Network Rail
Infrastructure Limited

Annual Report
and Accounts 2009

Innovation in action

Network Rail helps bring Britain together. We own, operate and maintain the rail network, delivering improved standards of safety, reliability and efficiency.

Our investment programme to enhance and modernise the network is the most ambitious it has ever been. We are delivering a 21st century railway for our customers and society at large.

Every day. Everywhere.

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While our railway system is largely a creation of the Victorian era, the management, maintenance and operation of today's railway is based on the most modern techniques and technology.

From new signalling systems to high-capacity track replacement machines via the latest in remote monitoring and measurement, Network Rail is focused on improving the railway using the latest and best technology and management expertise (as illustrated on the cover at Rugby Signal Centre). In this year's Annual Report and Accounts we showcase innovation in action in all areas of our business.

Growing passenger demand and shifting population centres increasingly require new and refurbished stations. In 2008 we opened a new station at Mitcham Eastfields and this year we opened two more, at Corby and East Midlands Parkway. All used modular designs and standardised construction techniques to reduce cost and save time. Modern design, materials and building techniques also reduce energy use and carbon emissions. The lower costs associated with our modular station programme provide a stronger business case for the construction of future stations.

Across the country Network Rail is rolling out a new communications system for Britain's railways using GSM telecommunications technology which requires the installation of mobile telephony masts the length and breadth of the network. The new technology will allow constant contact between individual train drivers and their controlling signal box to improve both safety and performance. Network Rail is pioneering new construction techniques to allow rapid deployment of the 2,200 masts and base stations to save money and time in delivering the project.

Our performance

Safety

Britain's railways are the safest they have ever been and rail is the safest form of transport available. Maintaining and improving safety will always be our top priority.

↓85%

The risk from signals passed at danger is down 85 per cent since 2001, due largely to the introduction of new technology.

10th year

Innovative ultrasonic inspection has resulted in an all time low of 163 broken rails in the year – the 10th successive year of reduction.

Reliability

Passenger numbers continued to rise during the year with around 1.2 billion passenger journeys. Freight traffic volumes suffered as a result of the harsh economic conditions but freight tonne miles have increased by 50 per cent in the last 10 years. All our customers deserve a service that delivers safely, comfortably and on time.

Improving punctuality is an increasing challenge as capacity on the network runs out. Improvements to date are the result of the hard work of everyone involved in the operation and management of the railways – both Network Rail and the train operators. Joint planning and delivery processes have contributed to this, as has the introduction of more integrated control centres.

90.6%

Punctuality for the year reached a new all-time record of 90.6 per cent. This significantly exceeds performance in the final years of both Railtrack and British Rail.

110mph

Our latest track measurement train, featuring ultrasound technology to check track geometry and condition, can operate at up to 110mph.

↓35%

Last year there were 35 per cent fewer delay minutes across the system than five years ago.

£1.4bn

During 2008/09 we spent £1.4bn improving train performance and increasing capacity.

1,100 extra trains

Completing the West Coast Main Line upgrade, on time and on budget, has enabled 1,100 extra trains a week to run on Britain's busiest mainline route.

Efficiency

2008/09 was the last in our five year Control Period 3. Over that period we have consistently reduced our cost base and improved our efficiency.

£2.8bn

Net cash from operations during the year of £2.8bn – all of which has been invested straight back in the railway.

£4.7bn

Some £4.7bn was invested in renewing equipment and improving the rail system during 2008/09.

↓27%

We have reduced our controllable cost base by 27 per cent over the last five years, saving a total of £1.7bn in 2009 prices.

4%

We have improved the efficiency of our expenditure by a further 4 per cent during the year.

People

By investing in our staff, we are building a highly-skilled and motivated workforce with the skills and knowledge needed run a modern innovative railway. By improving the skills base of our employees we can also deliver more work in-house.

We have expanded our graduate scheme by taking on 159 during the year.

200 people

We take on over 200 young people each year for our three year Advanced Apprenticeship Scheme, one of the largest of its type in the country.

0.23 AFR*

During 2008/09 our workforce accident rate was 0.23 reportable accidents per 100,000 hours worked, down from 0.60 in 2002/03. Tragically, however, there were three workforce fatalities in the year.

£27m

We spent £27m on training our people during 2008/09.

The future

Over the next five years, Control Period 4 (April 2009 to March 2014), Network Rail will work with the industry to increase capacity, improve services and modernise the railway for the benefit of all those who use it.

£12bn

We will invest nearly £12bn in improvements to the rail system over the next five years.

37%

We aim to reduce disruption to passengers caused by engineering work by 37 per cent by 2014, compared to 2007/08.

21%

Our target for Control Period 4 is for a further 21 per cent efficiency savings. Technological innovation will be an integral part of improving the business and delivering this level of efficiency.

