Network Rail's response to ORR's Draft Determination for CP6

31 August 2018

Contents

Summary

ORR's Draft Determination is a critical step in the development of Network Rail's Strategic Business Plan (SBP) for a better railway for a better Britain. It confirms the funding that will be available to enable Network Rail to run a safe, reliable, efficient and growing railway. This document is Network Rail's response to ORR's Draft Determination for CP6.

We welcome ORR's recognition of the progress that we have made during CP5 and its acceptance of the majority of our proposals. ORR has helpfully recognised the improvement in the development of our plans. This reflects the increasing role of the routes, leading to a much clearer set of route plans for CP6, with closer involvement of train operators and other stakeholders. This has enabled routes and the System Operator to own their business plans.

While there are many positive aspects of ORR's Draft Determination, there are a few important areas where we have developed an alternative proposal for adjustments to our SBP. We set out the basis for our alternative proposals in this response.

The key areas are:

- the scale of the further investment in improved asset sustainability
- the reduction in research and development (R&D) expenditure
- the level of additional efficiency savings.

The approach to regulation of train performance is important as there is a significant shortfall against this year's forecast and there continues to be misalignment between our forecasts and franchise targets.

ORR is concerned that renewals expenditure in the SBP is not sufficient to maintain **asset sustainability** in England & Wales. Its view reflects both the assurance review carried out by our Technical Authority and our long-term modelling of renewals expenditure and asset sustainability. We agree that there should be an increase in the investment in asset sustainability.

We have further reviewed our long term-models. As they are based on today's railway, they do not include future improvements in efficiency and asset management from future R&D investment and continuous improvement. In addition, the CP6 renewals expenditure in our SBP does not reflect all asset management activity, including activity that is carried out within enhancement projects. We therefore propose an increase in asset sustainability investment in England & Wales that is lower than ORR's proposal, while achieving the same outcome of sustainable funding.

In Scotland, we agree that an increase in asset sustainability investment is not required. However, since publication of the SBP, we have identified renewals cost increases relating to the emerging scope of the Carstairs project and the need for the replacement of seven bridges at potential risk of failure.

We agree that the SBP did not include a robust plan for **R&D investment**. We have therefore revisited and strengthened our plan and propose that R&D investment of £245 million is funded in CP6. This will deliver savings of around £900 million over the subsequent 15 years. ORR's proposals would result in a significant reduction from CP5 as it has not taken into account the consolidation of our R&D activity into a single programme for CP6. We are also proposing a formal programme review in 2021 to ensure the R&D programme is on target and to redirect funds if it is not.

ORR has proposed an increase in **efficiency savings** by £659 million. This represents a significant stretch on our SBP, increasing the required net savings by over 40 per cent. We have reviewed the evidence for further efficiency that underpins ORR's Draft Determination. Our response identifies a number of concerns with ORR's analysis which we do not consider provides sufficient evidence for the increased savings.

Recognising ORR's challenge, our routes and functions have revisited their plans. They have proposed additional savings of £347 million. While these further savings are owned at a local level, they are not yet underpinned by clear delivery plans and routes are concerned that they increase the risk to delivery of their core plans. While recognising the increased uncertainty, we are increasing the route proposals by a further £144 million to reflect potential unidentified efficiency savings. These could be achieved, for example, through our ongoing standards review. While routes do not have specific plans, they have accepted these further savings, while again highlighting the further increases in delivery risk. Route ownership of their plans is critical to successful devolution.

We agree that we should include **additional safety investment** of £80 million in our plan. We are concerned that ORR's proposed further increase in **property revenue** of £67 million over CP6 is not achievable as we are experiencing a slow-down in property retail income. We have further reviewed our plans and propose increasing our CP6 income forecasts by £25 million.

We welcome ORR's acceptance of most routes' forecasts of Network Rail delay based on the Consistent Route Measure of Performance. We have made some consistency changes to our **train performance** forecasts, including updating the forecast to P50 for South East route as highlighted by ORR.

Since the May 2018 Timetable we have seen a further deterioration in performance including a step change deterioration for some operators. It is not yet possible to be definitive about the full causes of that deterioration. There is therefore uncertainty about the required interventions and the time it will take to recover performance to previously planned levels. We have therefore further updated the forecasts, considering both the current issues and the likely delay to future changes to the timetable. Given the level of uncertainty in these forecasts, we are proposing that Schedule 8 benchmarks should be further reviewed in CP6.

There continues to be significant misalignment as many operators' franchise targets have been set at levels that are not substantiated by credible delivery plans. While many train operators informally acknowledge this, there is a reluctance to reduce targets without formal DfT agreement. We will continue to work jointly with train operators to further develop train performance improvement plans.

We have continued to discuss the requirements of the **Scotland High Level Output Specification (HLOS)** with ORR and Transport Scotland. As some requirements are not suited to being captured on the route scorecard, we have developed a HLOS Tracker to avoid any potential confusion with Scotland's route scorecard. Some requirements need coordinated activity across the industry. It will also help create clarity of responsibilities across the industry in responding to the HLOS.

We agree that we need to inform ORR about **changes in our business plan** and our organisational structure consistent with ORR's proposed managing change process. It will be important that materiality thresholds are appropriate, recognising that the organisation and the business plan will continue to evolve during CP6.

We are acutely aware of the need to deliver our plan in the early years of CP6. We have developed a range of leading indicators so that we can monitor **our readiness for CP6**. We review these indicators every period with routes, which are continuing to develop more detailed information to demonstrate their readiness for CP6.

The alternative proposal shows that we have responded to the challenges set out in ORR's Draft Determination. The routes and national functions have agreed to the proposed changes, which maintains ownership of the plan. We therefore believe that ORR should be able to use our response as the basis for its Final Determination. This would mean that routes would not be required to carry out further replanning following the Final Determination, increasing further our confidence in delivery and ensuring strong ownership of the plan continues at all levels in the organisation.

Network Rail's response to Draft Determination

1. Introduction

ORR's Draft Determination is a critical step in the development of Network Rail's Strategic Business Plan (SBP) for a better railway for a better Britain. It confirms the funding that will be available to build on the transformation of Network Rail that commenced in CP5. This document is Network Rail's response to ORR's Draft Determination for CP6.

We welcome ORR's recognition of the progress that we have made during CP5 and its acceptance of the majority of our proposals. ORR has recognised the improvement in our plans that has resulted from:

- Increasing the role of the routes and the creation of a more distinct System Operator
- Closer involvement of train operators and other stakeholders
- Preparation and justification on the basis of bottom-up analysis of the activity and efficiency plans for each route
- A separate plan for the System Operator to enable better use of the national network.

This has enabled the routes and System Operator to own their business plans, which ORR has recognised is an important step forward.

We welcome that ORR's approach has been guided by principles that are consistent with the transformation of Network Rail. It is consistent with devolution of accountability to routes, with separate funding settlements for each route and route-based monitoring. We strongly support ORR's approach to reinforce the relationship between Network Rail and its customers by embedding scorecards in the regulatory framework and stressing the importance of improved stakeholder engagement.

ORR's recognition of the need for a significant increase in funding for the railway has been critical for the development of the CP6 plan. ORR has supported the investment in maintenance and renewals as well as an increase in expenditure to strengthen the capability of the System Operator. This will enable the System Operator to provide transparent, independent analysis of how to improve the railway for all funders.

We are acutely aware of the need to deliver our plan in the early years of CP6. We have developed a range of leading indicators so that we can monitor our readiness for CP6. We review these indicators every period with routes, which are continuing to develop more detailed information to enhance their readiness for CP6.

While there are many positive aspects of ORR's Draft Determination, there are some areas where we are concerned about its conclusions. The key areas are the scale of the investment in improved asset sustainability, the reduction in research and development (R&D) expenditure and the level of additional efficiency savings. While we agree with ORR's objectives to maintain asset sustainability and drive efficiency, we consider they can be achieved in a better way. The approach to regulation of train performance is also critical as there is a significant shortfall against this year's forecast and there continues to be misalignment between our forecasts and franchise targets.

In this response, we provide an alternative proposal of the adjustments to our SBP that would maintain route ownership of our CP6 plan. We also explain the rationale for these alternative proposals. We believe that ORR should be able to use this as the basis for its Final Determination.

2. Expenditure and efficiency

Summary of alternative proposal for CP6

We agree with many aspects of ORR's Draft Determination. For those areas where we have a different view, we have developed alternative proposals for CP6, which are summarised in the table below, and discussed in further detail in this section.

