steps to reflect their priorities in its plans. We will monitor this closely.

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[1] CP6 began on 1 April 2019 and runs until 31 March 2024.
[2] Transport Focus is an example of one of the representative groups.

Based on the information that informed our 21 May Board meeting, we consider that we can still hold Network Rail to account for its activities in both England & Wales and Scotland under this new operating model by taking certain mitigating actions, e.g. Network Rail providing data for the new routes as well as the regions. Therefore, at the moment we are not directing Network Rail to change its programme or placing conditions on it.

Since our 21 May Board meeting, we have become aware of an issue in relation to the transfer of System Operator (SO) responsibilities to the regions[3]. Network Rail's proposal on this is not yet clear and our Opinion does not cover this proposal. We will not be in a position to provide an Opinion on this part of the "Putting Passengers First" programme until after we have adequate information to assess the change and its impact. In particular, by 31 May Network Rail needs to have provided us with a clear detailed proposal, assurance that it will not discriminate between its customers and identified the mitigating actions that it may need to put in place to ensure this.

Should other issues or information emerge about the programme, we expect Network Rail to inform us as soon as possible, so that we can assess the impact of those issues on the programme as a whole. If the information materially affects the programme or its expected impact, we may update our Opinion.

In this Opinion, we have focussed on the following principles and requirements:
- It is essential that while implementing the programme Network Rail maintains focus on its delivery of the PR18 requirements.
- We intend to regulate Network Rail on a regional basis under the new operating model, supported by information at the new route level where appropriate. This will mean working with Network Rail to agree a detailed 're-cut' of its delivery plan on a regional basis.
- To support regulation at a regional level, we will need to continue to use some information at a route level. This will also help to mitigate any issues with transparency and consistency. We will therefore work with Network Rail to identify our requirements for data at the new route level; this will include key scorecard measures (such as CRM-P, FDM-R and CSI[4]) and the financial baselines[5] as well as other information that we currently receive at a route level.
- One of the key themes of PR18 was the need for Network Rail to take account of local issues when delivering its CP6 requirements. Network Rail recognises this and that it needs to focus on understanding performance at a local level. It has said the "Putting Passengers First" programme will support that process and recognises the need for good quality data at a granular level. Therefore, it will continue to provide data on the existing route structure until data is available for the new route structure. Subsequently, it will provide data to us on the new route basis. This will support our regulatory processes and we will update the data protocol and regulatory accounting guidelines to reflect our requirements.
- Network Rail has agreed to provide additional information on how it will monitor its performance against its CP6 requirements, and how it will measure progress with its programme during the implementation period, e.g. how it will monitor

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[3] The issue relates directly to an area covered by Network Rail's network licence.
[4] CRM-P is the passenger consistent route measure, FDM-R is the freight consistent route measure and CSI is the composite sustainability index.
[5] The financial baselines will be provided at the same level of detail as the PR18 route annexes.

accountability and its reporting plans for the implementation period. We will outline our views on Network Rail's proposals in a letter in June 2019.

- Regarding the impact of the new structure on freight and national passenger operators, Network Rail will write to us by 31 May 2019 setting out how it will ensure its approach does not unduly discriminate between its customers, including the governance arrangements that will be in place to protect these customers' interests[6]. We also expect it to set out how it will engage with freight and national passenger operators to achieve this.
- The need for Network Rail to engage with us, passenger and freight operator representative groups, customers (including both passenger and freight operators), funders and other stakeholders, when implementing the plan.

In the annex to this letter, we provide some further context to our Opinion and our understanding of Network Rail's "Putting Passengers First" programme based on the information that informed our 21 May Board meeting.

Requirements on Network Rail

Delivery of the CP6 settlement

It is essential that Network Rail ensures the changes being implemented do not have an adverse effect on its ability to deliver, particularly during the implementation period between June 2019 and April 2020, when programme risk is higher.

We expect Network Rail to write to us by 31 May 2019 explaining the measures it has put in place (in addition to the normal monitoring measures) to enable it to monitor its progress during this period and ensure clear lines of accountability.

In particular, we expect Network Rail to proactively monitor any adverse impacts of implementing the changes on its ability to run a safe, reliable and efficient railway, and deliver for passengers and freight operators, customers (both passenger and freight operators), funders and other stakeholders. Where appropriate, it should take steps to review and amend its implementation timeline, such that it does not adversely affect the day-to-day running of its business. We will monitor this closely.

