OFFICE OF RAIL AND ROAD

Overall framework for regulating Network Rail

A PR18 consultation

July 2017

Contents

Summary

1. The aim for our 2018 periodic review of Network Rail (PR18) is “a safer, more efficient and better used railway, delivering value for passengers, freight customers and taxpayers in control period 6 and beyond”.

2. To deliver against this aim, we are making significant changes to how we regulate Network Rail, with a greater focus on route-level regulation and a targeted approach to regulating the system operator (SO). We also want to make the fullest possible use of the expertise and interests of Network Rail’s customers (principally passenger and freight train operators) and other key stakeholders (notably passenger representatives, funders and local transport decision-makers) in contributing to a successful railway.

3. Our vision is that, over time, customers and stakeholders can and should play a much more significant role in working closely with Network Rail’s routes and the SO to agree priorities and challenge performance.

4. This will be supported by our ongoing regulation of the company as a whole. Our legislative framework is unchanged, but we propose to target our monitoring and enforcement activities at the routes, the SO, or other parts of the business, as appropriate. As part of this, we will use and publish comparisons between routes and the SO to incentivise good performance and drive improvements. This comparative approach will help us prioritise our monitoring; and make greater use of reputational incentives. For comparisons to be meaningful however, each route needs clarity and certainty over its own regulatory settlement which identifies the funding available to the route together with the outputs it is expected to deliver.

5. We also see an important continuing role for the regulator to ensure there is transparent and full information on the performance of Network Rail and its constituent parts. Part of this will be to ensure that Network Rail delivers improvements in its capabilities over time, which support improved outcomes in the longer-term.

6. Some of these changes are already delivering benefits, notably the greater involvement of stakeholders in the routes’/SO’s business planning process. Others will be in place at the start of control period 6 (CP6), such as our new approach to monitoring and enforcement.

7. Other benefits will take longer to realise and may not be the reality from the first day of CP6. Instead, Network Rail and its key stakeholders will have to work together to develop and strengthen new ways of working over a period of time.

8. Our aspiration is to be in a position so that during CP6 the railway realises the benefits from:

- the improved quality of the PR18 business plans, built on more effective customer and stakeholder engagement;
- changes in how routes and the SO engage with their stakeholders during CP6, so that problems are identified and there is shared decision making about how to address them;
- informed comparisons between routes (and the SO, to the extent possible), based on more extensive data with which to benchmark route performance, which will start to reveal important information ahead of CP7; and
- a refocused role for the centre of Network Rail to provide a proportionate check and challenge for the routes and SO, spreading best practice and providing assurance to all stakeholders and ORR that underperformance by individual management teams is being addressed.

A greater focus on regulating at a route-level

9. Route-level regulation means that in PR18 and throughout the next control period we will be putting an increasing focus on regulating each of Network Rail's route businesses, building on changes that the company is making to devolve more responsibility to these routes. This means:

- encouraging closer working between Network Rail and train operators and other key stakeholders (e.g. local funders); and
- creating meaningful incentives for routes to deliver and be accountable for delivery, in particular by making greater use of comparison between routes.

10. These changes have already started, with Network Rail adopting a bottom-up approach to its business planning – with each plan owned by the route teams – which will form the core of the company's strategic business plan submissions later this year. This will also provide a more robust basis for the company to plan its maintenance and renewals work, and for it to deliver significant improvements in the efficiency of that work. Reflecting this changing approach, we have already moved towards route-level monitoring in CP5 as we prepare the ground for regulating in a different way during CP6.

A strengthened system operator

11. As an essential complement to route-level regulation, we recognise the importance of Network Rail developing a mature SO business. The SO performs two key roles in this regard, as it provides:

- expert analysis to support improved timetabling, better use of the existing network and analysis of how the network should be enhanced over time; and
- a check against the routes to protect the benefits of a coordinated and integrated network, while also ensuring that operators retain fair and non-discriminatory access to the network, and that operational decisions taken by routes treat all operators fairly.

12. These roles should be distinct from routes and other business functions so that, over time, the SO will be able to provide a single source of trusted analysis on which decision makers are able to rely, and decisions in which current and prospective customers have confidence. To achieve this, it needs to be increasingly independent from the routes.

Supporting customers and stakeholders to play a larger role

13. Constructive engagement between Network Rail and its stakeholders is critical to ensuring they can contribute to the success of the railway. We expect Network Rail to work with its key stakeholders to improve the extent to which they can inform its priorities within the available funding, monitor its performance, and challenge where issues arise. We expect the focus of this engagement to be at a route/SO level.

14. We want to facilitate this engagement and improve the incentives on Network Rail to be responsive and collaborative with its customers and other key stakeholders. However, this is against a background of ORR continuing its own monitoring and standing ready to increase its involvement where the relationship between Network Rail and its customers is not sufficient. Indeed, we see a clear ongoing role for ORR to protect the interests of users who are not likely to be well-served by such arrangements. Most obviously, this includes the priority of sustaining asset condition for the benefit of future rail users. We will also continue to play a proactive role in providing assurance in areas we consider high risk or critical to business success, such as securing improvements in efficiency.

Network Rail and our determination

15. The legal framework we are operating in has not changed, and the determination we issue and Network Rail's network licence remain the legal basis of how we set out what Network Rail is expected to deliver. In our determination we will distinguish between England & Wales and Scotland, reflecting the different national funders and their separate High Level Output Specifications (HLOSs). To determine funding, we will focus on scrutinising costs set out in routes' plans to operate, maintain and renew the network. The HLOSs of both the Secretary of State and the Scottish Ministers signal that the funding of enhancements will largely sit outside the periodic review.

16. Our determination will reflect the importance of health and safety; complementing our wider role in monitoring and enforcing health and safety legislation. However, the reforms set out in this consultation are not principally motivated by health and safety and do not change our overall regulatory approach in this area.

17. We will increasingly distinguish between three different aspects in our regulation of Network Rail, namely:

- **Routes** (including the Freight and National Passenger Operators route, or FNPO) – we will set individual settlements for each route so that they have clarity about the resources available to them to deliver the outputs they have agreed, and increasingly hold these routes to account for their delivery. Where issues relate to routes and the performance of the relevant management teams, we will target our regulation at this level;
- **System operator** – we will also set a separate settlement for the system operator, and hold the relevant management team to account for delivery. Much of the regulatory framework will be common to that applied to routes, albeit that the approach will be modified to suit the particular nature of system operator functions;
- **Whole company** - Network Rail continues to have a single licence. There will be some issues that relate to central functions, or are cross-cutting and/or so serious that our focus will be on the performance of the company as a whole and/or the role of Network Rail's senior management team.

18. In each case, our starting point is that routes and the SO should take responsibility for all aspects of their delivery. Importantly, this includes holding their suppliers to account; whether this is an external supplier or the parts of Network Rail that provide services to routes (such as the Route Services Directorate). Over time, we would expect routes and the SO to challenge whether the current delivery model for these services is effective, or whether additional responsibility should be given to routes and the SO.

19. Regulation of the Scotland route operates in a different context as there is ring-fenced funding that will reflect the HLOS and statement of funds available (SoFA) issued by Transport Scotland as part of PR18. While having the full potential to benefit from our comparative approach to route regulation, this means that some aspects of our overall framework apply differently or do not apply to the Scotland route, as we make clear throughout the document.

Scorecards

20. Network Rail has been developing scorecards to report on its business performance, including with a view to facilitating closer alignment with their passenger and freight operator customers. In PR18, the scorecards for each route and the SO should become the key means of agreeing expectations for what Network Rail is to deliver during CP6.

21. Scorecards have the potential to bring many benefits. They are a vehicle for capturing customer and funder requirements, and can help ensure Network Rail is driven much more clearly by those requirements. Where scorecards contain consistent measures across routes, they will facilitate comparisons between routes, supporting reputational incentives and providing important information to take into account when assessing performance.

22. There is therefore an opportunity in CP6 to make increasing use of the SO and route scorecards as an important part of how we formalise the expectations on Network Rail and monitor how well different parts of Network Rail are delivering.

23. To make full use of Network Rail's scorecards in CP6, we have certain expectations of them. In particular, we expect them to be balanced, to support comparison between routes and over time, and to appropriately reflect requirements in HLOSs. They also need to be supported by strong stakeholder engagement and quality assurance. We are consulting on specifying a small number of measures for the route scorecards, and setting a regulatory minimum floor (a breach of which would be likely to trigger formal investigation) in two of these: performance and network sustainability. Our approach seeks to support effective relationships between Network Rail and its customers while providing a backstop to protect key areas.

Network Rail's engagement with stakeholders to support effective delivery

24. For CP6, we expect Network Rail to engage meaningfully with its customers and other stakeholders so that those stakeholders are able to support Network Rail in delivering their individual priorities (so long as they represent efficient spend that Network Rail can afford). Delivering customer and stakeholder priorities will ultimately benefit passengers and other end-users.

25. Network Rail's individual routes and the SO should lead this engagement with their local stakeholders. We want to support Network Rail's progress in this area and allow for innovation across routes, reflecting scope for the routes/the SO to develop and share good practice in stakeholder engagement.

26. We will not prescribe how Network Rail routes or the SO should engage with their stakeholders. Rather, our proposed approach will focus on setting some principles and minimum expectations for engagement, and on assessing the quality of engagement and identifying best practice.

27. We would also look to empower stakeholders to build effective relationships with the routes and SO by:

    - ensuring there is good quality comparative performance information across routes (via scorecards) and on other aspects of business performance; and
    - giving stakeholders confidence that ORR will investigate and take appropriate action where performance problems are not being addressed.

28. It is important that routes and the SO engage with customers and stakeholders in developing scorecards, and reviewing performance against these. However, scorecards are inevitably a relatively high-level picture of what should be delivered and do not describe 'how' delivery will be achieved. We therefore expect scorecards to be only part of the way in which routes and the SO engage with their customers and other key stakeholders. While approaches will vary, at a minimum we expect routes and the SO to involve stakeholders in their annual business planning process, to provide ways for these parties to understand how the route/SO is performing, and provide mechanisms to agree suitable actions as issues arise.

29. It will be important to assess the effectiveness of each route's and the SO's engagement with stakeholders. These assessments, together with the routes and SO scorecard performance, will help us to prioritise our own activity. If, for example, we were concerned that a route or the SO is not engaging effectively, we would be likely to take a more proactive approach to regulation in order to protect interests that are not being addressed.

30. These proposals are intended to support Network Rail's recent efforts to increase engagement with local stakeholders and to enable the routes and the SO to develop their approach in this area over CP6.

Our approach to monitoring and enforcement in CP6

31. For CP6 we are proposing to:

    - use a more customer-focused approach based around Network Rail's scorecards, some elements of which we may designate 'reasonable requirements' under the licence; and

- use our overall assessment of Network Rail's performance against an overarching licence condition relating to network management (currently licence condition 1). We would take into account all the available evidence on Network Rail's performance.

32. As regulator, we must encourage improved performance by Network Rail, and take appropriate action where it is not good enough. We want to ensure there is a balanced set of incentives on Network Rail that reflects its business structure and public sector status, and provides clear benefits for good performance and clear costs for underperformance.

33. We are consulting on introducing a number of new incentives, including reputational, procedural and management. We wish to signal the types of responses we will be likely to consider in different performance situations, giving a clear message to Network Rail and its stakeholders about how we may escalate performance issues using an incremental approach to reflect Network Rail's progress in addressing any issues.

34. Our approach needs to adapt to the public sector status of Network Rail. The legislation and role of Network Rail's licence are unchanged. However, we expect reputational incentives in particular to play a larger role. Reflecting our overall approach to PR18, we particularly want to use comparisons across routes/the SO to recognise and incentivise good performance, to use the sense of rivalry to drive improvements, and to inform our approach to intervening and enforcing where necessary.

35. Our approach to monitoring and enforcement is subject to how effectively routes and the SO engage with their stakeholders, especially in addressing performance below what is expected of them. As a general principle, where there are strong mechanisms for customers and other stakeholders to work with Network Rail to agree and deliver appropriate action, we will give the space for these mechanisms to be used, supporting the relationship between Network Rail and its customers.

Managing change to our PR18 settlements

36. We have seen in recent years the potential impact that changing circumstances can have on what Network Rail can deliver and the role that regulation needs to play. Certain potential changes in CP6 may serve to weaken the routes'/SO's ability to plan, blur their accountability, and reduce our ability to compare across routes or over time. This could undermine the benefits of our regulatory approach. We therefore need to design the regulatory framework for CP6 in a way that is sufficiently flexible

to respond to change, while also providing a consistent framework for holding Network Rail to account.

