

John Larkinson
Chief Executive



Andrew Haines
Chief Executive, Network Rail
By email

11 December 2019

Dear Andrew,

Network Rail's preparations to deliver efficiently in CP6

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

Our PR18 determination required Network Rail to make £3.5bn of efficiency improvements in CP6 in its core operations, support, maintenance and renewals activities. This was against a backdrop of poor efficiencies and renewals delivery in CP5².

Network Rail has reported £155m of efficiency improvements during the first six periods of 2019-20, and £391m forecast for the full year, which is ahead of target. This is encouraging progress and a welcome turnaround from CP5, based on the strengthening of routes'³ efficiency planning and delivery, and stronger central oversight.

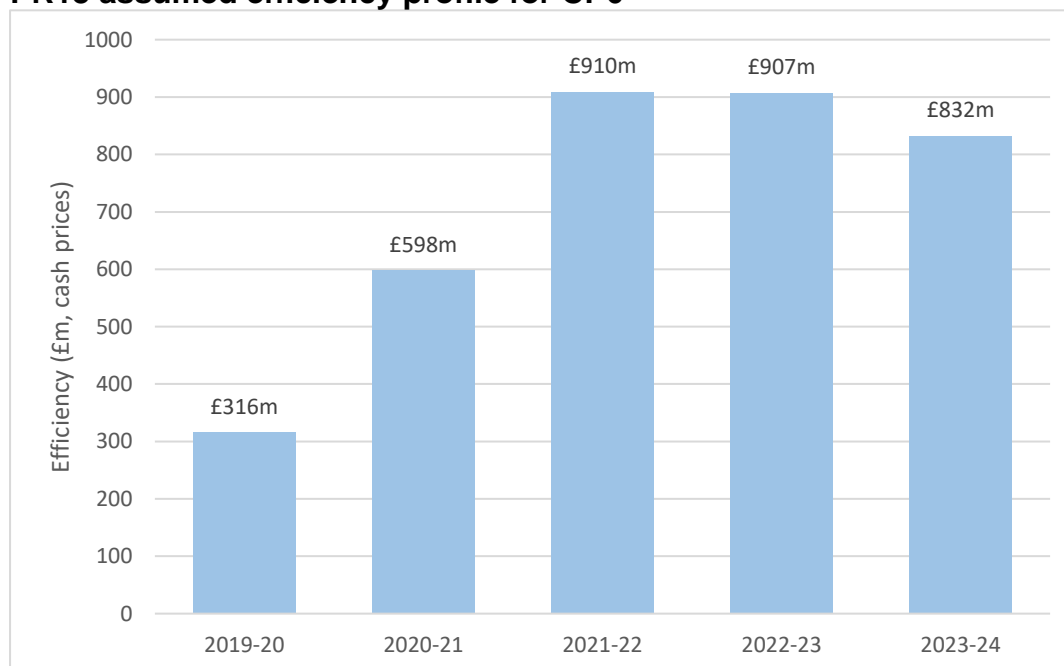
However, the efficiency challenge almost doubles in year 2 (see chart below) and in this respect more still needs to be done over the next few months, particularly in relation to the quality of a number of routes' renewals efficiency plans, as these are critical to delivering the increasing efficiency challenge in year 2 and later years of CP6. Areas include improving work bank planning and optimisation of access.

¹ See https://orr.gov.uk/data/assets/pdf_file/0020/40844/network-rails-preparedness-to-deliver-efficiency-in-control-period-6-2019-03-28.pdf.

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

³ Network Rail has recently reorganised its routes into regions. Because most of the recently available information has been for routes rather than regions, I generally refer to routes in this letter. I recognise that responsibility for these matters has transferred to regions.

PR18 assumed efficiency profile for CP6



Renewals volumes were 10% behind plan for the first six periods of year 1, which Network Rail intends to mostly recover by year-end. In most areas, routes have demonstrated that they are driving their plans to deliver their year 1 and 2 renewals workbanks including the use of overplanning provisions. However, Network Rail's supply chain has recently expressed concerns about lower than anticipated work orders. We are currently investigating this matter.

As with efficiencies, the renewals delivery challenge grows in CP6 and this will be increased by the deferral of enhancements from year 1. Renewals planning and delivery has improved compared to CP5 and Network Rail has developed leading indicators which it continues to improve (for example, expanding the renewals authorisations leading indicator by asset type). However, there is more to do to develop the leading indicators of renewals workbank planning and the quality of regions' narrative reporting of their leading indicators.

