Responses to consultation on ORR's approach to assessing Network Rail's efficiency and wider financial performance in CP6

Office of Road and Rail
One Kemble Street
London

Date: 02 March 2018

Reference: Abellio UKs Response to the ORR Consultation on assessing Network Rail's efficiency and wider financial performance

Introduction

This submission provides a specific Abellio UK response to the above consultation. It includes a collated set of responses from all of our UK Train Operating Companies, including feedback from Executive Team members in the following companies:

- Abellio UK
- Greater Anglia
- Merseyrail
- ScotRail
- West Midlands Trains.

Abellio UK Comments:

We support and endorse the response from RDG and have the following additional comments:

We believe that several of the metrics could potentially drive perverse behaviours if not appropriately regulated i.e. unit costs and productivity – we believe that there needs to be a balance between the most financially efficient and most efficient over the expected lifespan of assets. ORR have acknowledged this, but further work needs to be done to address how it will be reassured that selected options are best for the industry long term, as opposed to Network Rail's immediate financial performance.

It is critical that Network Rail become much more transparent in what has been achieved in engineering possessions (enhancements and renewals) this will allow for more work to be aligned and combined; thus driving more efficiency through a better performing network and fewer possession hours, for the benefit of customers.

We would like to see ORR support alliancing arrangements to facilitate TOCs sharing in improved efficiency, recognising that this has become much more difficult since Network Rail has been nationalised.

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8th March 2018

Re: Consultation on assessing Network Rail's efficiency

Question 1

Arriva supports the priorities that the ORR have laid out. In particular, the focus on driving the best outcomes for the users of the rail network including supporting the delivery of better value for money. With this clear objective in mind, Arriva agrees that it will be necessary to move away from technically precise measures to a more rounded assessment which looks at the drivers of performance and delivery. However, measures used should still be clearly defined as well as being strongly and consistently linked to the factors being assessed. Arriva also supports an approach that is more forward looking. As highlighted below, Arriva would encourage ORR to ensure that their assessment of Network Rail's considers the whole rail industry effects of Network Rail's delivery.

The "three E's" model outlined by ORR could provide a common approach to understanding what the ORR is looking for Network Rail to focus on and how the ORR might assess delivery. The structured consideration of "economy", efficiency" and "effectiveness" should support Network Rail in producing a coherent and targeted suite of initiatives and measures by which to monitor delivery.

Arriva would suggest that ORR ensures that its consideration of effectiveness considers both that work is undertaken when it is required (para 2.4) but also that the work is undertaken to the required quality and aligned with the priorities of Network Rail's customers.

Arriva has found the current Financial Performance Measure to be too complex to be of material value – not least because it is completely backward looking and includes too many different and unrelated sub-variables. The mixing of OPEX and CAPEX type variables into a single compound metric causes particular problems. It would therefore be of benefit if the ORR's approach would be more granular so that measures are strongly and consistently linked to the factors being assessed.

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This is likely to be best achieved by building the ORR's assessment by referring to the initiatives and outputs detailed in Network Rail's Strategic Business Plans. This would align with ORR's "emphasis on reviewing and reporting on how routes have delivered".

However, this approach may make direct comparisons between Routes more challenging rather than easier as different Route Strategic Business Plans (RSBPs) will likely be focusing on different outputs with necessarily different initiatives. Therefore, ORR may need to establish a framework to provide some degree of consistency. As well as assisting ORR in its assessment, this would also be of benefit to operators who interact routinely with more than one Route

It should also be noted that the circumstances of different Routes are vary widely including with regard to geography, the types and age of infrastructure in place, the types and density of train services operated and the scale and scope of projects to be delivered. Given this variety, ORR should therefore not necessarily expect to see equal results on all metrics for all Routes. Again, comparing results delivered against the original plan may be more informative.

Question 2
Arriva supports the use of a range of measures drawn from a variety of sources rather than the production of a bespoke composite measure. As noted above, it is likely that it would be most effective to align the metrics to the initiatives included in the Strategic Business Plans. Furthermore, a level of granularity to truly understand drivers is required.

Arriva is unclear how ORR might make greater use of information derived from their safety role. (but are we supportive in principle in that safety is of paramount importance?)

Question 3
It would be of benefit if the measures used by ORR to assess Network Rail's cost effectiveness were closely aligned to the metrics being used by Network Rail itself to manage the delivery of their Strategic Business plans. This would make it clearer to Network Rail's local leaders as to which matters they should focus their attention without the possibility of different metrics creating diverging incentives at this level. Subject to suitable protections of commercially sensitive data, this alignment would allow greater transparency to stakeholders with regard to the delivery of the initiatives included in the Strategic Business Plans as seen by Network rail's local leaders.

Question 4
A direct focus on unit costs and associated cost drivers would be a significant improvement over the current approach of monitoring complex aggregate metrics. This approach would also align better with the activity and unit cost based methodology used by Network Rail to produce the Strategic Business Plans themselves.

However, as noted above, the circumstances of different Routes do vary including with regard to geography, the types and age of infrastructure in place, the types and density of train services operated and the scale and scope of projects to be delivered. Given this variety, ORR should therefore not necessarily expect to see equal unit costs for all Routes although this should not be seen as a reason to not use comparison of unit costs as a valid assessment approach. Again, comparing results delivered against the original plan may be more informative. Network Rail should therefore ensure that the actual unit cost data that it generates should enable continuous validation of the unit cost projections inherent in the Strategic Business Plans.

As has been highlighted in previous consultation responses to ORR, a focus on unit costs should not disincentivise Routes from undertaking work to improve the capability of the network when and if it is cost effective to do so. In particular, renewals projects often present once in a generation opportunities to make such interventions. In addition, it is often necessary to improve the capability of individual assets if the capability of the network as a whole is to be maintained at current levels. This need is often driven by increases in the number, speed or length of trains being operated. A higher unit cost in these circumstances would reflect efficient and effective investment driving overall cost-effectiveness. The use of the normalising factors proposed by ORR may assist here as might the inclusion of some expression of the benefits delivered by the additional expenditure. This links strongly to the ORR proposed focus on the effectiveness of Network Rail's activities aimed at delivering cost-effective railway.

On the other hand, excessive focus on unit costs might result in a Route focusing on renewals work that have lower unit costs over other schemes which deliver greater benefit or are harder to deliver. Therefore a balanced set of metrics that are holistic is critical.

Question 5

The activity and unit cost based planning methodology used by Network Rail to develop the Strategic Business Plans should enable a simpler assessment of the effects of accelerating or deferring work. However, a broader assessment of the cost impacts of changes in Network Rail's work programme on other parts of the rail industry also need to be assessed to provide a complete picture. Overall, the ORR's approach to assessing the cost effectiveness of Network Rail's activities must take account of the impact of Network Rail's activities on the whole industry.

To do this, the ORR's assessment should not only focus on the Routes but also on the NSO and a number of other Network Rail functions such as the Technical Authority. While the level of expenditure in these other parts of Network Rail will be lower than for the Routes, the downstream impact of any failure to deliver felt by Network Rail's customers might be significant reducing the cost effectiveness of the rail industry as a whole. If Network Rail were driven to focus solely on economy in the delivery its own activities, potential additional costs and revenue losses incurred by Network Rail's customers might not be properly taken into account when management decisions were made.

Question 6

Arriva feels that ORR have correctly identified the strengths and weaknesses of the different measures listed.

As observed earlier, forward looking or leading measures would be most useful. For example, the extent to which Network Rail is undertaking planning for Access to deliver maintenance, renewal and enhancement projects sufficiently early to deliver the schemes efficiently and the extent of subsequent alterations to these access plans would be a potentially useful pair of indicators.

It might be useful if the suite of measures to be used were categorised in accordance with the 3 Es model under the headings of Economy, Efficiency and Effectiveness. Arriva is not convinced that substituting "productivity" for Efficiency provides any greater simplicity or clarity. It may be of benefit to ensure that each category of measures is structured to cover all relevant parameters including human resources, system capability and process effectiveness.

A separate set of measures focusing on financial performance by comparing actual cost and income levels to those set out in the original SBPs should also be included.

These combined should allow an overall assessment of cost effectiveness to be made. To the extent possible, this overall assessment should take account of costs and income impacts across the whole rail industry strongly linked to the delivery of the rail industry's objectives.

Question 7

A biannual and annual cycle of assessment would provide the correct balance between being able to monitor trends over the cycle of the Control Period without individual data points being distorted by short-term "noise".

This cycle of assessment will also provide Network Rail teams with time to recognise issues themselves and instigate corrective action.

Question 8

It would assist if ORR's assessments were presented in a manner that aligned them to the outputs and initiatives included in the Strategic Business Plans. It would also be of benefit of the assessment reflected the corrective actions reported by Network Rail against areas where divergence from plan was evident. A clear forward projection of likely outputs compared to the Control Period trajectory would also be of benefit.

Yours sincerely,

Richard McClean
Managing Director
Grand Central

Consultation on ORR's approach for assessing Network Rail's

efficiency and wider financial performance in CP6

February 2018

1. The Associated Society of Locomotive Engineers and Firemen (ASLEF) is the UK's largest train driver's union representing approximately 20,000 members in train operating companies and freight companies as well as London Underground and light rail systems.

2. ASLEF welcomes this opportunity to comment on how the ORR could improve its approach and to share our views on the proposed changes to financial performance measures for control period 6 (1 April 2019 to 31 March 2024). The ORR plays an important role in assessing the activities Network Rail needs to undertake to efficiently operate, maintain and renew the national rail infrastructure, and what the cost of these activities should be. It is a complex task to determine Network Rail's efficiency and judge whether it delivers its obligations, but ASLEF agrees that the current methods for assessing its efficiency improvements and wider financial performance suffer from a number of limitations and the current indicators don't always tell the whole story about the company's performance.

3. Due to problems with cost, delivery and budget overruns of £3.4 billion, projects that lapsed in CP5 have been deferred into CP6, with a knock-on effect on other projects. Obviously as a union we are concerned that all work required to maintain a safe and reliable network should be completed on time and to the highest possible standard, so it is important that Network Rail and the regulator pick up on any problems as soon as they arise. Improvements to ORR reviews of Network Rail's performance will hopefully assist in addressing this problem and will help to identify possible improvements in value for money which allow for more benefits at a

lower cost. This is particularly important given the current economic pressures on budgets for public spending.

4. ASLEF agrees that there is no perfect measure for reporting on financial performance and efficiency and supports the proposal to move away from only using technically precise measures. Some activities are easy to compare over time but other indicators of financial performance and efficiency can make comparisons from one year to another and between routes very complex. Statistics can easily be misleading when taken out of context: It is possible to reduce delays and improve productivity by ensuring that all materials are ready and available when they are needed but on the other hand, reductions in spending due to delays in work are an indication of a loss of productivity and efficiency. When focusing on numbers it is easy to interpret financial savings as an achievement and lose sight of whether planned outcomes have actually been achieved. Conversely, a rise in expenditure can be perceived as negative but if it has helped to achieve more, even in the long term, the expense will have been worthwhile. Every single measure for assessing and reporting has limitations, whether it be overly simplistic or difficult to understand, and no measure can by itself capture enough comparable data but a combination of different measures could provide a clearer, fuller picture of the link between expenditure and delivery and the extent to which efficiencies are being achieved.

