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29 October 2009

List of addressees attached

Dear colleague

Looking ahead to PR13

1. It is now one year since we published our determination of Network Rail's outputs and funding for 2009-14, and an independent evaluation of the process and management of the 2008 periodic review (PR08) has been completed.
2. This letter contains our response to the evaluation and although we will not be commencing our 2013 periodic review (PR13) yet, we outline our initial thinking on the process and timeline for PR13 and set out two key areas where progress needs to be made now to ensure that it can be successful: the role of the industry in planning for PR13 and Network Rail's own business planning.

Independent evaluation of PR08

3. We published the independent evaluation of the process and management of PR08 on 5 August 2009. The report contains 34 separate recommendations, the majority of which are aimed at us but there are some which directly concern others, in particular Network Rail, DfT and Transport Scotland.¹
4. As we said when we published the evaluation, we are pleased that, overall, PR08 was judged to be well managed and delivered. The evaluation found our process to be open and inclusive; and that we achieved our principal objectives for the review. Of course, the evaluation found that there are areas to improve the process and management for PR13. In our view, the main areas are:

- **periodic review objectives.** The evaluation recommended that we should consider starting PR13 with an open consultation on our objectives. We agree that a full consultation on our objectives is important and we will have a major open consultation on the objectives for PR13 when we commence the review in October 2010;
- **customer and stakeholder representation and engagement.** The evaluation recommended that we should seek "better and earlier"

¹ The report is available on our website at <http://www.rail-reg.gov.uk/upload/pdf/PR08evaluation.pdf>. My covering letter for the report may be accessed at www.rail-reg.gov.uk/upload/pdf/PR08evaluation_be050809let.pdf.

representation of passengers and freight customers (and other stakeholder groups beyond Network Rail and government, such as the suppliers). In particular, the evaluation emphasises the need to involve end users/passengers in the periodic review process more fully. We did engage extensively with a wide range of stakeholders in PR08 but we accept that we should look to strengthen this engagement in PR13. As we develop our plans for PR13 we will consider how we can best do this and, in the first instance, we look to the joint industry 'Planning ahead' work to ensure that it fully takes account of end user and other stakeholder views;

- **high level output specification (HLOS)/industry planning.** The evaluation recommended a variety of ways to improve the HLOS/industry planning process. We agree that it is important to build on the planning undertaken for PR08. In the first instance we look to the joint industry 'Planning ahead' workstream to identify and take this work forward. In addition, the DfT led 'HLOS2' group includes wider industry representation than the equivalent group in PR08, in relation to the development of the HLOS for England & Wales;
- **benchmarking.** The evaluation highlights the importance of benchmarking and recommends that we continue to develop international and other forms of benchmarking, working closely with Network Rail. We agree and are already taking this work forward;
- **Network Rail's submissions to us.** The evaluation recommends that we ensure that the information we require from Network Rail is set out clearly at the start of the review, and Network Rail's board should explicitly sign-off its periodic review submissions. We are starting to consider our requirements for PR13 and will discuss these with Network Rail and set them out clearly when we start PR13. Whilst we recognise the company's own sign-off procedures to be a matter for its internal governance we see merit in requiring Network Rail's submissions to PR13 to be accompanied by a declaration from the company. This is something we will be considering further as we develop our plans for PR13;
- **incentives on Network Rail.** The evaluation recommends that there is scope to consider whether Network Rail's management incentive plan (MIP) and the incentives on Network Rail are as effective as possible. The review and development of the incentive framework will be a core part of PR13;
- **Scotland.** The evaluation recommends that we should consider our approach to the periodic review for Scotland, given the separate responsibility that the Scottish government has for funding and setting the strategy for the railway in Scotland. We accept that it is right to review our approach, including the information we require from Network Rail and the analysis we undertake. We will be discussing this issue further with Transport Scotland and Network Rail as we develop our plans for PR13; and
- **ORR board composition.** The evaluation recommends that we consider whether we need a director (preferably a board non-executive) with railway engineering expertise. We are clear that our board needs to have access to

high quality railway engineering expertise. In filling board vacancies (either non-executive or executive) we will recommend to the Secretary of State that s/he appoint the best candidate(s) that meet the range of skills and experience needed for the director to play a full and effective part as a member of the ORR board.

5. Annex A sets out our detailed response to each of the 34 recommendations.

Process and timeline for PR13

6. We expect that PR13 will establish the outputs, access charges and other sources of funding, and the wider regulatory framework for Network Rail, for the period from 1 April 2014 to 31 March 2019. As with PR08, key inputs to our review will be the high level output specifications (HLOSs) of what the UK government (for England & Wales) and the Scottish government want to be achieved by the mainline railways, and statements of the public funding (SoFAs) they expect to make available to the achievement of these outputs. Figure 1 shows our initial view of the high-level process map for PR13.