£m	E&W DD	E&W proposal	Scotland DD	Scotland proposal
Asset investment	870	538	-	70
R&D	(309)	(174)	(32)	(21)
Efficiency	(586)	(428)	(73)	(63)
Safety	80	79	-	1
Property	(64)	(24)	(3)	(1)
BTP	-	-	(40)	(40)
Performance Innovation Fund	9	9	1	1
Total	**-**	**-**	**(147)**	**(53)**

We have included route analysis of the proposal in Appendix 1.

Asset sustainability in England & Wales

ORR is rightly concerned that renewals expenditure in the SBP does not appear to be sufficient to maintain asset sustainability in England & Wales. Its concern is informed by both the assurance review carried out by our Safety, Technical and Engineering (STE) team and our long-term modelling of renewals expenditure and asset sustainability. It has therefore proposed that Network Rail should increase its investment in improving asset sustainability in England & Wales by around £1 billion. This would be funded by reduced R&D expenditure and increased efficiency savings.

We note that the net savings identified by ORR totalled £959 million. As ORR also proposed additional investment in safety improvements and the creation of a Performance Innovation Fund, ORR's Draft Determination would provide additional funding of £870 million to invest in asset sustainability.

We agree that there should be additional investment in asset sustainability. In July, we provided ORR with details of the potential projects that would be delivered if funding of around £1 billion were available for asset sustainability investment, as proposed in the Draft Determination. Since then we have reviewed the rationale for this and have now developed an alternative proposal for the additional investment to total £538 million. This also needs to cover the further Schedule 4 costs.

Long-term modelling

This proposal is informed by a review of our long-term modelling of future renewals expenditure. Our long-term models suggest that the CP6 renewals expenditure in the SBP is around £2 billion less than the long-term average for subsequent control periods. However, they do not produce precise forecasts of future renewals or asset condition.

We have concluded that our long-term models are static as they are based on the application of today's policies and technologies. They do not include efficiency and asset management benefits from future R&D investment and continuous improvement.

We know from past experience that new technology will improve asset management practices. For example, we have achieved a reduction of five per cent in the required level of track work as a result of improvements since the start of CP5. Technology will also improve our asset condition knowledge and enable us to target maintenance and renewals more accurately, particularly for earthworks.

We have also made significant improvements in our asset management capability, which has been independently measured using the Asset Management Excellence Model. This increases confidence in our ability to deliver further benefits from our R&D programme, delivering sustainable benefits in long-run renewals.

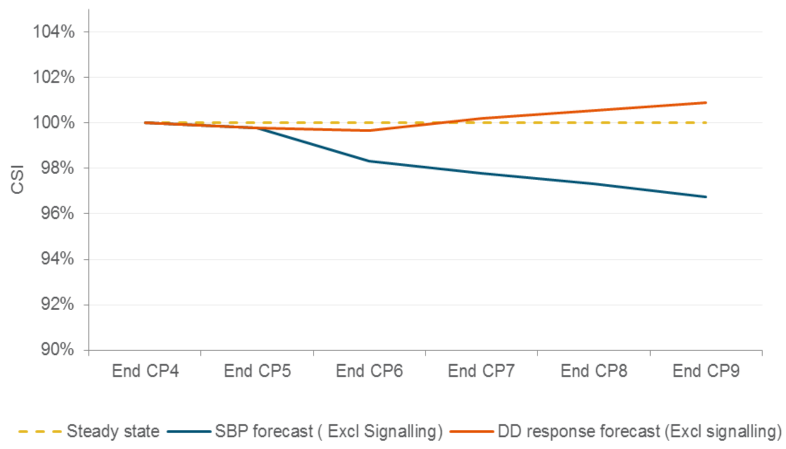
We estimate that investment in R&D during CP6, together with deployment of our Intelligent Infrastructure programme and continuous improvement in our asset management, will deliver benefits of £1.8 billion over the subsequent 15 years.

The models also do not include future efficiency savings. The models do not include the full effect of CP6 savings (£600 million) nor any savings beyond CP6. We have assumed additional savings of £300 million in subsequent control periods. While there is clearly considerable uncertainty forecasting efficiency beyond CP6, we consider our estimate of savings beyond CP7 is conservative.

These adjustments reduce average long run renewals on our core assets (excluding signalling) from £12.4 billion to £10.9 billion per control period.

Our analysis excludes signalling renewals. There is a significant bow wave of renewals in the next few control periods as signalling systems become life expired. Renewing on a like-for-like basis will require additional funding and present huge deliverability challenges. We are therefore developing our plans for the Digital Railway. We expect to be able to reduce significantly the cost of ETCS technology, potentially by 30 per cent. This will enable us to develop an affordable, deliverable programme for replacing signalling systems. The programme includes whole industry costs as there needs to be full integration between rolling stock and infrastructure. We are also exploring the potential for third party funding. The long-term costs of signalling renewals therefore need to be considered separately.

ORR is rightly concerned about the decline in the Composite Sustainability Index during CP6 and beyond. Like our long-term renewals modelling, this presents a conservative view as the models do not include future improvements in asset management, through R&D and continuous improvement, which will result in increases in average asset lives. Including this effect will therefore improve the CSI forecast. The impact of these changes is shown in the following graph.



In addition, the benefits to the Composite Sustainability Measure of increased investment during CP6 are not significant and there would only be a small, one-off reduction in future control period renewals. Whereas investing in R&D provides the opportunity for larger, recurring benefits that will continue reducing long-term renewals costs.

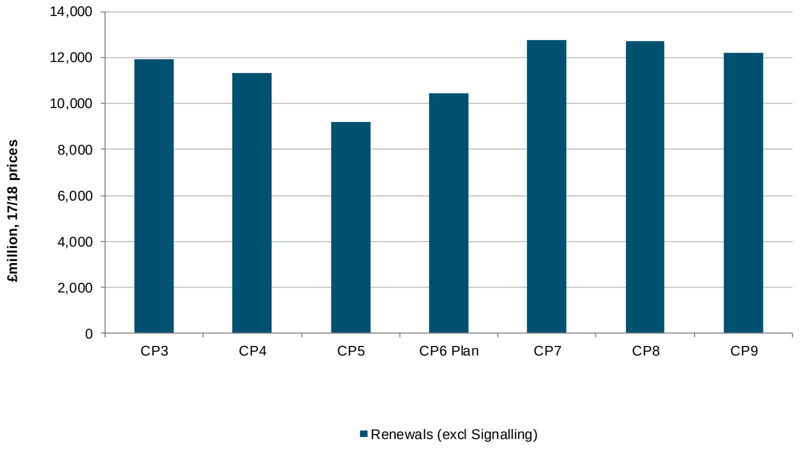
Further investment in asset sustainability

Average long run renewals of £10.9 billion per control period are still somewhat higher than the SBP core renewals of £10.4 billion. We therefore agree that there should be an increase in asset sustainability investment.

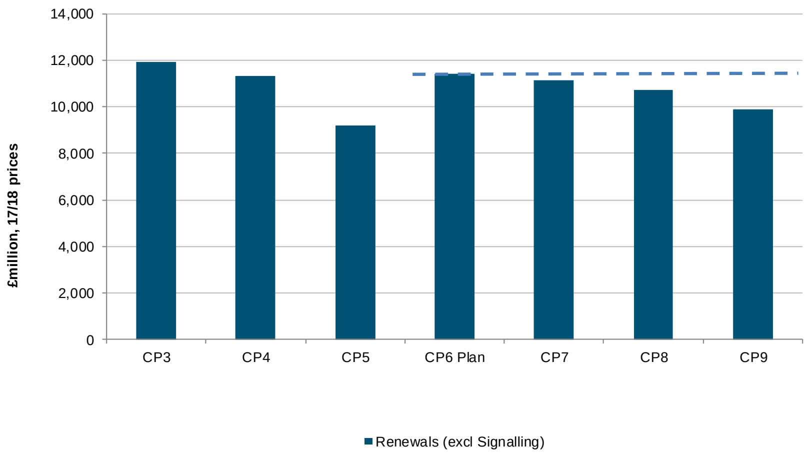
In considering the scale of the increase, it is important to recognise that renewals expenditure does not reflect all asset management activity during CP6. We will also upgrade our assets as part of enhancement programmes that are being separately funded. On the Transpennine upgrade alone we expect to invest around £250 million in our track and earthworks assets. Potential reactive expenditure on earthworks of £188 million will be separately funded through the Group Portfolio Fund or insurance (as it is not possible to predict where it will be needed).