5. The ORR is proposing to continue to use the financial performance measure on route scorecards and has suggested that the point-to-point efficiency measure should form part of future reporting. The financial performance measure does not fully capture the benefits of Network Rail’s work beyond a like-for-like renewal (e.g. improvement in line speed) or activities that do not have immediate outcomes and benefits (e.g. staff training) so as a single measure it is inadequate but we agree that in conjunction with other measures, the comparative data it can provide is valuable (e.g. overspending against budgets that could put projects at risk). Similarly, the point-to-point efficiency measure is useful for making direct comparisons on a like-for-like basis over time (e.g. expenditure on maintenance and renewals) but unable to reflect changes to expenditure and outputs that don't result from an efficiency improvement (e.g. changes to inflation, variations in the cost of materials, differences in the amount of work undertaken). This means that savings made as a result of failure to complete work could be

interpreted positively even though it would have a detrimental effect on customers. It is ASLEF’s view that the only way to address the limitations of these measures is to recognise them, and provide explanations and supplementary data using other measures.

6. The pressures and constraints of congestion, geography, age of infrastructure and other factors make comparisons of performance between operating routes problematic. It is not a case of comparing like-for-like because circumstances and challenges vary nationwide and are constantly changing. Nevertheless, it is important to identify the strengths, weaknesses, achievements and challenges on each route, and sharing ideas and possible solutions could be a valuable way of providing support to route boards. Initiatives that proved a success on one route aren't necessarily always transferable, but in the current context of devolution, it is important that route managers have as much information and guidance as possible. The HLOS for 2019 – 2024 sets out that under the new system, by the start of CP6 each of the nine routes will have its own strategic plan, separate regulatory settlements, and the managing directors will be handed the authority to approve 99% of all work. ASLEF is apprehensive about the experimental nature of this approach to setting standards and developing route-level performance targets. As a union we are fundamentally opposed to the privatisation of rail infrastructure and we have concerns about the government’s proposals for devolution and private investment, but we would like as much information, guidance and support as possible to be made available to those involved in the devolution process to ensure that standards are maintained.

7. Network Rail have objected to unit cost analysis because as a measure it fails to take account of external factors that increase costs and are beyond the company’s control. The geography and the nature of Network Rail’s work from one site to another vary so much that unit cost reporting can’t fairly reflect efficiency and performance. While ASLEF agree with the ORR that it should be possible to identify the extent to which changes are due to efficiency, we also believe that any objections from Network Rail should be taken on board and any alternatives they put forward should be carefully considered. Another drawback with unit cost analysis raised by Network Rail is that it can apply pressure to reduce unit costs and thereby incentivise projects that are low-cost but do not work out as good value for money in the longer-term. This

illustrates the importance of using different measures together to build a full understanding before making judgements about cost-efficiencies.

8. Little use has been made of productivity measures in reports to date, but the ORR has suggested looking more closely at the proportion of planned network possessions that are used, and whether the time allocated for track possession is proportionate to the time required to actually carry out work and clear up afterwards. Measuring how productively this time is used would highlight under-utilisation or other issues, which could then be explored with Network Rail’s supply chain. Given the pressures on congestion on our railways, ASLEF considers that adding productivity measures to the ORR’s assessment would be worthwhile.

9. We agree that looking at value for money is important. Sometimes trying to put a price tag on risks and outcomes is so subjective as to be impossible, but where it is possible, the information can be used to identify which steps to take to address wastage and help Network Rail to become more efficient.

10. Aside from carrying out efficiency and finance assessments, looking at Network Rail's activities that generate income and expenditure, the ORR also monitors Network Rail’s performance in respect of safety risk, train performance and asset management. ASLEF agrees that some of information gathered as part of its safety role would be relevant and could be used to build a fuller understanding of Network Rail's overall performance.

11. The union also agrees that forward-looking assessments of likely efficiencies would be useful. One of the main uses of ongoing monitoring and evaluation should be to inform future planning and, where possible, to identify ways of making efficiencies going forward. Any opportunities should be taken advantage of in order to make money go further – particularly since the railways are faced with limited budgets and uncertain funding. This said, these assessments should only be advisory, acknowledging it is impossible to plan accurately for every eventuality and some changes and outcomes (e.g. changes in the cost of electricity or the price of steel) can’t be foreseen or planned for.

12. ORR reporting has previously provided little opinion about whether Network Rail is on track to deliver improvements and clearly the company has been over-optimistic, so it is right that going forward, plans and forecasts should be more closely scrutinised – particularly now that much of this work is being devolved to route level. As a union we also believe that transparency is important when it comes to accounting for public money. Network Rail have expressed concerns about the burden that additional reporting requirements will impose on them and ASLEF is mindful that some of the proposed changes could have onerous reporting implications for Network Rail. We would not want to see resources diverted from Network Rail's work to collect pointless and unnecessary information, but if the right checks are not in place to ensure that everything is in place for planned work to go ahead and to clearly track progress, then it should be. If there is a danger of National Rail having to divert time and resources away from its real business and into monitoring and reporting, this would be counterproductive. Therefore, ASLEF's view is that additional funding would need to be allocated for staffing and resource costs required to fulfil additional reporting obligations.

13. As mentioned above, a number of the projects that failed to be delivered in CP5 have been deferred into CP6. The long-term cost of deferring projects has financial implications and failing to meet deadlines puts an already creaking system under strain with implications for passengers, because poor infrastructure affects service quality and reliability. The cost of these delays is difficult to price and difficult to reflect in comparisons of productivity over time. The easy solution to this problem would be to stop deferring work but clearly it is very difficult to forecast what can realistically be achieved over a five-year period when so many financial, environmental and political factors beyond the company's control can come into play. This is why comprehensive ongoing monitoring and evaluation is crucial, to assess performance, pick up on early warning signs of potential problems, and use to inform decision-making about whether to review assumptions and plans that are no longer realistic.

14. Network Rail operates under a network licence that requires it to manage the rail network in a timely, efficient and economical manner. The company's spending plans for CP6 were declared to be 'clear, consistent and well-developed' by the risk and assurance experts contracted by the ORR to look at their maintenance plans, target setting and plans for

renewals. This is reassuring, but the ORR's role in monitoring their performance and reporting whether income and expenditure are in line with the financial assumptions planned for this Control Period is imperative given the delays and budget overruns in CP5.

15. Efficiency and financial performance are not the same and to give a fully comprehensive assessment of Network Rail's efficiency, the ORR needs to be able to report beyond short-term cost reductions. In order to fully capture efficiency and reflect whether resources are used productively and whether they could be used more effectively to achieve outcomes without forfeiting on quality, it is necessary to use a range of different measures. While ASLEF agrees with the use of most of the proposals above, we urge caution with any comparisons being made between routes, each of which have very different conditions and constraints, that could result in unrealistic expectations and pressures. The union is also concerned that time and resources should not be diverted away from Network Rail's core work, so if any additional reporting requirements are placed on National Rail, then additional funding should be allocated to facilitate this.

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13 March 2018

Dear Sir/Madam,

Thank you for giving DfT the opportunity to comment on ORR's proposed approach for assessing Network Rail's (NR) efficiency and wider financial performance in Control Period 6 (CP6).

DfT welcomes the ORR's consultation – particularly the clear agenda for change and improvement to monitoring efficiency - which it sets out. The Government is providing up to £34.7bn of funding to NR in the five years from 2019 to 2024 to fund around £47.9bn investment in improving the railway network in England and Wales, including a huge increase in renewals to improve reliability and reduce service disruption, helping to deliver the railway that passengers want. The Government wants to see this investment generate a dynamic, efficient and confident rail sector that is able to drive through transformational change, research and development, and rigorous cost control to deliver both a better performing and more joined-up railway for its customers. Government also welcomes the clear emphasis on maximising the benefits of devolution – with comparisons of the performance of NR's routes and more effective benchmarking to drive change. Effective regulatory assessments of NR's financial performance and efficiency tell us how well the company is conducting its business to achieve these objectives and whether it is achieving the intended outcomes from the substantial taxpayer investment it receives. It should also, by presenting the information in a manner that is accessible to stakeholders, facilitate better engagement and challenge, helping to support a more joined-up and effective approach between track and train.

Our responses to ORR's specific questions are set out below.

Do you agree with our priorities? In particular, move away from technically precise measures to a more rounded assessment and making our assessments more forward-looking?

We would expect the ORR to continue to use technically precise measures internally to be able to make an overarching assessment of the work of NR and its routes. Having said this, DfT agrees with ORR's proposal to move towards a more rounded externally facing assessment using the toolkit suggested. Within this work, it will be important that ORR is able to scrutinise the detail underlying this assessment to understand and explain the contributory factors, and call upon this detail when required to hold NR's routes to account effectively.

It will be important, however, to ensure that the rounded assessment does not have the effect of masking elements of poor performance (e.g. because it allows the business to focus on the areas where it is performing well and inflate their significance) or supporting special pleading by routes that their differences to others mean certain metrics are not directly comparable. ORR will therefore need to consider how it would distinguish between justifiable and unjustifiable differences in performance when benchmarking routes against each other.

DfT agrees strongly that it would be beneficial to have more forward-looking assessments to facilitate identification of risks and issues and enable early proactive action by the ORR to assess concerns. It is also important that NR has effective programme governance and reporting in place for NR transformation so that the board can track progress.

We propose to improve our assessment and reporting of Network Rail's efficiency improvements, drawing on unit costs, cost drivers, productivity measures, leading indicators and safety reports. What are your views about this change of approach?

DfT agrees with ORR that despite the inevitability of site-specific variations in maintenance and renewals unit costs for like work, NR's routes should be able to explain these – and, indeed, will have to explain performance more generally given that comparable measures across routes will become a feature in CP6. We therefore agree that a better understanding of unit cost changes and cost drivers is vitally important and that NR should increase the robustness of its unit cost reporting.

Additionally, it is important that the CP6 regime sets up the right incentives on NR's routes to improve efficiency. In that regard, in respect of the efficiency measures discussed in the consultation document, we support ORR's proposal to use a point-to-point efficiency measure in CP6, noting, in particular, that the cumulative efficiency measure appears not to give credit to early and transformational changes that result in lower costs across the period.

We support an approach which takes into account Network Rail's commitments to meet the seven core challenges set out in the Transport Infrastructure Efficiency Strategy (TIES)[1]. NR has been a key collaborator in developing this strategy, which covers some of the actions which will be necessary in driving efficiency in CP6.

DfT agrees that productivity measures and outcome metrics are particularly important. It is also important that they are developed with a view to the wider, strategic discussions they will inform. External parties such as DfT, the TIES Taskforce, and wider industrial groups can all provide valuable insights in this regard. In terms of the availability of information, DfT expects NR to be tracking productivity measures closely in CP6 given that a lot of its planned efficiency measures relate to improving the use of engineering possessions.

[1] https://www.gov.uk/government/publications/transport-infrastructure-efficiency-strategy
The seven core challenges are: 1. Judge strategic choice and trade-offs; 2. Improve the way we set up projects; 3. Create a transport infrastructure performance benchmarking forum; 4. Establish a common approach; 5. Promote long-term, collaborative partnerships; 6. Challenge standards; 7. Exploit digital technologies and standardise our assets.