37. Aside from treatment of enhancements (which we do not discuss in this document), we think the relevant changes to consider are changes to the role of the SO/routes, route boundary changes, and changes to the budgets of individual routes/the SO.

38. We would not require our involvement in small changes. For large changes, which represent a fundamental change to our PR18 settlement, we would expect Network Rail to provide us and stakeholders with a business case assessment of the impact of the change ahead of any decision being made. This together with stakeholder input would give us an opportunity to consider the regulatory impact of the potential change and provide a formal opinion to Network Rail.

39. If a route/SO scorecard continued to meet our requirements, as set out in chapter 3, we would not expect to be involved directly the process for changes to it. However, we would expect to be informed of stakeholders' views regarding the change and the governance around the change.

Next steps

40. In addition to this consultation document, we are also publishing two documents on how we measure performance during CP6 with regards to:

    - Route requirements and scorecards; and
    - Possible measures of the System Operator's performance.

The deadline for all three consultations is 21 September 2017.

1. Introduction

Summary

We are consulting on the overall regulatory framework for control period 6 (CP6, which starts in April 2019), as we seek to adapt our regulatory approach to reflect the ongoing devolution of Network Rail.

Purpose of this consultation

1.1 For CP6, we are changing the way we regulate Network Rail to reflect the broader changes that are occurring – in particular the devolution of Network Rail and a greater focus on the needs of the customer.

1.2 Through this document, and the supporting documents that we are also publishing, we set out proposals for how regulation would work in CP6.

1.3 This chapter sets out the scope and structure of this consultation, and provides the contact information and deadline for responses. We look forward to hearing your views.

Scope of this consultation

1.4 Our PR18 aim is "A safer, more efficient and better used railway, delivering value for passengers, freight customers and taxpayers in control period 6 and beyond".

1.5 This consultation focuses on the regulatory framework for holding Network Rail to account for the outputs it provides to its customers (including future customers) on a day-to-day basis. Specifically, this document sets out:

- the organisational structure of Network Rail (for background and context);
- proposals for the future regulatory role of scorecards;
- how we propose to support Network Rail's engagement with its stakeholders in CP6;
- ORR's role in holding Network Rail to account; and
- how we propose to manage changes to our PR18 settlements during CP6.

1.6 This consultation does not seek to address every aspect of regulation for Network Rail in CP6. In particular, this document **does not** make substantial reference to:

- our review of charges and contractual incentives – We recently published our conclusions to the December 2016 consultation on changes to charges and contractual incentives. Development work will continue separately in this area, and we expect to consult further over the autumn on issues relating to the development of infrastructure cost charges (including emerging findings of the 'market-can-bear' analysis), possible changes to Schedule 4 and Schedule 8 of the track access contracts, the volume incentive, and on how to align incentives between Network Rail and operators (e.g. a 'Route-level efficiency benefit sharing' style mechanism);

- financial framework – The financial framework project centres on the calculation of the revenue required by Network Rail, which it recovers through track access charges and the network grants paid by the UK and Scottish governments. It also considers the broader financial structure for Network Rail. In PR18, we expect to calculate the revenue requirement at a route level, although we are still considering the detail of this. More background information is provided in our first consultation on the financial framework, and we expect to publish an update on policy development in autumn 2017;

- enhancements – We do not include substantial discussion of enhancements in this document because, unlike in previous control periods, neither the Secretary of State's nor the Scottish Ministers' High Level Output Specifications (HLOSs) include specific infrastructure enhancements. We comment on enhancements here primarily as a possible source of change to operations, maintenance and renewal plans;

- producing our PR18 determination – This document does not detail the contents of Network Rail's strategic business plans, on which we have published guidance, or how we will assess the quality of those plans or the efficient costs that Network Rail requires to deliver its outputs. In identifying those efficient costs, we will build on the work in our recently published consultation on improving Network Rail's renewals efficiency;

- implementation – This document does not set out the specific changes to be made to track access contracts, the network licence, or our economic enforcement policy. These will be picked up later in the periodic review process as our determination is firmed up; and

- this document does not cover the monitoring of Network Rail that government (i.e. Department for Transport, Transport Scotland and the Welsh Government) carries out, for example as described in the framework agreement between

Network Rail and DfT. We are discussing with government how this monitoring might change in CP6 to reflect the work described here.

Structure of this document

1.7 The document structure is outlined below:

(i) chapter 2 - Network Rail and our determination: provides some background around Network Rail's current organisation, and explains the role of our PR18 determination;

(ii) chapter 3 – Scorecards: explains the role we propose for scorecards in CP6 and our expectations regarding their content;

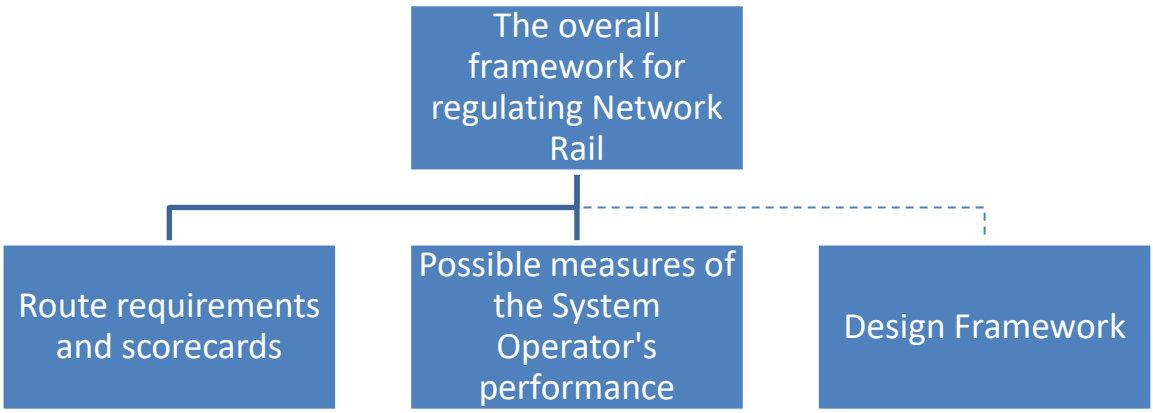
(iii) chapter 4 - Network Rail's engagement with stakeholders to encourage effective delivery: expands on how we see routes and the SO engaging more effectively with customers and stakeholders, and explains our proposed role as regulator to facilitate that;

(iv) chapter 5 - Our approach to monitoring and enforcement in CP6: explains how we propose to adapt our regulatory activities, including our risk based approach, and explain the tools we will use to incentivise good performance or address any underperformance; and

(v) chapter 6 - Managing change to our PR18 settlements: sets out proposals on how changes that affect the route and SO settlements will be managed in CP6.

1.8 In addition to this consultation document, we are also publishing subsidiary documents for consultation. The suite of documents we are publishing and the relationship between them is set out below in Figure 1.1:

Figure 1.1: Documents for consultation



- Route requirements and scorecards – This focuses on the geographic routes and the freight and national passenger operator (FNPO) route and sets out what measures we would expect to be included in the scorecards for those routes. This document also addresses non-scorecard issues including capability, availability and capacity.

- Possible measures of the System Operator's performance – This document presents a long list of potential measures of the SO's performance to support stakeholder engagement with Network Rail's ongoing development of its SO scorecard, and discusses principles that could inform any ORR-led measures which may be set at a future date.

- The design framework – This summarises, as a list, policy positions set out in the overall framework consultation. Each policy is accompanied by a classification depending on the status of the policy, for example whether it is our preferred option, our minded-to position or it is a policy on which we have already decided. We will publish this shortly after the other documents, and then reissue it when we conclude on the consultation. It forms part of the overall framework consultation rather than forming a consultation in its own right.

Responding to this consultation

1.9 This **consultation closes on 21 September 2017,** as do the consultations for the other documents we are publishing. Please submit your responses, in electronic form, to our PR18 inbox pr18@orr.gsi.gov.uk. You may find it useful to use this

pro forma to structure your response to this consultation. We have also provided pro forma for the other consultations, which are available on the consultation webpage.

1.10 We plan to publish all responses to this consultation on our website. Accordingly, when sending documents to us, we would prefer that you send your correspondence to us in Microsoft Word format or Open Document Format. This allows us to apply web standards to content on our website. If you do email us a PDF document, where possible please:

- create it from an electronic word processed file rather than sending us a scanned copy of your response; and
- ensure that the PDF's security method is set to "no security" in the document properties.

1.11 Should you wish any information that you provide, including personal data, to be treated as confidential, please be aware that this may be subject to publication, or release to other parties or to disclosure, in accordance with the access to information regimes. These regimes are primarily the Freedom of Information Act 2000 (FOIA), the Data Protection Act 1998 (DPA) and the Environmental Information Regulations 2004). Under the FOIA, there is a statutory code of practice with which public authorities must comply and which deals, amongst other things, with obligations of confidence.

1.12 In view of this, if you are seeking confidentiality for information you are providing, please explain why. If we receive a request for disclosure of the information, we will take full account of your explanation, but we cannot give an assurance that confidentiality can be maintained in all circumstances. An automatic confidentiality disclaimer generated by your IT system will not, of itself, be regarded as binding on ORR.

1.13 If you are seeking to make a response in confidence, we would also be grateful if you would annex any confidential information, or provide a non-confidential summary, so that we can publish the non-confidential aspects of your response.

2. Network Rail and our determination

Summary

In this chapter, we provide background information around Network Rail's structure and the format of our determination in PR18.This chapter describes the current status and structure of Network Rail in the context of ongoing devolution to the routes, and how we will regulate the company differently to reflect this devolution. It explains the status and structure of our determination, and the settlements we intend to create for each of the routes and the SO. It also outlines at a high level the process Network Rail will have to go through if it wishes to reject our determination.

Introduction

2.1 The structure of the chapter is as follows:

- the legal status of Network Rail;
- the organisational structure of Network Rail;
- our regulation of the whole company;
- our PR18 determination;
- what Network Rail is expected to deliver; and
- acceptance and implementation of the determination.

The legal status of Network Rail

2.2 Network Rail owns, operates, maintains, and develops, most of the mainline railway network in Great Britain. It is a not-for-dividend company, limited by guarantee. It was reclassified as a public sector arm's length government body in September 2014. Its sole member is the Secretary of State for Transport.

2.3 Network Rail is subject to companies legislation and its board is accountable to:

- the UK and Scottish Parliaments in respect of the stewardship of the public funding it receives;

- the Secretary of State for Transport, and the Scottish Ministers in respect of the management of the business and the public funding it receives; and
- the Office of Rail and Road (ORR) as the health and safety and economic regulator; in particular:
  - Network Rail must comply with health and safety legislation and regulations; and
  - for economic regulation, which is the focus of PR18 and encompasses Network Rail's financial and operational performance. Network Rail must comply with its network licence, which we oversee and enforce.

2.4 Government expenditure on Network Rail, while set as part of a periodic review for five years, must now compete for government funding with other publicly funded activities such as health and education. For CP5, Network Rail has been subject to fixed borrowing limits under its DfT loan facility, which has affected how Network Rail manages the risk of overspending. However, DfT states in its initial Statement of Funds Available, that it does not intend for Network Rail to obtain any further loan during CP6, either from government or other sources.

2.5 The public sector status of Network Rail means that financial incentives may be relatively weak. Instead, the importance of professional pride, belief in what Network Rail is trying to achieve and recognition for work well done, all of which we refer to as 'reputation', are likely to be more important motivators for its management teams and the company as a whole.

The organisational structure of Network Rail

2.6 Network Rail is responsible for the operation, maintenance, renewal and enhancement of much of the rail infrastructure in Great Britain.

2.7 As we set out in our consultation on improving Network Rail's efficiency, there are clear problems that have led to Network Rail becoming less efficient in how it renews the network. While asset reliability has been improving in some areas, operational performance on the whole is declining. Cost increases are ultimately met by passengers, freight customers and taxpayers.

2.8 Network Rail has started a process of transformation by reorganising around route businesses and a discrete system operator, each of which will have more responsibilities to take decisions.

2.9 In the following paragraphs, we outline how Network Rail is organised, and how its organisation is changing, to provide context for understanding our approach to regulating Network Rail in CP6, which we set out in the rest of this document.

2.10 Responsibility for day-to-day operation and management of the railway is devolved to eight geographic routes, with the six routes in England centred on the main line routes out of London, and separate geographic routes for Scotland and Wales.

2.11 In addition to these geographic routes, there is also a dedicated Freight and National Passenger Operator (FNPO) route, which was established in autumn 2016. The FNPO route provides a single point of contact and is accountable for the delivery of performance and other outputs for customers that operate nationally, across multiple routes. In this document, the term 'route' includes the FNPO route, with 'geographic route' used to indicate if the FNPO route is not included.

