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Ref: 2006/mar/cb/1703

17 March 2006

Infrastructure Capability – Breach of Network Licence

We note ORR's finding that we are currently in breach of Licence Condition 7 and reiterate our commitment to both remedying the breach and improving the situation.

Network Rail continues to believe that it should not be found to be in breach of its network licence for long standing industry-wide issues (in particular, those inherited from Railtrack) where we are already, and have been, taking appropriate action to remedy the issue concerned. We therefore agree with ORR's decision not to make a final order, or make or confirm a provisional order in relation to this contravention of Licence Condition 7 and its finding that to issue such an order would not deliver a better result than would be achieved by delivery of the steps as set out in our letter of 9 February. We focus in this response on ORR's proposal to impose a fine of £250,000 on Network Rail with regard to this breach. We believe any fine is inappropriate and we explain the reasons for this view in detail below.

Overview

In considering whether to impose a fine on Network Rail with regard to this breach, ORR appears to have taken two major factors into consideration. Those are:

- a) whether Network Rail did enough to resolve the matter in the period from December 2004 (when ORR first wrote to Network Rail about this matter) until an appropriate recovery plan was adopted; and
- b) whether Network Rail has a record of non-compliance which would make the imposition of a fine appropriate to incentivise proactive compliance with licence obligations.
- c) whether Operators have actually been disadvantaged.

Our response to these considerations is set out in more detail within this response. However, by way of summary, given that Network Rail has already formally committed to a clear remedial programme to achieve compliance with Licence Condition 7, much of which was developed in the period from December 2004, we are very disappointed and concerned by ORR's decision to impose a fine on Network Rail.

The size of the fine clearly does not have an impact on our ability to finance our relevant activities given our current strong performance in other areas. However, any fine sends a very strong signal that the company has failed to deliver what could reasonably have been expected of it in all the relevant circumstances. We reject this and we take the implications very seriously.

In this context, we do not believe any fine is justified and we certainly consider that the size of the proposed fine is disproportionate. In our view, this conclusion is reinforced by lack of evidence of customer detriment caused by this breach and the robust and challenging plans to which Network Rail has already committed itself for delivering compliance with this Licence Condition. We also believe it is important to recognise that it has been difficult to make progress on this issue but that relevant train operators are now engaging more constructively in the process. Similarly, the change in the ORR's position with regard to the funding arrangements for changes in the pattern of traffic clearly made it difficult to make progress in the early stages of the discussion.

We continue to believe that Network Rail is taking all such steps as are necessary and expedient to achieve the purpose to the greatest extent practically possible having regard to all relevant circumstances. As is confirmed within your letter, Network Rail is doing well on a number of fronts and whilst we are by no means complacent in this success, we retain an underlying belief that we should be judged on the overall rate of change achieved and the way in which we prioritise these improvements. Licence Condition 7 in particular, we believe, cannot sensibly be interpreted as an absolute standard in all areas.

The purpose of the proposed fine is seemingly to signal that Network Rail should not breach its network licence. Whilst this point is not disputed in principle, we believe that ORR must take a wider view as to whether Network Rail is securing the stewardship of the rail network in a manner expected of an efficient network operator. We believe that answer to this question is a resounding yes, given the circumstances in which we are operating.

It should also be remembered (as has already been stated in previous correspondence regarding this matter) that the proposal to impose a fine on Network Rail has no material impact whatsoever on our commitment, ability or incentive to address and resolve this matter or to avoid other breaches. This comment is in no way intended to undermine the regulatory regime or to signal that we do not take

regulatory action very seriously. On the contrary - rather, it reflects the fact that we have been committed to addressing this issue for some time and to ensuring that we meet the reasonable requirements of our customers and stakeholders across the board in a prioritised and proportionate manner taking account of all relevant circumstances.

We are also concerned that the decision to impose a fine on Network Rail appears to be inconsistent with ORR's draft Enforcement Policy and Penalties Statement which confirms that the 'principal objective in setting a penalty or imposing a reasonable sum would be to incentivise compliance with the relevant condition or requirement'. Indeed as ORR itself confirms at paragraph 19 of its section 57C notice, the 'proposed penalty notice does not relate to the continuing contravention and is in relation to the past conduct of Network Rail prior to the adoption of an appropriate recovery plan.'

By ORR's own admission, the purpose of the fine is therefore punitive and is designed to penalise Network Rail for past errors or omissions. It certainly does not seek to incentivise compliance with the relevant condition, given that ORR has in its section 55(6) notice expressed itself satisfied that we are taking all such steps as appear to ORR to be appropriate for compliance purposes, and no additional impetus would be afforded by further enforcement action. The level of fine would therefore appear to be excessive given the ORR's stated principal objective of incentivisation.