Our proposed approach will require Network Rail to provide better information to us. We consider that this is information that the company should already have. However, we want to ensure that any additional reporting is proportionate. Do you have any comments on this?

DfT agrees that it is important that NR's routes provide ORR and DfT with better and more accessible information, particularly where that information is already available. We also believe all parties must be clear what information they require, and why, in order to aid NR to provide clear, specific, actionable information. We are, however, mindful of the fact that NR is required to report to both ORR and DfT and we therefore support a proportionate approach. In that regard we would look for DfT and ORR, so far as practicable and appropriate, to share with each other information provided by NR and its routes, so as to reduce unnecessary burden on the company and to allow all parties to refer to one source of the truth.

Do you agree that having a better understanding of unit cost changes and cost drivers should be an important part of our analysis? Should Network Rail improve the robustness of its unit cost reporting if necessary to support this?

DfT agrees strongly that a better understanding of unit costs will be useful for benchmarking route performance. We believe there would be value in ORR/NR reporting information about changes in unit costs, including what has led to those changes. We believe that it would be beneficial for ORR to be able to make judgements about where such changes are controllable or not controllable by NR and to factor those judgements into its assessment of NR's route performance.

Changes in expenditure due to a deferral or acceleration of work can have a material effect on our assessments. This is technically challenging and requires judgement. We are interested in respondents' views on this.

DfT considers that a robust approach to reflecting renewals is critical, given the importance of this issue in any rounded efficiency assessment. DfT's view is that the regulator is best placed to make judgements about the relative efficiency of deferral or acceleration of maintenance and renewals work by NR, and that it is important that such judgements are reflected in ORR's performance assessments. The quality of information provided by NR to inform such judgements will be an important factor in this regard.

In light of the government's new approach to procuring enhancements from NR in CP6, DfT does not consider it appropriate or necessary for the ORR to make similar judgements about changes in expenditure in relation to enhancement projects.

Section 4 sets out some productivity measures and leading indicators that we could assess. How effective do you think these measures could be to aid our assessments? What other measures should we use?

DfT believes that the ORR should have regard to all potential measures for assessing NR's routes. We believe that it is also crucial that any measurement regime is flexible, and allows for additional or changed metrics where they are useful, and where the change is appropriately agreed.

Do we have the right level and frequency of reporting through our biannual Network Rail Monitor and annual efficiency and finance assessment publications?

DfT's view is that ORR should consider carefully what the intended audience is for each of these publications and tailor the level and frequency of reporting accordingly.

DfT would suggest that whilst there is a place for a set-piece Network Rail Monitor on a set schedule, up to date information should be available on a much more regular basis – for example through an online portal. This increase in availability of information will allow parties to make decisions based on the most up to date information possible. The Monitor could then be used as a 'stocktake' publication that allows the ORR to review overall progress and future challenges in the round.

How can we improve the presentation of our assessments to improve their effectiveness for stakeholder engagement and challenge?

Given the very strong emphasis which both the ORR and DfT has given to effective stakeholder engagement with its customers by NR, both to support a more efficient and joined-up railway, we consider that this information should be presented in a manner which is clear and widely accessible to stakeholders, facilitating effective engagement and challenge. We consider that this should be a core ORR priority.

DfT supports a move towards a simpler approach to reporting in CP6. Regulatory reporting on efficiency and financial performance is currently complex and sometimes impenetrable. As NR's primary funder, DfT would welcome a clearer line of sight between regulatory information and government information on NR's financial performance. DfT would also welcome better access to historical data that is presented in a simple, permanent format – e.g. through an ORR or NR data portal – to facilitate analysis of performance changes over time.

Conclusion

We very much welcome the ORR's approach to this consultation, particularly the clear changes it is making to increase NR's accountability and support stronger and more effective scrutiny of NR's efficiency and financial performance. To maximise its impact, it is important that the ORR ensures that its approach is forward looking, challenging and accessible to stakeholders, as well as being fully consistent with the Government's position. We continue to look forward to working closely with the ORR to facilitate this.

Yours faithfully,

Conrad Bailey

Network Rail's response to ORR's 2018 periodic review of Network Rail:
Consultation on our approach for assessing Network Rail's efficiency and wider financial performance in CP6

Executive summary

Having a robust, clearly defined and insightful measure of whether the money we spend each year has been invested appropriately is paramount to assessing Network Rail's financial stewardship of the railway network.

At the heart of assessing financial performance is a trade-off between accuracy and simplicity.

Whilst there is appetite for an intuitive, easily understood measure this does not always adequately reflect the financial performance of our organisation, especially given the complexity and number of capital projects we deliver.

In CP5, we have used the Financial Performance Measure to assess performance, using rules designed in concert with ORR. There are a number of benefits of the current approach including:

- The Network Rail organisation understands the measure and reacts to it to adjust performance
- FPM provides a single figure for Network Rail's financial performance
- Principles of calculation are documented and are already agreed with ORR
- Process is embedded throughout Network Rail, including assessment of performance on c.6,000 renewals projects each year led by Route Asset Managers
- It allows comparison of individual project costs to the Business Plan rather than evaluating performance against hypothetical portfolio unit rates. Using unit rate analysis can be too simplistic as it assumes that projects are uniform in nature
- It provides "line of sight" with contributions from each route and function being aggregated to determine the total Network Rail result
- There is engagement from route management teams in the current measure. Accountability rests with route/ function management teams

- The data used for the FPM calculations is used to derive our efficiency result meaning that there is a consistent data set used for these calculations. This also facilitates year-on-year comparisons of performance to be carried out

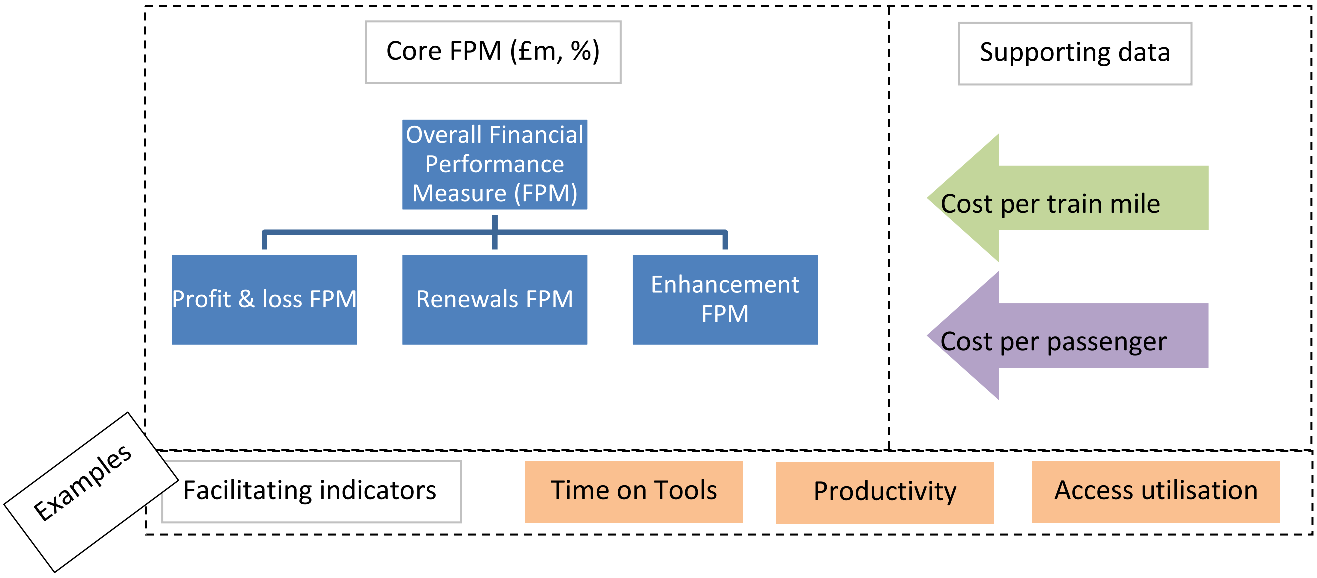
However, we do recognise that there are improvements that can be made. CP6 provides an opportunity to agree and introduce these improvements, which could include:

- FPM is currently reported in £m. The result could also be expressed in percentage terms to provide context of how much performance varies against targets.

- Disaggregation of headline number into key subsidiary areas: profit & loss (i.e. income and opex), renewals and enhancements. This would allow greater insight into the contributory factors of the result whilst still maintaining the benefit of a single overall score.

- Results could be normalised for impact of extra passenger journeys to help describe what is happening to costs.

- The proposed model for CP6 is set out below. This would be used for each of Network Rail's routes (including System Operator and FNPO) to derive the total for the organisation.



- Greater analysis of causality – including using a fishbone approach to understand actual changes in delivery cost s.

- Better identification of headwinds to illustrate exogenous factors Network Rail faces.

- Sharper focus on efficiency plans - Business plans need to clearly articulate targeted performance improvement and efficiency plans, using fishbone diagrams.

- Routes developing local supporting measures and targets to track and demonstrate the impact of efficiency plans.

- “Efficiency” should be renamed something more representative such as “Cost Movement Index”.

Reporting in CP6 should build on the current measurement framework. Significant progress has been made over CP5 and a number of enhancements have been identified to deliver further improvement.

Responses to ORR's consultation questions

Question 1

Do you agree with our priorities set out above? In particular, move away from technically precise measures to a more rounded assessment and making our assessments more forward-looking?

The two parts of this question are considered separately below. More broadly, we strongly support the continued use of the Financial Performance Measure as the main measure of financial performance. The assessment in the consultation of the merits of different measures (in Table 2.9 of the consultation document) reinforces strengths of FPM, although we think it underplays its understandability. We are concerned that ORR's assessment of alternative measures (particularly unit costs) overplays the merits of some measures in explaining overall financial performance.

We strongly support ORR's proposal that Network Rail's budget should be the baseline for reporting financial performance, recognising that there needs to be a clear reconciliation between the budget and ORR's PR18 financial assumptions.

Technically precise vs rounded measure

There is still likely to be a requirement for some technically precise measure of performance. In the wider world, financial reporting has a number of different standards and conventions to allow complex transactions and valuations to be reported consistently between companies and between years (measures such as profit, cashflows, balance sheets etc). Application of a set of defined accounting rules allows materially precise information to be reported despite the underlying complexity – the same approach should be possible for reporting regulatory financial performance. Even for a technically precise, complex KPI it should be intuitive for stakeholders to understand what is being measured.

There is a risk that multiple measures can tell conflicting stories, thus confusing stakeholders or allowing cherry-picking of certain measures to support preconceived notions rather than an objective description of the facts.

Using a range of measures adds complexity for the stakeholder to understand the mechanics and driving factors behind each of the various performance indicators.

In order to set scorecard targets and measure performance against these targets there is a need for a relatively precise number.

Given that there will probably still be an appetite for a precise measure it would probably be sensible to agree the rules with ORR and document these upfront before the start of CP6. This would allow a clear framework to assess performance. Supporting this precise measure with additional narrative and analysis can help explain the result and enable better understanding for stakeholders.