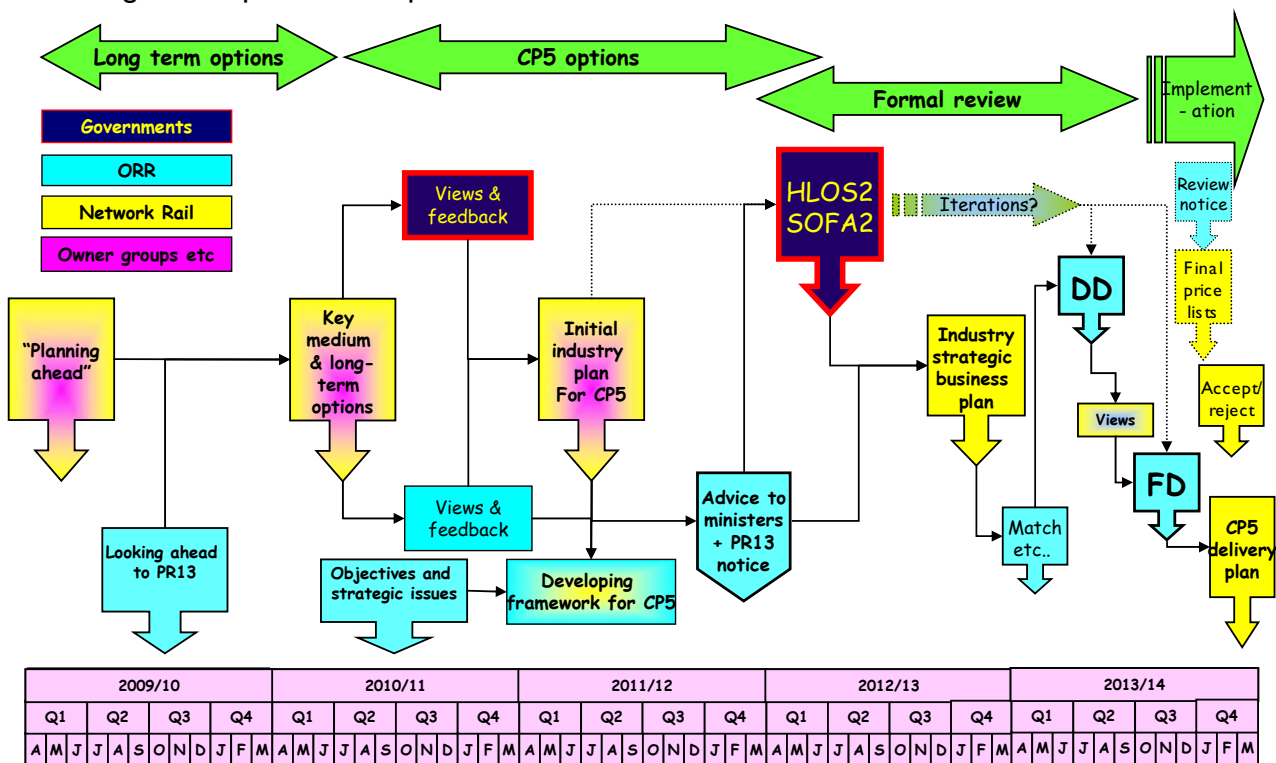


Figure 1: A possible 2013 periodic review process map

7. Our planned process for PR13 is broadly similar to PR08. The most notable difference is that the new cross-industry 'Planning ahead' work has a central role, to develop the industry's proposals for the next control period, based on a thorough assessment of credible options in the longer term context. This builds on the industry engagement in PR08 and we see it as essential input to the development by the two governments of their HLOSs and SoFAs. This is discussed further below.

8. We expect that there will be very tight constraints on the public finances available for the railway for the next control period in both England & Wales and

Scotland. This will have a significant bearing on PR13 and in particular the governments' HLOSs and SoFAs. There will be a sharp focus on the industry to demonstrate value for money and there will be increased expectations that Network Rail and the industry can deliver further efficiency improvements.

9. We currently plan to start the periodic review in October 2010 with a major open consultation on the objectives for the review and on any issues that require early public debate and resolution. Our objectives are framed by our public interest duties and informed by the HLOSs and SoFAs produced by the two governments

10. Network Rail and its industry partners will produce the initial industry plan, setting out proposals on outputs for 2009-14, based on robust costs. This is currently planned for June 2011.

11. We will set out the framework we will use to determine Network Rail's outputs and funding in February 2012, as part of our 'advice to ministers' (on our initial view on Network Rail's revenue requirement for CP5), when we start the formal phase of the periodic review. The framework will follow a period of thorough consultation that we plan to start during 2010-11. We expect that by July 2012 the two governments will produce their HLOSs and SoFAs. These will provide the basis for Network Rail, working with its industry partners, to publish its strategic business plan in January 2013. Network Rail's plan will need to contain all the information we need to make our determination; we do not intend to ask Network Rail to produce an update to its plan. We intend to publish our draft determination in June 2013 and, following consultation, our final determination in October 2013. After this follows the process to implement our determination and for Network Rail to produce its CP5 delivery plan.