Accountability

Given the proposed creation of the five regions (with 13 routes sitting beneath them) and the appointment of regional managing directors, it is Network Rail's, and our, view, that accountability will largely be at a regional level in the new structure[7]. It is important that this accountability is clear, so that we are holding the right people/parts of Network Rail to account.

As a result, it is our intention to regulate Network Rail on a regional basis under the new operating model, supported by information at the new route level where appropriate. We will hold Network Rail to account at a regional level for delivering the CP6 settlements and using the funding provided.

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[6] It will also provide this assurance for any other changes that have similar issues.

[7] However, we note that operations and maintenance will be carried out on a day-to-day basis by the new routes, including management of the customer relationship. It is our understanding that accountability for capital delivery (i.e. renewals and enhancements) will be at a regional level.

In order to enable this Network Rail will:

- agree 're-cut' CP6 settlements with us on a regional basis. We expect Network Rail to propose a clear methodology and carry out the necessary work to produce revised baselines including for scorecards (on an equivalent basis to that set out in our PR18 final determination). The revised numbers should be consistent with the delivery plan and simply 're-cut' the data into the regions. We expect Network Rail to undertake appropriate quality assurance to ensure the accuracy of this exercise. We have asked Network Rail to provide us with the additional information for 2019-20 by 31 May 2019. This will allow us to write to Network Rail in June 2019 on the detailed issues for 2019-20, for example in relation to baselines and regulatory minimum floors;

- work with us to put in place a process for identifying our requirements for data at the new route level that will help mitigate any issues of transparency or consistency[8]. This will include key scorecard measures (such as CRM-P, FDM-R and CSI) and the financial baselines as well as other information that we currently receive at the existing route level;

- continue to provide data on the existing route structure until data is available for the new route structure. This will support our regulatory processes and we will work with Network Rail to update the data protocol and regulatory accounting guidelines to reflect our requirements. We need to agree with Network Rail a clear set of principles, a plan and timescales for the provision of this data;

- provide agreed data restated on a regional and new route basis from the start of CP6, following joint work to update the data protocol;

- for the purposes of setting regulatory minimum floors and assessing trends over time, provide the data for CRM-P, FDM-R and CSI back to the beginning of CP5, on a regional basis; and

- take into account the views of passenger and freight operator representative groups, customers (both passenger and freight operators), funders and other stakeholders, when implementing the plan.

Although we plan to regulate Network Rail at a regional level from 24 June 2019, some areas will continue to require a route focus. For example, econometric benchmarking of maintenance and renewals costs is key to comparative regulation and we expect that it will be appropriate to continue to carry this out at a route level[9]. In order to facilitate this, Network Rail needs to maintain sufficient granularity in the data it collects, to ensure a consistent time series of data for its own analysis, which can also be provided to us. We will need to discuss this in more detail with Network Rail, as it develops its view of how the interface between regions and routes will work.

We need to be in a position to decide on the 're-cut' baselines for 2020-21 to 2023-24 as soon as possible and no later than March 2020 (we expect Network Rail to take appropriate steps to ensure we have the information in sufficient time to allow an appropriate review well before this date). We will continue to engage with Network Rail on the practicalities of this and we will report on progress in a letter in

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[8] One of the key themes of PR18 was the need for Network Rail to take account of local issues when delivering its CP6 requirements. Network Rail recognises this and that it needs to focus on understanding performance at a local level. It has said the "Putting Passengers First" programme will support that process and recognises the need for good quality data at a granular level.

[9] It is important that the comparability of the data is not lost through organisational changes.

June 2019. We will also work to identify what further datasets we may require at the new route level.

Safety

We are focused on ensuring that Network Rail assures itself that the changes do not lead to a loss of corporate focus on the key risk areas and that there is no loss of control over safety-critical work, which is currently mandated and monitored by the centre. In addition, the centre/route relationship and responsibilities need to be decided, so that the network functions safely.

In order to make the proposed changes to its business safely, Network Rail will need to employ good change management principles. In addition to our input into the safety validation panel[10], we will assess some of these matters when Network Rail submits a significant change Railway and Other Guided Transport Systems Regulations (ROGS) authorisation application later in the year.