We therefore consider that our proposal for additional asset investment of £538 million achieves sustainable asset management in CP6. This is illustrated by the charts below.

SBP long-term renewals



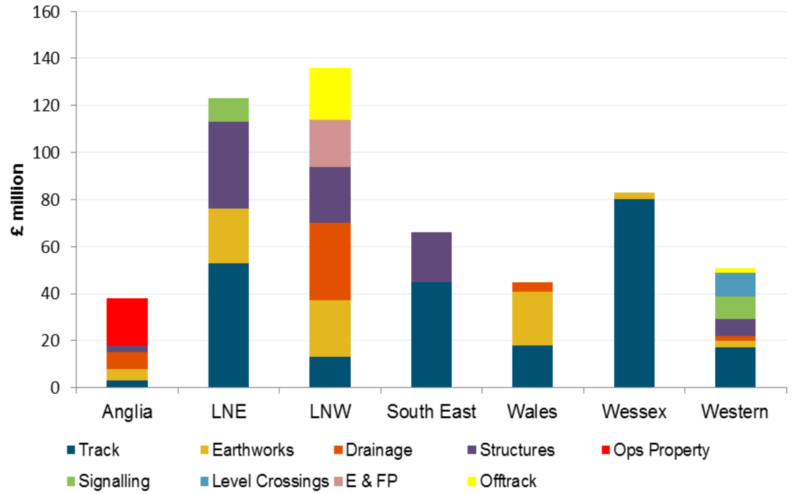
Updated long-term renewals increase



Our proposal takes into account the results of STE's assurance review of the SBP which identified that a further £400 million investment in asset sustainability would be desirable in CP6. Consistent with the recommendation in this review, our proposal includes specific activity totalling £212 million. This principally relates to track and earthworks with the main increases being in the Wessex, LNW and LNE routes.

We propose increasing asset sustainability investment by a further £326 million (resulting in a total increase of £538 million), with allocation to routes being based on a similar approach to our SBP. The approach has been reviewed with the Directors of Route Asset Management for each route with overall assurance by STE. We are currently updating the specific list of investments and the associated Schedule 4 costs (likely to be around £60 million). We will provide more specific detail and the impact on the Composite Sustainability Index to ORR in September. The overall investment is summarised in the table below.

Further asset sustainability expenditure by route and asset type



We note that there is the potential for further investment in asset sustainability. The Group Portfolio Fund includes 'contingent renewals' of £856 million in route plans which can be released for further investment if risks do not materialise. We also note that the other key recommendation in STE's assurance review was the potential for 'reactive' earthworks expenditure of £188 million, which we assume would be funded by insurance or the Group Portfolio Fund, as discussed above.

Asset investment (Scotland)

We agree with ORR that Scotland does not face the same asset sustainability challenges as England & Wales. However, there are two emerging issues that have arisen since the publication of the SBP.

First, the Carstairs rationalisation is a large, complex project which was at a very early stage of development when we submitted the SBP. Further work has identified necessary scope changes that increase the forecast cost by £50 million (to around £150 million) although the project is in the early stages of development so costs remain uncertain. We will continue to work with ORR as the project develops.

Second, the Scotland route plan identified the potential need to replace bridges that have recently been identified to be at risk of failure linked to high alumina cement. Surveys of affected bridges have now been completed. We have identified seven bridges that will need to be replaced in CP6 at a cost of around £20 million.

Given the scale of these cost increases that have emerged since the SBP, it is important that they are funded as part of Scotland's core plan for CP6. We consider that it is necessary that £70 million of the efficiency and R&D savings should be used to fund this additional expenditure in Scotland. If it is not funded in the Final Determination, it increases the risk that we will need to defer other renewals. This would not be consistent with sustainable asset management.

Research & Development

We agree that our R&D plan was not sufficiently well developed and it was not clear that the programme could be delivered. However, we consider that the proposed funding for R&D is inadequate to drive improvements in CP6 and beyond. The government's Industrial Strategy White paper (published in November 2017) and the Construction Sector Deal (published in July 2018 by the Department for Business, Energy & Industrial Strategy) both highlight the need to increase R&D to improve productivity for public services and business. The forthcoming Rail Sector Deal should reinforce this.

In CP5 (and previous control periods), much of our R&D activity has been delivered as part of individual investment projects or transformation programmes. In developing our SBP, we decided to bring together our R&D activity as a step towards our overall management of the programme. R&D expenditure throughout the business totalled around £238 million during CP5. The proposal in ORR's Draft Determination therefore represents a reduction in funding. This level of funding will restrict our ability to drive improvements in CP6 and beyond.

We have carried out a detailed review of the R&D Plan and provide an update as part of this response. We have focussed on R&D activity that drives improvement of infrastructure management. We have therefore removed the R&D activity that aimed to deliver wider industry benefits.

We are now proposing investment in R&D of £245 million, with further third-party funding of £112 million, resulting in an overall programme of £357 million.

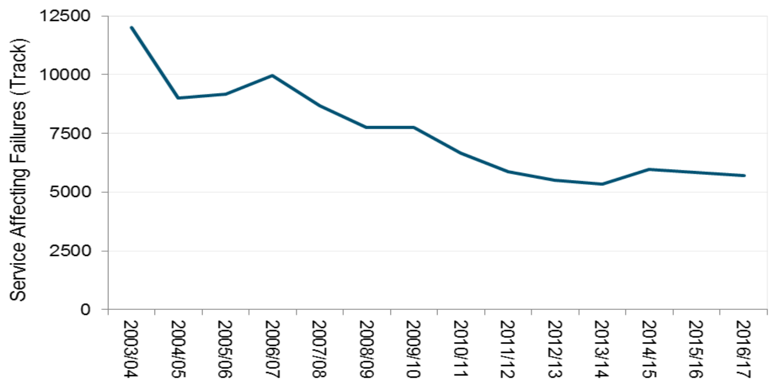
The R&D plan includes critical improvement programmes, such as Intelligent Infrastructure and improvements in our asset management strategies. We have developed summaries for each project, which outline the project purpose together with a forecast of the cost, benefits and matched funding.

We estimate that the investment in R&D will deliver asset management benefits of £900 million over the next 15 years, reflecting improvements in the approach to managing track, structures and earthworks which will enable us to extend asset lives and reduce renewals expenditure. The benefit to cost ratio of this investment is expected to be around 3 to 1.

During CP5, we have raised third party funding of £68 million. We recognise that our proposals for matched funding in the SBP were not well founded. We have reduced the proposal in our updated plan and we are now forecasting third party funding of £112 million. This is based on our experience of CP5, together with ongoing discussions with a range of organisations including rail and other infrastructure managers as well as suppliers.

We have a record of delivering successful investment in R&D. Over the last 15 years, there are a wide range programmes that have enabled us to improve our asset management. We have made particular improvements in the management of track, for example starting with the introduction of rail based train grinding in 2003 and more recently Plain Line Pattern Recognition in 2013/14.

These investments have enabled us to significantly improve asset reliability and safety with a reduction in service affecting failures by around 40 per cent as shown in the graph below. The number of broken rails has also reduced by 70 per cent since the start of CP3. It has also enabled us to revise our asset policies, which has reduced the required investment in track renewals by £1.5 billion over CP4 and CP5.



Projects are currently at different stages of maturity, which is assessed using the Rail Industry Readiness Levels. The majority of projects will be implemented during CP6 or in early CP7. As part of a balanced programme, there are some projects that are more exploratory (or 'blue sky') which we do not expect to be ready for deployment until CP8. We are assuming that there will be an ongoing investment in R&D to enable us to continue developing improvements in future control periods.

We have also assessed the overall deliverability of the programme. Over the last six months, we have significantly increased our delivery confidence as a result of more detailed planning for each project as well as the reduction in the scale of the overall programme.

We are proposing a new industry R&D advisory board which will include the DfT Scientific Officer and other industry R&D experts. Transport Scotland will also be invited to join this board. It is important that the R&D programme benefits the whole network, recognising that it is funded by both the UK and Scottish governments. The R&D programme will deliver benefit for the Scotland route with trials in Scotland relating to earthworks and drainage. We will be working with Heriot-Watt and Strathclyde universities, and are in discussion with The Oil and Gas Innovation Technology Centre in Aberdeen.

We recognise that there is uncertainty in delivering value from an R&D programme. We therefore propose to carry out a formal review of our progress in delivering the programme in 2021. If the programme is not making adequate progress, we will revise our plans for the rest of CP6 and redeploy the funding into asset sustainability investment. We will engage with ORR and the industry during this review.