The role of industry planning in PR13

12. In May 2009, ATOC, Network Rail and the Rail Freight Operators' Association (RFOA) together published 'Planning ahead', the first in a series of documents setting out a thirty year vision for the railway, so that the industry can, in turn, plan properly for the medium term (2014-19). This confirmed that the industry would produce an options document in June 2010 and an initial industry plan in June 2011 in line with our timetable. We are pleased that the industry has taken the initiative and has recognised the importance of putting a planning framework in place.

13. Since May the industry has made good progress. A cross industry planning oversight group (POG) has been set up to oversee production and specify the work needed to deliver the plan. This group includes senior representatives from ATOC, Network Rail, RFOA and TOC owner groups.

14. The options document is an important stepping stone to the 2011 plan. It is essential that it considers:

- **the strategic options facing the railway:** what are the main longer term choices the industry must make?;
- **whole industry costs:** what are the main cost drivers and what are the options to reduce costs?;

- **the views of passengers, freight customers and other stakeholders:** what are their views on the priorities and the trade-offs? Besides passengers and freight customers it will be important to ensure that the supply side and regional bodies are properly engaged in the process; and
- **the evidence base and what needs to be done to improve it:** existing processes such as the route utilisation strategies (RUSs) should be able to provide a solid basis for the work but there will be a need to commission new work to collect and analyse data. This needs to be properly addressed so that the work can be completed in time for the 2011 plan.

15. The options document should be accompanied by a workplan for the 2011 plan, so that momentum is maintained and there are clear expectations of what is required from all parties, including milestones and timescales. We know that the industry is discussing the exact timing of the 2010 and 2011 documents. We proposed June of each year in order to allow enough time to prepare each document, to reflect on each document and undertake the necessary further work. It is essential that the work for the 2011 document is robust and is completed in good time for our February 2012 advice to ministers.

16. DfT has established a HLOS2 joint planning group to contribute to the development of its HLOS in the context of the DfT's emerging strategy. It has a membership from across industry, government, Passenger Focus, Transport for London, Passenger Transport Executives and ORR, and will provide an important link between the industry's work and DfT's own work. We have also started to engage with Transport Scotland to support it in the development of its second HLOS.

Improvements to Network Rail's business planning

17. Network Rail has made significant progress over the last few years to improve its business planning. However, there are a number of key areas where the company needs to make further improvement so that it can better justify its plans for the next control period and beyond. Many of these were recognised in the independent evaluation of PR08 and we have been discussing them with Network Rail over the last few months, with the company accepting the need to continue to improve its business planning. The main areas Network Rail needs to focus on are:

- **benchmarking.** Network Rail needs to improve its benchmarking work, which includes costs as well as processes and outputs, and includes its own internal benchmarking. We expect Network Rail to make major improvements in its business planning/information systems ahead of PR13, which will include its unit cost framework and in its operating expenditure;
- **asset policies.** Network Rail is committed to submitting fully justified asset policies and CP4 plans to us by the end of 2009-10. We expect it, as a well managed business, to keep these under review and to be able to provide an economic justification for any changes. It will be important that Network Rail can underpin its PR13 submissions on the basis of an efficient whole-life approach to managing its assets;

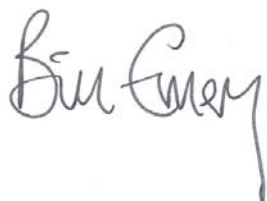
- **infrastructure cost model (ICM).** Network Rail developed its ICM during PR08 and this was very useful. The ICM can be developed further in many areas ahead of PR13. We will discuss with Network Rail in more detail our views on the development of the ICM;
- **unit costs.** Network Rail accepts that it needs to improve the accuracy and coverage of its unit costs. We are currently working on this with the company, in order to provide a reliable basis for monitoring efficiency during CP4 and providing a better information base for PR13;
- **the relationship between cost and output.** Network Rail needs to do more to understand the relationships between cost and output, to enable robust estimates of the costs of changes to be made;
- **Scotland.** Whilst Network Rail is a GB-wide company it is important that its plans provide sufficient detail in respect of the network in Scotland, reflecting the specific operational and political circumstances. We have started to discuss this issue with the company.

18. Over the next few months we will continue to discuss with Network Rail our expectations on the evidence base we expect to see in its PR13 submissions and we will publish our requirements in October 2010 when we start the consultation on the objectives for PR13.

Next steps

19. If there is any aspect of PR13 that you would like to discuss with us at this stage please contact Paul McMahon, deputy director, railway markets & economics (paul.mcmahon@orr.gsi.gov.uk, tel 020 7282 2095) or, if it relates to industry planning, John Larkinson, deputy director, railway planning & performance, (john.larkinson@orr.gsi.gov.uk, tel 020 7282 2193).