Scorecards

The CP6 scorecards are an important tool for enabling Network Rail to engage with, and be held to account by, its passenger and freight operator customers and other stakeholders on a local basis. Therefore, it is important that Network Rail engages with them about what its programme will mean for the scorecards. It also needs to be clear how it is intending to use railway boards to assist this process.

We understand that Network Rail intends to move to regional scorecards from 24 June 2019, and that it intends to allow regional managing directors to determine how to monitor and hold their own routes to account. Whilst it may be appropriate to present the scorecards on the same basis as other reporting, i.e. at a regional level, we are concerned about whether its passenger and freight operator customers and other stakeholders will have sufficient transparency and influence under this approach. Therefore, we expect Network Rail to engage fully with its train operator customers and other stakeholders on this issue and make any changes to the scorecards (through the existing processes) in order to address any concerns. We will monitor this closely.

For 2019-20, Network Rail has confirmed that all existing agreed route customer measures would transfer to the regional scorecards. We understand Network Rail will include new aggregated regional targets for the key measures that we required in our determination, e.g. CRM-P. Network Rail will do this by aggregating existing route level numbers to create a new regional level target line on the scorecards.

Network Rail is considering representing the measures for each passenger and freight operator customer (including train performance measures) as a single aggregate[11] customer measure on the regional scorecards[12]. We recognise the practical issues influencing Network Rail's decision, but we are concerned about the

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[10] The safety validation panel is part of Network Rail's process for managing changes and provides some independent governance.
[11] By an aggregate customer measure, we mean that Network Rail's performance against the operator train performance (e.g. time-3 and the Public Performance Measure (PPM)) and customer measures have been consolidated into one line on the regional scorecards.
[12] Except for Scotland.

impact of this on transparency and the ability of operators to see what measures and targets are being agreed across the company. We expect Network Rail to put measures in place to address this.

Network Rail has said that it will take a decision on whether new train operator customer measures for subsequent years would be set regionally or on the new route basis. It has indicated that this will be at the discretion of regional managing directors. As Network Rail's view on this is not yet clear, we cannot fully consider yet how we will hold the regions to account and how to take account of the relationship between the regions and the routes.

We also included requirements in our PR18 determination to enable us to assess whether Network Rail was delivering a sustainable network (such as an annual report per asset per route). We do not yet have sufficient information to understand whether we will need this at a regional or route level or both.

We will continue to require a comparison scorecard[13] for the measures we identified in our PR18 determination. Again, we expect this to be at a regional level, but we may also require some further comparison at the new route level.

Regulatory minimum floors

We need to decide how to treat the regulatory minimum floors for CRM-P, FDM-R and CSI, but we expect that these will be set at a regional level. We will need to test how this works (using data back to the beginning of CP5 as noted above) and expect to keep this under close review in 2019-20 (the first year of CP6). While recalculating the floors will be largely mechanistic, there are still material choices in how we do this (simple aggregation, weighted aggregation, or applying the same formula that we used for PR18).

Network Rail has said that it will provide the supporting information to us by 31 May 2019. Conducting the necessary analysis and reaching agreement on these issues by 24 June 2019 will be challenging.

Asset Management

In our PR18 final determination, we highlighted the importance of maintaining a sustainable asset base which supports both value-for-money and a punctual railway. We were equally clear that a significant increase in renewals spend was necessary, and that it should be targeted at those areas of most pressing need to ensure a safe, reliable and sustainable network. Whilst we are yet to see Network Rail's detailed proposals for the structure of maintenance and renewals responsibilities going forward, we are clear that those proposals must not be detrimental to the asset management plans.

To provide visibility of Network Rail's progress in meeting the above objectives, we expect that each routes asset management plan (RAMP) will be delivered in its entirety in CP6, subject to Network Rail's internal change control process.

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[13] This is a scorecard that compares performance across the routes.

To assure ourselves that Network Rail is meeting its licence conditions regarding asset management, we will continue to require route level information about asset performance and assurance activities, and on renewals and maintenance costs and volumes. This will also be the case for any wider asset management requirements set out either within the PR18 final determination or the RAMPs.