Progress since March 2019

There can be no let-up in the focus that Network Rail needs to put on delivering efficiently in CP6, which is why, in my March 2019 letter, I expressed concern about the different levels of maturity and uncertainty in routes' CP6 efficiency plans and the robustness of Network Rail's reporting on efficiency improvements.

In response to these concerns, Network Rail developed an efficiency improvement plan and we have seen good progress on most actions within the plan, including

improvements to its periodic efficiency reports. But it needs to do more, for example, the documentation of some planned business changes remains poor.

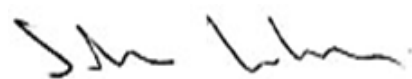
It also agreed to support an independent reporter review of routes' renewals and efficiency plans for years 1 and 2 of CP6. This review concluded that overall renewals delivery progress to date in year 1 is being reported broadly in line with baseline plans and has been positive about a number of aspects of routes' efficiency plans including clear route ownership of plans, dedicated resources and robust governance arrangements.

However, the review confirmed some of our concerns that we set out in our March 2019 letter regarding the quality of a number of efficiency plans. These matters are set out in an annex to this letter, together with an update on Network Rail's wider leading indicators of readiness for year 2 of CP6.

Next steps

We will continue our work reviewing regions' efficiency plans and wider leading indicators of readiness over the next few months. We will publicly report on these matters. You and Jeremy Westlake have also agreed to present Network Rail's CP6 efficiency plans to our January meeting of the ORR Board. This will provide an opportunity for our Board members to engage directly about Network Rail's CP6 efficiency plans and the challenges to delivering them.

Yours sincerely



John Larkinson
Chief Executive

Copied to:

DfT Directors General – Rail Group, Department for Transport
Bill Reeve, Transport Scotland

Annex

Progress of Network Rail's efficiency improvement plan

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

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

We have seen good progress on most of the actions in Network Rail's efficiency improvement plan. Network Rail has increased the size of the central team managing the process for reporting efficiencies. It has revamped its periodic efficiency report and it is continuing to develop this report, including taking on board our feedback. Your team continues to work with us regarding how efficiencies and headwinds should be calculated as part of the fishbone framework⁴ for explaining changes to routes' expenditure. This framework needs to be embedded before 2019-20 year-end reporting.

However, Network Rail needs to make further progress in some areas. The documentation of some planned business changes remains poor, although it continues to improve (including the recent deployment of a full time Communications expert to the central team). It also needs to improve milestone reporting for process delivered efficiencies⁵. As explained below, Nichols has confirmed our concerns about these matters.

Independent reporter review of renewals and efficiency plans

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

⁴ Network Rail is implementing a fishbones visualisation approach to show more clearly the separate drivers of changes to regions' costs over time.

⁵ Some of Network Rail's planned efficiencies result from changes to business as usual processes, as opposed to discrete projects. Network Rail refers to these as 'process-led efficiencies'. The most significant of these is 'Better Every Day' – the adoption of LEAN techniques to deliver multiple local improvements and to develop a culture of continuous improvement. Whilst we accept that it is harder to evidence such business changes, we expect more robust planning than we have seen.

The scope of Nichols' review was in two parts:

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

Nichols completed a Phase 1 report, covering the Wessex and Scotland routes in July, which we have published⁶. Nichols completed its Phase 2 (final) report earlier this month, which we are also putting on our website.

Part A – Renewals

Nichols' review concluded that overall renewals delivery progress to date in year 1 is being reported broadly in line with baseline plans. Full year forecasts for year 1 are also broadly in line with baseline plans. Key findings are summarised below:

- Routes have well-defined and well-developed asset renewals workbanks. These are consistent with the CP6 baseline set for each route both at asset group level and in aggregate.
- Routes have control processes that demonstrate that routes are driving their plans to deliver their year 1 and 2 workbanks. The processes have a strong cost and delivery focus that spans route leadership, route asset management, sponsors and delivery agents.
- Routes have built an amount of resilience into workbanks to counter potential over-optimism in delivery plans and also to mitigate the impact of projects being delayed or changed for a variety of reasons through the use of over-planning.
- However, the level of change recorded to planned renewals, the systems used to record it and the information stored with the change record varies in each route. Several routes have a significant amount of change in specific asset groups which is not evident in the overall workbank stability leading indicator.

⁶ See https://orr.gov.uk/data/assets/pdf_file/0013/41602/interim-nichols-review-of-network-rails-renewals-and-efficiency-planning.pdf.