Yours faithfully



Bill Emery

Addressees

ATOC

DfT

Freight train operating companies

HM Treasury

Network Rail

Passenger Focus

Passenger Transport Executives

PTEG

Rail Freight Group

Rail Freight Operators Association

Railway Industry Association

ROSCOs

Train operating companies

Transport for London

Transport Scotland

Welsh Assembly Government

Annex A: PR08 independent evaluation – final report recommendations and our response

#	Recommendation	Full text of recommendation (including paragraph number)	Our response
OVERALL CONCLUSION ON PR08			
Recommendation 1 (sections 3.3-3.7): To set the review off in the right direction			
1	Summarise existing policies and wider context at start of PR13	2.1.3 At the start of PR13 and as an important part of the context for the review, ORR should summarise its existing policies, Network Rail progress in delivering the CP4 Plan, and any changes in circumstance that may bear on its deliberations. These could be legislative, or might reflect aspects of public policy, relating for example to funding or the environment.	We accept this recommendation and when we commence PR13 we will summarise our relevant policies and set out the relevant context for the review.
2	Start PR13 with an open consultation on objectives	2.1.4 ORR should consider initiating the next review with an open consultation on its objectives discussing the possible options and their implications, and explaining how these link to its statutory duties. It should explain where specific duties have been traded off, and on what basis. If some duties are considered to be irrelevant to the purpose of the periodic review, then the reasons should be made clear.	We recognise that full consultation on the objectives for a periodic review is important. We will have a major open consultation on the objectives for PR13 when we commence the review in October 2010. When we do this we will provide an appropriate range of options and discussion of the implications of these, in the context of our public interest duties. Our objectives are framed by our public interest duties and informed by the high level output specifications (HLOSs) and statements of public funds available (SoFAs) produced by the two governments
3	Information requirements	2.1.5 At the outset of the next review ORR should make clear to the Board of Network Rail its requirements in terms of data and analysis, and indicate the consequences of the failure to meet these requirements in a timely way. This would clearly establish the terms of engagement and provide the context for expectations, for example, on the provision of information and its verification before being passed to ORR.	The quality of information that Network Rail provide for a periodic review is fundamental to the conduct of the review and the judgements we make. When we commence PR13 we will confirm our requirements and the implications for Network Rail if it does not meet these. We are already discussing the information requirements/evidence base for PR13 with the company and in this letter we have indicated the key areas of work that Network Rail needs to progress now to improve its business planning processes to produce better information for PR13. Our initial process for PR13 is also based on a single strategic business plan submission from Network Rail. This will mean that Network Rail's evidence base needs to be complete in time for that.

4	Stakeholder involvement	<p>2.1.6 At an early stage in the process ORR should set out who it believes are the main stakeholders in the review, and the particular issues upon which it seeks involvement from each. This should act to ensure earlier and fuller participation by the Train operating companies and owning groups in particular. This would also minimise the risk of stakeholders being unclear about what is expected of them in the process, a feature, which we think, did affect PR08. Nonetheless it should make clear that it does not expect stakeholders to be constrained in the contributions they wish to make on any issue they consider important.</p>	<p>We positively encourage stakeholder engagement in our work, and we engaged extensively with stakeholders in PR08. We recognise that there is room for improvement and during the next year, before we commence PR13, we will consider our approaches to engagement for the periodic review, which will cover all stakeholders, not just train operators. When we commence PR13 we will set out who we consider the main stakeholders to be and the engagement we anticipate from them. We are pleased that, in contrast to HLOS1, there is a single DfT-led HLOS2 working group where passenger and freight train operators are represented, along with ORR, Network Rail, TfL, PTEs and Passenger Focus, and that the industry is working together in the 'Planning ahead' process.</p>
5	Better passenger involvement	<p>2.1.7 In identifying stakeholders ORR should seek mechanisms for better representation of the interests of passengers as the end consumers of rail services. Consideration of the interests of passengers should include the use of relevant formal analytical techniques. ORR should review the practice of other regulators, such as OFWAT and apply it where appropriate, including preference studies and cost benefit analysis (perhaps in conjunction with the DfT and Transport Scotland). This could be especially important if funding were to be much more constrained in a future review than it was in PR08 and the emphasis in expressing outputs was to move from quantum to quality.</p>	<p>A focus on the end-user (passengers and freight customers) is at the heart of our work. We will ensure that our PR13 process fully involves passengers and freight customers and properly takes account of their views and interests. In the first instance we are looking to the joint industry 'Planning ahead' work to ensure that the 'options' and 'medium and long term plan' documents in 2010 and 2011 make sure that end-user views are properly taken into account and, as necessary, the industry undertakes further engagement and research to make certain of this. This research could include stated preference and cost benefit studies, building on the information that is already available to the industry. In considering end-user views we recognise that, unlike other regulated sectors (e.g. water and energy), there is a considerable amount of direct taxpayer funding of the industry and that, ultimately, the two governments will set out their specifications for the high level outputs of the railway.</p>
6	Freight	<p>2.1.8 Considering the needs of freight customers alongside those of passengers is also likely to provide more effective definition of the output specifications to be met.</p>	<p>In undertaking our work in a periodic review we take into account the reasonable requirements of all of Network Rail's customers and funders, including freight customers. The first HLOS (for England & Wales) did include funding provision for the strategic freight network. This recommendation is relevant for DfT and Transport Scotland as they develop their HLOSs, but we are pleased that freight is represented on the DfT led HLOS2 group.</p>