Financial highlights

For the year ended 31 March 2009	**2009 £m**	2008 £m
Revenue	**6,160**	5,960
Operating profit	**2,544**	2,412
Profit before tax	**1,524**	1,597
Profit after tax	**609**	1,189
Net cash from operating activities	**2,811**	2,434
Net debt	**(22,307)**	(19,743)
Net assets	**7,241**	7,162
Railway network fixed assets	**34,925**	31,443
Value of investment property	**700**	949
Capital expenditure	**4,743**	3,952

* Accident frequency rate

Chairman's statement

Ian McAllister, Chairman

We made an early strategic decision to focus on innovation and new technology

With the completion of Control Period 3 (CP3) in March 2009, Network Rail can look back with pride on its achievements – record numbers of passengers on a record number of trains; passenger satisfaction at 83 per cent has never been higher; 90.6 per cent of trains arrive on time – the highest national figure ever recorded; travel by train has never been safer and remains the safest form of transport; and the Company has reduced by £1bn a year for the British people, the cost of running the railway. Network Rail's success in delivering a high-performing, efficient railway for customers, passengers and freight users is based on long term thinking and planning. Since its inception, the Company has focused on innovation to derive value and efficiency which has helped the Company to deliver success.

This was a highly significant year for Network Rail with the completion in December 2008 of the West Coast Main Line project on time and on budget and the successful introduction of new train services every week under the new timetable. The Company also completed its five year Periodic Review with the Office of Rail Regulation (ORR) which has resulted in its funding settlement for Control Period 4 (CP4), running from April 2009 to March 2014. At the same time, Network Rail has run a very safe railway, provided paths for the highest number of trains ever to run on the network, improved train punctuality to an all time high and kept tight control of costs. Operating profit rose five per cent to £2,544m on the back of higher turnover, up three per cent to £6,160m, and controllable costs which rose 0.4 per cent in real terms to £908m.

To meet growing demand, Network Rail is investing £12bn in the next five years to add capacity and capability to the rail network. The major projects include upgrading the Bedford to Brighton Thameslink line, rebuilding Birmingham New Street station to improve access and facilities for passengers, remodelling Reading station to remove a major blockage, and transforming King's Cross station. In Scotland we are rebuilding a route between Glasgow and Edinburgh and building a new line to Glasgow Airport. These and many other projects are designed to attract passengers to the railway by improving the service for our customers, passengers and freight users.

Our strong financial and operational performance is a result of both a day to day focus on customers and their needs, and of a long term approach to innovation and investment. When Network Rail was created in 2002 taking over from Railtrack, an early strategic decision was made to focus on innovation and new technology as key elements for delivering a safer, more efficient and high performing railway. The Company, and consequently our train customers, passengers and freight users are now seeing the benefits of that strategy. One example was the opening of East Midlands Parkway station during the year. This brand new station is designed to be a transport hub, as it is connected to major trunk roads and next to East Midlands Airport. The station itself is of a standard, modular design to keep production and construction costs low and is built to minimise its carbon footprint. The East Midlands Trains service from the station has proved highly successful since opening in January 2009.

Governments too have gained confidence in the management of the railway and have recognised the need for increased investment because of the importance of rail to the overall economy. Following the 2007 High Level Output Specifications and the Periodic Review process run by the ORR, Network Rail has agreed an investment plan of £35bn for the 2009/14 regulatory period. While the settlement is a tough one – it demands major efficiencies from Network Rail – it is also an endorsement of Network Rail and the industry. For the first time in more than a generation, there will be sustained and major investment in improving the capacity and capability of the GB rail network.

Across the political spectrum, there is now near universal agreement on the need for new high speed rail lines in the UK. The success of Eurostar's move to St Pancras, and the performance of the HS1 line, (the high speed link from London to the channel tunnel which Network Rail maintains and operates), have been important in winning the debate. In January of this year, the Department for Transport set up a company called HS2 to examine the need for more high speed lines, and it is expected to publish comprehensive recommendations early in 2010. Prior to this, Network Rail will publish its New Lines Study. While the change in the political environment towards rail investment is very welcome, it is important that political thinking and decisions are consistent. As our roads become ever busier and the pressure mounts to limit the country's carbon emissions, the strategic advantages of rail as a high speed, mass transit system become clearer. The rail industry needs a consistent and stable approach from Governments to allow it to make major investments in the future.

Operationally, we continue to make steady improvements, for which the dedication of our employees is crucial. With much of the rail network running at near capacity, and increasing pressure on operations, they continue to respond magnificently. I thank every employee throughout the Company.

There have been a number of changes to the Board during the year. In October 2008 three of our senior executives, Robin Gisby, Simon Kirby and Paul Plummer, joined the Board. They were appointed to add strength and capability to the Board and to provide a good balance with our non-executive team. In March this year Rick Haythornthwaite, Chairman of MasterCard and former Chief Executive of Invensys and Blue Circle joined as a Non-Executive Director.