2.12 Every passenger and freight operator has a 'lead' route, which Network Rail has assigned to act as their primary point of contact within the company. For some operators this is a geographic route, but for freight and certain passenger operators, this is the FNPO route.

2.13 Network Rail has articulated its vision for its route based businesses, including the FNPO, as being focused on delivering a safe, reliable, operational railway within a national framework, demonstrably meeting customer needs through being clearly empowered, clear on accountabilities, with faster decision-making and a clearer customer-focused culture with the capability to find innovative ways of funding the railway.

2.14 As a complement to route devolution, we recognise the importance of Network Rail developing a mature system operator. The SO performs two key roles in this regard, as it provides:

- expert analysis to support improved timetabling, better use of the existing network and analysis of how the network should be enhanced over time; and
- a check against the routes to protect the benefits of a coordinated and integrated network, while also ensuring that operators retain fair and non-discriminatory access to the network and that operational decisions taken by routes treat all operators fairly.

2.15 These roles should be distinct from routes and other business functions so that, over time, the SO will be able to provide a single source of expert and trusted analysis on which different decision makers are able to rely, as well as decisions in which current

and prospective customers have confidence. To achieve this it needs to be increasingly independent from the routes.

2.16 In addition to the routes and SO, there are a number of central functions. We distinguish here between two broad categories:

- **service providers**: Some of these act as suppliers and service providers to the routes/SO and are organised centrally to realise economies of scale. These primarily sit within the central Route Services Directorate and include the National Supply Chain and some IT functions.
- **other central functions**: There are also central functions that set policies for the rest of Network Rail to follow and/or provide assurance to its board that Network Rail is satisfying its legal obligations. Functions in this category include the technical authority, which specifies asset policies and ensures that safety critical standards are consistent across the network.

2.17 For some central functions, the relationship with the routes is one of both supplier and assurer. For instance, Infrastructure Projects delivers some services to the routes, but also provides corporate assurance around deliverability and defines project management processes and standards.

Our regulation of the whole company

2.18 In CP6, we will continue to regulate Network Rail as a single company with a single licence, but with a greater focus at route and SO level, including tailored approaches to the Scotland route and also the route in Wales.

2.19 Reflecting this, in our determination, we will include a settlement for each geographic route, the FNPO, and the SO. The settlement for Scotland will be ring fenced, reflecting the separate responsibility of the Scottish Ministers for the strategy and funding of railway infrastructure in Scotland.

2.20 We will not produce separate settlements for the central functions. Instead, their costs are reflected in our determination as being re-charged to the routes/SO on a cost reflective basis.

2.21 We will continue to regulate central functions as currently, including by scrutinising Network Rail's strategic business plan submission, and through retaining the ability to take regulatory action against Network Rail if any part of the organisation is not meeting its licence requirements. In addition, in the role of customer, routes and the SO can challenge the quality of services provided by central functions and their

associated costs. We expect these commercial pressures to increase as a result of devolution, including through market testing, both in PR18 and during CP6.

Our PR18 determination

2.22 Network Rail is currently due to submit its strategic business plans to us in December 2017[1]. As part of this, each route and the system operator is preparing its own strategic plan. We expect each strategic plan to be signed off by the relevant director, to reflect their ownership and accountability for delivering the plan. These plans should take account of the priorities of passengers, freight customers and train operators, as well as other stakeholders. However, routes will have to prioritise their activities within the context of any funding constraints and how Network Rail corporately deals with this issue.

2.23 The strategic business plans will form the basis of our determination, which will distinguish between Scotland and England & Wales. The route and SO strategic plans will inform the settlements we determine for each route and the SO.

2.24 While Network Rail will submit one or more strategic plans for its central functions, their costs will be recharged to routes and the SO, and will not be subject to a separate settlement. There will therefore be ten settlements (eight geographic routes, the FNPO route, and the SO).

2.25 These settlements will consist of funding requirements calculated on the basis of assumptions regarding outputs that Network Rail is required to deliver, and the associated costs of delivering them, incorporating assumptions derived from bottom-up targets for Network Rail's efficiency. Settlements will be set in the context of the network licence, the financial framework, charges and contractual incentives, and the monitoring framework - the latter of which we discuss in chapter 5.

2.26 With the exception of the Scotland route, the settlements are not ring-fenced, and during CP6 Network Rail will be able to reallocate funds between routes in appropriate circumstances. We discuss issues and process around this in chapter 6.

What Network Rail is expected to deliver

2.27 In PR18 we will set what Network Rail is expected to deliver, within the framework of the HLOSs and its legal obligations, during CP6.

[1] The periodic review timetable is under review following the delay in the publication of the governments' statements of funds available.

2.28 Network Rail's network licence underpins delivery of the determination. The existing Condition 1.1 is particularly relevant in this regard. It sets out Network Rail's core obligations to secure:

- the operation and maintenance of the network;
- the renewal and replacement of the network; and
- the improvement, enhancement and development of the network,

in each case in accordance with best practice and in a timely, efficient and economical manner so as to satisfy the reasonable requirements of persons providing services relating to railways and funders, including potential providers or potential funders, in respect of:

- the quality and capability of the network; and
- the facilitation of railway service performance in respect of services for the carriage of passengers and goods by railway operating on the network.

2.29 For CP5, we explain in our economic enforcement policy that we consider that reasonable requirements include (but are not limited to):

- outputs established in a periodic review ('regulated outputs');
- disaggregated outputs established as a result of the transfer of responsibility for funding infrastructure in Scotland to the Scottish Ministers;
- firm commitments (as opposed to aspirations) included in Network Rail's delivery plan (including route plans); and
- effective communication with customers and funders about the delivery of these outputs and commitments.

2.30 For CP6 we are proposing to:

- use a more customer-focused approach based around Network Rail's scorecards, some elements of which we may designate reasonable requirements in our final determination We discuss this in chapter 3; and
- use our overall assessment of Network Rail's performance against an overarching licence condition relating to network management (currently licence condition 1). We would take into account all the available evidence on Network Rail's performance.

Acceptance and implementation of PR18

2.31 We will publish our final determination in October 2018 setting out our overall decisions for PR18.

2.32 To give effect to the determination we will issue 'review notices' specifying the necessary changes to track and station access contracts and the licence, using the procedure set out in Schedule 4A to the Railways Act 1993 (the Act). We plan to do this in December 2018. Network Rail has the right to object to the proposed changes set out in the review notices.

Accepting or rejecting the determination

2.33 Although there will be ten settlements, only Network Rail as a whole (having appropriately engaged with its routes and the SO) can accept/reject its determination. In the event that Network Rail objects, we can either:

(a) accept its objection and make changes to the periodic review determination and issue one or more new review notices and restart the implementation process; or

(b) refer the matter to the Competition and Markets Authority to determine.

2.34 In either scenario, it would be unlikely that PR18 would be implemented in time for 1 April 2019. The Act does not specify what should happen in this scenario. We consider that it would mean a significant gap in Network Rail's funding because certain key charges (in particular the fixed charge paid by franchised operators) would not automatically roll-forward. To avoid this eventuality (and consistent with the approach taken during the previous periodic review, PR13), Network Rail will be consulting on specific contingency arrangements in autumn 2017.

3. Scorecards

Summary

- Network Rail introduced scorecards in CP5 and we expect these to continue in broadly a similar structure in CP6. Scorecards have the potential to bring many benefits. They are a vehicle for capturing customer and funder requirements, and can help ensure Network Rail is driven much more clearly by these requirements. Where scorecards contain consistent measures across routes, they will facilitate comparisons between routes, supporting reputational incentives and providing important information to take into account when assessing performance.
- This presents an opportunity for us to use scorecards as part of how we monitor and assess how well or poorly different parts of Network Rail are delivering. We intend to focus on the routes (geographic and FNPO) and the SO.
- To make full use of Network Rail's scorecards in CP6, we have certain expectations for what they look like. In particular, we expect that the scorecards are balanced, that they support comparison between routes and that they reflect appropriately the requirements in HLOSs. We expect to specify a small number of measures for the route scorecards, and to set a regulatory minimum floor – likely to trigger formal investigation if breached - for two of these: performance and network sustainability.
- Our approach seeks to support effective relationships between Network Rail and its customers while providing a backstop to protect key areas.
- Our separate consultations on route requirements and scorecards and possible measures of the system operator's performance set out some more detail in this area.

Introduction

3.1 In the previous chapter, we set out the wider picture of what Network Rail is required to deliver in a control period. Route and SO scorecards will be a key element of how we monitor and assess Network Rail's delivery of its requirements. Our approach in CP6 will be new, and so this chapter focuses on how we propose this will work.

3.2 Scorecards are used by Network Rail as a way to improve how its business performs, including through creating closer alignment with train and freight operating companies' objectives. While it is for Network Rail to decide how best to run its

business, we support the use of scorecards for this purpose and the potential for them to improve outcomes, consistent with our PR18 aim.

3.3 However, we also see an opportunity for scorecards to be used as part of our regulatory framework. We think they could improve the approach for setting targets, sharpen the incentives on the company to deliver, and influence the way that we undertake monitoring and enforcement. Scorecards could have a different status in CP6; for instance, parts of the scorecard could be considered reasonable requirements under the licence. To do this, we have a number of requirements for scorecards which we set out in this chapter.

3.4 The rest of this chapter is structured as follows:

- Network Rail's scorecards in CP5;
- the CP5 outputs framework;
- Network Rail's thinking on scorecards in CP6;
- proposals for specific requirements in CP6 scorecards;
- scorecards in the routes and SO strategic plans;
- our PR18 determination for scorecards and other requirements;
- reasonable requirements in CP6; and
- regulatory minimum floors.

Network Rail's scorecards in CP5

3.5 Network Rail introduced scorecards during CP5 in order to help it manage its business and to facilitate closer alignment with its passenger and freight operator customers. In Box 3.1 we set out Network Rail's view on the purpose of its scorecards.

Box 3.1 Network Rail's view on scorecards

In order to help build understanding and promote discussion, Network Rail has set out that it sees the purpose of scorecards to be as follows:

- assess business performance with measures and targets on key metrics on the overall core areas of safety, financial performance, train performance, asset management, investment and locally driven measures, to help it drive improved safety, operational and fiscal performance and create greater transparency throughout the organisation;
- provide an at-a-glance summary of Network Rail's achievements against key indicators and areas in which it needs to do better;
- measure performance every period, making performance against Network Rail's targets transparent to everyone in Network Rail, and a key factor in determining performance related pay to ensure that employees have a direct financial interest in the success of the business;
- measure the overall business performance of each Network Rail route based on the needs of its stakeholders, measuring both long-term stewardship of the railway and current operating performance;
- create closer alignment with train and freight operating companies; Network Rail also believe scorecards could be used to measure the joint performance of Network Rail and train operators in the areas where it is jointly accountable for delivery; and
- make the performance of Network Rail transparent to the public, and help ensure that stakeholders consider each of Network Rail's responsibilities in a balanced way.

3.6 Network Rail currently has a number of scorecards that reflect various parts of its business, including:

- a national corporate scorecard;
- geographic and FNPO route scorecards; and
- scorecards for other key parts of its business including property and infrastructure projects.

3.7 It has also developed an SO management scorecard that it has begun to share with operators and funders, albeit on an informal basis.

3.8 Route scorecards reflect, to varying degrees, the following areas:

- safety;
- financial performance;
- asset management;
- investment;
- train performance; and
- locally driven/customer measures.

3.9 The FNPO scorecard does not include the asset management area, because the FNPO does not manage infrastructure assets.

3.10 Each area on a scorecard includes one or more measures. For each measure, a recorded range of targets is included, reflecting the level of performance that would be considered to meet, exceed, or fall short, of the target.

3.11 While there is consistency in measures across some of the key areas, customer-led and locally determined measures by their nature are not consistent across routes. The scorecards also reflect the different situation in Scotland (with the role of Transport Scotland and the deep alliance) as opposed to routes in England & Wales.

3.12 Network Rail sets out each route's performance on its national corporate scorecard by recording the extent to which the route has delivered in aggregate against its scorecard targets.

3.13 In 2016-17 Network Rail consulted with passenger and freight operators to develop customer-led scorecards. These are route-level scorecards for individual customers, and are established for some, though not all, customers. Each of these customer-led scorecards are summarised as a single line in the route's scorecard. This enables more customer-focused targets to be used, including those supporting franchise targets. Customer-led scorecards include customer-agreed measures and targets including high level measures (e.g. aligned with franchise targets), and more detailed measures focused on specific operational priorities for those operators (e.g. right time departures at key stations).