7	Better involvement of supply side / RIA	2.1.9 The needs and potential contributions of supply companies as well as of freight and passenger owning groups in the rail industry could be explicitly considered at the outset of the process to provide better definition to the strategies, including partnerships, that could be adopted to support an integrated approach to whole industry planning and investment. Again this could be especially important if funding were to be much more constrained in a future review than it was in PR08.	We engaged extensively with the Railway Industry Association (representing industry supply companies) during PR08 and RIA and supply companies responded to our consultation documents. We value our engagement with supply companies and will ensure that we engage with them thoroughly during PR13. We note, and welcome, the planned closer engagement during CP4 between Network Rail and the supply companies to identify opportunities for efficiency improvement.
Recommendation 2 (sections 3.3-3.7): To manage the review effectively			
8	ORR 'railway engineering' non-executive	2.1.11 Given the central role in the review played by engineering issues ORR should consider whether it needs to appoint a director with railway engineering expertise as part of the Board's Periodic Review Committee.	We agree that both our board and periodic review committee need to have access to high quality railway engineering expertise to inform decisions on many of the issues under consideration. We also value the insights from other engineering disciplines and experience from other sectors. Where such expertise is not available within ORR then we have and will continue to obtain the necessary advice from relevant external experts. In filling board vacancies (either non-executive or executive) we will recommend to the Secretary of State that s/he appoint the best candidate(s) that meet the range of skills and experience needed for the director to play a full and effective part as a member of the ORR board. In our deliberations on specific issues we will ensure that we do have access to relevant high quality advice either from our internal teams or from external sources.

9	Better engagement with NR board	2.1.12 ORR should ensure that the Board of Network Rail is fully engaged in the PR13 process from the start, including provision for hearings at each key stage. It should consider whether these hearings should be public.	We will continue to encourage and expect the Network Rail board to be engaged fully in all the key aspects of the periodic review. However we consider it is a matter internal to Network Rail how it decides to play its part and who it decides should be involved in the meetings/workshops we hold with the company and the industry at all the key stages of the review. We will consider whether we should incorporate formal hearings (closed or in public) into the process for PR13 (to supplement the wide range of bilateral, multilateral and industry workshops used in PR08). We would expect to test whether hearings would be better at exposing and debating the issues in constructive ways and build stakeholder confidence in both the process and decisions being taken.
10	Data accuracy and role of reporters	2.1.13 ORR would expect the specific cost studies to be the responsibility of Network Rail (management information it needs anyway for running its business and arguing for efficient, cost-reflective access prices from the periodic review). ORR should protect itself by requiring Network Rail directors to sign appropriate declarations, and for these to be accompanied by audit reports signed by reporting engineers employed by the company but with a specific duty of care to the regulator. ORR could then focus on any residual 'gaming' elements which might exist, and responsibility for variance analysis of plans with outturns. This would also be likely to reduce the costs and resources devoted to the review.	Network Rail will be responsible for preparing its submissions for PR13 and we would expect these to be robust. In PR08 a number of areas of weakness in Network Rail's plans were identified and we expect the company to address these, as well as continuing to improve its business planning more generally, ahead of and during PR13. In PR08 we made use of the independent reporters to review some of Network Rail's submissions, as well as our own internal teams and other specialist advisers we engaged. We would expect to use a similar broad approach to PR13 and ahead of commencing PR13 we will be giving this further consideration. Network Rail's board will have engaged fully in PR08 and whilst we recognise that the company's own sign-off procedures to be a matter for its internal governance we see merit in seeking the company's submissions to PR13 to be accompanied, as appropriate, by reports from the independent reporter and an appropriate declaration from the company. In PR08 besides the three formal submissions (initial strategic business plan, strategic business plan (SBP) and SBP update) and the company's response to our draft determinations Network Rail made a range of additional submissions which were often distracting and difficult for us to deal with given that they were submitted later in the periodic review process. This is something we intend to avoid in PR13.