Ron Henderson, Group Finance Director, who had been with the Company since its inception, retired in April. On behalf of the Board, I would like to thank him for his significant contribution to Network Rail. Patrick Butcher, previously Finance Director at English Welsh and Scottish Railway (now DB Schenker) is his well qualified successor.

At the Annual General Meeting of Network Rail Limited in July, Jim Cornell will be retiring from the Board. I am most grateful to Jim, as is the whole Board, for his valuable guidance and support. I also intend to stand down and Rick Haythornthwaite is my nominated successor. After nearly eight years with Network Rail, I am pleased to be handing over a well run, innovative and efficient Company with a strong management team. I am very proud of the Company's achievement in that time and am confident that the Company will continue to be successful. I wish Rick, Patrick and all the people of Network Rail the very best for the future.

Ian McAllister
Chairman
3 June 2009

I am pleased to be handing over a well run, innovative and efficient company with a strong management team

Chief Executive's review

Iain Coucher, Chief Executive

The last seven years have seen huge change. Network Rail is now at the highest levels of performance since records began. This record performance has been achieved while we run the highest number of trains ever seen on the network.

Looking forward, if we are to meet the CP4 challenges of a growing railway and meet the expectations of passengers and our train and freight operating customers, we need to deliver even more.

We have shown we can deliver, and so when we look to the future we do so with optimism and confidence.

Iain Coucher
Chief Executive
3 June 2009

Our strategy is focused on innovation to deliver its business targets

Iain Coucher answers your questions

Why is 'innovation' the main theme of this Annual Report?

Because we want to correct a misconception that the railway industry and Network Rail are old fashioned and use outdated technology. This is not the case. Our strategy is focused on innovation to deliver its business targets, whether that's in engineering, property, operations and customer service, maintenance, or the way we plan the future of the rail network. Innovation, finding new and better ways of doing things to deliver value for customers, passengers and freight users, is vital to the Company. As we move into a new control period, with really tough efficiency and output targets, we are planning further ways to make innovation central to the way Network Rail works.

So how has the business performed?

Firstly, the operating profit of £2,544m is right in line with our expectations and the regulator's assumptions. We kept good control of our operating costs and we ran more trains than ever before. The completion of the construction phase of the West Coast project is a good example of this. We delivered the project on time despite the overruns we had at New Year 2008, and finishing the upgrade has allowed us to run 1,100 extra trains a week. In response to last year's overruns, we have changed the way that we undertake major engineering work over weekends and bank holidays to reduce risk of delays and also to keep sharper hold of costs and value. Looking forward, we have proposed a new regime for engineering possessions that will minimise the number of times passengers have to transfer to a bus service and hope that the entire rail industry will sign up to this.

Going back to profit, you also have to look at our funding sources and the return that we are allowed to generate on our asset base for a full explanation. During Control Period 3 (CP3) our return on assets was fixed at 6.5 per cent. To achieve this we charged the train and freight operators to use the network, received Government grants, borrowed money, and raised money through our commercial real estate. In the last year alone, the value of our commercial property portfolio has dropped by £208m as a result of general economic conditions. This is reflected in our Income statement and has had a significant impact on our profit before tax.

As a monopoly what incentives do you have to drive improvements in the business?

Network Rail is price regulated by the Office of Rail Regulation (ORR). Price regulation caps the allowable return on our asset base and sets tough targets for the Company to meet. In the Control Period 4 (CP4) settlement we are pleased that the ORR has focused on Network Rail's outputs, such as overall on-time train performance and safety. Previously, targets were much more prescriptive, so we expect this new approach to drive further innovation and focus in our Company. Although regulation is designed to drive efficiencies and prevent abuses of a dominant position, our ambition for the Company is to be much more successful than this. Our ambition is to be a world class company. For example in the UK, Network Rail is the major player in the railway market and in some sectors there is a lack of competition and choice of supplier. We are therefore looking to tap into the bigger continental supply base and stimulate competition by making it easier for suppliers to serve the UK market.

What have been the highlights of the year?

Undoubtedly our completion of the construction phase of the West Coast project and introduction of the new timetable. We took over the project from Railtrack and it was in a mess. The projected costs were £14bn and the stakeholders had lost confidence in that Company's ability to deliver it and run its overall business. Together with the Strategic Rail Authority, Network Rail reconfigured the project so that it was deliverable and affordable. I am very proud of the results and all the efforts that our people and our suppliers have put in. We have rebuilt the busiest route in Britain while keeping the trains running, and passengers and freight users have got a great service as a result – more trains and more seats, faster intercity journeys, fewer delays and a smoother ride. It is a great advert for a modern, mixed use railway.

The other achievement that stands out was the completion of our Periodic Review and the CP4 financial settlement. This was a long and difficult process that has resulted in some very challenging targets, but that ultimately delivered a five year financial plan acceptable to Network Rail, and to the ORR, yet is within the Governments' funding plans. Just as importantly it will deliver value for our train and freight customers and better services for passengers. And we achieved it in a constructive manner that bodes well for our long term relationship with the ORR.