Equally, if we are delivering the programme successfully and there are further projects with a strong business case, we will consider investing further in R&D using the Group Portfolio Fund if financial risks have not materialised. We welcome ORR's support in the Draft Determination that this is an appropriate use of the Group Portfolio Fund.

Efficiency and headwinds

ORR has assumed that Network Rail can make further efficiency savings of £659 million during CP6. This represents a significant stretch on our SBP, which included net efficiency savings (i.e. efficiency less headwinds) of £1,578 million, increasing the required net savings by over 40 per cent. By the end of CP6, the net efficiency in the SBP (7.5 per cent) would increase by more than two per cent.

In the following sections, we set out our proposal for further savings and our concerns about ORR's assessment of the proposed further savings.

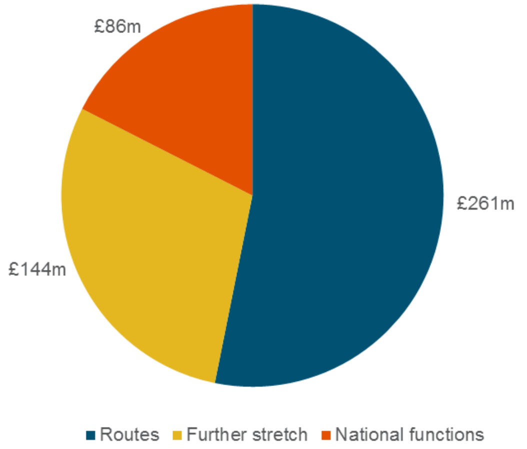
Responding to ORR's challenge

We recognise that forecasting efficiency savings is uncertain and requires judgement. In the light of ORR's challenge, our routes and functions have revisited their plans.

Routes and national functions have reduced the level of headwinds in the plan by £100 million, informed by further work carried out by Nichols, the independent reporter. They have also proposed additional savings of £246 million. This includes savings committed by national functions of £86 million. While these further savings are broadly owned at a local level, they are not yet underpinned by delivery plans and routes are concerned that they increase the risk to delivery of their plans. Further savings reflect each route and function's individual approach. We have not required a fully consistent approach so that we maintain local ownership which will increase the likelihood of successful delivery and benefit from innovation. The source of these savings is largely based on delivering further savings from the initiatives in the SBP.

While recognising the increased uncertainty, our proposal includes further route savings of £144 million to reflect potential unidentified further efficiency savings. The level of this further stretch takes into account the relative additional efficiency proposed by each route. These could be achieved, for example, through our ongoing standards review. While routes do not have specific plans, they have accepted these further savings, while again highlighting the further increases in delivery risk.

The total further savings of £491 million will largely be achieved by reductions in renewals costs.



The inclusion of these additional savings in our plan will increase the overall net efficiency savings during CP6 to £2,069 million. This is summarised in the table below.

£m	SBP	DD response	Increase
Procurement delivered route efficiency	392	408	16
STE delivered route efficiency	80	204	125
Route delivered route efficiency	201	215	14
Optimisation of access	190	210	20
Improved workbank stability	189	189	0
LEAN and other local improvements	169	253	84
Efficiencies linked to increased asset sustainability investment	-	45	45
Non route renewals efficiency	357	443	86
Opex efficiency	788	788	0
Total gross efficiency	**2,366**	**2,756**	**390**
Headwinds	(788)	(687)	101
Total net efficiency	**1,578**	**2,069**	**491**

While the reduction in headwinds affects the whole control period, the other efficiency savings are largely included in the later years of the control period to avoid undermining the stability of the plan in the early years of CP6.

This additional commitment seeks to maintain ownership of the plan at a route level, while delivering most of the additional savings that ORR proposed.

Reviewing ORR's efficiency evidence

We have also reviewed the evidence for further efficiency that underpins ORR's Draft Determination. We have a number of concerns with ORR's analysis which we do not consider provides robust evidence for the increased savings.

ORR's proposed adjustment is based on quantitative analysis by the independent reporter, Nichols, of the headwinds that were included in the SBP, which totalled £787 million. ORR considers that most of the SBP headwinds were potentially double counted in the base costs, inadequately justified or could be mitigated by additional efficiency. These findings were supported by further qualitative analysis.

We are concerned that ORR's efficiency assumptions are an 'overlay', which undermines ownership of the CP6 Plan at a local, granular level. This has been one of the key successes of the SBP, which we do not wish to see compromised.

We summarise our concerns below.

Headwinds

We have worked with Nichols to understand better its review of the headwinds in the SBP. As a result, we continue to consider that most of the headwinds are legitimate cost pressures.

The inclusion of headwinds is a major step forward in our planning. We did not make a specific allowance for these cost pressures in our SBPs for previous control periods. We acknowledge, however, the potential for improving the quantification of headwinds in the future.

We accept that there should be a reduction in headwinds by £100 million on the basis that they have either been over-estimated or are difficult to justify, and are better represented as a risk to our plan. However, we cannot see any evidence to justify the removal of a further £559 million. In particular, no double counts were identified in the base cost by Nichols. We are also concerned that Nichols has noted headwinds are difficult to quantify resulting in uncertainty in their valuation (although it has not identified any adjustments that should be made). We note that both ORR and Nichols have recognised that the inclusion of headwinds is appropriate. It is therefore difficult to understand how the quantification of proposed efficiency savings by ORR is solely based on the analysis of headwinds.

Qualitative analysis

We have reviewed the qualitative analysis in the Draft Determination. We consider that there are a number of factors that ORR has not taken into account in concluding that our efficiency assumptions are conservative.

ORR states that "a period of unusually poor performance on efficiency" will have affected perception of what can be achieved in CP6. We are clearly very aware of the risk of committing to a level of efficiency that is not realistic. However, we do not consider that this means that our plan will include "inevitable conservatism". While routes and functions have developed more detailed plans to underpin our efficiency assumptions, many improvements are still at an early stage of development. There is therefore a significant risk that our plans are optimistic and that delivery challenges have not been fully understood.

It is not inevitable that the significant cost pressures during CP5 will reverse during CP6. In particular, we expect the pressure on the availability of engineering access to continue which is a key driver of costs, maintenance and renewals costs will be higher due to the increase in the electrified network (for example due to additional isolation requirements) and it is unlikely that the increase in renewals costs (which largely reflects the Tender Price Index which increased by significantly more than RPI in CP5) will reverse due to the scale of infrastructure work in Great Britain over the next decade.

There are likely to be additional cost pressures during CP6. In particular, additional costs are likely to arise in CP6 as the industry delivers improvements that will be needed following the Glaister review of the causes of the major problems following the introduction of the May 2018 timetable. These could include additional resources to strengthen the capability of the System Operator.

ORR considers that there will be further benefits from a stable plan. This does not appear to acknowledge that we have already included savings of £197 million as a result of more stable workbanks and £253 million reflecting early contractor involvement in renewals planning, which can only be achieved with a stable plan.

It further considers that the SBP has not reflected the full opportunities of route devolution. As our plans have been developed at a local level, this has given routes the confidence to develop stretching efficiency targets. Delivering the efficiency levels in the SBP will already require a much more disciplined approach. Our plan already reflects the effects of devolution and is underpinned by route ownership.

The base costs in the SBP have been reviewed by ORR's consultants, Gleeds. It did not identify any significant errors that required adjustment. We recognise that the approach to costing our plan is complex, particularly the adjustments to ‘normalise’ current costs (i.e. remove one-off costs / outliers that are not expected to be incurred in CP6). As Gleeds has concluded that the approach to costing is reasonable, there does not appear to be any evidence that the base costs include “inappropriate inefficiencies”. We consider that our approach to normalisation means that it is less likely that there will be a double count with the inclusion of headwinds.

ORR is particularly concerned that the SBP includes almost no tailwinds. This is a reasonable challenge. However, we believe potential tailwinds are already included in the plan. Almost all cost reductions require positive management actions and therefore the impact of tailwinds will largely have been included within the overall efficiency savings. Recognising that ORR is concerned about how cost changes are classified, we want to work closely on the presentation of cost changes during CP6.

ORR has provided some examples of potential tailwinds that it considers have not been reflected in the SBP. The most significant is input price inflation for IT costs which is expected to be lower than RPI. As part of our SBP, we provided ORR with overall input price analysis. This demonstrated that our overall costs generally increase by around 0.4 per cent more than RPI. This is broadly consistent with the total input price headwinds that we have included in the SBP. We therefore do not agree that the SBP has omitted input price tailwinds. However, we recognise that, while the aggregate input price inflation is broadly reasonable, there are likely to be inaccuracies in how input price inflation has been reflected in individual route and function plans.