11	Consultation questions	2.1.14 ORR should improve the focus of its consultations by posing direct and specific questions to stakeholders, rather than simply inviting comment on any aspect of the document.	We accept the principle of this and will ensure that, where appropriate, our consultations in PR13 include a range of specific questions.
12	More participative methods of engagement	2.1.15 Whilst the PR08 documentation was clear and easy to read the weight of it, whilst understandable, did appear to represent a barrier to participation by some important stakeholders and consideration should be given in PR13 to more participative methods of involving consultees – workshops at which minutes could be taken for example.	Any periodic review involves a significant amount of consultation on a wide range of often complex issues. Whilst we worked hard to ensure that we engaged widely and produced clear documents we recognise that, inherently, it can be challenging for all stakeholders to engage thoroughly throughout the review. We did have a lot of workshops in PR08 as well as more informal bilateral and multilateral meetings. When we establish the detailed process for PR13 we will consider the most appropriate forms of engagement including, including minuted workshops.
13	Explaining our determination	2.1.16 ORR should conclude the periodic review by explaining why its determination best meets its objectives and discharges its duties.	In PR08 we tended to address our objectives and duties in more of a high level or strategic way, rather than going through them one by one. When we make our determination in PR13 we will ensure that we provide adequate explanation of why our decisions meet our objectives and our public interest duties.
CONCLUSIONS IN RESPECT OF THE HLOS/SOFA AND INDUSTRY PLANNING			
Recommendation 3 (section 3.8)			
14	Role of ORR vis-à-vis government	2.2.6 Next time to bring clarity to the relationship between HLOS and PR08, ORR should give stakeholders a clear exposition of its relationship to the two governments in HLOS, SOFA and PR13 including its view of the roles and responsibilities of each of the parties in each of these processes. These may be clear to some of the participants at the moment but they are not necessarily clear to a wider audience. ORR should articulate the approach it intends to take as part of the HLOS process, and identify the components of that contribution.	We did in PR08 set out our role vis-à-vis government, as we saw it, in particular in our first PR08 consultation document. Clearly, it is for the two governments to decide how they carry out their work but we will ensure that in PR13 we explain fully how we see our role and how we will interpret it, in conducting our periodic review using the HLOSs and SoFAs produced by the two governments as key inputs.
Recommendation 4 (sections 3.8-3.9)			

15	Planning process	<p>2.2.7 In the meantime there are likely to be a number of options available to improve the planning process at a disaggregated level to complement top down industry models. Indeed it may be feasible to integrate them. In particular:</p> <p>2.2.8 We would encourage ORR with DfT, Network Rail, Transport Scotland and other interested parties to review the planning processes with a view to developing such integrated top-down-bottom-up mechanisms.</p>	<p>Developing a robust long term plan is important and we support improvement to the industry's planning process, including the development of analytical capability. We see the industry's plan as having a central role in PR13.</p> <p>In PR08 we supported development of the network modelling framework (NMF) and we support the ongoing development of the route utilisation strategies (RUSs). We are looking to the joint industry 'Planning ahead' work to consider, in the first instance, the necessary tools and information required to develop a robust plan. Going forwards we expect to discuss and work closely with DfT, Transport Scotland and the industry to ensure that the planning processes provide a solid basis for PR13.</p>
16	Localised outputs	<p>2.2.9 Given that the needs of customers are most closely related to delivering outputs at a train company level (irrespective of whether passenger or freight) consideration should be given to the extent to which these can be matched at a route or disaggregated network level. The Route Utilisation Studies and route planning mechanisms (together with the partnership working that exists at a more localised level) could provide an effective framework for such issues to be considered as part of the next review. Mechanisms to ensure national operators are not excluded from the process should also be considered.</p>	<p>We recognise that the needs of most customers are closely related to the delivery of outputs at a local level. We agree that the route utilisation strategies (RUSs) and other route planning mechanisms (including joint performance improvement plans (JPIPs)) provide a good basis to both deliver and plan at local levels.</p> <p>As part of PR13 we will consider, and consult on, the structure of outputs as one of the core workstreams and through that workstream will consider the appropriate level of disaggregation of the outputs that Network Rail needs to deliver in CP5.</p>
17	Industry involvement	<p>2.2.10 ORR should work with DfT and Transport Scotland to ensure that the railway industry, especially TOC's but including important stakeholders such as TfL and the PTE's, are more engaged in service quality and capital investment decisions both at the HLOS stage and in the subsequent generation of specific outputs.</p>	<p>Decisions on the processes to develop the HLOSs are for DfT and Transport Scotland. We strongly support industry involvement in the periodic review, including development of the HLOSs. We welcome the greater formal involvement of TOCs and FOCs in the DfT led HLOS2 process.</p>
18	Involvement of DfT's franchising teams	<p>2.2.11 DfT should consider the role those involved in franchise delivery within the Department could play in providing a process link with strategic planning as an input to HLOS.</p>	<p>This recommendation relates to DfT. It is for DfT to decide its internal arrangements for the development of its HLOS.</p>