What about the overhead line problems on West Coast and Virgin's reaction?

It's true that we had issues with the overhead lines, but as confirmed by the Office of Rail Regulation, the causes weren't connected – one was from a light aircraft crashing into the lines. The problem we had was that the disruptions were on consecutive days and this compounded the annoyance felt by the thousands of passengers who were inconvenienced. But I have always maintained that you have to judge the infrastructure over a longer period. All our research shows that passengers are enjoying the new services. As to Virgin's reaction, it's important not to exaggerate our differences. Together, Network Rail, Virgin and London Midland have introduced a very high frequency timetable, for example there is a Virgin train every 20 minutes to Manchester. Quite rightly however, they hold us to account for the performance of the network and quite rightly are exercised when things go wrong. Virgin is as tough as anyone in negotiating with Network Rail, and when criticism gets into the public domain it can be taken out of context. That's one of the ways our stakeholders hold us to account, but our relationship with Virgin and other train operators is focused more on how we improve joint performance in the future rather than public debates about yesterday's trains.

How does Network Rail's innovation help the train and freight operating companies?

We are very focused on delivering value to customers and improving the performance of the network. In the five years of CP3 we improved on time train performance by seven percentage points from 83.6 per cent to 90.6 per cent and we are running over one thousand more trains every week. The network is more heavily used than ever before. This allows the train and freight operators to run more trains to meet demand and increase income, and make better use of rolling stock to reduce unit costs. Better performance also helps improve the image and marketability of the railway.

We have innovated in many different ways to deliver these results. One of the simplest ways is through our joint operations centres with the train and freight companies. We now have a number of joint control centres where Network Rail controllers and train controllers sit alongside each other to improve the speed and quality of operational decisions. Our joint teams better understand how each other works and can take better decisions and make improvements that benefit passengers.

Our innovative approach to remote condition monitoring of lineside equipment is part of wider strategy to minimise emergency maintenance which tends to be more expensive and often

We are focused on delivering value to our customers and improving the performance of the network

Our task is to transform our business. It involves everything from our processes to our office accommodation

results from a failure and consequent disruption on the railway. This move to a predictive and preventative maintenance approach allows us to prioritise our maintenance work more efficiently, reduce the need for visual inspections and deliver a safer more reliable network by solving potential problems before they impact passengers. In terms of track maintenance, we have invested in a high-tech track measurement train with the latest in ultrasound technology to check the condition and geometry of the track. The 110mph train allows us to check large sections of track overnight. We also use helicopters equipped with thermal cameras to assess the condition of power supply equipment. This has revolutionised our approach and productivity and greatly improved the performance of our assets.

What role will innovation play in delivering your CP4 targets?

Innovation will have a huge role. Our task is to transform our business so that we can meet our outputs and improve efficiency – that's the scale of the task set to us by the ORR. We are deliberately using the word transformation – it's a big word for a big change that will impact every part of Network Rail and every one of our employees. And it means more than reorganising and streamlining the business. It involves everything from our processes through to our office accommodation. Let me give you a couple of examples. We will be consolidating our operations in a new purpose built centre in Milton Keynes and moving people from across the country. Not only will this save us a lot of money as leases on old buildings expire, it will also allow us to introduce the latest technologies and encourage new and more efficient ways of working across teams.

A second example of our transformation programme is the way we are looking at the plant and equipment we use on the railway. During a single year we spend millions of pounds on the contract hire of road-rail equipment – construction machines adapted to work on the railway. Our data shows that there are numerous incidents each year using this equipment. The problem is that these machines are not designed specifically for railway use. So as part of our transformation programme we are working with manufacturers to redesign the equipment, and with the contracting industry to improve safety and drive down costs. This is a fundamental reappraisal of the way we do things that should lead to big wins for Network Rail.

Is your transformation programme designed to save money or provide better service?

It's designed to do both. Cutting service to customers or running down the network simply won't work. We have to run the railways in a way that is sustainable and delivers long term benefits as well as meeting shorter term targets. Take our award winning Advanced Apprenticeship Scheme. We take on over 200 apprentices every year and put them through an intensive three year training programme. This is a real innovation in learning and is widely recognised as one of the country's leading residential engineering apprenticeship schemes of its type. By investing in our staff, we are building a highly skilled and motivated workforce who have the requisite skills and knowledge for a modern innovative railway. By improving the skills base of our employees we can also deliver more work using our in-house experts instead of always going to the outside market where costs tend to be higher.

At the same time we are mindful of the need to maintain a competitive and cost effective supplier base. Take our track suppliers. Our current unit rate for track renewal is too high and it is more cost effective to extend the life through other forms of investment. So we have re-phased our renewals programme for CP4 and worked very closely with our partners to allow them to improve efficiency, yet retain certainty about future business – hugely valuable in the teeth of one of the worst recessions since World War II. This is a tough but responsible approach and encapsulates our vision.