As was set out in our response to ORR's consultation on its draft Enforcement Policy and Penalties Statement, in terms of proportionality, we believe that financial penalties should only be applied as a last resort. Where a licence holder accepts that remedial action is required to address a potential licence breach and puts in position a timely and effective action plan to address that potential breach (as has been the case in relation to this matter) it would then seem to be disproportionate to seek to apply a financial penalty. Whilst we accept that the mere existence of an action plan does not in itself constitute compliance, the current actions of Network Rail should be fully taken into account when seeking to impose any financial penalty. Indeed, even if ORR prima facie believes that it is appropriate to apply a financial penalty in this case we believe that our compliance plans and the actions that we have already been undertaking should significantly mitigate down the level of the fine, and that no more than a nominal figure is required in order to make the point that ORR wishes to make, that being that Network Rail should not get into the situation where it risks being in breach of any aspect of its network licence.

With regard to the issue of our record on licence compliance, ORR referred to the enforcement order on T-12. This did indeed share many of the same characteristics of the current situation. In particular, both issues were long-standing industry problems which we were seeking to address with our industry parties. We explain further below why we believe that our record does not justify a fine.

We recognise that the decision to propose a fine of £250,000 on Network Rail involves balancing a number of considerations and that ORR has sought to do so by reference to its draft penalties statement. We believe that the criteria that ORR has set itself under paragraph 7 of that draft statement do not support a fine of the level proposed, and we therefore address those criteria in more detail below.

The seriousness of the contravention

With regard to the seriousness of this contravention, Network Rail takes the finding of any breach of its network licence extremely seriously. However, as ORR remarks at paragraph 21 of its section 57C notice, the discrepancy between the published and actual route capability only applied to a relatively small number of routes across the country. Whilst we are continuing to verify whether the full extent has been identified, there is no evidence that we are concerned with anything other than a relatively small number and generally those routes for which in any event there is limited known potential for use. We believe that in applying proportionality ORR needs to recognise that this is the case and, whilst ORR's comments on the function of accurate information for customers and funders are apt in principle and are such that we are taking seriously, we do not consider that there is evidence of significant detriment in the context of the network as a whole that should give rise to an assessment of significant seriousness of contravention.

Culpability

As regards culpability, we welcome ORR's recognition that this problem was inherited from Railtrack. Whilst ORR rightly stipulates that Network Rail is required to address inherited shortcomings in a timely and efficient and effective manner, it must be recognised that since Network Rail acquired Railtrack, it has been addressing a wide range of legacy issues focussing on key priorities identified in conjunction with customers and industry parties. These key priorities have been clearly set out in our annual business plans, of which ORR has had fully visibility. We do not believe that the time over which we have been addressing this is culpable in the context of an appropriate balancing of priorities with which we have been dealing. We comment further below as regards what has been undertaken during that time.

Whether the contravention or possibility of the contravention would have been apparent to a diligent licence holder; and the impact the contravention has had on third parties

ORR considers that a diligent licence holder would have identified the contravention earlier and either started to resolve the problem immediately or stated when and how it proposed to do so. However, initially there was a significant degree of uncertainty as to whether Network Rail was actually funded for aligning discrepancies between actual and published capability. This made it more difficult for us to develop firm remedial plans until confirmation had been provided as to whether funds were actually available under ACR2003 or whether such cost of works would need to be

logged up to the RAB. At this time Network Rail's view was the latter and we subsequently consulted the industry on that basis.

In September 2004 Network Rail met with senior ORR staff to discuss this issue and in particular whether, under ACR2003, Network Rail was funded to maintain the published capability of the network at 1 April 2001 or to maintain the capability for the use of the network (in terms of traffic flows) at 1 April 2001. Clarity regarding this funding was only provided by ORR in July 2005 some 11 months after Network Rail had submitted a process paper to ORR for assessing the implications of new traffic proposals on routes where capability was less than was specified in the Sectional Appendix. Whilst it is accepted that the formulation of the recovery plan has taken time to develop, we do not accept that our conduct in this period fell short of what might reasonably be expected of a diligent licence holder. The course of events between September 2004 and July 2005 should clearly be considered as mitigating circumstances.

In addition, it should be recognised that since December 2004, a huge amount of proactive work has been ongoing to address this matter. During 2005 Network Rail implemented a process for resolving previously identified discrepancies between published and actual capability (shared with industry parties in September 2005), consulted with the industry on a proposed new definition of capability and enhanced the process for dealing with fragile routes in line with customer priorities. Internally, we developed our project planning approach and created a Sectional Appendix Working Group to bring all key stakeholders within the organisation together. This enabled us to develop a more detailed understanding of the implications of errors in the published infrastructure capability for our customers and begin to work on our high level strategy for resolving the matter in conjunction with our Civil, Track and Structural Engineers.

