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OFFICE of
RAIL REGULATION

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3 February 2006

Periodic Review 2008 - Network Rail's initial strategic business plan

1. I am writing to set out expectations for your initial strategic business plan submission. We expect you to submit your plan on or before Friday 23 June.
2. We see your plan as a key step in the periodic review process and anticipate that it will meet two primary objectives:
 - to enable you to set out your initial view of how the likely needs of the train and freight operating companies servicing the demands of both passengers and freight customers, government, other funders and other stakeholders can best and most efficiently be met;
 - to inform development by the Department of Transport and Transport Scotland of their high level output specifications and statements of funds available.
3. We expect your submission will be a complete strategic business plan. The focus will be on the next control period 2009-10 to 2013-14 (CP4) setting this in the context of the plan for the remainder of CP3 but also including high level projections over a longer time period. Your plan should represent your own proposed strategy for operating, maintaining and developing the network, setting out what you believe you can reasonably achieve consistent with your view of the likely availability of funding. You will need to expose all the material assumptions underpinning your plan. In order to meet the second of our primary objectives we expect your submission will also include assessments of a number of variants and sensitivity analyses to key material assumptions.
4. To assist you in developing your initial strategic business plan we set out below guidance and our expectations in a number of areas. These relate to planning assumptions, alternative scenarios/sensitivities, efficiency, asset management and sustainability, outputs and finally disaggregation.

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Planning Assumptions

5. The plan should be based on your assessment of what you can and should do during the control period and beyond to enable:
- the railway industry to meet a reasonable projection of passenger demand growth and the reasonable requirements of freight operators;
 - the railway industry to deliver sustained good performance at or above the level you plan to have achieved by the end of the current control period;
 - the railway industry to maintain and improve its position in the market for transport and meet the reasonable expectations of passenger and freight operators and their customers;
 - Network Rail and other railway companies to meet their safety obligations, which we believe should lead to continued incremental improvement in safety;
 - you to sustain the longer term capability and availability of the network needed to meet reasonable requirements of users.
6. You should set out, at a high level the criteria and all the material assumptions, which you have adopted in developing your plan.
7. We expect this and subsequent submissions to draw increasingly on the outputs from your programme of route utilisation studies to develop coherent route-based plans from a whole-industry perspective.
8. We note that a consensus view of passenger demand trends is emerging through work on development of the high level output specification, and we expect that your planning assumptions will be compatible with this.
9. For this submission, you should plan based on the current structure of access charges. We will issue further guidance on the future structure of charges later in the periodic review.
10. The revised timetable for the long term signalling review identifies that you will be able to make your full funding submission in this plan. This element of your plan should therefore be fully developed and supported, to enable us to issue draft conclusions on signalling activity and expenditure in advance of the main review.

Alternative scenarios

11. We consider it will be important as a benchmark, to understand the efficient minimum cost and the implications for outputs of just **maintaining a non-degrading infrastructure** in CP4. This could best be illustrated by a full variant of your plan based on the following assumptions:



- providing for traffic volumes as projected for the end of CP3, plus any additional commitments to which you are contracted, but only for such further growth in train-kilometres as would be self-financing;
- maintaining the existing overall capability of the network together with currently committed enhancements (allowing for local variation in capability within a route to meet future customer needs where this can be delivered by planned renewal programmes at no extra cost); and
- holding overall asset condition constant from the end of the current control period.

12. We think it will be necessary for you to demonstrate fully the implications of such a scenario in the context of growing passenger and freight demand, including the extent to which it would affect levels of crowding and thereby also train service performance.

13. Clearly, it will be important for us all to understand the implications of alternative outputs or assumptions. We look to the network modelling framework (and particularly the infrastructure cost model and performance model which you are developing) to play a significant part in this. You will need to develop, test and commission these models rapidly to inform your plans.

14. As a minimum your plan will need to evaluate variant scenarios around factors including:

- safety: identifying any targeted investments which might be appropriate to address specific areas of risk, which would deliver benefits efficiently whilst not in themselves being required by legal obligations;
- possessions: implementation of a radical change in possession strategy to reduce overall industry costs (it will be essential for the 'core' submission to make clear the possessions strategy on which it is itself based); and
- performance: illustrating how performance trajectories would be affected by higher or lower levels of Network Rail expenditure for a given level of network use.