The CP5 outputs framework

3.14 In PR13, we determined regulated outputs, which are specific targets, set at a national level (Scotland, England & Wales), in areas including network performance and asset condition. We explained that we considered the regulated outputs to be reasonable requirements under the existing condition 1.1 of the network licence. The implication of this is that Network Rail is required to deliver the outputs to the greatest extent reasonably practicable, having regard to all relevant circumstances including the ability of the licence holder to finance its licensed activities. If Network Rail fails to do this, we would consider whether this constitutes a licence breach and we may take enforcement action.

3.15 In our final determination, we set out how the regulated output on network performance should be supported through the performance strategy process, which is set out in the Network Code. We said that we would intervene if Network Rail and an operator could not agree a performance strategy target.

3.16 In addition, in PR13 we made a number of forecasts for CP5, including for Network Rail's financial efficiency in different areas of expenditure, which we have then subsequently reported on as part of our monitoring activities.

3.17 We have identified the following potential weaknesses in this approach:

- some in the industry, including Network Rail, felt that when the regulator set a number of targets, this encouraged Network Rail to focus on the regulator as the main customer of Network Rail, at the expense of its actual train and freight operating customers, and funders. This ultimately resulted in it being less focused on delivering services that benefitted passengers and freight customers;
- the approach relied upon there being reasonably accurate forecasts for the targets used, which for the end of the control period are effectively set seven years in advance. For some measures, this may not be realistic. In CP5, we have tended to find the performance strategies a more useful tool for monitoring performance than the associated regulated outputs. Network Rail reviews each performance strategy with the relevant operators annually, allowing the strategies to be updated to take account of, for example, external shocks; and
- related to this, Network Rail's status as an arm's-length government body means that the fines we can levy for breach of licence may be a less effective tool for achieving better outcomes than locally set, challenging but realistic, targets (especially when coupled with inter-route rivalry). We discuss the role of enforcement further in chapter 5.

3.18 Network Rail's scorecards for CP5 have generally not reflected PR13 regulated outputs, instead updating targets annually.

Scorecards in PR18 and CP6

Some of Network Rail's thinking on scorecards in CP6

3.19 Network Rail currently uses scorecards as part of its performance related pay. Box 3.2 sets out how it expects this to work in CP6.

Box 3.2: Network Rail's scorecards as a financial incentive mechanism

Network Rail will set in advance which scorecard measures will count towards its performance related pay arrangements. Within each broad scorecard area, routes and the SO will determine the weighting of each measure in consultation with their customers and relevant stakeholders, as appropriate.

Some scorecard measures could be zero-weighted. This is most likely for measures that are not within Network Rail's gift of control, or where the purpose of the measure is primarily for reporting relative route performance, rather than being a key driver for that particular route business and its customers.

3.20 We think that it is useful and important that scorecards are the basis for performance related pay.

3.21 To date, Network Rail has reset its scorecard targets on an annual basis. It then monitors performance relative to target, updating some measures each four-week railway period.

3.22 As part of its strategic business plans, Network Rail is developing forecasts that would give a longer term view of its performance. Box 3.3 on the following page sets out how Network Rail proposes this would work in CP6.

3.23 In addition, Network Rail notes that its scorecard targets could be developed jointly with bidders for franchises, which would enable alignment of interests. Those franchise operators that develop the most effective ways of challenging and working with Network Rail, and in therefore driving up performance, could gain some advantage in the bidding process.

3.24 We understand that Network Rail intends to continue with customer-led scorecards that contribute to the route level scorecard in CP6.

Box 3.3: Network Rail's proposal on forecasting trajectories in scorecards

For each measure within Network Rail's scorecards, it will include a forecast trajectory over CP6.

Having engaged with its customers and relevant stakeholders to understand their requirements and priorities, this trajectory will be the forecast of what Network Rail considers it can deliver at the time the forecast is made. Reflecting the inherent uncertainty and complexity in forecasting measures over the control period, each measure will be included in the scorecard as a range with an upper and lower bound around the forecast trajectory.

Scorecards will be reviewed and updated on an annual basis. Network Rail anticipates that the forecast for the year ahead would become the target for that measure, with the upper and lower bounds of a range captured in scorecards to reflect the uncertainty around a point target forecast.

The forecast trajectories (and associated ranges) for the following years would not be targets, but a forecast of what Network Rail believes it can deliver over a longer time horizon.

Proposals for specific requirements in CP6 scorecards

3.25 To use scorecards in our regulatory framework for CP6, we propose to set out a number of requirements for the content of routes and SO scorecards for the strategic plans and each year in CP6. Our proposals are set out in Box 3.4.

Box 3.4: Proposed requirements for PR18 and CP6 scorecards

Scorecards should:

- **be balanced**, and so reflect the full range of outcomes that Network Rail is required to deliver. This includes current end-user interests, but also that of the taxpayer and longer-term interests of future passengers and freight customers (notably their interest in network sustainability and improved safety outcomes);
- **support comparison between routes** (and, where appropriate, the SO), so that they provide an additional source of incentives on each route to improve performance and a stimulus for sharing best practice; and
- capture requirements specified in an HLOS, **where this is appropriate.**

We are consulting separately on whether we should **require specific measures** to be included in routes or the SO scorecard.

3.26 It is for routes and the SO to develop the content of their scorecards, working with their customers and key stakeholders. To support this, we have published the following consultations:

- **System Operator scorecard measures**: We have published a separate document that discusses ways in which the effectiveness of the SO could be measured, and what measures might be included on its scorecards. This document should support stakeholders in their current conversations with the SO around the evolving contents of its scorecard. Once it is developed, we will review the SO scorecard as part of our review of its strategic plan, and consider whether it provides a balanced set of measures. In light of the difficulty in measuring some aspects of SO performance in a quantitative way, we also discuss ways in which the SO might also report on its performance outside of its scorecards.
- **Route scorecard measures**: In common with the SO scorecard, we will review the routes' strategic plan scorecards to ensure that they are sufficiently balanced. However, there are measures that we require to be included in route scorecards (particularly geographic route scoreacrds) if we are to make full use of them in

our regulation of Network Rail. We have set these requirements out in a supporting document, together with guidance that should be reflected for a scorecard to be considered balanced.

3.27 For us to consider a scorecard to be balanced, it should reflect the variety of outcomes that Network Rail contributes to delivering. Given this, just as Network Rail has done with its CP5 scorecards, we expect route scorecards to reflect, to varying degrees, the following: health and safety; financial performance; asset management; train performance; and investment delivery milestones where appropriate.

3.28 In addition, geographic route scorecards need to take account to the needs of all passengers and freight operators using their route, and not just those for which the route is their lead route. Indeed, we see particular risks of undue discrimination if operators were only partially represented. In particular, it is important that freight and national passenger operators' interests are appropriately represented in geographic route scorecards.

3.29 The FNPO scorecard could potentially be aligned with the individual measures across the geographic routes (which could support FNPO in holding geographic routes and the SO to account for delivery on their behalf); and have additional measures and targets to reflect important national-level aspects of performance.

Scorecards in the routes and SO strategic plans

3.30 The scorecards process presents an opportunity for the different parts of Network Rail to set out a series of measures and levels of expected delivery over CP6 through their strategic plans.

3.31 We expect the routes' and SO's scorecards to be consistent with our expectations set out in our SBP guidance and to have regard to our proposals in Box 3.4.

3.32 In our SBP guidance we stated that, as a minimum, we expect that:

- each route develops objectives that balance the needs of stakeholders, but which are ultimately consistent with the priorities of end-users and value for money;
- wider stakeholders have opportunities to engage with the routes' strategic plans on an individual route-level basis, including workshops / meetings that are open to all stakeholders; and
- given anticipated funding constraints, the focus of much of the engagement should be on priorities and trade-offs, identifying cost-effective ways forward.

3.33 We expect the routes and the SO 'strategic plan scorecards' and associated interventions to transparently relate to stakeholder priorities supported by proportionate business cases. We have set out our expectations on stakeholder engagement and supporting information in the preparation of these in our SBP guidance. We discuss stakeholder engagement further in chapter 4 of this document.

Our PR18 determination for scorecards and other requirements

3.34 As part of PR18, we will review the scorecard, including the CP6 forecasts, in the strategic plan of each route and the SO. We anticipate that these PR18 scorecards and forecasts, incorporating any adjustments we have made, for example on financial performance, and any regulatory minimum floors we determine (discussed below), would form part of our final determination, and thus provide a description of the high-level outcomes that Network Rail is expected to deliver over CP6. This would provide a set of baselines with which to monitor the company's performance against the determination.

3.35 In our routine publications, notably our annual efficiency assessment and the Network Rail Monitors, we will use PR18 baselines. Where routes / the SO have established alternative targets through a good process of stakeholder engagement, including securing customer agreement, then our reporting will put greater emphasis on those targets. We will focus to a much greater extent on comparing routes, and potentially the SO, using the consistent measures that we require for the scorecards. We see these publications as an important means to recognise success, highlight underperformance, and incentivise routes to outperform.

3.36 We currently monitor a larger set of Network Rail information than that set out in the scorecards, which Network Rail needs to compile and use as part of the normal management of its business. We will continue to do so in CP6, focussing at the level of the routes and SO, and other specific parts of the business, such as infrastructure projects or the technical authority. We will codify our requirements in an updated data protocol between Network Rail and ourselves.

3.37 There will be other, more qualitative, requirements we need to place on Network Rail (such as capability of the network), which are not conducive to being reflected on scorecards. This may particularly be the case in relation to the SO and potentially certain central functions.

Reasonable requirements in CP6

3.38 For CP6, we are proposing to take into account both performance against scorecards, and the quality of stakeholder engagement around scorecards, in determining whether routes, the SO and Network Rail more widely is meeting its licence conditions. Building on the lessons of CP5, however, we propose to focus to a greater degree on routes' comparative performance. We discuss our proposed approach to monitoring in chapter 5.

3.39 Targets that are realistic but challenging, typically set annually, are a key means of incentivising performance in both commercial companies and the public sector. Our proposed approach will allow more focus to be given to realistic targets, better aligned with franchise commitments and customer needs, not least through inter-route comparison and rivalry. This should lead to better outcomes for passengers, freight customers and taxpayers.

3.40 With regards to the regulatory regime for health and safety, while scorecards could be used by Network Rail to support health and safety performance, we do not see them as in any way replacing our principal methodology in this regard: the Risk Management Maturity model (RM3). We discuss this further in chapter 5.

Regulatory minimum floors

3.41 In a limited number of cases, we think it would be helpful to codify the link between a particular outcome – at the level of route, SO, or company - and the requirements of the licence. We propose to set regulatory minimum floors (as reasonable requirements), below the assumed trajectories set out in our PR18 determination. If the regulatory minimum floor were breached, we would be likely to undertake formal investigation for licence breach. Enforcement is discussed further in chapter 5.

3.42 We think that a regulatory minimum floor may be useful:

- to provide an additional level of assurance that Network Rail will deliver at least a certain level of performance, which could be important for key areas of delivery, including having regard to relevant franchise terms;
- to secure an outcome that no other party would be likely to secure e.g. long term sustainability of the network; and
- to better secure an HLOS requirement (where appropriate – i.e. if we consider this is a funded requirement) if Network Rail has not adequately reflected it for the funding it receives.

3.43 However, we propose to determine regulatory minimum floors only where there is a strong case for doing so, recognising that formal licence investigation can be highly resource intensive and potentially disruptive to day-to-day operations.

3.44 On the basis of these considerations, we see merit in determining a regulatory minimum floor in two areas:

- for **performance** (punctuality and reliability for passenger operators and possibly for freight), where in light of their importance we will need to have sufficient confidence that the measures, trajectories and ranges agreed between Network Rail and customers are sufficiently challenging and robust and that we can be clear when we would be likely to take action; and
- for **network sustainability**, where there may be an insufficient incentives in all routes to agree a suitable trajectory and range, but where there is a particular risk that long-term network condition is not maintained appropriately.

3.45 Our supporting document on route scorecards sets out more detail on this proposal.

Evolution of scorecards during CP6

3.46 As part of PR18, we will set out what we require from route and the SO scorecards throughout CP6 in order for us to use them, together with effectiveness of stakeholder engagement (which we discuss in chapter 4), as the key means by which we monitor and report on Network Rail's performance.

3.47 We foresee requirements relating to:

- **content**: Those requirements that we have set out in Box 3.4;
- **quality assurance**: Network Rail should maintain a clear and auditable record identifying how each measure is calculated. It should also ensure, where applicable, that measures are being calculated consistently for each route;
- **consistency over time**: Network Rail should not change the calculation of any measure without having a case for doing so and going through a transparent process with its customers and ourselves. (chapter 6 sets out where we expect it to go through a process with its stakeholders); and
- **engagement**: Revisions to scorecard measures and targets are undertaken with appropriate stakeholder engagement. We discuss engagement in chapter 4, and changes to scorecards in chapter 6.