Forward-looking

Providing analysis of forward looking forecasts rather than a simple backwards view is probably more useful for stakeholders to understand financial pressures and provide context for current results. The regulation of financial performance and efficiency should be consistent with ORR's approach for evaluating other regulatory outputs.

We note that evaluating the accuracy of future expenditure and efficiency plans are inherently difficult. Exogenous factors can mean that targets are not achieved or exceeded rather than the quality of the plan itself. There may also be other unforeseen problems delivering the plan.

Assuring a business plan is intuitively risky, which is why auditors will usually only provide an opinion on historic data and limit their review of the future to going concern considerations. An assessment could be performed of the suitability of the process for deriving forward-looking Business Plans, rather than the numbers themselves.

We agree that the use of leading indicators will be helpful to inform a forward-looking assessment. We will work with ORR to develop suitable measures, and we comment later in this response on ORR's specific suggestions.

Question 2

We propose to improve our assessment and reporting of Network Rail's efficiency improvements, drawing on unit costs, cost drivers, productivity measures, leading indicators and safety reports. What are your views about this change of approach?

We think that the proposed efficiency measures reflect changes in costs over a period of time. This is not really what most people interpret as efficiency. Delivery of efficiency strategies is only one of many factors which influence how costs move over time. Therefore, we think that the name requires updating to prevent misleading stakeholders. A more representative name might be something like "Cost Movement Index".

There is a risk that reporting on a number of different measures could result in selectively focusing on those measures which support a particular pre-conceived view. Having a single agreed key measure would enable greater objectivity.

Efficiency

In para 5.6 ORR note its preference for continuing with measuring efficiency on a "point-to-point" basis to allow analysis of cost trends over a period of time. We support this approach as it represents consistency with current convention, building on principles understood by stakeholders.

We also acknowledge that efficiency measures need to be viewed in conjunction with a range of other metrics to understand total financial performance, as efficiency is largely focused on the costs of operating, maintaining and renewing the network, rather than considering turnover (including Schedule 4 & 8) and enhancements.

We note ORR's proposal that Network Rail should "quantify and explain the factors that have affected its efficiency" (para 5.8). Whilst this is in line with our intended approach of using fishbone analysis, ORR should be mindful that quantification of efficiencies can sometimes require subjective assessment and can be difficult to evidence.

Unit costs

Unit costs can provide some background for cost movements between years. However, as a measure of performance we consider that it would be over simplistic and potentially quite misleading. Unit costs are useful in situations of product homogeneity to allow comparisons between locations and years. However, railway renewals projects are usually not homogenous. Unit costs will vary due to a number of factors unrelated to the quality of the planning and delivery cycle, such as the location of the worksite, the number of volumes completed or the weather conditions. This is particularly true of maintenance works, the nature of which does not lend itself to meaningful unit cost analysis. Unit cost assessment also has some other limitations such as:

- Incentivising delivery of extra renewal units as part of a job as this will help reduce average costs
- Incentivising selecting renewals with favourable unit rates (easier jobs or more favourable access)
- Incentivising renewal versus maintenance decisions which may not be the optimal whole life cost solution for assets
- Penalising scope choices even if improving safety, performance or lifetime costs
- Limiting coverage – not all renewals investment has an associated unit cost (c. 60% coverage)

In addition, understanding unit cost movements may not be as straight forward as it first appears. We deliver hundreds of different volumes which would require a composite measure to be developed. Changes in volume mix could have a significant impact on the measure, thus undermining its intuitiveness.

Therefore, whilst unit cost data can provide some broad insights it should be used with caution when attempting to understand efficiency or comparing performance between routes or years.

Cost drivers

An understanding of what influences costs, with focus on both internal and external factors, is crucial to understanding our business. To reflect this, we are currently embedding a fishbone analysis technique across the business with the intention of using this approach as a key part of our reporting in CP6.

As part of the efficiency assessment, ORR could consider progress against efficiency registers. In its consultation, ORR notes that they use this approach to monitor Highways England so this would provide a consistent monitoring approach throughout ORR. This method could allow a detailed, route-based, bottom-up evaluation of different efficiency plans to allow the regulator to understand the various cost-saving initiatives being undertaken throughout the business.

There would also be a benefit in considering the impact that market prices (such as the Tender Price Index) has upon Network Rail's cost base.

We understand that ORR is considering moving from using RPI to CPI for CP6. Evidence shows that our input costs increase in excess of RPI each year. We are concerned that ORR's move to using CPI to index our charges and the costs in our CP6 plan will have a negative presentational impact on our forecast efficiencies in our CP6 plan.

In our SBP, we forecast 10% gross efficiencies, in real terms, which assumes that our cost base / funding is uplifted by RPI. If ORR moves to using CPI in CP6, the CP6 efficiency in our plan could appear to be around 5% lower over CP6 (assuming CPI is around 1% lower than RPI each year). How this is handled is critical. We think that ORR would need a much stronger focus on gross efficiency in how CP6 reporting is carried out.

During CP6, we think that we should continue to report against RPI as well as CPI for the first few years of CP6 to better explain our outturn costs on a comparable basis with previous control periods. We note that other regulators have recognised the need for forms of transitional arrangements in moving to CPI.

Question 3

Our proposed approach will require Network Rail to provide better information to us. We consider that this is information that the company should already have. However, we want to ensure that any additional reporting is proportionate. Do you have any comments on this?

We consider that the focus should be on the information that Network Rail's local and central management use to allow a better understanding by ORR of how the business is governed. This approach to monitoring Network Rail using route-based scorecards would appear consistent with ORR's "Conclusion on our initial consultation on the 2018 periodic review" and specifically monitoring Network Rail using route-based scorecards.

Utilising existing information would be preferable to creating additional data and reports which will not be used by the business to make decisions or analyse performance. We would like to work with the regulator to aid its understanding of the information and measures that the business currently utilises, including identification of the strengths and weaknesses of these different metrics.

We would be interested in understanding how ORR monitors financial performance of Highways England in greater detail and how this could apply to Network Rail. There are a number of similarities between Highways England and Network Rail including:

- both involved in maintaining, renewing and operating transport infrastructure
- both regulated by ORR
- both arm's length bodies of DfT

Therefore, there is likely to be an opportunity to apply a consistent approach.

<u>Question 4</u>

Do you agree that having a better understanding of unit cost changes and cost drivers should be an important part of our analysis? Should Network Rail improve the robustness of its unit cost reporting if necessary to support this?

Unit costs are considered in more detail in our response to Question 2 (refer to above). There are a number of different factors which drive changes in costs, not least changes in the actual work delivered (both in terms of the size of the job and the specification of the outputs).

Our analysis has shown that there are large variations in the unit costs of seemingly similar renewals activity. Movements in costs between years are so large that the standard deviations are not statistically significant. This undermines the usefulness of this approach.

We consider that there would be benefit in ORR aligning their requirements to the data and KPIs that management (both central and route teams) use to evaluate performance and control the business.

Developing unit cost models (particularly around maintenance activity) will be time consuming, expensive and probably not lead to a better understanding of the business as it is likely that the data would only be produced for the benefit of regulatory reporting. In addition, and as stated earlier, we consider this data is also likely to be of limited value in terms of its comparability between different parts of the network.

Our reporting of costs and volumes is robust. Information of renewals unit costs have been reported at a detailed level in the 2016/17 Regulatory Financial Statements (available on Network Rail's website). Despite this, we are still seeking to make improvements. We are currently undertaking a project to increase automation of volume reporting, using fewer systems to achieve greater accuracy.

Question 5

Changes in expenditure due to a deferral or acceleration of work can have a material effect on our assessments. This is technically challenging and requires judgement. We are interested in respondents' views on this.

In measuring financial performance there is a trade-off between complexity and accuracy.

A key part of any financial analysis needs to consider what outputs have been delivered for the investment undertaken. Purely focusing on the inputs (i.e. the level of expenditure) is unlikely to provide much insight, although it may be more straight-forward to administer. This more basic approach could also create perverse incentives, such as reducing short-term renewals investment to generate outperformance.

Workbanks in the railway require an element of flexibility to optimise delivery, reduce passenger disruption and generate efficiencies. This necessitates re-profiling activity between years, and between control periods.

An understanding of asset management is fundamental to assessing financial performance, making sure that the right work is done to maximise the benefits of investment in the railway.

We understand the point ORR raises about judgements because the railway network is a complex heterogeneous asset. Network Rail employs competent asset management professionals in each of its operating routes who make the decisions of where to invest. They work within a centrally-managed framework, allowing commonality of safety standards and sharing of best practice. Assurance could be provided to ORR through the use of third party experts in asset management or through ORR developing its competencies in this area to allow more informed judgements to be made.

Question 6

Section 4 sets out some productivity measures and leading indicators that we could assess. How effective do you think these measures could be to aid our assessments? What other measures should we use?

In its consultation ORR notes: "*We want to work with NR to agree most suitable measures".* We support the objective of working collaboratively with the regulator on this. As part of the move to route-based regulation there will potentially be different leading indicators that are relevant for different routes, reflecting the different risks and characteristics of each of the routes.

In addition, we consider that it would be sensible for leading indicator measures to be flexible throughout the control period, changing as different risks or priorities emerge.

We feel that using the measures that each route use to understand their costs and manage their business is more useful and insightful than selecting a number of centrally-mandated metrics.

There is a risk that focusing on productivity measures or leading indicators can miss the bigger picture and has some other drawbacks such as:

- Quantifying financial savings from business improvements is highly subjective, making the figure difficult to assure and audit
- Not providing the full picture of performance across all financial areas
- As this is hypothetical it does not necessarily tally with the direction of costs

The below considers the measures suggested by the ORR (shown in italics) in more detail.

<u>Leading indicators</u>

No. of network possessions secured 6 months ahead of works

Proportion of works that have been tendered

There are certainly efficiency benefits that can be generated through workbank stability but there also needs to be flexibility to allow the most appropriate asset management in the face of changing circumstances. Externalities, such as weather, or asset management risks, such as defects identified as part of our inspection regime, may necessitate interventions to occur at short notice. We will need to be mindful of these factors when considering performance in this area, rather than focusing on just a single KPI.

Changes to project remits previously agreed with contractors is another risk to workbank stability. Including measures around workbank variations, and the timing of when during the project lifecycle these variations have been agreed might be useful.

<u>Other measures</u>

There are a number of supportive measures identified by the regulator in the consultation. Whilst these are not directly indicative of performance, they could provide additional insight. The items included in the consultation are considered below.

Time on tools

This can provide some understanding but it is important to consider why certain individual jobs would have a lower or higher result than the hypothetical average which is not often related to the efficiency of the job. These include:

- Travel time – both workforce and material/ plant

- Train related delays – late possession due to late running train. This can be a factor to traffic density
- Weather and environment delays
- Safety setup

The myriad factors which can influence time on tools can make it difficult to appreciate the relative performance of routes or identify trends over a period of time.