How are staff responding to change, there appears to have been a lot of union activity?

People always worry about change and ours are no exception. Network Rail has a low staff turnover because our people are loyal and enjoy working in the industry. We also provide good jobs, good pay and good pensions. So this is about balance and working responsibly together. In terms of our unions, we understand that there is a lot of uncertainty about the consequences of the recession and the

CP4 plans. We are looking to work with the unions to make the changes that will enable us to forge a strong industry. I don't underestimate the scale of the challenges ahead, but I am optimistic that our people will recognise and respond to the need to adapt and change.

Let's move on to high speed railway. What are your views?

My first reflection is just how far things have changed in the six and a half years since Network Rail took over. When we started, it was the nadir of the railway industry with Railtrack in administration and Network Rail tasked with rescuing the operation of the country's rail infrastructure. Fast forward the years and we have a five year, £12bn programme of railway improvements and political unity on the need for high speed lines. In part that is because the railway is performing well and its day to day running has become de-politicised. Network Rail can take some credit for delivering this. But it is also down to prevailing political mood – the acknowledgement that investment in infrastructure is a long term business that needs consistent investment from Governments.

There is also no doubt that climate change, alongside the recession, are the prevailing influences on public policy, and rail scores highly on both counts – it is a catalyst for economic development and is a very low emission form of transport. Put this together with increasing congestion on the roads and you have a potent combination. On the specifics of high speed lines, I am leaving this to our New Lines Study which will be published later this year, and the work of HS2 – the company examining the case for high speed lines. Suffice to say that Network Rail is in favour of new railway, we want to increase our share of the transport market, and we want fewer people to travel by car or by air.

What about fares?

Fares are a crucial part of the railway package. There are some great deals for passengers who book ahead and travel off-peak, but research shows that passengers are unhappy about the cost of peak fares. Rail has many advantages over other modes of transport in terms of speed, lower carbon emissions and its ability to move large numbers of passengers or volumes of freight.

We believe these advantages should mean rail is recognised as the integral part of Britain's 21st century transport network – fares and transport planning should reflect its status. A transport and fares policy that favours rail will allow us to be radical in our thinking and planning. Instead of passengers feeling priced off the railway, Governments should be looking at pricing people onto trains in the medium term.

If Governments are to provide a genuine alternative to the car for shorter distances and the plane for intercity journeys, it cannot ignore the impact of ticket price. Over the years the demographic using the railway has narrowed. This cannot be right. Railways should be available for all – the modern equivalent of the penny railway. Addressing the issue of price will require a radical rethink of budgeting and capacity planning, but will deliver major benefits for the general public, passengers and the UK economy, and is also vital if the UK Governments are to actually meet carbon targets rather than treat them as aspirational. As climate scientists increasingly believe that the rate of environmental degradation is quickening, UK Governments policy needs to recognise the requirement to up the pace of our move to a low carbon economy.

What are you doing to reduce overcrowding on trains?

Lots! It is the number one issue that passengers want us to address. Across the network we have a programme to lengthen platforms and run longer trains at peak hours – and we are looking at where we can squeeze even more trains into the busy timetable. We are also looking at new innovations to see how we can do it cheaper and quicker so that passengers feel the benefits earlier – at our new station at East Midlands Parkway for example, we used new materials and techniques to do just this.

Elsewhere, we are improving Birmingham New Street and King's Cross stations to improve facilities and capacity for passengers, and rebuilding a line in Scotland between Edinburgh and Glasgow and building a new line out to Glasgow airport. But our biggest programmes are aimed at improving London's rail transport system with the Thameslink, Crossrail and Olympics work; improving the Western route which goes to Bristol, Cardiff and beyond; and providing many more train paths to freight users, for example by upgrading diversionary routes on the East Coast route. The growth of freight traffic is a very important part of our strategy and we have ambitious plans to grow that market further. By taking freight trains off the main lines, we will have more space to run passenger services.

Finally, we should not forget the new high speed commuter service from Kent on the high speed line into St Pancras owned by London and Continental Railways and maintained and operated by Network Rail. This new service will give Kent commuters faster journey times, relieve pressure on the existing network and give passengers an increased choice of speed, destination and fares. All in all these are ambitious plans to improve the network and the experience for passengers right across the country.

Network Rail features a lot in the media, does that concern you?

Only when things are taken out of context or ill informed – overall I think the media interest goes with the territory. Although a private company, we provide a public service and should be held to account when our performance is not good enough. But we also deserve credit for the major improvements we have made to the railways. This report can play a part. It is here to show how we run our business and the performance we deliver for our stakeholders.

Group Finance Director's review

Patrick Butcher, Group Finance Director

We are embarking on a period of very significant investment and expansion

This year end was a significant milestone in the history of Network Rail as 31 March 2009 marked the end of the five year settlement, Control Period 3, determined by the ORR.