Questions

1) Do you agree with our proposed use of scorecards in CP6?

2) Do you have any comments on what scorecards should include in order to make them balanced (recognising that there is a limit to how much can be included on a scorecard)?

3) What are your views on our proposed approach to specify a small number of measures and two regulatory minimum floors for route scorecards, in order to leave Network Rail with greater flexibility to satisfy its customers' needs?

4. Network Rail's engagement with stakeholders to support effective delivery

Summary

- For CP6, we expect Network Rail to engage meaningfully with its customers and other stakeholders so that those stakeholders are able to support Network Rail in delivering their individual priorities (so long as they represent efficient spend that Network Rail can afford). Delivering customer and stakeholder priorities will ultimately benefit passengers and other end-users.
- Network Rail's individual routes and the SO should lead this engagement with their local stakeholders. We will not prescribe how they should engage with their stakeholders. Rather, our approach will focus on setting some principles and minimum expectations of the routes and the SO and on assessing the quality of their engagement against best practice. This will also determine our approach in monitoring Network Rail and addressing performance issues where they arise, which we discuss in Chapter 5.
- These proposals are intended to support Network Rail's recent efforts to increase engagement with local stakeholders and to enable the routes and the SO to develop their approach in this area over CP6.

Introduction

4.1 This and the next chapter set out how our proposed regulatory approach will support Network Rail's effective delivery in CP6 and beyond.

4.2 We want to build on our current approach by:

- updating how we monitor and report on Network Rail's performance, including by making more use of comparison between business units to drive good performance;
- refreshing our approach to escalation and enforcement, including by identifying additional ways to hold the company to account, which reflect the increased importance of making use of reputational incentives when comparing performance across Network Rail; and

- promoting greater involvement of Network Rail's customers and other stakeholders in encouraging effective and efficient delivery.

4.3 These three elements will support us in adopting an increasingly targeted and risk-based approach to the way we regulate Network Rail. It will also support Network Rail and its customers to develop strong effective commercial relationships and to work together to improve outcomes for passengers and freight customers. However, where issues arise and cannot be resolved effectively, this would prompt greater involvement by ORR, including the potential for escalation of issues for formal investigation and remedy against Network Rail's licence.

4.4 This chapter focuses on the how we improve the prospects for effective engagement between Network Rail's routes/the SO and its stakeholders. It discusses, in turn;

- the role of Network Rail's stakeholders in supporting effective delivery;
- our expectations of how Network Rail should engage with stakeholders over CP6; and
- how we might assess Network Rail's engagement with stakeholders over CP6.

4.5 Chapter 5 discusses our role in supporting this engagement, including how we will monitor Network Rail to drive high performance and to escalate and enforce where performance falls below this.

The role of Network Rail's stakeholders

4.6 For CP6, we want to ensure that Network Rail's customers (passenger and freight operators) and other key stakeholders (e.g. funders, passengers and their representatives, local transport authorities) are able to engage with Network Rail routes and the SO to influence what Network Rail delivers, so that it better meets their individual requirements. This is what one would expect to happen in a normal customer-supplier relationship.

4.7 However, there are some complications to ensuring this happens, for example:

- Network Rail is a monopoly supplier. For the customer-supplier relationships to be effective they need to be supported by a regulatory approach that provides customers with sufficient confidence that, if Network Rail were not to act appropriately, ORR would act accordingly;
- Network Rail's customers are not fully exposed to Network Rail's costs (e.g. franchise agreements give most train operators significant protections from

changes in charges and only some freight services contribute to fixed costs). This makes it more difficult for Network Rail's stakeholders to consider, in the round, what they want from Network Rail and what they are prepared to pay for it. This makes it more difficult to inform Network Rail's relative priorities; and

- some operators may not adequately represent future passengers, for example, beyond the length of a franchise term.

4.8 Network Rail's stakeholders have different interests, capabilities and resources that will impact their potential contribution in supporting Network Rail's effective delivery; see Box 4.1. Typically, passenger and freight operators are well placed to engage with Network Rail about its day-to-day decisions in running the network. Decisions for the longer-term, however, will be more likely to be informed by passenger and freight research; funders and ORR, though some operators may have a long-term perspective (e.g. owner groups in respect of the SO's activities).

Box 4.1

Box 4.1: Interests and capabilities of Network Rail's different stakeholders

Passengers and freight customers (i.e. the end-users of rail) are highly impacted by what Network Rail delivers, and how. This makes it vital that their interests are reflected in what Network Rail delivers. However, individual passengers and freight customers are unlikely to have the time or willingness to engage with Network Rail routes/the SO about its day-to-day activities, or inform decisions that require trade-off across different services/customer groups. Market research (including analysis on how passengers respond to changes in services) and representative organisations (e.g. Transport Focus, Rail Freight Group) can play a significant role in ensuring Network Rail considers passenger and freight end-user interests.

Operators' quality of service to passengers and other end-users is significantly influenced by Network Rail's performance. Operators have considerable capabilities to challenge Network Rail on delivery of its activities and have more resources and incentives (compared with the typical passenger) to engage with Network Rail. As such, operators can play a key role in supporting Network Rail's delivery – as customers, but also, as with the Scotland route, in an alliance with Network Rail. This is not without limitations, however: operators' interest in Network Rail's financial performance is quite limited and may focus on those areas that increase fare revenue / turnover or are material to delivering their franchise commitments.

Funders (i.e. principally national governments but also some local transport authorities) have particular interests in enhancements that they are funding. In addition, as Network Rail is a publicly owned company, the DfT also has a 'shareholder function', meaning it is involved in high-level financing issues and financial performance (e.g. material changes to the annual business plan). Franchising authorities, including the Welsh Government, will be interested in what Network Rail can do to improve services to passengers, particularly at time of franchise renewal.

Wider stakeholders, including local business groups and line-side neighbours, are also often interested in 'how' Network Rail undertakes it activities (e.g. night time working, local procurement).

Our expectations of how Network Rail should engage

4.9 This section sets out proposals for:

- the minimum requirements we expect Network Rail routes/the SO should follow in engaging with its stakeholders; and
- the high-level principles we expect Network Rail routes/the SO to work within over CP6.

4.10 This seeks to build on the different approaches that Network Rail takes to engage, including through various fora and processes (especially with respect to day-to-day performance). It also builds on the changes that are already happening over CP5, whereby routes and the SO are increasingly leading engagement with their own local stakeholders and adopting more bespoke approaches with certain parties.

Minimum requirements

4.11 We do not intend to be prescriptive in determining how routes/the SO should engage with their stakeholders. They will need to take different approaches to reflect their different needs and those of their stakeholders, and we want to support innovation in this area. However, at a minimum, we would expect each of the routes and the SO to support stakeholders' role in ensuring effective delivery by:

- having a **CP6 strategic plan** that takes account of stakeholders' priorities (recognising that it is not efficient or affordable to meet all stakeholders' wants or needs). Our expectations for the strategic plan are set out in our February 2017 guidance on Network Rail's strategic business plans;

- developing **scorecards** with their stakeholders so that the route/SO is working towards and reporting against measures including customer-led measures, including those supporting franchise targets, as discussed in Chapter 3;

- making use of **annual business plans and actions plans** that set out in more detail what the route/the SO is seeking to achieve; how this reflects stakeholders' priorities; and what this will deliver for those stakeholders; and

- having face-to-face **discussions on a bilateral and multi-lateral level** to complement the approaches above. We note that the Western route has established a Route Supervisory Board (consisting of senior decision-makers from the route and the relevant operators, as well as Transport Focus), which could serve a role in this respect; see Box 4.2 for a further discussion on the Route Supervisory Boards.

4.12 Routes and the SO will need to take different approaches with their different stakeholders. For example, the Scotland route will need to continue to take account of its alliance in working with ScotRail and Transport Scotland, and other routes will need to reflect the role of third party funders given the increasing role for local transport authorities and the Welsh Government in franchising and funding decisions.

4.13 The routes and the SO will also need to engage with passengers and their representatives to ensure what they are delivering reflects passenger views, including by way of passenger research. The routes and the SO should also consider how well the strategic plans, scorecards and business plans enable their different stakeholders to engage.

4.14 Reflecting its different role, the nature of the SO's stakeholder engagement may differ with that of the routes. For example, it will engage on issues that relate to the activities the SO is responsible for (enhancing the network and managing access to it, including through timetabling) and a wider range of stakeholders (i.e. all relevant operators, local authorities etc). We expect the SO to meet the same principles of stakeholder engagement but adopt different ways to meet its own needs (and those of its stakeholders).

Principles of stakeholder engagement

4.15 We propose setting some high-level principles of stakeholder engagement for CP6 that we expect to see in the way Network Rail engages. These are intended to provide the routes and the SO with sufficient flexibility to tailor how they engage with their different stakeholders to enable different and innovative approaches to develop over CP6.

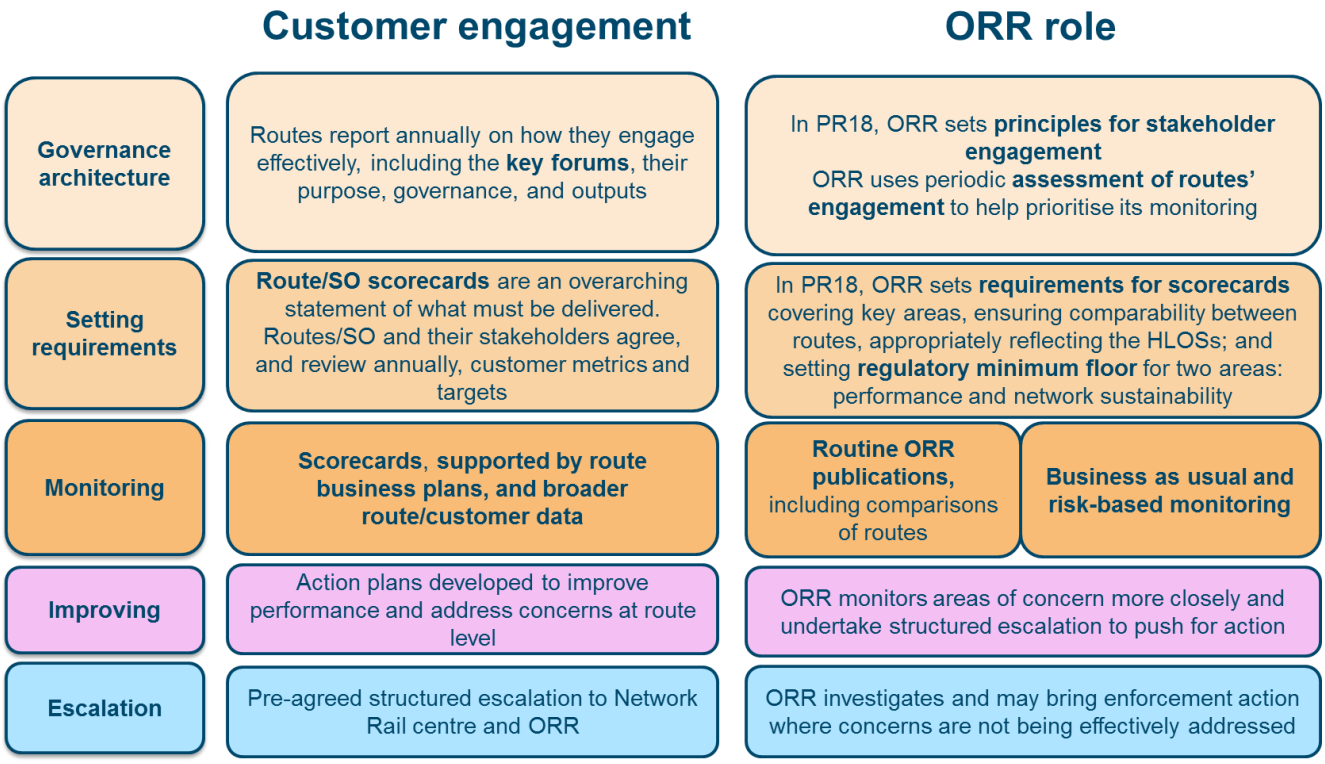
4.16 Our draft principles are that the route / SO engagement is:

- **effective**: The engagement is effective in supporting delivery of our overall PR18 aims and, specifically, that it enables stakeholders to influence priorities and challenge performance (where necessary). The engagement should also be proportionate to what it is seeking to achieve (so that money on engagement is well spent);
- **inclusive**: The overall engagement should seek to involve all relevant stakeholders (without undue discrimination) and should adopt different approaches to reflect differing stakeholder capabilities and interests;
- **well governed**: There should be processes that encourage meaningful engagement and accountability, as well as providing mechanisms for challenge and escalation; and
- **transparent:**
  - On performance: There should be provision of appropriate and relevant information and data to enable stakeholders to influence and challenge in an effective and timely way; and
  - On engagement: It should be clear how engagement arrangements have been implemented and what impacts they have had on Network Rail's actions and delivery. For example, there should be a record of key points made by different stakeholders and how they have been acted on (or, if not, why not).