Workload stability

Possible measures that we could use include variances between planned and actual work delivered and the proportion of projects settled with post contract variations greater than five percent of the anticipated final cost

This seems largely sensible. However, it is worth noting that in certain circumstances, there could be justifiable variances between planned and actual work delivered. This could include optimally using subcontractor or possession availability to deliver extra work for the benefit of safety or performance capability. Being penalised for undertaking additional scope which has rational merit may incentivise the wrong behaviour.

Network access:

Network Rail needs to restrict network availability to undertake many of its renewals activities. As the rail network has become busier, ensuring that planned network possessions are effectively used has become increasingly important. Possible measures that we could use include the proportion of planned possessions that are not used and the proportion that are subject to late changes, which may help assess delivery performance. Again, there may be justifiable non-compliance, such as when adverse weather has meant that engineering possessions cannot deliver the planned renewals activities. Any assessment of performance should seek to understand the reasons for the KPI result.

Question 7

Do we have the right level and frequency of reporting through our biannual Network Rail Monitor and annual efficiency and finance assessment publications?

The reporting of financial performance should be consistent with the frequency of reporting on the other areas that the regulator is monitoring. The current biannual Monitor publication therefore seems appropriate.

The timing of the year end monitor publication should be consistent with publication dates for other documents such as the Annual Report and Accounts and the Regulatory Financial

Statements. This would minimise the risk of different numbers being included in different reports which can happen as numbers are finalised as part of the year end process. Producing numbers with minor differences would risk detracting from the overall picture of efficiency and performance.

The annual efficiency and finance assessment is a useful opportunity for ORR to present its view on Network Rail's performance but there is a significant overlap between this document, the year end Monitor and the Regulatory Financial Statements. These different documents can potentially confuse stakeholders as the commentary within them may be contrasting. In addition, there is some repetition of data between the documents. Whilst we note the improvements made by ORR in reducing the size of the annual efficiency and finance assessment document we still consider that there is opportunity for further streamlining as we move into CP6.

Question 8

How can we improve the presentation of our assessments to improve their effectiveness for stakeholder engagement and challenge?

The current reports contain too much information, often repeating or reworking data tables from other publications (such as the Regulatory Financial Statements). The repetition of data and slightly different presentation of information in the various documents is confusing for stakeholders. Referencing other documents might make the documents more streamlined and accessible.

There may also be potential for more graphics, particularly in executive summaries, which could help deliver the salient points, such as using RAG (Red Amber Green) techniques. However, we would like to work with ORR to develop what measures, graphics and colours are included.

Rail Delivery Group

Response to

ORR's consultation on assessing Network Rail's efficiency and wider financial performance in CP6

Date: 14 March 2018

Rail Delivery Group response to

ORR's consultation on assessing Network Rail's efficiency and wider financial performance in CP6

Organisation: Rail Delivery Group

Address: 200 Aldersgate Street, London EC1A 4HD

Business representative organisation

Introduction: The Rail Delivery Group (RDG) was established in May 2011. It brings together Network Rail and passenger and freight train operating companies to lead and enable improvements in the railway. The purpose of the RDG is to enable Network Rail and passenger and freight train operating companies to succeed by delivering better services for their customers. Ultimately this benefits taxpayers and the economy. We aim to meet the needs of:

- Our Members, by enabling them to deliver better outcomes for customers and the country;
- Government and regulators, by developing strategy, informing policy and confronting difficult decisions on choices, and
- Rail and non-rail users, by improving customer experience and building public trust

For enquiries regarding this consultation response, please contact:

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Introduction

1. The RDG welcomes the opportunity to respond to ORR's consultation on assessing Network Rail's efficiency and wider financial performance in CP6. We confirm that we are content for this response to be published on the ORR website.

2. A key proposal in the ORR consultation is to improve the understanding of efficiency of Network Rail's Routes. We fully support this.

Discussion on the Proposals

3. We agree it is important to assess efficiency separately for each of Network Rail's Routes and to report this. Network Rail believes the best way to do this is to retain the financial performance measure (FPM) in Route scorecards, but some operators consider the FPM is too complex and hence less value to them. However, the industry agrees that the assessment should be supported by other analysis and information to provide a more rounded and forward-looking view rather than relying on a single approach. We also support the ORR proposal (paragraph 5.11) that Network Rail's internal budget would be a better baseline for assessing FPM rather than the ORR determination assumption.

4. Network Rail is considering improving its reporting in CP6 including the following proposals that we support:

   - greater analysis of causality to provide greater understanding of changes in cost;
   - better identification of exogenous factors the company faces;
   - more focus on efficiency plans for business units;
   - more discussion between the regulator and the Routes to establish appropriate supporting measures, based on the risks and issues that matter most in those areas.

5. We believe that as far as possible a whole industry approach should be considered when developing efficiency. Network Rail's transformation and devolution to the Routes enables local efficiency plans to be developed with operators in a more coordinated and effective way, balancing the needs of passengers and freight users (through a strong TOC/FOC voice) with the need to operate, maintain and renew the network in as efficient a way as possible.

6. The ORR consultation proposes a move away from technically precise measures that stakeholders felt were confusing, to a more rounded and forward-looking assessment; we support this. However, the document also refers to a wide range of detailed measures that appears to increase the complexity of the assessment.

7. We consider that the more rounded ORR assessment could include monitoring delivery compared to the initiatives, efficiency plans, activities and costs assumed in Network Rail's business plans.

8. Unit cost analysis could be a useful way of identifying areas of good practice between Routes and to help track delivery compared to assumptions in Network Rail's business plans. However, the ORR should be mindful of not placing too much reliance on unit costs because they can be misleading. This is because variations in unit costs do not necessarily

reflect efficiency, but instead are influenced by other factors. To illustrate this, renewal work is not uniform, as location and the availability and timing of access are major determinants of cost.

9. Similarly, it is also important to note that renewals often present once-in-a-generation opportunities to do significant work in an area and, with a growing demand on the network, the industry considers these opportunities should be taken. Network improvements and, for example, the introduction of faster trains, may have taken place since the infrastructure to be renewed was first installed. As a result, it is sometimes necessary to replace the asset to a higher specification just to maintain current performance. Hence a higher unit cost is not necessarily inefficient.

10. Another potential issue about relying on unit costs relates to the adverse incentive effect this can have on Network Rail. For example, it can:

    - incentivise carrying out extra (potentially unnecessary) renewal work as part of a project to help to lower the unit rate;
    - incentivise selecting renewals with favourable unit rates (easier jobs or more favourable access);
    - incentivise renewal versus maintenance decisions which may not be the optimal whole life cost solution for assets.

11. The consultation document focuses on the efficiency assessment of Network Rail's operating Routes. However, we believe it is also important that there is a separate assessment of the System Operator (SO). The costs involved with the SO are relatively small and there is widespread support across the industry for increased funding for a well resourced SO function. Hence, we consider that the assessment should place greater emphasis on the outputs, such as providing a quality service, rather than an assessment that drives the lowest cost.

12. We are aware that ORR is proposing a change in indexation from using RPI to using CPI. We would not want this change to provide an additional efficiency burden on Network Rail, if for example, Network Rail's costs were more in line with RPI and income increased by a possibly lower index using CPI.

13. In the response to the autumn consultation on improving renewals efficiency, the industry stressed the importance of adequate and stable funding; i.e. efficiency targets should not be so stringent that they are not achievable as this leads to re-planning workbanks and inefficiency.

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14 March 2018

ORR CONSULTATION: APPROACH FOR ASSESSING NETWORK RAIL'S EFFICIENCY AND WIDER FINANCIAL PERFORMANCE IN CP6

1. INTRODUCTION

1.1 This submission constitutes the response from the Railway Industry Association (RIA) to the above consultation published on 31 January 2018.

2. BACKGROUND TO RIA

2.1 RIA is the trade association for UK-based suppliers to the UK and world-wide railways. It has over 200 companies in membership covering all aspects of rolling stock and infrastructure supply and covering a diverse range of products and services. As well as the vast majority of the larger, multi-national companies, 60% of RIA's membership base is comprised of SMEs.

2.2 The recently launched report from Oxford Economics shows that the UK rail sector contributes annually over £36 billion Gross Value Added (GVA) to the UK economy, employs 600,000 people and generates £11billion in tax revenues. It is also a growing industry with the numbers of rail journeys expected to double in the next 25 years along with significant growth in rail freight traffic. The full report can be accessed via the following link: https://www.riagb.org.uk/RIA/RIA_new/Press/Oxford_Economics.aspx

2.3 RIA provides its members with extensive services, including:

- Representation of the supply industry's interests to Government, Network Rail (NR),TfL, HS2, ORR and other key stakeholders
- Providing opportunities for dialogue and networking between members, including a number of Special Interest Groups
- Supply chain improvement initiatives
- Provision of technical, commercial and political information every week
- Export promotional activity, through briefings, visits overseas, hosting inwards visits
- Organising UK presence at exhibitions overseas.

Executive Summary

- **RIA support the use of a more rounded assessment centred on key messages about performance drivers and how efficiencies are being achieved, set within a narrative.**
- **RIA support the use of route level efficiency targets and performance measures.**
- **RIA recommends an enhanced performance measure around supplier engagement.**
- **Renewals volumes delivered during CP6 must be carefully monitored by ORR and rapid action taken should the planned "smoothness" not be achieved.**
- **RIA strongly support the introduction of mechanisms to update efficiency assumptions.**
- **RIA support NR being able to move money between budgets and between regions/ routes in the event of over or underspends in particular disciplines**.
- **RIA would be concerned if routes are required to operate under an annual budget regime.**

3. RESPONSES TO CONSULTATION QUESTIONS

Q1 DO YOU AGREE WITH OUR PRIORITIES SET OUT ABOVE? IN PARTICULAR, THE MOVE AWAY FROM TECHNICALLY PRECISE MEASURES TO A MORE ROUNDED ASSESSMENT AND MAKING OUR ASSESSMENTS MORE FORWARD-LOOKING?

3.1 RIA supports the priorities for assessment as set out in the consultation document. Of particular importance are:

- Performance comparisons of Network Rail (NR) routes and how this can be used to support future benchmarking
- Use of a more rounded assessment centred on key messages about performance drivers and how efficiencies are being achieved
- More assessment over time of unit costs, cost drivers and productivity measures
- A forward-looking view of the likely efficiencies that NR will achieve across CP6; this could, in turn, be used to update assumptions on the level of efficiency/target expected in CP6, for example due to unforeseen material changes. It would be helpful to understand whether, in cases where ORR monitoring suggests that NR delivery of efficiencies is off track, the regulator will seek to identify mitigating actions.

3.2 RIA agrees that no single measure, e.g. unit costs, can provide a rounded assessment of performance; this is better achieved through a basket of measures and an accompanying narrative to set the assessment and performance in context.

3.3 RIA would support the use of the point-to-point efficiency measure both in NR's and the ORR's reporting of NR's efficiency improvements in CP6 at a route level. This reporting should be set in context within a broader narrative.

Q2 WE PROPOSE TO IMPROVE OUR ASSESSMENT AND REPORTING OF NETWORK RAIL'S EFFICIENCY IMPROVEMENTS, DRAWING ON UNIT COSTS, COST DRIVERS, PRODUCTIVITY MEASURES, LEADING INDICATORS AND SAFETY REPORTS. WHAT ARE YOUR VIEWS ABOUT THIS CHANGE OF APPROACH?