Other proposed adjustments

We included options for incremental safety investment in route plans, largely relating to additional investment in level crossings and improvements to the safety of access walkways. We agree with ORR’s proposal to include these in our base plan, resulting in an £80 million increase in safety investment. This included increased spend of £25 million relating to improved level crossing technology at the highest priority user worked crossings on the network. We have allocated this to routes based on level crossing risks, including £1 million for Scotland route.

ORR identified a potential increase of £67 million for additional property revenue in CP6. We are particularly concerned by the significant uplift in retail income. We are currently experiencing a reduction in station footfall. As a result of this, and other factors, we are currently falling short of this year’s retail shops budget by three per cent. This presents a significant risk to the further growth in the CP6 plan. Achieving ORR’s further stretch appears unrealistic as it would require an upturn in market conditions at a time when there is considerable economic uncertainty due to Brexit, as well as a very challenging environment for retail and restaurant businesses. However, we have reviewed our property plans and have identified a further £25 million of additional property revenue for inclusion in our CP6 plan.

We understand that DfT has confirmed that BTP costs in Scotland will be funded separately and therefore agree that they will not be funded by the Scotland SOFA.

ORR has proposed the creation of a Performance Innovation Fund of £10 million to fund the development of innovative proposals to improve passenger and freight performance. We are unclear what sort of activity this is intended to fund as ORR has provided us with very little further information since publication of the Draft Determination. We are keen to discuss this further so we can better understand the value of this proposal. We note that ORR considers this fund will need specific governance. We need to make sure that governance is appropriate to the scale of the fund.

Since publishing the SBP, we identified to ORR that we omitted the Crossrail Access Charge Supplement which reimburses Network Rail for part of the Crossrail construction costs. It is expected to be between £260 million and £280 million in CP6, depending on the cost of debt determined by ORR in the periodic review.

We have proposed that part of this income could be used for replacement of the Ryde Pier (currently estimated to be £40 million). This was not included in the SBP as the Isle of Wight infrastructure has previously been funded through the franchising process, separate from the periodic review.

This income could also be used for other emerging costs, such as network change relating to the rail vehicle effluent discharge policy which is around £13 million. We also note that there is an opportunity for some of this income to increase further the investment in improving asset sustainability.

We have also recently identified that Schedule 4 cost are likely to be around £40 million higher than the SBP in 2019/20. This is due to the ongoing impact of the current timetable issues. It has not been reflected in our proposal in this response. We would like to discuss this with ORR, including the implications for the Schedule 4 Access Charge Supplement.

Digital Railway

We welcome ORR's support for the inclusion of Digital Railway's central programme costs and the enabling network-wide investments in the SBP. In terms of overall Digital Railway funding DfT expects to take incremental business case decisions on route deployments from the National Productivity Investment Fund (NPIF) and through the separate enhancements pipeline process.

We are reviewing the transition of conventional signalling renewals to ETCS schemes and assessing opportunities for attracting private finance with Government. We are working with DfT and industry to prioritise the most valuable schemes on the basis of safety, life cycle cost, capacity and performance for delivery within the available funding.

The supply chain is supporting the Digital Railway programme's new approach to efficient delivery. This is reflected in the proposed Rail Sector Deal. For example, the East Coast Main Line South scheme is demonstrating contestability of delivery while also moving to outcome-based procurement which is linked to operational improvements for passenger and freight users.

Following the joint launch of the Digital Railway Strategy by the Secretary of State for Transport and Mark Carne in May 2018, Network Rail has committed to developing a long-term plan for digital train control and signalling by February 2021. This will link the initial digital deployments in CP6 with the longer term, and will align rolling stock and network infrastructure investments to deliver the optimum benefits. This will enable our supply chain partners to plan their resources to deliver greater efficiencies. We will be transparent about any resulting changes to our plan, consistent with ORR's process for managing change in CP6.

Expenditure profile and deliverability

In the Draft Determination, ORR expressed some concern about the annual profile of expenditure. We have asked each route and function to carry out a high-level review of expenditure in advance of the next detailed plan update. As a result, we have updated our annual spend profile for renewals, moving £177 million from the first three years of CP6 into the final two years of the control period.

We have also carried out a further deliverability review of our capital expenditure programme, which included the impact of additional asset sustainability investment. Factors such as engineering access, supply chain capability, deliverer, delivery strategies and key resources were considered in the review.

The additional asset sustainability investment for most asset groups is considered deliverable with a good confidence rating. Additional track volumes are considered deliverable although a few issues were identified. Recommendations have been made to ensure smooth delivery alongside existing delivery levels and routes are planning most work for the last three years of CP6. This should ensure that development and access and resource planning can be achieved in a timely manner without compromising the safety and efficiency of the network.

Cost allocation

ORR continues to review the allocation of central costs between England & Wales and Scotland. As ORR's consultant, CEPA, has not identified any specific issues with the allocation methodology, we do not think any adjustments should be made. We also note that the allocation methodology is consistent with the approach adopted when the SOFA funding was being determined.

3. Outputs

We welcome ORR's confirmation that our route and SO scorecards will form a key part of its approach to regulation in CP6. Importantly, this creates a regulatory framework that 'wraps around' the way we run our business and meets the requirements of our customers and stakeholders. We agree with many of ORR's conclusions relating to its assessment of route and SO scorecards although there are some aspects where we have a different view or require clarification. Our response to the key points in ORR's assessment of scorecards is summarised below.

Reflecting the HLOSs

We are pleased that ORR agrees our scorecards support the delivery of the governments' High Level Output Specification (HLOS) requirements. Some requirements set out in the Scotland HLOS are not necessarily suited to being captured on the route or customer scorecards. While we agree with ORR on the concept of a 'HLOS scorecard' for Scotland, we propose that it is referred to as the 'HLOS Tracker'. This will be important in removing any potential confusion with Scotland's route scorecard.

The Scotland route has worked with the SO and FNPO to develop a draft HLOS tracker, which is included as part of our Draft Determination response. A number of its components require coordinated activity across the industry (for example including passenger and freight operators and funders). We will continue to engage with ORR and Transport Scotland to provide greater clarity of the roles and responsibilities across the industry in delivering these plans.

It will be important to clarify with ORR and Transport Scotland the process for taking decisions on which major renewals projects proceed in CP6. Our view is that Network Rail should retain ultimate accountability for decisions but that we should work together to develop improved means of consultation on major renewals decisions.

Train performance

The train performance forecasts included in the SBP were developed by the routes, in collaboration with operators, who have provided input and challenge. Routes considered these 'ground-up' forecasts were stretching but realistic.

ORR proposed specific changes to the Consistent Route Measure of Performance (CRMP) for three routes. It also expressed concern about the misalignment between Network Rail and train operators on industry performance forecasts. Beyond that, it considers Network Rail's proposal for the CRMP threshold should be adjusted. For Scotland, ORR proposes that the route should be measured against the HLOS target of 92.5 per cent PPM. The following sections set out our response to these issues.

Forecasting train performance

Forecasting and modelling future train performance continues to be a major challenge for the industry due to the interaction of many variables. It is particularly difficult when there is congestion on the network or where there are a number of complex, interacting changes (e.g. the interaction between the timetable resilience and the resources available to deliver it). This is partly because the available data is based on attributing delay to the primary cause of incidents rather than a detailed analysis of the drivers of total train delay. Around 70 per cent of delay is reactionary.

There are many factors that impact train performance. Key drivers of improvement include more reliable infrastructure and fleet, benefits from enhancements and more effective incident management. However, there are also downward pressures, including increasing passenger numbers, more complex train services, industrial action and the current timetable issues. Over the last few years there has been a significant improvement in infrastructure and fleet reliability, while train delay has deteriorated as the delay caused by each incident has increased significantly.

Developing performance plans

During CP6, our plans reverse the predominantly downward trend in train performance of the last seven years. Delivery of performance requires close collaboration with train operators and is an outcome of whole industry delivery. Our plan has been built 'ground-up', informed by engagement with operators. We need to continue working collaboratively to develop joint improvement plans, with route scorecards being used to hold routes to account. We believe that this will enable the industry to deliver a system wide approach to addressing performance.

However, there is currently significant misalignment between franchise targets and the levels of train performance. We expect this misalignment to reduce, gradually, as new franchises are awarded, with franchise targets being signed off by the System Operator. We note that in its response to the Draft Determination, DfT states that it is prepared to discuss targets with current franchised operators if it is a material issue.