4.17 These principles build on Network Rail's existing licence obligations with respect to stakeholder engagement (for CP5, we treat effective communication with customers and funders about the delivery of outputs and commitments as a reasonable requirement under the licence) and our expectations of how it should develop its SBP with stakeholders (as set out in our SBP guidance).

4.18 Figure 4.1 illustrates what a structure of engagement with customers at route level might look like.

Figure 4.1: Possible model for route customer governance



Assessing routes' and SO's engagement with stakeholders

4.19 We will assess and grade the extent to which the routes and the SO's strategic plans reflect engagement with stakeholders, including how they take account of different stakeholders' priorities. We discuss our approach to this in our February 2017 SBP guidance.

4.20 We also want to see a regular assessment of the routes' and the SO's effectiveness at engaging with their stakeholders over CP6. This should help identify good practice, drive improvements and create stronger accountability to address poor engagement, where it arises. Understanding how well Network Rail routes and the SO are engaging with stakeholders will also inform our approach to monitoring Network Rail, including in escalating performance issues; which we discuss in Chapter 5.

4.21 This assessment would be based on those principles of effective stakeholder engagement that we have set out in draft in this chapter.

4.22 In principle, Network Rail centre could take on the role of collecting information on and assessing the relative quality of the routes'/the SO's engagement, similar to their role in other areas. They could, for example, seek stakeholder feedback (e.g. by way

of a questionnaire or route board reporting) and/or assess by grading routes' and the SO's governance processes/ongoing implementation. This might be similar to Network Rail and our work comparing and grade the route strategic plans when they are submitted. We could also make use of independent input to help us consider the quality of stakeholder engagement.

4.23 We could report on different routes' quality of engagement periodically, including a reference in our six-monthly Network Rail Monitors. Alternatively, while route and SO stakeholder engagement is in the early stages of development, it could be done on a more ad hoc, flexible basis.

4.24 Our eventual aim would be to grade the routes and the SO stakeholder engagement with reference to the principles of engagement; we anticipate that the criteria will be refined over time.

4.25 As discussed in Box 4.2, the effectiveness of our approach is likely to depend on the role of one or more of Network Rail's central functions with respect to stakeholder engagement, in particular in:

- allowing routes and the SO freedom to develop their own approach, while providing some support and guidance (which we anticipate will become less prescriptive over time, particularly for the business units that are performing well in this regard); and
- reporting to us about how well routes and the SO are engaging – one model is that Network Rail centre takes much of the responsibility for objective impartial assessing and grading of routes / SO on their engagement.

Box 4.2

Box 4.2: Role of Network Rail's central functions in supporting effective delivery

It is helpful to consider the potential implications of Network Rail's business structure for the role of Network Rail's centre, since Network Rail remains one single entity and the route and SO Managing Directors are directly accountable to the Chief Executive. We are interested in views on what the appropriate role of Network Rail's centre might be and how far as regulator, we should place reliance on the role of the centre in overseeing routes. Actual or potential roles include:

- in setting guidance to routes (and the SO) on good practice, for example in their engagement with stakeholders;

- in collating and assuring comparative data on routes'/SO performance (as now), including in the quality of their stakeholder engagement;
- as now, in assessing and reporting on routes'/SO performance; and
- serving as a point of escalation to address performance concerns, before involving the regulator.

Questions

4) What role should customers and stakeholders (including end-users and their representative groups) play in influencing what routes/the SO commit to deliver, and what role should they play in supporting and challenging Network Rail to deliver on these priorities?

5) How do you think Network Rail routes and SO should engage with their customers/stakeholders and what are your thoughts on the principles and minimum expectations we propose?

6) How should the quality of stakeholder engagement be assessed, and who is best placed to assess this?

5. Our approach to monitoring and enforcement in CP6

Summary

- We want to ensure there is a balanced set of incentives on Network Rail that reflects its business structure and public sector status, and provides clear benefits for good performance and clear costs for underperformance. We are consulting on introducing a number of new potential incentives, including reputational, procedural and management.
- Reflecting our overall approach to PR18, we particularly want to use comparisons across routes/the SO to recognise and incentivise good performance; to use the sense of rivalry to drive improvements; and to inform our approach to intervening and enforcing, where necessary.
- Our approach to monitoring and enforcement is subject to how effectively Network Rail routes and the SO engage with their stakeholders, especially in addressing areas of poor performance. As a general principle, where there are strong mechanisms for customers and other stakeholders to work with Network Rail to agree and deliver appropriate action, we will give the space for these mechanisms to be used, supporting the relationship between Network Rail and its customers.
- We wish to signal the types of responses we will be likely to consider in different performance situations, giving a clear message to Network Rail and its stakeholders about how we may escalate performance issues using an incremental approach to reflect Network Rail's progress in addressing the issues.

Introduction

5.1 This chapter covers our proposals for incentivising Network Rail's performance during CP6 through our monitoring, as well as processes for escalation of concerns and any potential enforcement action. While the focus in CP6 will move towards the routes and the SO, our overall approach, as previously articulated in our economic enforcement policy, will continue to be to:

- support the whole industry to work together to improve performance and standards of service across the railway network, for passengers and freight and in the public interest;

- facilitate and encourage the industry to deliver safe and efficient services which meet the reasonable requirements of funders and passenger and freight customers; and

- use our enforcement powers, where appropriate, to ensure that railway operators comply with their licences and so work in the public interest.

5.2 In CP6 any enforcement of performance will continue to be against the network licence. This could be through either:

- **our overall assessment of Network Rail's performance against an overarching licence condition** relating to network management (currently licence condition 1). We would take into account all the available evidence on Network Rail's performance (including scorecards, business plans, action plans, wider measures reported by Network Rail and any additional ORR monitoring).

- **with reference to Network Rail's performance against any more specific reasonable requirements** (as currently referred to in licence condition 1). This could be the case where we designate certain targets in scorecards and/or in our final determination as reasonable requirements (potentially including both quantitative and qualitative measures). In effect, this provides greater clarity over certain areas where we would be more likely to take enforcement action if performance is poor (although a breach of licence finding is never automatic).

5.3 Although the monitoring discussed in this chapter spans all of Network Rail's performance, its focus is primarily on economic (rather than safety) regulation, as underpinned by the network licence. The regulatory regime for safety has a different legal framework. In pursuit of a safer railway we have a range of tools, for which our principal methodology is the Risk Management Maturity model (RM3), which brings together evidence drawn from our inspections and dealings with Network Rail into 26 different criteria.

5.4 This chapter is structured as follows:

- **strengthening incentives for effective delivery,** to reflect Network Rail's public sector status and devolved business structure;

- **monitoring performance,** supporting strong reputational incentives; recognising good performance and best practice as well as identifying any areas of weak performance, where we may need to take further action; and

- **taking action where we have concerns**, consulting on the range of regulatory approaches we could use in different circumstances.

Strengthening incentives for effective delivery

5.5 We want to create a balanced and effective set of incentives for Network Rail, and in particular its routes and the SO, to perform well. These must incentivise good performance as well as deter and resolve poor performance.

5.6 The public sector status of Network Rail means we have reviewed our regulatory approaches, drawing on the experience of regulators of other public sector bodies. Our aim is not in any sense to reduce our regulation of Network Rail, but rather to make the best use of our resources, and improve the overall effectiveness of our oversight and regulation of Network Rail.

5.7 Regulation of entities in the public sector, where there is no private capital at risk, tends to rely on different approaches to create meaningful incentives for management teams to perform. In particular, there is usually a greater emphasis on reputational incentives (in the widest sense, encompassing incentives including professional pride, individual recognition, and belief in what the organisation is trying to achieve for instance) and procedural incentives (whereby the level of scrutiny or process is linked to performance i.e. good performance is rewarded with greater freedom). These can be effective in industries, such as rail, where there can be high levels of motivation, and a desire for operational freedom and earned autonomy.

5.8 One clear way we can strengthen **reputational incentives** is by highlighting the relative performance of individual business units through our routine monitoring and publication of comparative information as well as in any escalation or enforcement action. While we will continue to monitor and enforce Network Rail under its network licence, focusing on the business units responsible (as far as possible) can help provide reputational rewards for good performance as well as incentives to raise performance.

5.9 The transparency and accessibility of the information that ORR routinely produces will be important for realising reputational benefits. For example, the rail industry may wish to reflect ORR data in awards schemes that it runs.

5.10 **Procedural incentives** mean the burden of regulation should be linked to performance, in line with our current risk-based monitoring approach. We explicitly want to incentivise good stakeholder engagement by using our assessment of routes' and SO stakeholder engagement to inform and prioritise the level of our monitoring activity and other interventions.

5.11 Network Rail has **management incentive schemes**, with financial rewards for staff based on performance. We think that scorecards are an effective means by which

Network Rail can link performance related pay with the financial and operational performance of their business unit.

5.12 In addition to the above incentives, there is a range of financial incentives for Network Rail to perform. Notably, the system of **charges and contractual incentives** between Network Rail and operators, including Schedule 8 (the performance regime) and Schedule 4 (the possessions regime) can have significant impact on Network Rail's financial performance.

Monitoring performance

5.13 We want to signal the types of circumstances in which we will be likely to take particular types of action. We set out below proposals on the broad type of regulatory response that would typically apply in different circumstances. In practice however, we would reserve our discretion to take into account the specifics of each situation, including the views of relevant stakeholders. The stages are cumulative; for example, we would continue with our routine publications and meetings in all circumstances.

5.14 In CP6 we want to support comparisons between routes (and the SO, to the extent possible) in our monitoring, to target our scrutiny appropriately and to strengthen reputational incentives and the sense of rivalry for routes to perform well relative to their peers. We will:

- focus monitoring, incentives and enforcement at route and SO level to a greater extent (noting that formal enforcement action is legally taken at whole company level);
- use our routine publications to compare performance of different business units, primarily as reflected on scorecards, in order to strengthen reputational incentives and help prioritise our monitoring; and
- continue to take into account a wide range of information (particularly scorecards, but also business plans and action plans) in forming our judgements on whether Network Rail is doing everything reasonably practicable to fulfil its licence obligations.

5.15 Our monitoring is also designed to build a robust evidence base over CP6 that allows us and others to compare the relative performance of different business units and understand the potential for further efficiencies.

5.16 As set out earlier in this document, we want scorecards to play an important role in facilitating comparisons between routes as well as providing a balanced picture of performance across the key outcomes that Network Rail needs to deliver. Balanced

scorecards will help us to assess Network Rail's performance in the round, which will inform our proportionate and risk based approach to regulating Network Rail.

Business as usual monitoring

5.17 We expect to use our routine publications to monitor and comment on Network Rail's delivery against each of its route (geographic and FNPO) and SO scorecards in particular, as well as looking more closely at certain specific measures where we feel this is appropriate. We are likely to compare outcomes across routes, over time and/or to a PR18 baseline or scorecard target.

5.18 Scorecards are not the only source of information we will monitor. We will continue to collect a wide range of information that in large part we expect Network Rail to compile as a normal part of running its business, which we will require as part of our updated data protocol with Network Rail. We will also gather information on specific areas of concern, for example progress on associated action plans, and intelligence through engagement with Network Rail and its stakeholders.

5.19 In the normal course of business, we would expect to use **routine publications**:

- **ORR's Network Rail Monitors** will provide clear comparisons of the relative and absolute performance of Network Rail routes (and SO). ORR commentary and reporting can refer to the specific business areas of Network Rail, to strengthen reputational incentives on the relevant management teams. The Monitors could also develop to include sections that clearly identify and name areas of best practice to support lesson learning;
- **publishing route-level regulatory accounts and our annual efficiency assessment of Network Rail,** showing the financial performance of routes, the SO and the company; and
- **wider data on Network Rail performance** published on our data portal.

5.20 We would also have **routine engagement** with routes and the SO, through regular meetings with route/SO management teams to understand the operating environment and challenges.

5.21 ORR would carry out **targeted monitoring and analysis** for:

- any areas where local stakeholders may not have the interest or capability to engage with Network Rail (for example, long-term asset sustainability); and
- areas where stakeholders/Network Rail have been unable to agree scorecard measures and targets.