<u>Unit Costs</u>

3.4 While unit costs are relatively straightforward to understand for repeatable activities, they are also a blunt tool for measuring efficiency; thus should not be used in isolation, but as one of a basket of measures to assess efficiency. Setting unit costs relies on an extensive and robust dataset over a number of years, and, particularly in the case of renewals, differences in geography and environmental conditions that influence costs. As identified by ORR, this requires the identification and recording of site-specific factors that underpin cost differences. That aside, cost can also be influenced by external factors, such as skills shortages (insufficient availability of specific skills in the marketplace) and gaps in skills capability (the absence of specific skills in the marketplace), which can inflate wages and drive up the cost of work on the rail network.

3.5 ORR itself highlights (in para 3.21 of the consultation document) that it has not made much use of the unit costs NR has provided for most of its renewals activities, partly because of concerns about the robustness/maturity of NR's cost capture, analysis and reporting in CP4 and CP5. Going forward, the ORR will need to have confidence in the robustness of NR's data, if unit costs are to be a more important/visible element of the ORR's assessment. It is worth bearing in mind that unit costs are not a measure of quality.

3.6 There are both advantages and limitations of a unit cost approach. On the latter, while the unit cost may be going up, this does not necessarily mean that efficiency is going down. This approach does not capture situations where, while unit costs are increasing in activity A, this results in unit costs decreasing in activity B, and/or activity C. It also does not reflect circumstances where there are emergent and unforeseen costs post project commencement.

3.7 There is a further issue around the use of unit costs, in so far as the degree to which they reflect the commercial marketplace at the time of tendering; if set too low, there is a risk of a race to the bottom with tender prices, along with a risk that businesses may simply be unwilling to bid for work (reducing competition); or if set above the market rate/expectation at the time, there is a risk of setting a higher than necessary benchmark for future similar work, which would reduce economy. It may be that unit costs are not constant throughout the length of a Control Period.

<u>Renewals and unit costs</u>

3.8 Efficient delivery of renewals in CP6 is essential. It is therefore important that any efficiency targets set by ORR are realistic – there is, we believe, general agreement that the efficiency target set for CP5 (roughly 18%) was too rigorous in the light of the aggregate 40+% combined efficiencies made in CPs 3 and 4. Additionally in CP5, the actual level of track access achieved has been roughly 20% less than that predicated when the 18% efficiency target was set – making efficient delivery even more difficult.

3.9 When measuring unit costs and/or cost efficiency it is critical to ensure what is being measured is both transparent and accurate. For example, it had become clear towards the end of 2016 that there was a significant issue around CP5 renewals efficiency and unit costs. As a result, RIA established in early 2017 a Renewals Unit Cost working group (chaired by RIA with representatives from NR, ORR and supply chain companies) to look into how the cost of this work could better managed. The group's work has identified the four main cost drivers:

1. Restricted network access
2. Workload instability/ scope creep
3. Blurring between Enhancements and Renewals – in reality, to maximise track access, enhancement works are often carried out at the same time as renewals, thereby blurring the true cost/artificially inflating the cost of the renewals work. Therefore, in any establishment of unit costs and comparison with previous CPs, **this blurring between enhancements and renewals needs to be fully understood and properly reflected**.
4. Changes in Standards during CP5; to address this in CP6, the **routes must not apply differences in standards** generally not just in terms of renewals.

3.10 In order to optimise levels of track access it has become commonplace for renewals projects to have an element of enhancement added to them. This makes logical good sense, but when all the costs are then attributed to renewals, it inflates renewals unit costs whilst taking no account of the benefits the enhancement element is affording the network. So we have a paradox whereby an activity that in itself is a more efficient use of resources, is actually seen as increasing renewals unit cost. One possible way of addressing this would be to set up a specific enhancement fund to cater for these additions. It is, however, of critical importance that in any future analysis of unit costs, like is compared with like and the benefits to the network of a particular piece of work are properly assessed. It is also important that unit costs are not seen as the sole arbiter of efficiency where other benefits may be being delivered but not properly recognised.

3.11 The Renewals Unit Cost working group will be unpacking further the above main cost drivers during 2018. In order to get a better grip on the issues, the group will be adding TOC representation (probably via the Rail Delivery Group), as well as inviting Department for Transport (DfT) representation.

3.12 Separately, it should be noted that, although the overall CP6 national profile is relatively smooth, there are more obvious peaks and troughs in the work banks of the individual routes (e.g. Western and Anglia); and looked at by discipline, there appears to be a spike in signalling renewals around 2021/ 2022, (around £1bn) followed by a fairly significant drop in the final year (£0.77bn) – some further smoothing of this would be helpful. Overall, the expectation is that the regime, new to CP6, of the individual routes creating their own estimates on a bottom-up basis will create a more robust bedrock for renewals planning. We would hope that that proves to be the case but **we strongly suggest that the renewals volumes delivered during CP6 need to be very carefully monitored by ORR and rapid and appropriate action taken should the planned smoothness not be achieved.** The renewals supply chain, indeed the industry, cannot afford another CP5.

3.13 As well as creating a backlog of renewals, with consequent impact on asset condition, breaks in renewals activity are also highly detrimental to the supply chain. For example:

- Such peaks and troughs in workload sap confidence from the supply chain, reducing the incentive to invest in new kit, new processes and personnel (including apprenticeships)
- It can threaten the survival of some of the smaller supply chain companies who cannot survive the troughs
- All of which leads to a sub-optimal supply chain in terms of both delivery and efficiency

Risk

3.14 We understand that budgetary constraints influence choices around sweating and renewing/replacing assets. However, RIA believes that the risk profile of assets and asset reliability need to be monitored, not least as there is a risk that we could be exiting CP6 with a higher asset risk profile. For some assets, such as electrification assets, emphasis needs to put on not just renewals and life extension, but also where possible engineering out the inherent asset risk. This will improve economy and underpin network reliability.

Productivity

3.15 Rather than ORR measuring 'time-on-tools' during network downtime, it could consider using capacity utilisation. This measures the extent to which a business is using its production potential, and is often used as a measure of productive efficiency. As average production costs tend to fall as output rises, so higher capacity utilisation can reduce unit costs, making a business more competitive. So firms usually aim to produce as close to full capacity (100% utilisation) as possible. It is important to remember that increasing capacity often results in higher fixed costs, therefore a business should aim to make the most productive use it can of its existing capacity.

3.16 In its assessment, ORR may find it useful to include measures, such as the proportion of planned possessions that are not used, and the proportion that are subject to late changes. This may reveal a pattern or underlying trend on the use/non-use of possessions that identify causal reasons that hamper efficiencies and how these can be managed/ addressed through the possessions regime.

Efficiency Registers

3.17 This an approach worth exploring by NR, and which, if adopted, may improve with experience. It is not clear, however, how efficiencies are shared systematically, for example across Highways England, or how these are being taken up. This would be useful for NR to understand and learn from.

3.18 RIA agrees that assessing efficiency requires both quantitative and qualitative measures to understand the 'what' and 'how' of improvements. Given that the recording and collating of individual efficiency initiatives requires detailed analysis, some of which requires judgement, there would need to be checks and balances built into the reporting. This should also address the risk of NR, and the devolved routes, cherry-picking areas of the business that are improving, whilst ignoring areas that are becoming less efficient.

Efficiency drivers

3.19 One of the key challenges to delivering efficiency is the uptake of innovation rather than the generation of good ideas. In the main, there is a creative supply chain in the UK presenting innovations to the railway. It is the low rate of uptake that can result in smaller companies struggling to weather the so-called 'innovation valley of death', or larger companies having the confidence to invest in development. The client's, i.e. NR's, risk appetite can stifle innovation.

3.20 A whole life cycle view of costs and outcome specifications will support efficiency improvements. Focussing purely on first or lowest cost tenders stifles innovation and leads to longer-term inefficiency of the railway. NR would (continue to) improve its performance if it adopted this approach on a wholesale basis.

Procurement

3.21 Successful delivery of NR's strategic business plans is vital to the future of our railway; achieving success requires early supplier engagement and a stable and visible workload pipeline for the supply chain. This will include, as per para 3.20, the need to use sustainable procurement methodologies, covering issues such as through-life costing and output, rather than input, specifications. Furthermore, NR will need new suppliers, as well as existing ones. Importantly both large and small businesses need confidence to invest, based upon seeing a commercial return; this is particularly so for SMEs where their specialist capabilities are able to deliver real value.

3.22 Commodity pricing risk is directly related to the procurement strategies NR employs. NR procurement via a centralised Route Services contract for 'strategically important' materials, such as rail and ballast, offers economies of scale and should be recognised, particularly in the debate around devolution. Other products are bought via an extended supply chain (such as small part steel e.g. catenary) where NR does not currently utilise its purchasing power to drive economies through the supply chain; this should be addressed. Product procurement strategies that provide volume commitment and long-term contracts will drive down volatility and cost compared to the existing use of zero volume/value frameworks.

Traffic Adjusted Performance

3.23 We are not convinced that traffic adjusted performance is an appropriate approach for a business as complex as NR. At face value, this approach would not appear to take into account fully, the fixed/sunk cost of a business comprised of multiple business units, some of which will have relatively high fixed costs and relatively low patronage. RIA also shares the same concerns that ORR has set out in its observations of traffic adjusted performance measures (para 3.28 of the consultation document).

Q3 OUR PROPOSED APPROACH WILL REQUIRE NETWORK RAIL TO PROVIDE BETTER INFORMATION TO US. WE CONSIDER THAT THIS IS INFORMATION THAT THE COMPANY SHOULD ALREADY HAVE. HOWEVER, WE WANT TO ENSURE THAT ANY ADDITIONAL REPORTING IS PROPORTIONATE. DO YOU HAVE ANY COMMENTS ON THIS?

3.24 In RIA's view, if the better information sought by the ORR is information that NR already has, then this seems sensible, particularly if such information is also important for NR's own management. However, the ORR should first set out clearly how it will use this information and the improvement/benefit it will deliver, not least as there will be a time and cost element to its provision. ORR should agree up front with NR what is the most sensible information. Collection of this further information should be on a risk based / risk management approach.

3.25 We note ORR's intention to make greater use of information from its safety role, including making more use of relevant information from safety reports. A way to enhance the use of such information would be to ensure, where appropriate, it is reflected in NR's and the devolved routes' asset management plans.

Q4 DO YOU AGREE THAT HAVING A BETTER UNDERSTANDING OF UNIT COST CHANGES AND COST DRIVERS SHOULD BE AN IMPORTANT PART OF OUR ANALYSIS? SHOULD NETWORK RAIL IMPROVE THE ROBUSTNESS OF ITS UNIT COST REPORTING IF NECESSARY TO SUPPORT THIS?

3.26 In short, we agree with the above proposed approach, but would re-iterate that unit costs should be one of a basket of measures used to assess efficiency and financial performance. Please also refer to paras 3.4 to 3.10 of this response.

Q5 CHANGES IN EXPENDITURE DUE TO A DEFERRAL OR ACCELERATION OF WORK CAN HAVE A MATERIAL EFFECT ON OUR ASSESSMENTS. THIS IS TECHNICALLY CHALLENGING AND REQUIRES JUDGEMENT. WE ARE INTERESTED IN RESPONDENTS' VIEWS ON THIS.