Initial response to Draft Determination

It is encouraging that ORR and the independent reporter, Arup, largely concluded that our CRMP forecasts in the SBP are reasonable. ORR proposed that Anglia, Wessex and South East routes should revise their CRMP forecasts. We provided an initial response to ORR in July with the following key changes:

- Anglia amended its modelling and responded to evidence from two operators to support higher performance
- South East updated its forecast to P50, validating the consistency of its approach with other routes
- Wessex did not revise its forecasts as it provided further details to justify the "unknown decline" highlighted by ORR.

We also made a small number of other changes including an update of Western route's forecast. This reflected further engagement with Great Western Railway on the phasing of its CP6 PPM trajectory.

2018/19 train performance

Our SBP submission assumed performance improvement during 2018/19, with a PPM forecast of 89.0 per cent by the end of CP5. Actual train performance in 2018/19 is significantly worse than target. PPM has fallen to 86.0 per cent. The principal reasons for the deterioration in train performance are the robustness of the May 2018 timetable and the resources available to deliver it. In addition, the extreme heat in the summer caused further deterioration in performance.

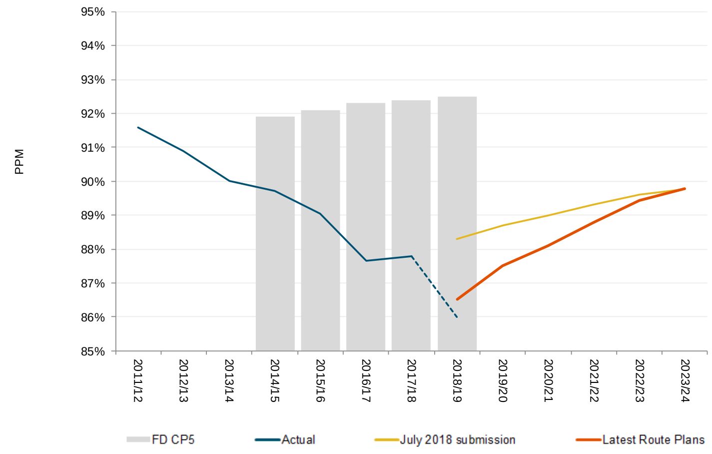
The impact of the May 2018 timetable and the lack of resources are major system issues and we will not recover the shortfall in train performance by the start of CP6. Since our interim update to ORR in July, the impact of the current issues is now better understood. We have therefore further updated some of our train performance forecasts in this response.

In updating the forecasts, we are also conscious that there has been a sustained downwards train performance trajectory for the last seven years. The improvement required to return to the planned trajectory in our July response by the first year of CP6 (2019/20) would be unprecedented.

Updated CP6 performance forecasts

In developing updated forecasts, our overall aim is to return to planned performance levels as quickly as possible. We have considered how quickly the industry is likely to recover from the current issues. In broad terms, we expect there to be sufficient resources in place by the end of the current year and the current timetable issues to be largely resolved through the next two timetable updates. However, there is a significant impact on the development of new timetables to accommodate new services. As a result, there will continue to be challenges to resolve until the middle of CP6.

We have focused the changes to our forecasts on the train operators that are most significantly behind target this year. The largest change is for Northern. We have also revised the forecasts for TransPennine Express, ScotRail, South Western Railway, LNER and Great Western Railway. The revised forecasts are based on the likely timing of future improvements. For example, for Northern we are assuming a significant improvement in 2019/20 with the improvements to the timetable and completion of the Bolton corridor electrification project. There will be further improvements over the next two years with the introduction of new fleet together with further timetable and infrastructure improvements. The overall impact of the updated forecasts is summarised below.



Train performance – Scotland

In respect of Scotland's PPM target, ORR has stated that the route should be measured against the 92.5 per cent PPM target set out in the Scotland HLOS for all five years of CP6.

We fully support the intent of working towards 92.5 per cent. However, we do not think this will be achieved in the first two years of CP6. We do not think that there will be sufficient systematic performance improvement outputs from the Donovan Review and other improvement plans. This has been reinforced by train performance trends since the SBP was published.

We are forecasting train performance of 90.5 per cent PPM in 2019/20 and 91.5 per cent in 2020/21. It is important that the likely (not aspirational) PPM outcome is reflected in Scotland's CRMP trajectory and Schedule 8 benchmarks in ORR's Final Determination.

Freight performance

We welcome ORR's view that the national and route FDM trajectories set out in our SBP submission are reasonable and its acceptance of the route FDM regulatory minimum floors. When we update our CP6 delivery plan for publication in March 2019, we will review freight trajectories with customers in the context of updated performance trajectories.

Proposed approach to train performance

We are proposing that ORR should agree that, since publication of the SBP, there has been a material change and that the CP6 train performance forecasts should be updated. In this response, we are providing updated train performance trajectories for the train operators where there is a significant shortfall in 2018/19. The impact of the revised forecasts of industry forecasts on CRMP are summarised below. The table shows the changes to CRMP in 2023/24.

We propose that ORR uses our revised CRMP forecasts as the basis for setting Schedule 8 benchmarks and CRMP thresholds. This will maintain route ownership based on deliverable trajectories developed in conjunction with operators. It is important that Schedule 8 benchmarks are set at a level that is realistically achievable. Unrealistic benchmarks will result in significant additional costs for Network Rail and restrict the funds available to invest in improving train performance and asset sustainability.

Minutes / 100 train km	SBP 2019/20	DD response 2019/20	SBP 2023/24	DD response 2023/24
Anglia	1.46	1.44	1.46	1.43
LNE	1.34	1.43	1.27	1.22
LNW	1.62	1.71	1.59	1.52
Scotland	0.96	1.06	0.95	0.89
South East	3.03	3.03	2.79	2.81
Wales	1.54	1.61	1.52	1.51
Wessex	2.35	2.78	2.22	2.53
Western	1.80	2.12	1.69	1.61

We recognise that there is considerable uncertainty in these forecasts. We have already proposed that fundamental changes in circumstance should result in a contractual reopener of the Schedule 8 benchmarks in CP6 (e.g. following the introduction of Thameslink and Crossrail services). We also recognise that the May 2018 timetable has had some positive effects, for example on Southern. We also propose that there should be a reopener if these forecasts are materially / systematically understated. We would like to discuss this further with ORR.

ORR should support the continuation of collaborative working between Network Rail and its customers to agree annual performance targets throughout CP6, underpinned by performance strategies, with scorecards being used to hold routes to account. ORR would then monitor the effectiveness of engagement and the extent of agreement throughout CP6. This would inform whether any further intervention by ORR is required. It would also be consistent with ORR's overall approach to regulation in CP6. We also believe that the use scorecards should be included in future franchises to further build alignment.

While we understand why changes have not been made to Schedule 8 for CP6, we believe that a review is required in CP6 to consider whether it is providing the right incentives to Network Rail and train operators.

CRMP thresholds

The CRMP trajectories in ORR's Final Determination will inform the CRMP regulatory minimum floor and Network Rail's CP6 Schedule 8 benchmarks. We are continuing to discuss the minimum floor with ORR with discussions focussed on two key areas – the level of the margin and the methodology for calculating the threshold. We are concerned that the proposal to set the CRMP minimum floor at a consistent margin of 20 per cent below the CRMP trajectory would be susceptible to breach because of natural variation. We also believe that a methodology based on historic average performance over CP4 and CP5 is not the best way to calculate the threshold given the wide variations in performance over that period. We will continue to discuss this with ORR.

While CRMP trajectories will be updated annually in CP6 through the route scorecards, the regulatory minimum floor will remain fixed, unless there is a fundamental change in circumstances. We consider that, if Schedule 8 benchmarks are amended, the CRM-P threshold should also be reviewed.

Asset management

We welcome ORR’s acceptance of our proposed regulatory minimum floor for network sustainability in CP6.

ORR asked Anglia, LNW, South East and Wessex to review their service affecting failure (SAF) and Composite Reliability Index trajectories in light of the STE assurance review. They have reviewed their SBP trajectories, considering various route-specific factors in deciding whether changes are needed. For example, the impact of additional traffic and new rolling stock, and potential benefits from improvements to prevent asset failure. They have concluded their trajectories remain realistic, while also challenging.

We agree that asset sustainability should be monitored across a broad range of performance indicators (including inputs and outcomes). We will produce an annual, route-based engineers’ report for each asset type. Route asset engineers will update ORR on progress of work plan delivery.