Recognising good practice

5.22 We can contribute to incentivising outperformance through ensuring our publications recognise success as well as highlighting underperformance, and through keeping our monitoring to the minimum necessary in areas where engagement and delivery is strong.

5.23 By highlighting comparative performance of routes, we expect to draw attention to better performing (as well as worse performing) areas of the business. In addition, we envisage giving more information where we have identified good practice that could be adopted elsewhere.

5.24 Where routes/the SO perform at or above the expected level, we would aim to limit the (procedural) regulatory burden on Network Rail (i.e. we would be unlikely to have in depth investigations).

Taking action where we have concerns

5.25 Our preference is that Network Rail and its stakeholders resolve issues at a route/SO level. This is more likely to be timely and effective. Where we take action, we will continue to be guided by a risk-based, proportionate approach. In practice, this means we will focus our attention on:

- those areas where performance is demonstrably weaker or rapidly deteriorating (taking into account scorecard performance, including performance relative to other routes and leading indicators of likely performance, including Network Rail capability); and
- areas identified as high risk because of past performance patterns and their criticality to Network Rail's whole business performance. For example, our recent focus on Network Rail's renewals efficiency, which we have consulted on and discuss further in Box 5.1.

Box 5.1

Box 5.1: Monitoring Network Rail's efficiency

The efficiency with which Network Rail delivers work to renew the network has fallen in the first three years of CP5. As a result, we are changing the way we monitor Network Rail's delivery of its planned efficiency improvements in CP6, to provide more in depth challenge on progress. We will focus on ensuring Network Rail puts in place better:

- **detailed diagnostic information**. We want to ensure there is sufficient information available about how routes are performing in this area, to better identify where further changes may be needed. For example, Network Rail needs to improve the data it collects to provide better analysis in areas such as the availability of access; the productivity achieved during access; and the scope of work delivered. This will provide better information on what is driving efficiency levels.

- **leading indicators of delivery** and the quality of delivery. Building on the process Network Rail is already developing, we will make greater use of leading indicators about the likely level of efficiency including the stability of work banks; the quality of past delivery (e.g. 'right first time'); the development of plans for future renewals; and the extent to which unit rates are being achieved.

5.26 ORR's escalation, in response to any concerns identified, will continue to take a staged approach based on the available evidence. We want to signal the types of circumstances in which we would be likely to consider undertaking certain actions, to provide a clear incentive around avoiding such circumstances. However, we consider it important to retain discretion in our final judgements over when it is appropriate to monitor, escalate and investigate issues under Network Rail's licence obligations (ensuring the basis for discretionary judgements is transparent and understood).

5.27 Our existing approach, which we consider remains broadly appropriate, is to:

- focus our resources and priorities on systemic issues or one-off events of material significance and those aspects of compliance which are most important to passengers, freight customers, funders and where non-compliance would cause most harm;

- fulfil our duty under section 68 of the Act to investigate any complaint about an alleged or apprehended contravention of a licence condition, unless we deem it to be frivolous or vexatious;

- adopt a staged process of review, investigation and escalation, within reasonable timescales according to the urgency of the case, leading ultimately to consideration of enforcement action; and

- consider the range of regulatory tools we have available before choosing the most appropriate.

Performance is "Below expectations"

5.28 Where local engagement has identified and is addressing concerns:

- ORR is likely to focus on providing appropriate information to stakeholders to enable performance discussions. ORR will monitor progress of these discussions and outcomes.

5.29 Where local engagement is not adequately identifying or addressing concerns (including for potentially serious or systemic issues), our responses could include:

- enhanced monitoring, including informal investigations, creating a procedural cost for underperformance (as we do currently);
- providing more detailed, targeted reporting of these aspects of performance in our Monitor publication (as we do currently);
- publishing correspondence documenting performance concerns and Network Rail's responses (as we do currently);
- public reporting of some issues and actions on our regulatory escalators;
- requiring Network Rail to communicate formally and publicly with its customers, for example, letters of explanation setting out the reasons for under performance, what they are doing to address it and by when it should be resolved; and
- recommending or requiring that Network Rail establish an improvement board (such as the Freight Recovery Board in CP4).

5.30 Although we can only take enforcement action against Network Rail as a whole, the above actions would be expressly signposted towards the relevant part of the business, as appropriate.

Performance that is "Unacceptable"

5.31 Our approach to formal regulatory sanctions will continue to be informed by the following principles:

- **proportionality** in applying the law and securing compliance;
- **targeting** of enforcement action;
- **consistency** of approach;
- **transparency** about how we operate and what the industry may expect; and

- **accountability** for our actions in line with best practice in regulation.

5.32 Our potential actions where performance is or is likely to become unacceptable, include:

- **formal investigations**. These remain likely, with the associated procedural costs;
- **attributing a sanction to route or SO-level regulatory accounts**. Where Network Rail has agreed to recognise financial performance and efficiency as measured by these accounts in management pay incentives, attributing a sanction to these could provide an attractive alternative to traditional ORR imposed financial penalties (providing both a reputational incentive and financial incentive to the responsible managers);
- as currently, requiring (under an enforcement order) Network Rail to **establish cross-industry improvement boards**, with particular governance arrangements, including powers to refer to ORR if matters are not satisfactorily progressed within a short deadline. An example of this in CP4 was the Freight Recovery Board;
- where we are not satisfied with progress, calling Network Rail management teams to **attend a public hearing**, perhaps alongside operators. We use public hearings in other contexts, for example to support controversial access decisions. They are attended by industry participants with a full transcript published; Their purpose would be to seek public commitments to improvements and to provide evidence to inform ORR judgements on formal enforcement action;
- where we consider there has been, or is likely to be, a breach of licence, it may be appropriate to formally **notify the Secretary of State** (as shareholder) and/or **Scottish ministers**, as applicable;
- in some cases, it may also be appropriate to notify **the Transport Select Committee** (representing the UK Parliament) or the **Scottish Parliament Transport Committee**, strengthening reputational incentives;
- **enforcement orders.** These would continue to be used for current and potential future licence breaches, and can carry a strong reputational impact;
- as an alternative to financial penalties, offers of **reparations**, together with associated publicity. These may have continued relevance in certain situations (as currently), by providing reputational incentives, but with the added potential to

direct resources to address underperformance. Given that reparations divert resources from other activities, the governance over use of funds is particularly important. It may be appropriate for the stakeholders who have been disadvantaged by poor performance to play a role in advising on and overseeing the use of reparations (we currently consult with relevant parties on receipt of offer of reparations, but it is a decision for the ORR board to accept reparation offers); and

- ultimately, (as currently) **financial penalties** (for current and past licence breaches). These would remain in our toolkit as a last resort, given their strong reputational impact. Again, we would seek to clearly signpost in which part of Network Rail responsibility for the problem sits.

5.33 Table 5.1 on the following page summarises the options set out above.

Table 5.1: Our proposed approach to monitoring and escalation

<table>
<tr><th>Description of performance</th><th>Route / SO is engaging effectively with its stakeholders</th><th>Route / SO is not engaging effectively with its stakeholders</th></tr>
<tr><td rowspan="5">Performance exceeding or in line with expectations For example, performance is in line with or exceeds expectations in scorecards and ORR wider monitoring does not indicate any serious concerns</td><td colspan="2">Routine publications compare relative performance (against targets and over time) of routes/SO and highlight good/best practice (e.g. Network Rail Monitor; publication of route-level regulatory accounts)</td></tr>
<tr><td colspan="2">ORR targeted monitoring in areas where local stakeholders do not have the interest/capability to engage with Network Rail</td></tr>
<tr><td colspan="2">Assessment of stakeholder engagement compares performance of routes/SO and highlights good/best practice and any routes that are not engaging effectively</td></tr>
<tr><td rowspan="2">ORR routine engagement with route/SO and stakeholders</td><td>ORR increased engagement with stakeholders</td></tr>
<tr><td>ORR role in providing appropriate (additional) information to stakeholders to support reasonable engagement</td></tr>
<tr><td>Performance is below expectations

For example, performance against scorecards is below expectations (or there is a very clear trend in this direction); or wider monitoring indicates concerns about Network Rail’s ability to deliver on expectations.</td><td>ORR monitors progress of Network Rail / stakeholder discussions, including their actions and consequential impact on route/SO performance.</td><td>Increased ORR scrutiny – increased monitoring; informal investigations.

Public reporting of some aspects of the regulatory escalator

Increased requirements on Network Rail reporting to stakeholders about how it is addressing relevant issues</td></tr>
<tr><td>Unacceptable performance

Performance is well below expectations in scorecards (e.g. in breach of a regulatory minimum floor); or performance ‘below expectations’ has not been addressed within a reasonable time period</td><td colspan="2">Likely to result in a formal investigation, potentially leading to further formal actions (e.g. sanctions on route/SO-level accounts, requirement to establish cross-industry improvement boards, industry hearings, notification to Secretary of State, Scottish Ministers or parliamentary committee, order, financial penalty)</td></tr>
</table>

Questions

7) What are your views on the relevance and balance of the incentives we describe in this chapter, and the circumstances in which would it be most appropriate to apply them?

8) What are your views on the format and content of publications and data that you would find most accessible and useful?

9) How should we reflect the level and quality of route and SO engagement with their customers/stakeholders in our monitoring, escalation and enforcement?

10) How should we respond if Network Rail fails to meet scorecard targets agreed with customers? Specifically, what should be the balance between designating scorecard targets as ‘reasonable requirements’ (creating specific enforceable expectations on Network Rail), and relying on our overall assessment of Network Rail’s performance against an overarching licence condition?

6. Managing change to our PR18 settlements

Summary

- Certain potential changes in CP6 may weaken the routes/SO's ability to plan, as well as undermining accountability and comparison and therefore undermine the benefits of our regulatory approach. We are therefore considering developing potential controls around such changes.
- Aside from the treatment of enhancements, we think the relevant changes to consider are organisational changes to the role of the SO and/or routes; route boundary changes; and changes to funding levels of individual routes/the SO.
- For large changes, which represent a fundamental change to our PR18 settlement, we would expect Network Rail to provide us and stakeholders with a business case assessment of the impact of the change ahead of any decision being made. This together with stakeholder input would give us an opportunity to consider the regulatory impact of the potential change and provide a formal opinion to Network Rail.
- Provided that a route/SO scorecard continued to meet our requirements, as set out in chapter 3, we would not expect to be involved directly in the process for implementing changes to it. However, we would expect to be informed of stakeholders' views regarding the change and the governance around the change.

Introduction

6.1 In a periodic review, we set revenue requirements and expectations of what Network Rail is to deliver for the control period. A key rationale for a periodic review, rather than an annual review, of a network industry is that certainty regarding funding and requirements allows an infrastructure company to plan operations, asset maintenance and investment. This, for a number of reasons including improved management of the supply chain, reduces costs.

6.2 In CP5, we have largely regulated Network Rail as a single organisation, albeit with separate national funders and hence HLOSs for Scotland and England & Wales. The key processes for managing change to our CP5 settlement have been:

- **Interim review**: The determination can be re-opened if Network Rail has experienced a material changes in circumstances that we think warrants it being

re-opened. In CP5, an additional provision applies for Scotland, under which there could be a re-opener if expenditure was forecast to be more than 15% higher than our determination over a forward-looking three year period. These provisions, contained in track access contracts, were established prior to Network Rail's reclassification and we referred to the possible need to update them for CP6 in our PR18 financial framework consultation; and

- **Enhancements**: Milestones for enhancements were set out in Network Rail's CP5 delivery plan and a change control mechanism was established. The England & Wales enhancements baseline comparisons was amended following the Hendy review, and a governance procedure established to manage further changes.

6.3 There have also been other major changes since the start of CP5 associated with Network Rail's reclassification, notably the implementation of borrowing limits and government initiated asset sales.

6.4 For CP6, we are moving to route level regulation and a separate regulatory treatment of the system operator. However, potential changes in CP6 could affect:

- the routes'/SO's ability to plan effectively;
- the accountability of routes/the SO to stakeholders and ourselves; and
- the ability to compare across routes.

6.5 These impacts could undermine the benefits of our proposed route level approach.

6.6 We think that the changes that can have implications for our route and/or SO settlements can be categorised as follows:

- organisational change affecting the role of the SO and/or routes;
- primarily for England, and a lesser extent Wales:
  - route boundary change; and/ or
  - financial change, in particular changes to the funding of individual business units (Scotland will not be affected by these due to its ring-fenced status); and
- changes to what Network Rail is expected to deliver during CP6, for example to coincide with a new franchise.

6.7 There may be potential unforeseen changes that could occur in CP6 due to other wider economic factors or changes to the economic and legislative environment. While larger changes may require a bespoke approach, our starting point is to manage such change using the same principles and broadly the same approach as those we set out in this chapter.