This is my first Group Finance Director's review for the Company. I would like to take this opportunity to thank Ron Henderson, the Group Finance Director since inception of the Company, for the legacy left by his able financial leadership. The Company has a strong and stable financial base and the results are in line with our business plan and improve on last year's results.

Looking back over CP3, it is clear that the Company has a story of success to tell. Huge progress was made towards meeting demanding efficiency challenges with the underlying cost base being reduced by 27 per cent, a hugely creditable achievement even though it fell short of the overall target of 31 per cent, largely as a result of difficulties in driving down the cost of track renewals.

The key measure of financial success for CP3 is that we outperformed the regulator's determination by over £0.9bn. Considerable benefits have been generated through the regulatory incentive mechanisms on asset stewardship and passenger volumes as well as train performance payments and interest costs. These reflect the improvements the Company has made to its operations, performance and financing during the control period.

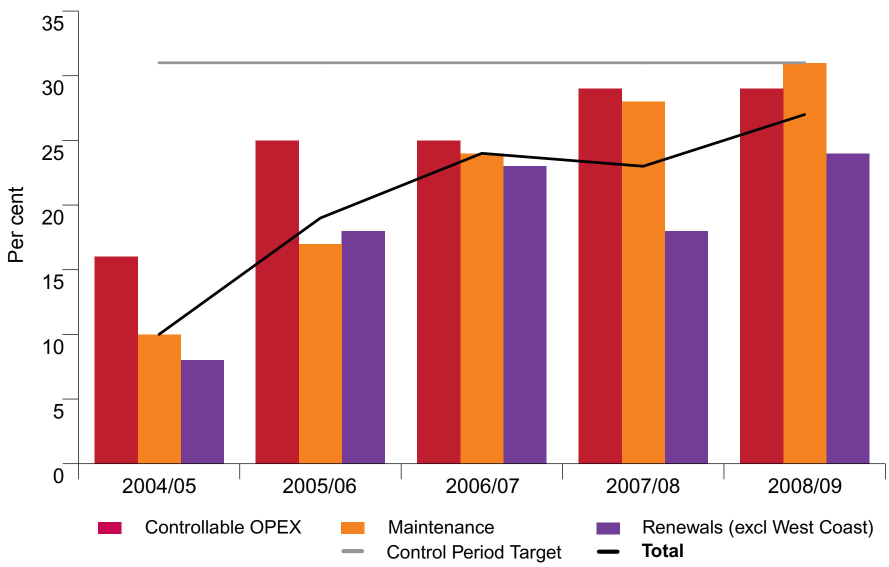
The challenges of the future as the Company enters CP4 are to build on its successes. The Company has embarked on an exciting transformation programme that will drive step changes to the way we operate to address the challenges, and take advantage of the opportunities that CP4 offers. Our driving ambition is to develop a railway that responds even better to our customers' needs within the financial constraints of the regulatory regime.

The recently published CP4 Delivery Plan provides more details about how we will take the railway forward over the next five years. This is a very exciting time for Network Rail as it embarks on a period of very significant investment and expansion.

Performance against the ORR Control Period 3 determination

The graph below demonstrates the progress made in improving the efficiency of the business during CP3. In financial terms it is worth £1,705m at 2008/09 prices.

Efficiencies delivered – Control Period 3



Performance in 2008/09

The year saw a good performance in maintenance where costs fell by four per cent in real terms through a combination of tight cost management, control of headcount, productivity improvements and organisational change. Overtime costs and the number of labour sub-contractors were both reduced for core work. In many instances employees were used on other work which would otherwise have been carried out by contractors, thus minimising the loss of work for our staff.

The amount of technical training provided to front line staff was significantly increased, improving productivity. Implementation of a new maintenance management organisation provided supervisors with dedicated administrative and planning support. They now spend more time on site, which has been a major factor in increasing workforce productivity during the year. The number of maintenance delivery units was reduced and an entire organisational layer eliminated. However, there are more opportunities to drive further productivity improvements, which will be implemented in the coming year.

Renewals efficiency improved in the year, bettering the annual target of five per cent. As mentioned above, driving down the cost of track renewals has proved difficult. Action taken in early 2009 to reduce volumes has provided the opportunity for us to address this in coming years.

During 2008/09 we delivered a substantial investment programme totalling £4.7bn. In December 2008 the West Coast Route Modernisation Programme was completed on time, a massive project and a great success for customers. The successful completion of the first major milestone on the Thameslink project is another example of our ability to manage and deliver high profile works. This milestone enabled the timetable changes in March which created capacity for almost twice as many trains through the heart of London between Blackfriars and St Pancras – and it allows Network Rail to continue transforming the line and its stations at Blackfriars, Farringdon and London Bridge to accommodate longer, more frequent trains.