Freight and national passenger operators

We are mindful of the need for adequate governance arrangements to give sufficient visibility and influence to freight and national passenger operators[14]. The new arrangements (in which the Freight and National Passenger Operators route (FNPO) becomes part of a service directorate, accountable to the regions for supporting their effective operation) could potentially worsen rather than improve existing concerns.

Network Rail has said that the changes it is making will not affect the ability of the FNPO to deliver its PR18 requirements. It will confirm to us by 31 May 2019 how it will ensure its approach does not unduly discriminate between its customers, including the governance arrangements that will be in place to protect these customers' interests[15]. It will also set out how it will engage with freight and national passenger operators to achieve this.

Other issues

It is not yet clear how the new routes will be created from the existing eight routes, e.g. the proposals for the London North Western and East Coast routes. Given our requirements for some data to be provided at the new route level, we need to better understand Network Rail's proposals and timescales in this area.

Next steps

We will continue to engage with Network Rail as this programme progresses. In particular, Network Rail needs to work with us on the issues identified above and provide the required information.

By 31 May 2019, Network Rail will:
- provide a clear detailed proposal of the transfer of SO responsibilities to the regions, assurance that the transfer will not discriminate between its customers and identified the mitigating actions that it may need to put in place to ensure this;
- provide a clear methodology for revising the baselines for scorecards (including financial data);
- provide the information needed to calculate the regulatory minimum floors;
- write to us explaining the measures that it has put in place (in addition to the normal monitoring measures) to enable it to monitor its progress during this period (and ensure clear lines of accountability); and
- write to us explaining how its approach does not unduly discriminate between its customers, including the governance arrangements that will be in place to protect freight and national passenger operators' interests. It will also set out how it will engage with the freight and national passenger operators to achieve this.
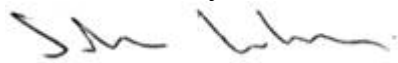
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[14] We raised concerns about this in our PR18 settlement for the FNPO.
[15] It will also provide this assurance for any other changes that have similar issues.

We will be seeking the views of passenger and freight operator representative groups, customers (both passenger and freight operators), funders and other stakeholders on how well Network Rail has engaged with them on the "Putting Passengers First" programme.

We will outline in a letter in June 2019 how Network Rail will monitor performance against its PR18 requirements and progress with its programme during the implementation period. The letter will also outline our views on Network Rail's proposed baselines (including for scorecards) and regulatory minimum floors.

Yours sincerely,

John Larkinson
Chief Executive

Annex: Further context to our Opinion

1. Background

Managing Change Policy

The 2018 periodic review (PR18) determined what Network Rail should deliver in respect of its role in operating, maintaining and renewing its network in control period 6 (CP6[16]) and how the funding available should be best used to support this. This determination provided individual settlements for each of the geographical routes[17], the Freight and National Passenger Operators (FNPO) route and the System Operator (SO) to enable us to monitor Network Rail's delivery at a route and an SO level, including through the use of the routes'/SO's scorecards.

We put in place a Managing Change Policy (MCP) to help manage changes to route and SO funding and PR18 requirements during CP6. Network Rail is required under its network licence to comply with this policy.

The MCP applies to 'Relevant Changes', which are those that affect the accountability or funding of a route business and/or SO. Relevant Changes can be categorised as Level I, Level II or Level III depending on their impact and significance.

For smaller Level I changes Network Rail needs to notify us of the changes that have been made (annually, after they have been made). Network Rail must discuss more significant Level II changes with us, and seek our Opinion on Level III changes before it decides whether to go ahead with the change. ORR can direct that a change is not made or place conditions on the change being made, if it is deemed 'exceptional' in that it would undermine the settlements in a way that cannot be mitigated.

In determining the appropriate way of managing a potential change, the MCP focuses on three key aspects:
- the impact on our ability to regulate Network Rail and hold it to account effectively, including being able to compare the performance of the route businesses;
- the materiality in terms of its monetary impact and potential impact on outcomes delivered to customers, end-users[18] and funders; and
- whether the route businesses and/or SO impacted by the change agree[19] to it.

In addition to the processes set out in the MCP, we will consider the forecast impact on end-users, customers (both passenger and freight operators), funders and other stakeholders and the outcome of Network Rail's stakeholder engagement and the impact of the change on the conditions in Network Rail's network licence, such as those regarding undue discrimination between its customers or information requirements.