6.8 Separately, and outside the scope of this document, changes to enhancements are likely to have a material effect on the settlements. Their impact on maintenance and renewals volumes and hence funding could be important. Therefore, as with CP5, they should be subject to detailed change control arrangements.

Options for managing changes to our PR18 settlements

6.9 We are considering potential controls around changes to route and SO settlements, We propose that the key options are built around:

- requirements for Network Rail to transparently report the changes being made;
- treatment of and potential adjustment to reported baselines; and
- Network Rail making the case for change, including engaging with stakeholders on the change, prior to its introduction. Under this option, we might formally take a view on the case for change.

6.10 Establishing process and controls around such change has:

- **benefits** through restricting changes that may undermine the settlements, or allowing a change but enabling meaningful comparison to be maintained. A good change control process – whether initiated by ORR or Network Rail – can also improve the actual implementation of the change itself, for example through better engagement with stakeholders; and
- **disbenefits** of reducing Network Rail's freedom to run its business, for example to introduce improvements, respond flexibly to changing circumstances, or share risks across its business.

6.11 To maximise the net benefits of a change control process, we consider it needs to be:

- **codified and understood**, so that Network Rail has greater certainty, and the associated incentives regarding managing change are effective;
- **proportionate** (because small changes should not require extensive processes or time);

- **consistent** (unless there are good reasons for differences), both over time and across different types of change; and
- **proportionately transparent** (to promote stakeholder engagement).

Proposed approach for CP6

6.12 We set out in Figure 6.1 our proposed approach with respect to what we have labelled here as medium or large changes, and for which we will develop definitions in due course. We envisage:

- **a medium change** in broad terms to mean a change that will have a material effect on the route/SO's performance, and therefore be important when undertaking comparisons; and
- **a large change** as being a substantial change to our PR18 settlements.

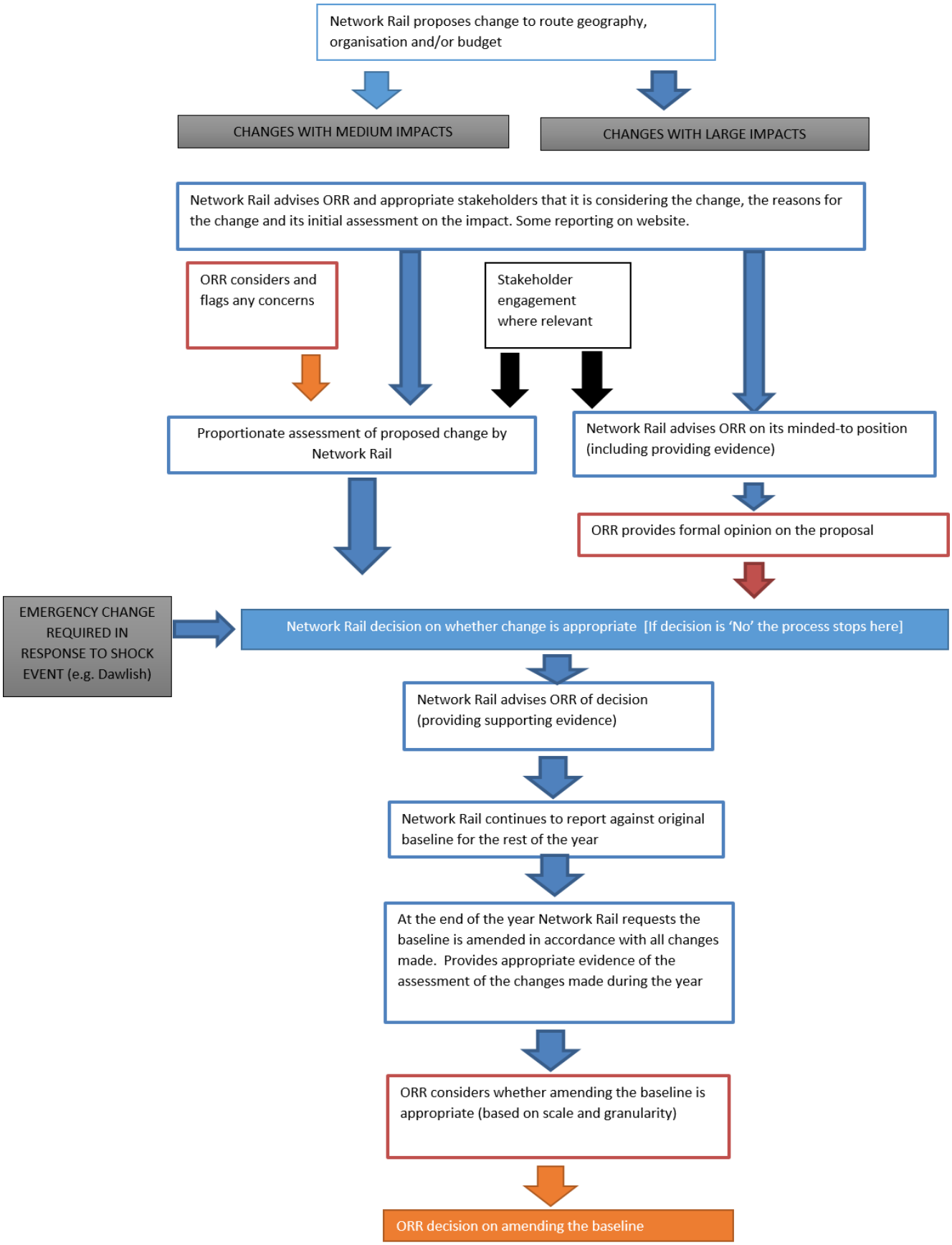
6.13 We set out some potential examples of changes in sections below.

6.14 The flow chart does not show **small changes**, by which we mean changes that are classified as neither medium or large. We would expect small changes to be dealt with, as now, in aggregate. This would probably be through annual reporting arrangements and presentation of information before and after the aggregated changes to support inter-year comparisons.

6.15 For medium changes we would expect Network Rail to engage with us and other stakeholders ahead of a decision on a change taking place (including providing information on the scale, effect and value for money). This would give us, and others, an opportunity to consider the impact of the potential change and discuss any concerns with Network Rail.

6.16 For large changes, we would expect Network Rail to more formally involve us in the discussions and provide us with a business case assessment of the impact of the change ahead of any decision being made. This would give us an opportunity to consider the impact of the potential change and provide a formal opinion to Network Rail.

Figure 6.1: Our proposed approach to managing changes to our PR18 settlements



6.17 For changes driven by a ‘shock event’ we would expect Network Rail to be transparent (potentially retrospectively) in the changes made, but that any process should not hinder an emergency response. We expect that the processes we set out in this chapter could apply for the medium term actions following a shock event, however. The damage to track at Dawlish, and the consequential high cost of repair, is an example of such a change in CP5 that materially impacted the relevant route and Network Rail more widely.

6.18 We think that there is an important distinction between:

- changes that will directly affect services to customers and end-users (and, more widely, external stakeholders); including, the introduction or cancellation of enhancements, and in some cases, financial changes; and
- changes that affect customers and end-users only indirectly, if at all, by affecting the settlements and therefore Network Rail’s incentives to perform.

This distinction should inform the nature of stakeholder engagement associated with the change.

6.19 As indicated in Figure 6.1, we anticipate that Network Rail will lead the change management process while:

- keeping ORR and stakeholders appropriately informed;
- undertaking sufficient analysis of the impact of the change; and
- providing proportionate evidence to allow ORR, where appropriate, to amend the baselines we use to monitor Network Rail to take into account the changes made.

6.20 The different types of change may also need a different approach, but we outline a high-level process for managing changes below in Figure 6.1:

Changes to financial expenditure

6.21 The PR18 determination will include the financial settlements for routes in CP6. With the exception of Scotland, these will not be ring-fenced. We want to use these route level and SO financial settlements to monitor and compare performance, and to hold the routes accountable for expenditure levels, efficiency, and the delivery of reasonable requirements and the requirements of the licence.

6.22 In CP5, parts of the expenditure budgets have been moved between routes frequently, in particular as part of the business plan updates that occur a number of

times each year. There may be good reasons for changing a route's budget during CP6, not least as an effective means of managing risk. However, it is important that the benefits of such changes outweigh the consequences of potentially undermining a route's accountability for what it delivers, and its ability to plan.

6.23 Consistent with the approach we set out in Figure 6.1, we expect Network Rail to establish protocols for moving money between routes that balances:

- the need for Network Rail to be able to manage resourcing and financial risks and opportunities across its business as a whole; and
- the need to observe the integrity of route level settlements.

6.24 We will set principles for the protocols, with key distinctions (determining whether the change is small, medium or large) with consideration to the:

- scale of route budget change; and
- timing of budget changes, in particular between:
  - our determination and the delivery plan (or, during CP6, the previous annual business plan); and
  - in-year changes.

6.25 We want to ensure that we can identify out-performance and under-performance of routes, and the SO. For example, we would want to be able to recognise out-performance where a route/SO has delivered in line with expectations/targets, but has done so on fewer resources than we deem efficient in our settlements.

Changes to route boundaries

6.26 The introduction of route level regulation means we will be holding each route accountable for delivering reasonable requirements and the broader licence requirements within its boundary during CP6.

6.27 Boundary change, (which will be more relevant to routes in England than in Scotland or Wales), could mean anything from merging existing routes, the creation of new routes, or a shift in assets from one route to another.

6.28 We use examples of changes in CP5 to illustrate what we consider to be medium and large changes:

- medium sized change: change to a route boundary; and

- large change: the merger of East Midlands and LNE routes.

6.29 Small changes, such as a shift in responsibility for a small number of assets that will not have a material effect on the route as a whole, are unlikely to need regulatory input. We do however expect to be consulted if there are a number of planned small changes to route boundaries that, when aggregated, could have a medium or large impact.

6.30 It is important that Network Rail provides us with robust data to support effective comparison, both over time (before and after the change), and between routes. To support this and in order to establish a PR18 baseline, in our guidance on the strategic plans we have asked Network Rail to submit detailed references to the definition of each route.

6.31 Given that there are likely to be some changes to route boundaries in CP6, if we were to update baselines for transparent and accurate reporting, we think it would be appropriate to do this not more than once a year as part of annual reporting cycles.

6.32 We would expect engagement with stakeholders to be proportionate to the change. In the case of boundary changes, engagement is needed not least because points of contact may change.

Organisational change

6.33 While we would expect to be informed about any significant planned change to Network Rail's organisation, we would only consider being formally involved in a change management process with respect to how Network Rail is organised when this has a significant impact on routes' responsibilities, or that of the SO. Such changes run the risk of undermining our regulatory settlement, and therefore our ability to hold Network Rail to account.

6.34 We use examples of changes in CP5 to illustrate what we consider to be medium and large changes:

- medium sized change: the recent reorganisation of the System Operator function; and
- large change: the programme of non-core asset disposals following the Hendy review.

6.35 We would expect the approach would be similar to that of changes to route boundaries.

Changes to scorecards

6.36 We set out our approach to using scorecards in how we monitor Network Rail in Chapter 3. We have certain expectations regarding the contents of scorecards, including some specific measures; and we expect to set a regulatory minimum floor for two measures.

6.37 We do not expect to change the regulatory minimum floor during the control period, unless there is a material reason to do so. Such reasons may include a change to a franchise that results in the floor being inconsistent with equivalent franchise requirements, or resetting following enforcement action. Such a change, which means a change to what we deem to be a reasonable requirement under the licence, would require our approval.

6.38 Network Rail currently updates its scorecards annually. There may be good reasons for updating the targets, to reflect changing customer requirements, including a new franchise, Network Rail's capability and other external events. Routes/the SO should make changes to scorecard targets with appropriate stakeholder engagement in a process similar to that set out in our guidance with respect to the strategic plan scorecards.

6.39 In particular, for us to place weight on the revised target in our monitoring, we need to be assured that the change was justified. We would not expect to be involved directly in the associated process, but we expected to be provided with information regarding:

- whether the change to the target was agreed with the relevant stakeholders; and, where not; and
- whether the governance around the change, including the role of Network Rail centre, and the case for making that change (similar to the case made in Figure 6.1).

6.40 Leaving aside measures relating to near-term delivery, Network Rail should not change the methodology for calculating any measure, or reporting on particular measures, without having a case for doing so and going through a transparent process with its customers and ourselves. This would include circumstances where a measure is replaced for a technical reason.

Questions

11) What are your views on the approach we set out for managing change? In particular, do you think our proposed level of involvement, and role for stakeholders, are appropriate?

12) Are there other options for managing change you think we should consider?

13) Are there any other types of change you think we should consider?

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