In our recently published CP4 Delivery Plan we focus on sustaining high levels of investment in the network to help meet the demand for a bigger, modern railway. In particular we plan significant enhancement expenditure to improve train performance and increase capacity. During 2008/09 we invested £1.4bn enhancing the network and plan to deliver a similar amount in 2009/10. A key focus of our enhancement spend is on increasing capacity on the network. The King's Cross, Thameslink, East Coast Main Line improvements and Crossrail projects are four major schemes that will be undertaken during CP4 to meet customer demand.

Financial performance in 2008/09

Financial highlights

- during the year the Group generated cash of £2,811m (2007/08: £2,434m) from operating activities. The increase in the year was due to increased operating profit and working capital movements. All of this cash was used to fund the investment programme
- turnover was £6,160m an increase of £200m against prior year of £5,960m
- operating costs before depreciation totalled £2,463m, an increase of £74m compared to the prior year total of £2,389m but representing an £82m saving after adjusting for inflation
- profits of £70m were achieved from the sale of properties (2007/08: £62m)
- net interest charges before remeasurements of debt and derivatives fell by £72m to £810m from £882m last year, despite increases in net debt levels from £19.7bn to £22.3bn. This has been achieved by benefits from RPI index-linked debt and efficient cash management
- through increased efficiencies this year the Company delivered a substantially improved financial efficiency index (FEI). The FEI is a weighted index of controllable opex, maintenance, track renewals and major resignalling schemes intended to measure the value for money of the Company's spend in relation to prior years. The final FEI at 31 March 2009 stands at 75.3, which is an actual improvement of some 3.6 per cent on the prior year. In financial terms this represents a reduction of £113m in the cost of performing work on the railway.

Carrying value of the railway network

The value of the railway network has increased by £3.5bn from £31.4bn to £34.9bn. The increase in the carrying value reflects capital expenditure of £4.7bn less depreciation of £1.2bn and a downwards revaluation of £113m, primarily because the ORR Regulatory Asset Base (RAB), on which the valuation is based, was amortised at a faster rate than the depreciation charge.

Under depreciated replacement cost accounting the network is valued in the accounts at the lower of its same state replacement cost (which is estimated at circa £75bn) and its value in use. This value in use is derived from a discounted future cash flow that assesses the value to the business of the net income stream produced by the railway network. This is a function of the RAB set by the ORR which is used as a proxy for that value together with appropriate adjustment for any forecast cash flow variance from the determination.

The RAB anticipated in the Access Charges Review 2003 for 31 March 2009 was £30bn. The actual ORR RAB is £4.4bn higher, which represents the value to the railway network by Network Rail in the form of additional enhancements of £1.4bn and rewards for better performance. Rewards for better performance came as a result of better Asset Stewardship (£0.4bn) and higher Passenger Volumes (£0.6bn). These represent rewards for achieving much improved levels of asset condition and for increasing the amount of usage of the railway network across the control period.

Pensions

Included within the Income statement for the year is a charge of £135m (2007/8: £107m) for pension costs. The balance sheet liability (which represents the Company's share (60 per cent) of the deficit of the Network Rail section of the Railway Pension Scheme (RPS)) increased by nearly 79 per cent from £370m to £664m. The main driver for the increase in the pension deficit has been the 28 per cent reduction in the value of pension fund assets in the year, as a result of global falls in equities and other assets. Over the same period the FTSE 100 fell by 34 per cent.

The level of pension deficit stands at 33 per cent (2007/08: 17 per cent) when comparing the scheme's assets to its liabilities. This is a significant issue for both the Company and the scheme members and it is something that the Company, and the trustees of the scheme, keep under close review.

The Company has taken action to address these issues and during the year introduced a career average revalued earnings pension scheme (CARE) to offer employees a defined benefit pension on a more affordable basis. Changes to the RPS have also been agreed to address the rising costs of the final salary scheme.

Taxation

The tax charge for the year is £915m (2007/08: £408m). Except for £9m (2007/08: £14m) all of the tax charge is deferred tax. Deferred tax is provided on timing differences in recognising gains and losses for tax purposes and accounting purposes. The tax payable relates mainly to profits from the Group's property portfolio.

The most significant movement in deferred tax arose as a result of legislation to phase out Industrial Buildings Allowances over a four year period from 2008. The cost to the Company of this lost benefit has been assessed as £524m.

Cash flow and financing

Network Rail's principal financing vehicle is Network Rail Infrastructure Finance PLC (NRIF), a special purpose financing company, which acts as the issuer under Network Rail's Debt Issuance Programme (DIP) and is not a member of the Network Rail group, although for accounting purposes NRIF is treated as a subsidiary in the consolidated accounts of Network Rail Infrastructure Limited.

The DIP is supported by a financial indemnity from the Secretary of State for Transport which expires in 2052. As at 31 March 2009, substantially all Network Rail's long term debt is covered by the DIP. Within the DIP is a £25bn note programme which has the highest possible rating (AAA by Fitch, Aaa by Moody's and AAA by Standard and Poors).