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[16] CP6 began on 1 April 2019 and runs until 31 March 2024.
[17] At the time of the PR18 determination, Network Rail had eight geographical routes, the FNPO and the SO as well as various central functions.
[18] End-users include passengers and freight customers.
[19] The meaning of 'agreement' in this context is explained in the MCP.

Network Rail's "Putting Passengers First" programme

In February 2019, following an extensive review ("the 100-day review"), Network Rail announced that it will make changes in how it operates. Network Rail's proposal is a new model for the organisation; one that Network Rail considers will better align with train operators and franchises. Network Rail has confirmed that this is intended to bring track and train closer together, embed a customer service mind-set and ensure a better focus on performance.

Network Rail has advised us that this is expected to mean:
- creating five regions, each led by a managing director. These will be Eastern, North West & Central, Scotland, Southern and Wales & Western;
- increasing the number of routes from eight to 13[20], with these routes reporting into the five new regions. Each route will have responsibility for the day-to-day delivery of its operations and maintenance activities and managing the customer relationship;
- the regions will have accountability for capital delivery (i.e. renewals and enhancements);
- devolving the Infrastructure Projects directorate to the five regions;
- forming a Network Services directorate to support the regions and routes in delivering operational performance and customer service. FNPO, national performance team, incident management and operational security will form part of this Network Services directorate;
- Network Rail will make some relatively small changes to its consistent measures in its scorecards; and
- devolving to the routes/regions, some SO activities (e.g. early project development, early (pre-D40) timetabling and franchise specification) and some aspects of the Safety, Technical & Engineering directorate.

Network Rail intends to implement the programme in four phases. The first phase is expected to go live on 24 June 2019 with the creation of five regions and the devolution of parts of Infrastructure Projects and the SO. The final phase is expected to be completed by May 2020.

Basis of our Opinion

Network Rail has said that it thinks that the proposed changes will have benefits to customers and other stakeholders over the medium/long term. However, we note that the changes are significant in scale, complex, time consuming and potentially costly. It is for Network Rail to determine whether these changes will better enable it to deliver its commitments to customers and other stakeholders over the control period and beyond. As such, our Opinion is not an assessment of the potential costs and benefits of these changes. Instead, our Opinion focuses on the implications of the change for regulating Network Rail and the effect on end-users, customers (both passenger and freight operators), funders and other stakeholders.

This is the first Opinion we have issued under the MCP (which is new for CP6). As the programme is still in development by Network Rail, we do not currently have all

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[20] This includes a route to cover the existing Network Rail High Speed activities.

the information necessary to form a detailed view on the entirety of the change. In view of this, our Opinion focuses on the high-level issues, based on the information we have received to date.

We are also mindful of ongoing discussions on outstanding issues with the 2019 Delivery Plan. We expect these issues to be resolved shortly. We will then follow up our opinion with a letter in June 2019 on the more detailed issues, such as the baselines that will be used to hold Network Rail to account during the implementation of the programme. We expect to issue a letter around the end of the year on any residual issues, which will affect how we hold Network Rail to account for the remainder of the control period.

2. Categorisation of the change

Based on the information provided to us by Network Rail so far, we consider that the proposed change will affect the accountability of the route businesses and change the allocation of funding across England & Wales. As such, the proposed change is considered to be a 'relevant change' under our MCP.

The MCP classifies changes by the potential scale of the impact on route funding and accountability. We have engaged with Network Rail over the last few months, in order to better understand the rationale for the changes and their likely impact.

Given the scale of the proposals and the likely effect on accountability, we have agreed with Network Rail that the change should be treated as a Level III change as defined in the MCP. On the basis of what we have seen so far, we do not consider that the change should be treated as exceptional, and we will not be placing conditions on Network Rail.

The evolving nature of the proposed programme means we are not yet in possession of all the information we need to fully assess the impact of the changes. Our requirements in this regard are set out in more detail above. Should additional information emerge about the potential impact of this proposed change that could alter its categorisation as a Level III change or alter the views set out in our Opinion, we would expect Network Rail to inform us in a timely manner, in accordance with the MCP. We would then need to consider what steps we might take.

Outside of the MCP, we also have other tools for addressing issues that may arise because of these changes, such as the Network Licence. This contains other provisions that we can use to address any further requirements that may arise as we move through the process (e.g. regarding undue discrimination or information requirements).