15. Given the time pressures we will be content for these scenarios to be provided separately from the main June submission, but will be required not later than Friday 29 September. We will work with you and colleagues in the funding bodies to agree details of these variants in the coming weeks.

Efficiency, asset management and sustainability

16. You should base your plan on your view of the best and most efficient means of delivering the outputs from a whole industry perspective. Given the size of the funding challenge faced by the industry, we would expect you to be exploring any radical options to achieve cost reduction as well as continuing the process of incremental improvement. You should consider whether the distribution of your expenditure could be optimised to deliver a higher overall level of outputs for a given level of expenditure, whilst continuing to meet the reasonable requirements of users on different parts of the network.



17. You should also identify the scope for alternative decisions about the timing of maintenance and renewal expenditure on assets, where this would affect the profiling of expenditure between CP4 and later periods but would not materially detract from outputs.

18. You will need to demonstrate how your plans contribute to the long-term sustainability of the industry. In this connection, we ask you to provide summary high-level projections of key financial and other measures for each of the three following 5-year periods (ending in 2028/9).

19. Wherever possible, we expect you to provide details of the technology choices you are considering that affect CP4 and beyond.

Outputs

20. We expect your plan to include projections of outputs at both Network Rail and – where appropriate – industry level. We expect these projections to include:

- any changes to network capacity and capability;
- improvements to levels of safety risk;
- changes to passenger load factors and crowding;
- train service performance as measured by delay minutes (passenger and freight, separately for Network Rail and operator-caused delay) and PPM (passenger only). This should reflect the impact of any changes to levels of crowding;
- network availability, initially in qualitative terms (and by the end of this year based on a suitable agreed KPI); and
- asset condition and serviceability measures, including an improved measure for the condition of stations.

Disaggregation

21. We will write separately to Paul Plummer to provide you with the templates of the detailed information and data that we expect you to include in your initial strategic business plan.

22. These templates will include:

- a breakdown of income into the various categories. This will include franchised track access income e.g. fixed charges and schedule 4 income, grant income and other single till income e.g. property income;
- an analysis of expenditure. This will identify expenditure by cost type e.g. salaries and materials and activity e.g. maintenance and human resources. It will also identify expenditure by asset type. Where appropriate further detail may be required;



- your financial assumptions which will be in a suitable format for inclusion in the financial model that we used to support our December 2005 initial assessment . The assumptions will include items like amortisation, RAB additions, interest costs, allowed rate of return, inflation and tax;
- analysis of the volume of your projected activity and projected outputs e.g. track renewal and PPM.

23. My colleagues will be working with your team to develop these templates. We expect to be able to send them to you before the end of February.

24. We are expecting your submission to provide complete and separate plans for GB, England and Wales, and Scotland that clearly identify income, expenditure (including appropriate financial assumptions), activity volumes and outputs as described above. In addition, expenditure, activity volumes and outputs should also be identifiable separately for each of your strategic routes. We understand that your submission will include detailed figures at the level of your infrastructure cost model route sections, which should facilitate this.

25. It would help if you were able to identify separately any material expenditure you are anticipating which would be supported by funding from the National Assembly for Wales, Transport for London, PTEs other local government bodies or private sector third parties.

Next steps

26. Throughout the periodic review process, we will look to you to lead work to develop and substantiate your submissions, including assumptions about the scope for further improvements in efficiency. We will work closely with you to ensure that we have a shared understanding about the nature of the supporting evidence that you will be providing.

27. Initially we will seek to ensure, through your corporate planning and regulatory affairs team, a mutual understanding of the requirements I have set out above.

28. We note that the development of the infrastructure cost model and performance model are also crucial to the review process. We will continue to work with you to agree, as early as possible, further stages of the development programme which will clearly define how these models will be able to contribute to the review.

29. We will review your plan and query any area where we are unclear or do not have a full understanding. We will analyse your plan closely and provide you with structured feedback on areas where we have concerns and doubts. We will look to the Reporters to assist us as appropriate in our review and analysis of your plan. Our aim will be to assist you to address these concerns etc. in the later submissions you will be making as part of the review.

30. We will publish our initial assessment of your plan in late November 2006.



31. I am copying my letter to Mike Mitchell (DfT), Malcolm Reed (Transport Scotland), Justin McCracken (HSE), Adrian Shooter (ATOC) and Keith Heller (EWS). I am placing a copy on the ORR website.

Bill Emery

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