CONCLUSIONS ON NETWORK RAIL'S OPERATIONS, MAINTENANCE AND RENEWALS (OMR) ACTIVITIES AND ITS EFFICIENCY			
Recommendation 5 (sections 3.10-3.11): To ensure that the momentum achieved in reaching determinations on activity and efficiency is maintained through CP4 and into CP5 and to avoid reliance on data emerging late in the review process			
19	Opex efficiency	2.3.4[a] Joint effort should be put in at an early stage to determine the factors on which the next review of operations will be undertaken.	We agree with this recommendation. We had already recognised that Network Rail's submission for PR13 will need to represent a marked improvement over PR08. We are already starting to develop our thinking in this area and will be shortly starting to engage with Network Rail on our requirements for its operations plan submission for PR13.
20	International benchmarking	2.3.4[b] The use of international benchmarking, though contentious in PR08, offers a good basis on which to build for the next review and efforts should be made jointly with Network Rail to further develop this work as a priority. In particular processes to better understand the differences between network characteristics need to be put in place.	We agree with this recommendation. We have been having constructive detailed engagement with Network Rail over the last few months to discuss and plan the ongoing international benchmarking work – much of which we expect to conduct jointly with Network Rail. We intend to carry out much more work to understand the characteristics between different rail networks.
21	Domestic comparators	2.3.5 To facilitate benchmarking of Network Rail activities early consideration should also be given to ways in which meaningful UK comparators can be introduced. These might range from the use of internal data within Network Rail to comparisons with London Underground and the possible implementation of devolved structures.	Domestic benchmarking was undertaken in PR08, which included comparing Network Rail's costs/efficiency to firms in other relevant sectors, and Network Rail undertook internal benchmarking of its renewals costs. For PR13 we will continue with domestic benchmarking, including expecting Network Rail to produce robust internal benchmarking and to explore comparisons with London Underground. We also intend to develop further benchmarking against other industries in the UK.
Recommendation 6 (sections 3.10-3.11): To improve confidence in the quality of technical scrutiny and to build on what was achieved in PR08			
22	Data/assessment for PR13	2.3.6[a] ORR should seek to reach an early understanding with Network Rail on the statistical and engineering comparisons that will underpin the next assessment.	In PR08 we set out to Network Rail what financial/engineering information and assessment was required. We will do this again for PR13 and give further thought to this – to ensure that we do it as early and clearly as possible to provide Network Rail with sufficient time to produce its analysis. We are confirming to them in this letter the key areas of work that the company needs to continue to work on and improve for PR13.

23	Use of experts	2.3.6[b] Whilst sources of evidence and strong analysis are vitally important, so too is the use of experts. Given the contentious debate that took place around “efficiency” the professional expertise deployed by ORR could be enhanced by the use of international as well as UK based experts.	PR08 did involve input from international experts (alongside UK based experts). In particular, Network Rail engaged the German management consultancy BSL and EWS engaged the senior Canadian railway engineer Brian Abbott to support their input to the periodic review. In addition, many UK based experts have extensive international experience. Nonetheless, we recognise the need to ensure that there is adequate expert input to the debate on efficiency given its importance in the periodic review process. We will ensure that, as appropriate, we draw on expert skills for PR13 to augment our in-house capability, including international experts.
24	Joint appointments of consultants	2.3.7 ORR should consider using more joint appointments of consultants with Network Rail on technical issues to avoid the danger of consultant capture and confrontation by either side in PR13.	We often make joint appointments with Network Rail or ensure that our consultants have a “duty of care” to Network Rail. Some of the studies conducted in PR08 were carried out on this basis. We intend to continue this arrangement and will ensure that there is as much joint appointment as is appropriate for PR13. The role of the independent reporters is also relevant in this respect.
25	Senior railway engineer as a non executive	2.3.8 It could aid the ORR’s consideration of maintenance and renewal activities, efficiency and projects if it were to have a senior railway engineer as a Non Executive Director on its Board.	See recommendation 8.
26	Career development for engineers	2.3.9 ORR should review methods of career progression for engineers within the wider industry that would enable a cross fertilisation of experience between Network Rail, its suppliers and ORR.	We recognise that career development/training is important for engineers (and indeed for other professionals) in the industry, and this is recognised in our corporate strategy. We will give active consideration to this recommendation and will discuss with Network Rail, its suppliers and others.

27	Monitoring efficiency	2.3.10 The ORR process for monitoring Network Rail's progress in securing CP3 efficiency targets might have been expected to have improved the quality of data in helping determine the longer term trajectory. The fact that this does not seem to have been the case suggests that the link between monitoring efficiency in one control period and what might be achievable in the next is not sufficiently strong. ORR should consider how the linkages between monitoring in one control period and planning for the next can be strengthened.	Network Rail's data did improve over CP3, including that for monitoring efficiency, but not to the extent we expected. We readily accept that further improvement is possible, and indeed necessary. It is something that Network Rail accept and we have been discussing with them. We expect better information on efficiency to be available for CP4 which will allow us to better monitor the company's progress in achieving efficiency as well as providing a better information basis for our judgements in PR13.
CONCLUSION ON ENHANCEMENTS			
Recommendation 7 (section 3.12)			
28	Enhancements	2.4.2 We have no major recommendations to make in this area but given the importance of the schemes to delivering HLOS, the monitoring and enforcement processes adopted by ORR will be crucial to the credibility of the outcomes that ORR has determined.	We note the point made and we agree that the monitoring of Network Rail's delivery of its enhancement programme is central to the success of CP4 and the achievement of the two governments' HLOSs. To this end, we have strengthened our own internal processes, including dedicating more resources, to monitoring enhancements.
CONCLUSIONS ON THE FINANCIAL FRAMEWORK			
Recommendation 8 (section 3.13)			
29	Financial framework	2.5.2 To the extent that any future determination involves assumptions on the use of either equity or unsupported debt, ORR should make every effort possible to ensure the maximum alignment between itself, Network Rail, DfT, Transport Scotland and the credit rating agencies to minimise the risk that the desired financial structure turns out to be undeliverable at costs which represent good value for money	We did engage with stakeholders on this throughout the course of PR08, in what was a high-profile and complex part of the periodic review. We always accepted that we would need to consider value for money in making decisions on Network Rail's financial framework. At present Network Rail is unable to begin to raise unsupported debt. During CP4 we will continue to engage with Network Rail, the credit rating agencies and the two governments on the company's financing strategy and we will take account of progress when we start to do more work on the financial framework as part of PR13.
Recommendation 9 (section 3.13)			