- There is evidence across routes of monitoring of the progress of issuing remits for their workbanks. However, this was inconsistent with routes using various different metrics, and to varying levels of detail.
- Some routes are reporting significant variances against plan for specific asset groups whilst their full year forecast is to recover back to plan. Routes explained how they intend to manage this recovery through over-planning and the re-phasing of work. Nichols recommended that their progress in doing this is monitored by ORR in future progress reports. The upcoming Rolling Forecast 8 (RF8) is an appropriate point for routes to validate progress and make any necessary changes to their year 1 plan.
- Nichols did not find evidence of widespread issues or risks in renewals delivery planning in the sample of projects they reviewed. There were, however, instances where specific routes are managing and mitigating challenges on specific projects around booking access.

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

Part B - Efficiency

Nichols' review has been positive about a number of aspects of routes' efficiency plans including clear route ownership of plans, dedicated resources and robust governance arrangements. Nichols has also been positive about the engagement and support that routes provided to support their work. However, Nichols has confirmed some of the concerns that we set out in our March 2019 letter regarding the quality of a number of efficiency plans. Nichols general findings are summarised below:

- more complex renewals efficiencies require a greater level of documentation and evidence of planning including a better specification of 'what' and 'how' efficiencies will be delivered;
- routes should improve their documentation of the business changes leading to efficiency improvements and ensure that there is a clear record of assumptions and calculations of forecast efficiencies;
- routes should enhance milestone planning, and the monitoring of enabling and implementation actions to deliver renewals efficiencies. This needs to be resourced and driven as a change programme which some routes have already done; and
- some routes need to strengthen their change management office (CMO) resources to provide greater coordination and oversight of the delivery of efficiency initiatives.

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

Although the focus of Nichols' review was years 1 and 2 of CP6, their finding about the variability in the quality of efficiency plans and forecast calculations is a concern for us as it is a risk to delivery of the far higher renewals efficiency targets in years 3 to 5 of CP6. Routes need to do more now to develop and implement those plans to improve preparedness for these later years.

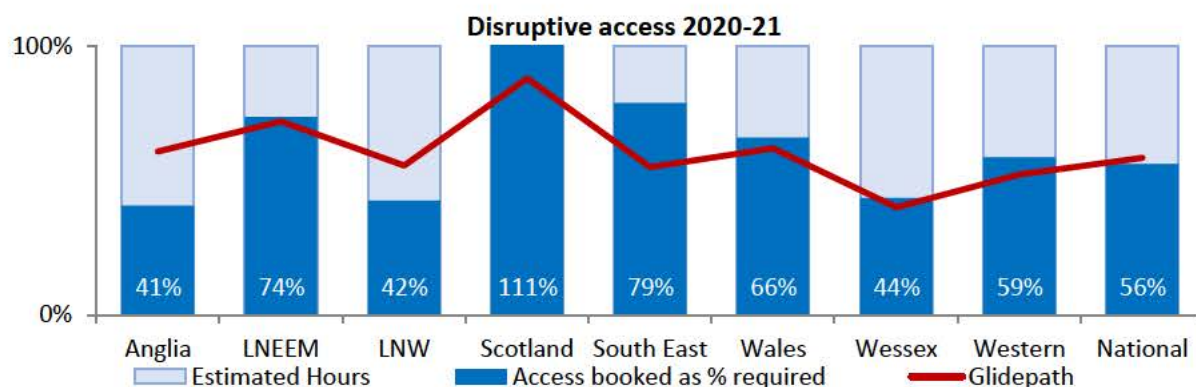
We will continue our work reviewing regions' efficiency plans and delivery over the next few months. We will publicly report on these matters.

Wider leading indicators of CP6 readiness

Alongside our PR18 determination we required Network Rail to show that it is better prepared to deliver efficiently from the start of CP6. Network Rail developed a periodic leading indicators report, which, in consultation with us, has improved over time. We have reported on these indicators of year 1 readiness in our 2018 and 2019 Network Rail Monitor publications. This section provides a short summary of year 2 readiness based on some of the key indicators in Network Rail's latest (period 7) report⁷.