3.27 RIA's view is that unforeseen changes that have a material impact/effect on ORR assessments should be taken into account and a judgement made by the ORR. Often it is not the fact of the change itself, but the reasons for the change that are important; so a judgement by the ORR can helpfully put material changes into context and facilitate wider stakeholder understanding. Conversely, it may also be helpful for the ORR to explain decisions/judgements where it considers that deferrals or accelerations of work do not have a material effect on its assessments. These explanations/reasons can help paint a richer picture of how the ORR assesses NR and increase awareness of its work more widely.

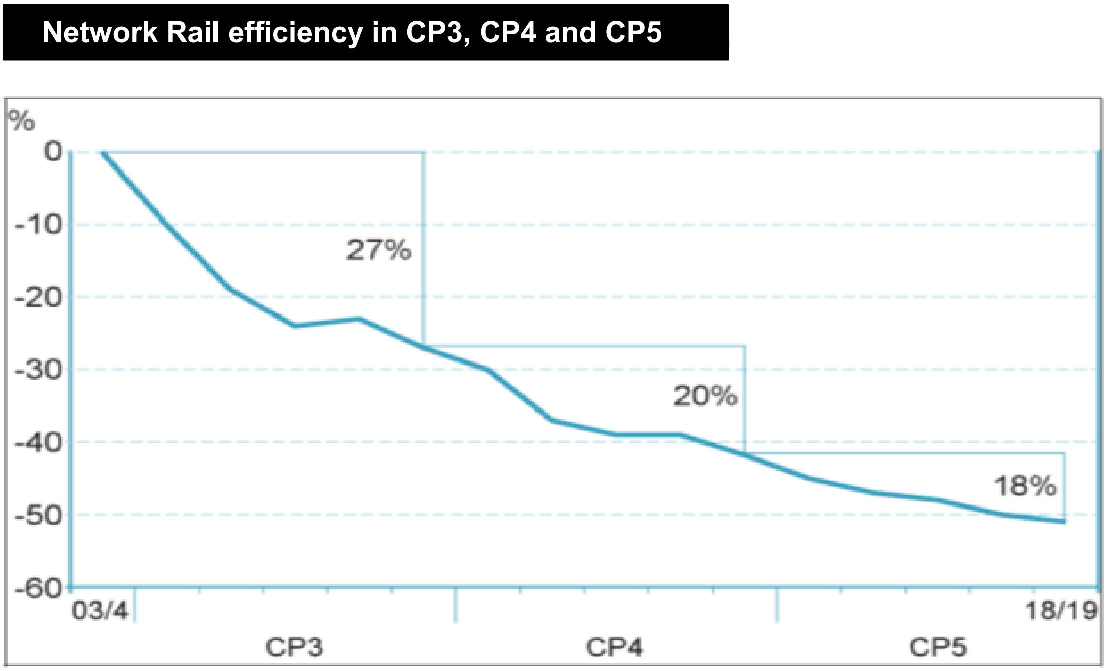
Q6 SECTION 4 SETS OUT SOME PRODUCTIVITY MEASURES AND LEADING INDICATORS THAT WE COULD ASSESS. HOW EFFECTIVE DO YOU THINK THESE MEASURES COULD BE TO AID OUR ASSESSMENTS? WHAT OTHER MEASURES SHOULD WE USE?

<u>Efficiency Assumptions</u>

3.28 **RIA strongly supports the introduction of mechanisms to update efficiency assumptions**. We agree with the generally held view that the efficiency target for CP5 was overly rigorous, particularly given it would mean that since 2004, NR would have improved its efficiency by over 60% (see Chart 1 overleaf). This would be challenging for any business; and has undoubtedly had an impact on the sustainability of the UK rail network and the rail supply chain. A significant proportion of the efficiencies sought have been achieved through the rail supply chain stripping out costs for the work being delivered; this has the potential to reduce quality and therefore the need for more frequent work than otherwise might be the case to maintain asset condition. Failure to maintain the asset can result in passenger delays and slower running trains, which, in turn, reduce efficiency.

3.29 A smoother and more visible work bank pipeline would support efficiency and help control costs. ORR might consider monitoring the impact of dependencies in project delivery, such as the possessions regime and its effectiveness. It should be noted that the cost of contingency built into possessions is significant, given the financial cost of a possession overrunning coupled with reputational damage.

Chart 1: Network Rail efficiency across control periods



Financial Performance

3.30 While ORR should report on the drivers of performance, RIA has no firm view on whether NR's financial performance should become a regulatory output. Since reclassification as a public sector arm's length body, NR cannot technically go bust, as it is effectively underwritten by Government. That said, it should be subject to financial discipline, as would any commercial entity – thus making its financial performance a regulatory output would not seem unreasonable. RIA agrees with the ORR that only categories of expenditure that are deemed controllable should be included in NR's reporting of efficiency and financial performance.

3.31 On the question of whether NR and devolved routes should provide more geographically disaggregated financial information, as requested by sub-national transport bodies RIA's view is that this be provided over time.

3.32 NR may benefit from greater financial flexibility, such as the ability to vire monies between operations, maintenance and renewals to reflect variances in actual delivery and operational need. For example, the problems experienced with the renewals programme during CP5 are widely known. NR's renewals budget was effectively exhausted with roughly 18 months of the control period remaining, leaving a shortfall of some £500 million. As a result of concerted lobbying by RIA and by NR, agreement was eventually reached for NR to vire £200m to renewals from elsewhere within their CP5 allocation. Although not ideal, this did go some way to redressing the shortfall in a timescale in which the programme could be brought back on track.

3.33 One of the problems with renewals funding in CP5 was the fact that, following reclassification, NR did not have the flexibility it previously enjoyed to enable suitable funding adjustments to be made. It remains a concern for CP6 that in continuing to be subject to Government accounting procedures NR may be subject to an unwelcome financial straightjacket, which might **prevent them taking timely and appropriate action prudently to move money between budgets and between regions/routes in the event of over or underspends in particular disciplines**. It is also a **concern should routes be required to operate under an annual budget regime** and we believe that routes should have similar financial agility to move money between years should that be prudent and necessary. We would urge ORR and DfT to look at this to ensure NR has the appropriate level of financial flexibility to smooth work profiles should problems arise in CP6. Otherwise, NR will be less agile and unnecessarily hamstrung in its operational delivery.

3.34 As well as creating a backlog of renewals, with consequent impact on asset condition, the aforementioned breaks in renewals activity are highly detrimental to the supply chain, e.g.

- Such peaks and troughs in workload sap confidence from the supply chain, reducing the incentive to invest in new kit, new processes and personnel (including apprenticeships)
- It can threaten the survival of some of the smaller supply chain companies who cannot survive the troughs
- All of which leads to a sub-optimal supply chain in terms of both delivery and efficiency

3.35 Such peaks and troughs are not limited to CP5. As RIA Chief Executive, Darren Caplan, pointed out at his appearance before the Transport Select Committee (TSC), on 29 January 2018, the supply chain has been faced with significant peaks and troughs in activity in Control Periods 2, 3 and 4 also. This is an inefficient and unsustainable way of tackling renewals. The transcript of the TSC appearance can be accessed via the following link: http://data.parliament.uk/writtenevidence/committeeevidence.svc/evidencedocument/transport-committee/rail-infrastructure-investment/oral/77855.html

3.36 We believe that in the longer term, we need to find some way of changing the Periodic Review (PR) process so that early in a PR process **a minimum guaranteed baseline of renewals expenditure is established for each year in the control period**. This will give the supply chain some confidence to invest and the baseline can be adjusted upwards following the Final Determination. It would also aid NR in delivering efficiency improvements.

Other Measures

3.37 We would welcome the development of route based scorecards aligned to stakeholder priorities, which the supply chain could support developing, as a key stakeholder ourselves. For example, route-level considerations might include route level efficiency targets and other performance measures that enable benchmarking, not least to facilitate comparative competition between the routes (how routes perform relative to each other). The incentive for routes would be better reputation and credibility and lighter touch regulation/scrutiny from the ORR.

3.38 While we welcome the ORR’s proposal to measure the performance of individual NR Routes in CP6, this should not be used as an opportunity for Routes to diverge from national infrastructure standards.

3.39 RIA members generally, and in particular those members that are owners and asset managers of rolling stock, would be **concerned were Routes to opt out of, or unilaterally amend, national standards relating to the condition and/or capability of NR infrastructure**. Were Route specific standards or maintenance regimes to be introduced, this might result in a negative impact on both the quality, and residual value, of specific geographical fleets. RIA would also be concerned that differing infrastructure standards by Route would reduce opportunities to deploy vehicle fleets to other areas of the country to meet evolving operator, passenger or shipper demands.

3.40 The NR business plan, as well as those of the devolved routes, cannot be successfully delivered without the engagement and involvement of the rail supply chain. RIA would therefore recommend an enhanced performance measure around supplier engagement/ early contractor involvement, at both corporate and route level. RIA has previously recommended a metric to measure actual delivery of work to market against that planned – and also a metric to measure route engagement with suppliers. For example, this could include metrics around the extent to which NR is engaging with the suppliers (both Tier 1 contractors and Tier 2/ SME suppliers) before schemes/projects reach GRIP3, and how stakeholder/ supplier engagement has influenced planning and delivery, i.e. in terms of what actions NR has taken on board.

3.41 We believe it would be useful to set ORR reviews of financial performance in a wider industry context. This context could include: whole life costing; output specifications; and the NR standards challenge, but also as importantly, the degree to which NR has smoothed the work bank pipeline, particularly for renewals, to ensure greater consistency, supply chain visibility and efficiency, and to avoid the peaks and troughs in work that the supply chain has experienced since the establishment of the control period process. This 'boom and bust' cycle is inefficient and can add up to 30% to costs. Fundamentally, this means a worse performing rail network, increased costs and reduced economic benefits from rail investment.

Q7 DO WE HAVE THE RIGHT LEVEL AND FREQUENCY OF REPORTING THROUGH OUR BIANNUAL NETWORK RAIL MONITOR AND ANNUAL EFFICIENCY AND FINANCE ASSESSMENT PUBLICATIONS?

3.42 RIA believes the current frequency of reporting is about right. Going forward, we would expect the level of reporting to include NR corporate functions (such as Infrastructure Projects and System Operator) separately to reporting on each of the devolved routes.

Q8 HOW CAN WE IMPROVE THE PRESENTATION OF OUR ASSESSMENTS TO IMPROVE THEIR EFFECTIVENESS FOR STAKEHOLDER ENGAGEMENT AND CHALLENGE?