Externally during 2005, we were involved in a regular dialogue with both ORR and our customers (especially EWS) about this matter and were active participants in the Freight Working Group, chaired by the DfT, where infrastructure capability was a key issue of industry debate. We readily acknowledged that infrastructure capability was an area which required close scrutiny and have worked hard in conjunction with our stakeholders to identify the best way forward.

Network Rail has engaged and continues to engage openly with our customers on all of these matters, involving all relevant functions within Network Rail. We believe that we have been able to demonstrate to our customers that we are willing to develop innovative yet practical solutions to long standing industry issues. This proactivity, we believe, has gone some way to mitigating the impact that this breach has had on our customers. Work is ongoing to verify that our knowledge (in respect of those existing elements of the capability of the network which our customers have agreed are most important business needs) is reflected in the published capability of the network.

During the course of 2005, proactive work was undertaken to address a number of matters that were identified with regard to infrastructure capability and whilst it is accepted that the actual formulation of the recovery plan may have taken some time to develop, it is certainly not the case that we let this matter stagnate during 2005, as I hope I have been able to demonstrate.

Network Rail has been very keen to take such steps as are necessary to lead to a sustainable resolution of the underlying issues surrounding infrastructure capability, and which have a wider industry dimension. As regards proportionality, therefore, we believe that this criterion does not point towards a material level of fine.

Whether the licence holder has profited from the contravention

As regards whether Network Rail has profited from the breach, I can categorically assure you that this is not the case. In developing our action plan and undertaking industry consultation in 2005, Network Rail has already expended significant resource in addressing the position and we will continue to do so during the period of completing the recovery plan.

The licence holder's record of compliance or non-compliance with this and other obligations

In terms of the licence holder's record of compliance or non-compliance, ORR highlights that within the last two years Network Rail has been in breach of its network licence in respect of timetabling. In proposing to impose a penalty fine, ORR stipulates that as this is the second time that Network Rail has been found to be in breach of its network licence in a relatively short period of time, a penalty fine is appropriate to incentivise proactive compliance with licence obligations.

In proposing to impose a penalty fine, ORR is clearly signalling that as an efficient network operator Network Rail should not get into a situation where it risks being in breach of its network licence. Whilst we appreciate this as a matter of principle, we do take this opportunity to restate our underlying belief that Licence Condition 7 cannot sensibly be interpreted as an absolute standard but should be assessed taking into account the rate of change.

Under Licence Condition 7 paragraph 2, in assessing whether Network Rail has achieved its purpose it is necessary to have regard to 'all relevant circumstances'. It is Network Rail's fundamental belief that such relevant circumstances include the assessment of a licence breach taking into account all relevant circumstances including other key priorities facing the business and the resources available to deal with these issues. Whilst it is always our aim to deliver a high quality rail infrastructure and related services to our customers and funders, it should be recognised that its achievement needs to be managed through balancing priorities and competing demands for resource. Accordingly, whilst it may be the case that Network Rail could have dealt with this issue sooner, it must also be recognised that

this would have resulted in resources being deferred from other key projects. We believe that since Network Rail has been in charge of Britain's rail infrastructure, we have amply demonstrated our resolve to place the stewardship of the network on a firm footing, fully focussed on passengers and freight customers' priorities of delivering a safe, better performing and more affordable railway. Vast changes have been made and we have worked long and hard to put things right. If ORR is to have regard to any earlier breach of licence, we believe that it is also appropriate in the context of compliance with stewardship obligations to have regard to our overall stewardship performance, and the effectiveness with which we have undertaken this, as the reliability, quality and performance of our infrastructure continues to improve.

Taking all these circumstances into account, Network Rail would urge ORR to review the size of the penalty that it has sought to impose on Network Rail in its finding of breach of Licence Condition 7 in respect of the published capability of the rail infrastructure. We do not believe that any fine is necessary or appropriate to achieve the ORR's stated purpose. If a fine is imposed, we believe that the point can be made with a much smaller fine of, say, £50,000.

In particular, we believe that further consideration of the criteria that ORR has applied in its decision points to a level of proportionality which the proposed penalty level exceeds. As has already been stated, we believe that our compliance plans and the other actions that we have undertaken should significantly mitigate down the level of the fine, and that no more than a nominal level is required in order to enable ORR to make the point that it wishes to make. Should we fail to deliver our recovery plan, within the challenging timescales which we have set ourselves, we believe that this would be a more appropriate time to consider the possibility of financial penalties, which of course is contemplated by your letter under reply.

Finally, I would like to take this opportunity to reiterate that Network Rail will deliver these plans and make good this historical anomaly. Indeed our plans will take us beyond remedy of the identified breach by addressing fundamental long term issues with regard to the definition and availability of information on network capability.

John Armitt