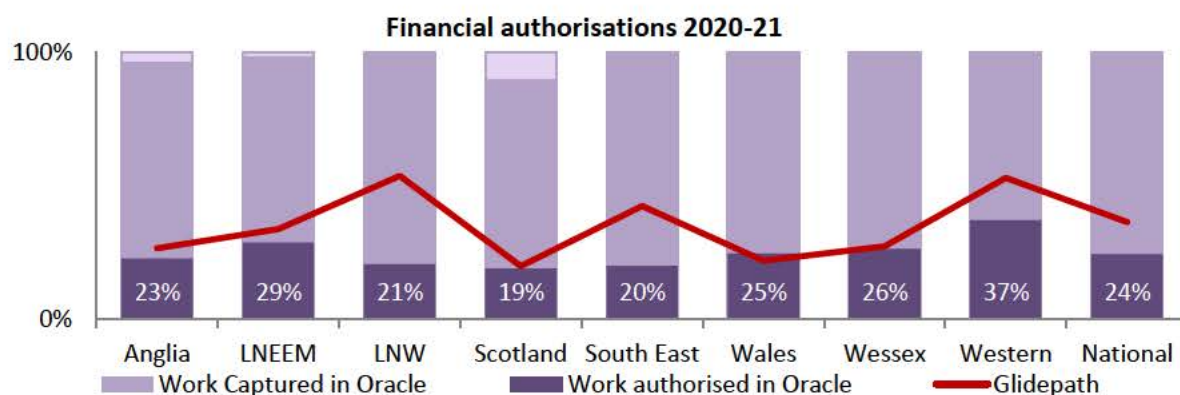
⁷ We agreed with Network Rail that as good progress had been made with year 1 planning, the focus of the leading indicators report should be year 2 from period 6. Network Rail has implemented these changes.

Securing engineering access to the railway



Most routes appear to be mostly on track for booking disruptive access to the network for planned engineering work in 2020-21. Nationally, 56% of forecast disruptive possessions in 2020-21 have been booked in Network Rail’s possession planning system, which is slightly behind Network Rail’s 58% internal target⁸.

Renewals workbank planning



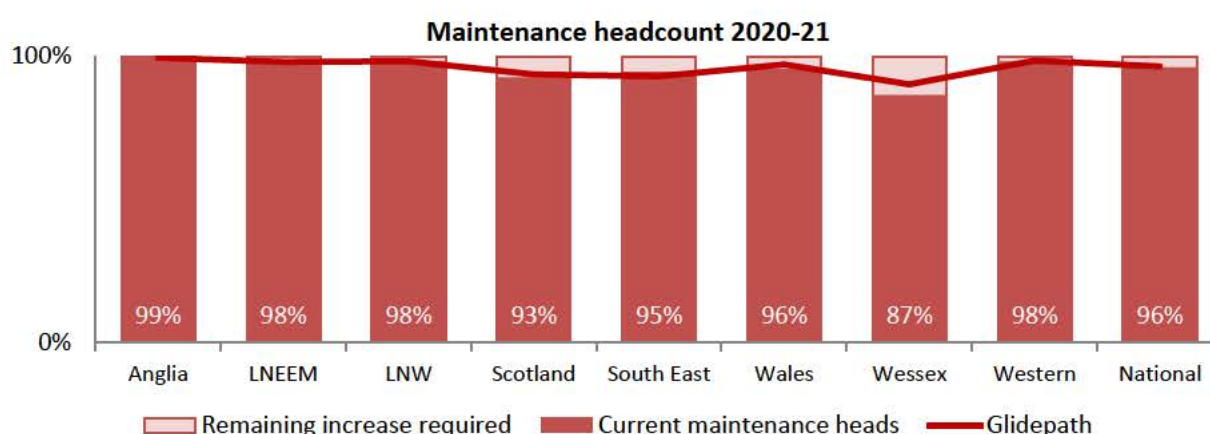
Nationally, only 24% of renewals projects for 2020-21 (by value) have completed detailed designs and received financial authorisation for delivery. This is behind Network Rail’s 36% internal target. Given that over three quarters of forecast renewals have not yet received financial authorisation, this suggests that Network Rail still has substantial work to do to finalise its renewals workbanks for 2020-21.

As we have previously reported, financial authorisation is not a particularly useful indicator for understanding the progress of earlier stages of renewals planning. We welcome

⁸ Network Rail uses the term ‘glidepath’ for its internal targets for leading indicators.

Network Rail's current work to develop a consistent measure across routes/regions of renewals remits issued and accepted. This should provide a better understanding of the progress of earlier stages of renewals planning. I also recognise the work that Network Rail has done to disaggregate the financial authorisations indicator by asset type to help better understand where key risks may reside.

Maintenance capacity



Network Rail's maintenance headcount is currently around 4% lower than planned for 2020-21. This is in line with Network Rail's target at this point.

Efficiency plans for year 2

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

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

Network Rail uses a colour coding approach in the above table. Overall, Network Rail considers that 8% of year 2 target efficiency improvements will be achieved from projects that have already been delivered; 59% have projects in place with delivery plans and milestones; 31% have been assigned to strategic enabling themes with routes'

commitment to deliver, but no plan in place; and 3% have not yet been identified. Given our concerns about the quality of some renewals efficiency plans and the increased scale of efficiencies that need to be delivered, we consider that the current level of confidence in year 2 efficiencies could be overstated.

Year 2 readiness assessment

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

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

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