3.43 In part, the presentation of ORR assessments needs to speak to metrics that are meaningful to respective stakeholders, for example, for the supply chain:

- The degree of smoothing of work bank pipelines to avoid peaks and troughs, which reduce efficiencies; this may include confidence levels around achievability/deliverability of the pipeline against the proposed timescale and number/percentage of schemes delivered on time
- With an eye on monitoring deferral of work, metrics might include in-year percentage of planned renewals delivered and year-on-year (cumulative) percentage or planned renewals delivered
- Supply chain visibility of work/pipeline (i.e. x months/ years forward) – the longer the time period, the more likely this will support supply chain investment in skills and innovation
- Outturn of expenditure on renewals, to provide a more accurate picture than forecast spend
- Overspending against budgets, which could put at risk planned renewals programmes, particularly if NR is unable to vire monies between operations, maintenance and renewals

- Levels of track access for suppliers to carry out renewals and the level of booked possessions over e.g. the coming year
- An ‘on-track’ scale of expected efficiencies being delivered
- The proportion of planned work that has been designed, tendered, awarded
- All the above would have more resonance at route based level and would assist future benchmarking.

3.44 In short, the ORR needs to consider the audience for the information it is presenting and tailor its communications accordingly.

3.45 In terms of the presentation itself, it might be worth adopting a RAG approach; in cases where the rating is amber or red, detail the mitigating actions being taken/needed to bring the metric back to green and over what timescale.

4. CONCLUSION

4.1 RIA welcomes the opportunity to comment on the ORR’s approach to assessing NR’s efficiency and wider financial performance in CP6.

4.2 The strong CP6 SoFA settlement provides an excellent opportunity for the industry collectively to make a step-change to our railway and its growing number of customers. We must also prove to our funders that the supply sector can deliver these substantial volumes of work, if we are to continue to secure such funding settlements.

4.3 The railway supply chain stands ready to plays its part in a collaborative push to achieve this delivery. But in order to do so, we need in turn successful adoption of the points referenced in the Executive Summary.

4.4 We hope this response is helpful and we stand ready to discuss any part of it with the ORR at any time.

For more information, please contact RIA Policy Manager Damian Testa.

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8th March 2018

Dear Sir/Madam,

Consultation on the assessment of Network Rail's efficiency and wider financial performance in CP6

This letter sets out TfL's responses to the questions raised in the ORR's consultation on Network Rail's efficiency and wider financial performance in CP6. TfL is content for its responses to be published and shared with Third Parties.

1. **Do you agree with our priorities set out above? In particular, the move away from technically precise measures to a more rounded assessment and making our assessments more forward-looking?**

TfL agrees with the priorities set out in the consultation documentation. It is important that the measures used are meaningful and enable all parties to understand and address emerging trends in the level of efficiency being achieved. It is important that any measures used are transparent and not subject to manipulation.

2. **We propose to improve our assessment and reporting of Network Rail's efficiency improvements, drawing on unit costs, cost drivers, productivity measures, leading indicators and safety reports. What are your views about this change of approach?**

This change of approach is reasonable and likely to enable the industry to engage with Network Rail in a more meaningful manner on the topic of its efficiency.

3. **Our proposed approach will require Network Rail to provide better information to us. We consider that this is information that the company should already have. However, we want to ensure that any additional reporting is proportionate. Do you have any comments on this?**

TfL agrees that this approach is appropriate. Network Rail will have access to a very large knowledge base on costs for different types of works on a variety of asset classes and should be able to segment this by factors that can influence efficiency such as geology and intensiveness of use to deliver meaningful information. This is central to its role as an Infrastructure Manager so it is important that Network Rail is required to deliver the information that is needed to enable its efficiency to be monitored in a meaningful fashion.

4. Do you agree that having a better understanding of unit cost changes and cost drivers should be an important part of our analysis? Should Network Rail improve the robustness of its unit cost reporting if necessary to support this?

TfL agrees that achieving a better understanding of unit cost changes and cost drivers should form a key part of the ORR's analysis, as these will enable the effective understanding of trends in efficiency and drive measures to improve this. Network Rail should be required to improve the robustness of its unit cost reporting to support this process where necessary. As an Infrastructure Manager with circa 15 years of experience of managing a diverse portfolio of assets they should be able to categorise unit cost data in a manner that facilitates the analysis of this data over time.

5. Changes in expenditure due to a deferral or acceleration of work can have a material effect on our assessments. This is technically challenging and requires judgement. We are interested in respondents' views on this.

The cost and volume of activity delivered are the key measures. A robust, properly segmented analysis of unit costs should provide clear insights into cost trends regardless of the volumes of work delivered.

6. Section 4 sets out some productivity measures and leading indicators that we could assess. How effective do you think these measures could be to aid our assessments? What other measures should we use?

These measures are actually listed in Section 5. TfL prefers measures of average efficiency over time rather than between two points as these ensure that all performance is taken into account and are therefore less vulnerable to manipulation. As stated above robust unit cost analysis should provide a guide to evolving trends in cost and efficiency, enabling action to be taken where necessary and appropriate. The productivity measures listed appear sensible.

7. Do we have the right level and frequency of reporting through our biannual Network Rail Monitor and annual efficiency and finance assessment publications?

The level and frequency of reporting proposed is sensible, and should incorporate the range of disaggregated measures referred to in the consultation documentation.

8. How can we improve the presentation of our assessments to improve their effectiveness for stakeholder engagement and challenge?

The definitions of the measures used should be clear and transparent and they should relate to tangible items e.g. asset types to ensure that the data provided is meaningful. Once established definitions should remain consistent unless there is a compelling reason for change.

Yours sincerely,

Alan Smart,
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Rail Strategy and Funding
Rail

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Date:
20 March 2018

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Response to the ORR`s consultation on the approach for assessing Network Rail's efficiency and wider financial performance in CP6

Thank you for the opportunity to comment on the ORR`s consultation on the approach to assessing Network Rail's efficiency and wider financial performance in the next rail control period, CP6. We have set out below some general points that we would wish the ORR to reflect on and take into account as well as our responses to the specific questions in the consultation paper.

We note that ORR have had sight of the Scottish Government's responses to a number of related ORR consultations namely the PR18 Financial Framework (May 2017), the ORR's consultation on Network Rail's Renewals Efficiencies (September 2017), and the ORR's consultation on the Overall Framework for Regulating Network Rail (also September 2017). Some of the key principles are highlighted again below but we expect the ORR to have already had full cognisance of these as well as others submitted during the Periodic Review process.

The Scottish Government recognises the changed financial context in which PR18 is being developed following the reclassification of Network Rail (NR). The approach to assessing NR's efficiency and financial performance should reflect this and ensure that NR is aligned to best practice for a publicly funded body, with the framework supporting behaviours and decision-making such that robust governance, transparency, effective planning and financial discipline will underpin all of NR`s activities in CP6.

The Scottish Government is also clear that irrespective of the financial challenges facing NR and funders in CP6, the railway works best when the industry works collaboratively to deliver solutions that are focussed on the needs of customers. That is why the Scottish Government has supported the creation of the ScotRail Alliance which has brought infrastructure management and service delivery together to support a whole-industry approach driving transformative change in the quality and provision of services by placing the needs of customers at the centre of thinking and decision making.

Despite the changed financial context brought about by reclassification, and the consequent introduction of NR`s fixed borrowing limit in CP5, NR`s primary risks are its ability to plan and assess project costs accurately and to deliver efficiently and to budget. It was the failure to adequately manage these risks in CP5 that resulted in cost increases, non-delivery of outputs and the failure to deliver efficiency targets. Therefore a key aim for PR18 is to encourage NR to better manage its efficiencies and financial risks across all its operations, maintenance, renewals and enhancements activities, and so bring about a noticeable improvement in its position with regard to genuine efficiency and long-term financial sustainability. This is set in the context of fixed availability of capital funding through the SoFA in CP6.

We welcome the greater focus on route level assessment of financial performance in the Periodic Review. The Scottish route is ahead of the other routes and we would welcome a discussion with the ORR on how we move that onto the next stage. We would not want this to stand still in CP6 while the other routes caught up. The Scottish route is in a good position to test new approaches, and as main funder, we would be receptive to that.

Questions

1) Do you agree with our priorities set out above? In particular, the move away from technically precise measures to a more rounded assessment and making our assessments more forward-looking?

We would agree that this is a more rounded assessment and seems a logical and sensible approach.

2) We propose to improve our assessment and reporting of NR's efficiency improvements, drawing on unit costs, cost drivers, productivity measures, leading indicators and safety reports. What are your views about this change of approach?

We welcome this approach and in particular the focus on unit costs which should be of particular value. We have already highlighted to the ORR the importance of identifying standard efficient unit costs at Route level. It would also be useful to understand the detail behind the leading indicators. NR is not unique in the challenges it faces and there should be international benchmarking available which both the NR and ORR can utilise.

3) Our proposed approach will require NR to provide better information to us. We consider that this is information that the company should already have. However, we want to ensure that any additional reporting is proportionate. Do you have any comments on this?

It is important to highlight that data and information should be a means to an end with value derived from analysis. NR are best placed to provide accurate data and the ORR are best placed to assess this and provide the Government with meaningful insight – based on this analysis - into the reasons for the lack of efficiency.

4) Do you agree that having a better understanding of unit cost changes and cost drivers should be an important part of our analysis? Should NR improve the robustness of its unit cost reporting if necessary to support this?

This is of critical importance and we strongly agree with this proposal and consequential actions required by NR.

5) Changes in expenditure due to a deferral or acceleration of work can have a material effect on our assessments. This is technically challenging and requires judgement. We are interested in views on this.

There needs to be a robust system in place which will flag up any changes in expenditure at the earliest opportunity with an assessment framework capable of responding appropriately. Updating assumptions during a control period is only acceptable when accompanied by appropriate scrutiny and judgement.

6) Section 4 sets out some productivity measures and leading indicators that we could assess. How effective do you think these measures could be to aid our assessments? What other measures should we use?

We would suggest that the ORR as economic regulator is best placed to take a view on this and should draw on UK and International best practice.

7) Do we have the right level and frequency of reporting through our biannual NR Monitor and annual efficiency and finance assessment publications?

We would again suggest that the ORR as economic regulator is best placed to review this. What may be of more value is to consider what the Monitors and annual publications actually tell their audience. There is a necessary time-lag with the Monitors and the ORR should also focus on advising funders such as Transport Scotland as soon as issues and risks emerge based on either qualitative or quantitative evidence or both.

8) How can we improve the presentation of our assessments to improve their effectiveness for stakeholder engagements and challenge?

Please see the answer above to question 7).

<u>Specific additional points</u>

In addition to this we would add that we strongly recommend that financial performance measures should be treated as a regulatory output in CP6 linked where possible to staff incentives, and the fundamental principle that all NR systems for data and cost information should be fit for purpose to allow the optimum measurement of efficiency and setting of targets. We consider that the inflation measure used for efficiency should be the same index as used elsewhere – whether CPI or RPI.

Conclusion

We reiterate the importance of improved NR efficiency and wider financial performance in CP6 reflecting the new financial context following reclassification of NR and compelling NR to achieve and sustain the highest levels of best practice for a publicly funded body. Efficient planning and delivery of railway expenditure is absolutely necessary in a manner that, when taken in concert with the charges and incentives regime, maximises value for money for funders and system availability for train operators and end users.

Taxpayers and end users quite rightly expect a railway that is efficient, reliable and available, and we expect that the ORR and associated regulatory architecture will regulate and drive the right behaviours and decision-making to make this a reality in CP6.

Yours sincerely,

John Provan

John Provan
Head of Rail Strategy and Funding