We will update our asset sustainability forecasts as part of our business planning process. Consistent with the process for managing change in CP6, we will explain the basis for changes. This will support alignment between regulatory reporting and information used within Network Rail.

We are working with ORR on the development of an alternative, improved measure of network sustainability and will provide ORR with a plan for this by the end of September 2018.

Other scorecard measures

We agree with the majority of ORR’s assessment of other scorecard measures for CP6. We have a few concerns about ORR’s proposals.

We will report the passenger satisfaction results from the twice-yearly National Rail Passenger Survey (NRPS) in the route comparison scorecard. Comparisons should be made between results of the same season (e.g. comparing autumn to the previous autumn). This will provide a more meaningful comparison, highlighting areas of genuine difference rather than seasonal variations.

We do not consider that a measure for third party investment is currently suitable for inclusion on route scorecards. It is a new measure that is not yet fully developed. We are also concerned that increasing the number of measures will reduce the effectiveness of scorecards. Instead we propose to include a section on third party investment in each route within our quarterly scorecard report. This will provide transparency and enable routes to be held to account for progress in raising third party investment.

We will include two measures for passenger and freight traffic growth in our route comparison scorecard. We do not agree that the traffic baselines should be fixed for CP6. There is considerable uncertainty about traffic levels, particularly given the current timetable issues. We are concerned that fixed traffic baselines would undermine the value of these measures and fail to incentivise routes. Our business plans are based on annually updated traffic forecasts. We propose therefore to report quarterly actual traffic against an updated annual forecast.

We welcome ORR’s recognition that the Possession Disruption Index measures are no longer considered fit for purpose. To monitor use of the network for engineering access in CP6, we proposed to use an annual customer survey which will build on the initial survey that ORR carried out in 2017. We will also monitor the core measures which focus on the impact of engineering access on end users and customers. We do not agree with ORR’s proposal to include extended journey time in the CP6 monitoring framework. It does not drive Network Rail decisions and we do not believe it is meaningful to our customers or end users.

We are working closely with ORR and the Independent Reporter to develop appropriate metrics for network capability in CP6. It is important that all parties are clear how any assessment of capability will be made.

4. Financial framework and affordability

The CP6 framework is important for our financial viability and stability. This section responds to the key issues in ORR's Draft Determination.

Group Portfolio Fund

We welcome ORR's acceptance of the proposed Group Portfolio Fund (GPF) of £2.6 billion. We accept ORR's decision to move £856 million of the centrally-held GPF in England & Wales to routes, although we note that it reduces the competitive tension between routes. We agree that each route should identify 'contingent renewals' that will be delivered if risks do not materialise. This will be included in our updated CP6 plan following ORR's Final Determination.

The reduction in centrally-held GPF funding means that routes will need to manage all, but exceptional, risks within their own funding settlements. Decisions to release the GPF for incremental investment will be made as part of our continuous business planning process. We have reviewed the governance arrangements for the use of GPF in CP6. The corporate business planning process is still at the core of our proposals, which provides regular points throughout the year for routes and national functions to identify changes in the degree of financial risk they face. We have strengthened the key role of routes in deciding how money from the GPF will be used during CP6. For example, Route Managing Directors (RMDs) will now report directly to the Chief Executive and will play a key role in reviewing the release, and use, of the GPF.

Prior to the Final Determination, we will work with ORR and Transport Scotland to clarify how the £284 million GPF is controlled in Scotland. We expect that the governance arrangements to be largely consistent with those in England & Wales.

Budgetary flexibility

ORR's Draft Determination sets out the financial controls framework that will apply to Network Rail at a GB-level in CP6. We continue to clarify arrangements in Scotland with Transport Scotland.

We recognise that the framework provides greater flexibility than most public sector arm's length bodies. However, the controls will constrain our ability to adjust budgets between years of the control period.

We recognise we can go some way to mitigate the risk of either significant underspending, or overspending, against our budgets by continuing to improve the accuracy and effectiveness of our business planning, and our cash flow forecasting. We are also improving how we assess the degree of financial uncertainty in our plans.

We will include GPF funding in CP6 plans as 'resource' expenditure for government accounting purposes. This approach would provide flexibility to use this funding for risks that materialise in resource expenditure, and, otherwise to transfer the remaining GPF to capital expenditure, which can be used or carried forward to future years (subject to government budget limits on the level of change).

Network grant

We need certainty over the grant payments that we will receive each year to provide a stable funding environment to allow us to deliver our CP6 plan. We are working with DfT and Transport Scotland to agree how we can formalise the annual grant payments in CP6 so that we have the same certainty of funding as CP5.

We propose that ORR should use the updated high-level expenditure reprofiling provided as part of this response to determine CP6 annual grant payments. This will represent the most up-to-date information. It will also be based on the same information that government will be using to set expenditure profiles.

However, this information will not be based on a fully assured, bottom-up review of plans. This will be completed in March 2019, and will be updated annually during CP6. Since it will not be possible to match exactly Network Rail's income in the Final Determination with expenditure, it is likely that some form of working capital flexibility will be required.

Our discussions with DfT and ORR on the mechanics of grant payments in CP6 are ongoing.

Indexation

We welcome ORR's commitment that its decision to annually increase charges and other contractual payments (including network grant) in CP6 by CPI should not affect the funding that we receive in cash prices. It will be important, however, that ORR identifies all areas of the CP6 settlement that this change affects to avoid any unexpected consequences.

5. Charges and incentives

We welcome ORR’s log of the PR18 charges and incentives decisions that it has taken to date. This section responds to two key aspects of the charges and incentives regime on which ORR is yet to conclude.

Changing the structure of Fixed Track Access Charges

During PR18, we have highlighted the need to improve the incentives that we currently face to grow traffic, particularly in light of ORR’s decisions to remove the Capacity Charge and Volume Incentive.

We support ORR’s new Infrastructure Cost Charge (the new name for FTAC) proposals. It is important that implementation of these changes does not subject us to significant financial risk. We welcome ORR’s recognition that it is appropriate to cap our exposure to downside risk in this area.

ORR discusses an ‘upside only’ option. This would recognise that we are unable to reduce our fixed costs in the short term, if traffic levels are lower than expected. However, we recognise that ORR may be attracted to exposing Network Rail to some downside financial risk in CP6 to financially incentivise us to grow traffic under more scenarios.

Based on discussions with ORR, we understand that the £280 million level of financial exposure in CP6 in the Draft Determination was an error and ORR plans to limit our financial exposure to approximately £50 million. This level would be much more reasonable, given our limited ability to flex our fixed cost base in response to changes in traffic levels.

Any adjustments to charges should be based on a CP6 traffic forecast against which we have a realistic chance of outperforming. An unachievable baseline is likely to be demotivating and will not encourage us to grow traffic on the network.

Sustained Poor Performance

We welcome ORR’s recent proposal to increase the Sustained Poor Performance thresholds for CP6 to 25 per cent. This will improve industry relationships and provide a more realistic financial incentive. We submitted our response to ORR’s proposals in July 2018.

6. Holding Network Rail to account

We broadly support ORR’s proposed approach for CP6, but there are a number of areas where we believe changes are required.

Role of scorecards

We welcome ORR’s confirmation that it will focus much of its monitoring and reporting of our performance on routes and the SO, and the importance of scorecards to inform this.

We agree with ORR’s principles relating to our internal governance arrangements. We have explained to ORR how our current arrangements meet these principles and will provide updates to ORR as they continue to develop.

We recognise some of ORR’s reservations on the governance and assurance process for the definitions of consistent scorecard measures. We will publish definitions for these and centrally assure them.

The current baselines for CRMP, FDMR and network sustainability, subject to any further changes in ORR’s Final Determination, will form the basis for reporting at the start of CP6. As our forecasts are updated through the continuous business planning process and engagement with customers, these will be included in route scorecards. Like ORR, we see increased value in scorecards where they are informed by, and agreed with, customers. Where agreement is not reached, it is likely that ORR would scrutinise performance more carefully.

During CP6, we will continue to work with customers to update customer performance trajectories during CP6.

We agree with ORR that delivery below the regulatory minimum floors would be likely to trigger an initial investigation. We believe, however, that any initial investigation should focus on considering the circumstances behind performance decline as opposed to investigating a possible licence breach. A formal investigation into whether Network Rail has breached its licence would only follow the issue of a ‘case to answer’ letter by ORR.

Managing change in CP6

We are pleased that ORR has accepted our proposal to express the managing change criteria as financial thresholds. However, we are concerned that ORR has rejected our proposal that the criteria to meet a level II or level III change are more significant. Specifically, we proposed that a material reduction in funding below the route/system operator base plan should constitute a level III change. We do not agree with ORR's conclusion to define a level III change as any reduction to the core budget of a route.