30	Contestability	2.5.3 Competitive testing of inputs is an important element of information for regulators. Given the political context for outsourcing in rail and the concerns of many stakeholders about Network Rail's pricing for schemes and projects, ORR needs to explain its regulatory stance, and what it expects.	We agree that this is an important issue and in principle we support greater contestability (Network Rail competitively tenders much of its work). Developing greater contestability is a potentially valuable source of improved efficiency and delivery in the industry. It is an area that Network Rail and train operators have identified (e.g. who is best placed to undertake work at stations) and it is something we are currently discussing possible opportunities with them, and we are reviewing the scope more generally for greater contestability.
Recommendation 10 (section 3.13)			
31	Early resolution of methodological issues	2.5.4 In undertaking analytical work on, for instance efficiency and the cost of capital, ORR should attempt to engage stakeholders on appropriate proposals and methodologies in principle before it focuses on the numbers, to minimise gaming.	<p>We agree. This is how, in principle, we undertook PR08 – through developing the framework (as set out in our ‘advice to ministers and framework for setting access charges’ in February 2007 and our ‘update to the framework for setting access charges’ in February 2008).</p> <p>We intend to continue with this broad approach for PR13 and are committed to resolving as much of the methodological debate early on and, for instance, are currently discussing with Network Rail methodological issues relating to efficiency benchmarking which we hope can lead to broad agreement early in PR13 before the detailed analysis needs to be undertaken.</p>
CONCLUSIONS ON INCENTIVES			
Recommendation 11 (section 3.14)			
32	MIP and incentives on Network Rail	2.6.2 ORR should consider whether the Network Rail management incentive plan (MIP) is driving the achievement of an appropriate balance of outputs, standards and cost-effectiveness. A full range of options for incentivisation, including profit based tools, should be evaluated before the next determination.	Reviewing and developing the incentive framework is central to our work and to the periodic review process. We take an interest in Network Rail's MIP (under the MIP licence condition). In PR08 we said that Network Rail should include in its MIP customer satisfaction measures or we would introduce a regulated output for customer satisfaction. We will review the incentive framework as part of PR13 taking account of how Network Rail is progressing in CP4 and taking account of company's structure and status.
CONCLUSIONS ON MONITORING			

Recommendation 12 (section 3.14)			
33	Monitoring “enablers”	2.7.3 Although ORR is clear that it is an economic output regulator, Network Rail’s activities represent "enablers" of delivery. A question arises as to the extent to which ORR should concern itself during CP4 with the progress Network Rail makes in developing certain of these activities. ORR will need to decide how it will monitor those activities that were ear marked in PR08 for significant improvement. Examples might include asset management policies, efficiency plans, enhancement scheme delivery and the “softer” actions Network Rail takes to work with its customers and stakeholders, all of which are fundamental to optimising whole industry costs and standards.	Our determination for CP4, and our broad approach to monitoring Network Rail, is focused on whether Network Rail is likely to meet its output obligations, and also on the sustainability of its asset management plans, which must be based on justified whole-life-efficient asset policies. Network Rail must submit these policies and plans to us by the end of 2009-10. Alongside this we do undertake a wide range of important monitoring of “enablers” and inputs, partly to support the monitoring during CP4 (e.g. on enhancement schemes) and partly to improve our information base ahead of PR13.
CONCLUSION ON THE PERIODIC REVIEW AS IT AFFECTED SCOTLAND			
Recommendation 13 (section 3.15)			
34	Approach to Scotland	2.8.2 ORR and Network Rail should specially review their approaches going forward as devolution raises important questions as to how Scottish needs are to be met within the context of the next periodic review.	We accept that it is right to review our approach to Scotland to ensure that how we undertake the periodic review, the information we require from Network Rail, and the analysis we undertake, is fit for purpose given the nature of the railway in Scotland, the Scottish HLOS and the separate responsibilities and strategy of the Scottish government / Transport Scotland. This is, of course, undertaken in the context of a GB wide network and Network Rail being a single GB wide company. We have started to discuss this issue with Transport Scotland and Network Rail and, as we develop our plans for PR13 in more detail, we will be able to confirm the approach for Scotland.