Route budgets change regularly and decisions to agree changes are often made by our Executive Committee. We continue to believe that unless a level of materiality is applied, it will result in a disproportionate regulatory involvement in our regular budgeting process (e.g. a £1 reduction in route expenditure should not trigger the level III change process). We do not think this is in line with ORR's aims. We propose, therefore, that we continue to discuss what a suitable level of materiality should be in CP6 in relation to the definition of a level III change.

It is also important to clarify the definition of a 'reduction in funding'. Our understanding is that the criteria to define change relate to a reduction in route funding for the whole control period. This will need to be confirmed in the Final Determination.

Review of Network Licence

We support ORR's aim to better reflect our devolved structure in the Network Licence and to align it with changes to the regulatory framework.

It will be important to ensure that the allocation of obligations does not unduly constrain how we operate as a business or make accountabilities unclear.

Given the intended scale of licence change, we consider that ORR should carry out a formal review in early CP6 to allow an assessment of whether the reform of our existing licence has achieved the desired outcomes and to make any adjustments needed to reflect the way the business operates.

Monitoring and reporting in CP6

We disagree that Network Rail should continue to report on a scorecard measure where we have demonstrated that it is no longer fit for purpose. This is to avoid unnecessary and inefficient reporting (e.g. reporting on ten routes in CP5 for regulatory purposes, when our operational structure has comprised eight routes since the beginning of CP5).

Our SBP set out our commitment to monitor and report on reactionary delay. We agree that this data should be made public and we propose to include this in our Annual Return. We will agree a reporting protocol with ORR for CP6, which will set out the arrangements for regulatory reporting.

Efficiency and financial performance in CP6

While we agree with many aspects of ORR's conclusions, we remain concerned about the impact of using CPI as the uplift factor for cost baselines, in the consideration of efficiency measurement. As ORR has recognised that Network Rail's overall costs increase by more than RPI, the measurement of financial performance needs to take this into account. This will enable consistent comparison of costs between CP6 and preceding years.

We are concerned about ORR's guidance on efficiency calculation. We will work with ORR to agree the methodology and ensure a consistent approach for CP6.

We remain concerned that ORR's proposals to label cost movement as 'efficiency' are misleading. We consider that 'cost movement index' is a more accurate description. The costs of delivery are impacted by factors beyond efficiencies (e.g. scope changes). While it is helpful that ORR recognise that our fishbone analysis should provide analysis of significant cost drivers, most stakeholders will focus on ORR's headline reported efficiency figure.

7. Stakeholder engagement

We recognise that we need to further develop our stakeholder engagement processes. We are developing a stakeholder engagement framework for CP6 that addresses the areas for improvement identified by ORR. This includes proposals for the publication of an annual stakeholder report for each route and the SO. Routes and the SO would assess the quality of engagement against consistent criteria, which would also be reviewed centrally.

It will be important that ORR's approach to assessing the quality of route/SO stakeholder engagement is informed by our framework. We propose that ORR uses a risk-based approach based on the results of our assessment (as well as any direct feedback to ORR from stakeholders).

We will also continue to develop our approach to supplier engagement.

Railway Boards

We welcome ORR's support for Railway Boards (which were previously called Supervisory Boards).

We have reviewed the effectiveness of the Boards that are currently operating. We have also considered what ORR needs from Railway Boards for it to be able to take them into account when monitoring routes'/the SO's performance, as well as requirements from DfT.

This has resulted in a number of changes to the remits of Railway Boards to strengthen their accountability. This includes a role to involve stakeholders in the annual business planning process, to agree and deliver route scorecards and to hold the routes to account by escalating concerns to ORR. We consider that these changes will allow ORR to take Railway Boards into account when monitoring routes' performance in CP6.

We also intend to set up a FNPO Railway Board. We are currently discussing this with our customers to agree how we manage the meeting, recognising their different business needs.

The inaugural meeting of the SO Advisory Board took place in July 2018.

8. Update on risks and opportunities in CP6

We welcome ORR's agreement to the risk funding levels included in the SBP. We summarised the financial and non-financial risks to successful delivery in the SBP. The key risks include our ability to deliver the planned level of work, efficiency savings and train performance improvements.

It is important to recognise that we still need to mitigate these risks to enable successful delivery during CP6. This is further highlighted by developments since the SBP. As already described, there is a significant shortfall against train performance target in 2018/19. This reinforces the uncertainty in forecasting which can result in major variations in Schedule 8 payments. The investigation into the current timetabling issues is likely to result in proposals for change. This could include, for example, an increase in System Operator resources, increasing our CP6 costs.

Our response proposes increases in asset sustainability investment. This puts further pressure on both Network Rail's and the supply chain's delivery capability. Each route and national functions' efficiency savings have also increased from SBP levels, which further increases the risk that we will be unable to deliver the overall planned savings.

Since the SBP, DfT has confirmed the budgetary flexibility that will be available during CP6. We acknowledge this provides greater flexibility than most public sector bodies. However, our ability to adjust budgets during CP6 will be constrained which increases the risk that we will be unable to use the full CP6 funding to deliver the planned CP6 improvements.

The funding of CP6 enhancements is being managed through a separate 'pipeline' process. As funding is confirmed, this may present both risk and opportunities for our operating, maintenance and renewals plans. For example, as HS2 continues to be developed this may result in changes to the cost of work that needs to be delivered by LNW route. We are currently sizing the Infrastructure Projects teams to deliver around £22 billion of renewals and enhancements in CP6. If there is a material reduction or delay in work, there is a significant risk that there will be unfunded costs.

Some assumptions regarding risk have improved since the submission of our SBP. In particular, ORR has proposed to cap our maximum downside financial exposure resulting from the implementation of the infrastructure cost charge at a level that is significantly less than our SBP assumption.

9. Next steps

The alternative proposal included in this response shows that we have responded to the challenges set out in ORR's Draft Determination. The routes and national functions have agreed to the proposed changes, which maintains ownership of the plan. We therefore believe that ORR should be able to use our response as the basis for its Final Determination. This would mean that routes would not be required to carry out further replanning following the Final Determination.

Following the publication of ORR's Final Determination, routes and national functions will update their CP6 plans in early 2019 (notwithstanding Network Rail's decision to accept or reject the Final Determination in February 2019). This will form the basis for Network Rail's CP6 Delivery Plan, which will be published in March 2019.

We are working currently with ORR on the requirements to be set out in its CP6 Delivery Plan notice, which we understand ORR will publish around the time of the Final Determination in October 2018. Routes and the System Operator will continue to engage with their customers as they further develop their CP6 plans.

We will also publish final CP6 price lists, consistent with the Final Determination, on 21 December 2018.

Appendix 1: route analysis of alternative proposal

	Anglia	LNE / EM	LNW	South East	Wales	Wessex	Western	E&W total	Scotland	FNPO	System Operator	National functions	CP6 Total
Alternative proposal													
Efficiency	(30)	(90)	(84)	(44)	(29)	(28)	(43)	**(349)**	(56)		(1)	(85)	**(491)**
R&D												(195)	**(195)**
Property												(25)	**(25)**
Asset investment	37	123	136	66	44	83	50	**538**	70				**608**
Safety	9	5	25	4	8	2	4	**57**	1	22			**80**
BTP								**0**	(40)				**(40)**
Performance Innovation Fund												10	**10**
Total	**16**	**38**	**77**	**25**	**22**	**58**	**11**	**247**	**(25)**	**22**	**(1)**	**(274)**	**(53)**
Allocation of central costs													
National function efficiency	(9)	(17)	(19)	(13)	(4)	(8)	(7)	**(78)**	(7)				**(85)**
R&D	(19)	(41)	(44)	(28)	(8)	(18)	(17)	**(174)**	(21)				**(195)**
Property	(2)	(4)	(2)	(6)	(0)	(8)	(2)	**(24)**	(1)				**(25)**
Safety								**22**					**22**
Performance Innovation Fund	1	2	2	1	0	1	1	**9**	1				**10**
System operator								**(1)**	(0)				**(1)**
Total	**(29)**	**(60)**	**(63)**	**(46)**	**(12)**	**(33)**	**(25)**	**(247)**	**(27)**	**0**	**0**	**0**	**(274)**
Fully allocated total	**(13)**	**(22)**	**14**	**(20)**	**10**	**25**	**(14)**	**0**	**(53)**	**22**	**(1)**		**(53)**