The DIP allows access, through a single platform, to the widest possible sources of funding, at the lowest possible cost, including the long term capital markets. This gives Network Rail a stable base for financing a continuing programme of long term investment in the national rail network.

In April 2007 Network Rail launched a programme of RPI index-linked bond issuance under the Company's DIP. The majority of Network Rail's revenues are linked to inflation so aligning the cost of debt to income is a prudent, cost effective way of financing the railway over the long term and for that reason Network Rail will look to issue more index linked debt in the future. As at 31 March 2009, over 40 per cent of net debt was in index-linked format.

During the year ended 31 March 2009 £6.4bn of bonds have been issued (including premiums of £0.2bn) under the DIP, £3.9bn of which was long dated inflation linked and $2.25bn (£1.3bn) in nominal US Dollars. As with all previous non-sterling public issuance under the programme the US Dollar issuance was swapped into fixed sterling payments to protect against movements in interest and foreign exchange rates.

The Company had £5bn of undrawn committed facilities available at 31 March 2009 through the DIP working capital facility (£1bn) and the Secretary of State for Transport standby facility A (£4bn).

Treasury operations

The Group's treasury operations are co-ordinated and managed in accordance with policies and procedures approved by the Board which prohibit trades of a speculative nature. The treasury department is subject to regular reviews by the Internal Audit function.

Group policy is to ensure that there are sufficient facilities (excluding refinancing of existing debt) and short term investments to cover, as a minimum, the next 12 months' funding requirements.

The major financing risks that the Group faces are its foreign exchange risk, interest rate fluctuation risk and liquidity risk. Treasury ensures sufficient liquidity is available to meet the Group's needs, while reducing financial risks and prudently investing surplus cash.

Counterparty limits are set with reference to published credit ratings. These limits dictate how much and for how long Treasury may deal with each counterparty and are monitored on a regular basis.

Financial instruments

The Group uses derivative financial instruments to hedge exposure to foreign exchange risk and interest rate movements. This is in accordance with a comprehensive risk management process which is monitored by the Board through the Treasury sub-committee and includes documented treasury policies, counterparty limits, controlling and reporting structures.

The net fair value of derivatives on the Group's balance sheet at 31 March 2009 was an asset of £919m (2007/08: asset of £276m) based on a notional value of swaps of £20.0bn (2007/08: £10.3bn).

The net impact on the Group's Income statement of hedging in the year ended 31 March 2009 was an expense of £72m (2007/08: income of £33m) and a negative movement in the Statement of Recognised Income and Expense (SORIE) of £347m. This SORIE movement reflects the Group's cash flow hedges increasing in value by £44m, off set by £391m of foreign exchange losses in the underlying hedged debt.

The reason that the gains and losses in the accounts are not equal and opposite is that the hedging instrument protects against movements in interest rates as well as foreign exchange. It follows that if the value of the derivative was split into its constituent parts it would show broadly £391m of foreign exchange losses were avoided by hedging, but around £347m of additional interest was payable as a result.

Summary

This year saw Network Rail again delivering a strong, stable and efficient financial performance, which supported record investment into the railway network. As I outlined at the outset of this report the last five years have seen the Company reduce its operating cost base by 27 per cent. The next five years will give the Company a huge opportunity to build on its successes and to further enhance its reputation for delivering an expanding and increasingly cost efficient railway.

Patrick Butcher
Group Finance Director
3 June 2009

A strong and efficient financial performance, which has supported record investment

Directors' report

Under its network licence the Company is required to publish such corporate governance information as would be required if it was a listed company and also to comply with the principles of good governance and code of best practice under, or approved for the purposes of, the listing rules of the Financial Services Authority. As such, it is publishing this Report and Accounts which contain information required to be disclosed by a listed company.

Details of the Group's business activities, key events and changes during the year and likely future developments are contained in the Chairman's statement, the Chief Executive's review and the Group Finance Director's review. This Report should also be read in conjunction with the Corporate governance report and the Directors' remuneration report set out later in this document. All the information detailed in those sections of the Annual Report which is required for the business review, or otherwise for this Report, is incorporated by reference in (and shall be deemed to form part of) this Report.

Business review and principal activities

Network Rail Infrastructure Limited has responsibility for the management of the national rail infrastructure. Its principal activities are the operation, maintenance, renewal and, in co-operation with train operators and funders, the development and enhancement of the national rail network and in particular:

- provision to train operators of railway track access
- management of train timetabling, train planning and signalling
- maintenance, renewal and enhancement of the infrastructure and undertaking major capital programmes.

In June 2005 the relevant provisions of the Railways Act 2005 came into force facilitating a number of significant changes to the structure and organisation of the railway. These included giving Network Rail additional responsibilities for industry performance, planning and projects. The changes were designed to deliver improvements in reliability and the effectiveness of industry planning, building on the already close collaboration between Network Rail and train operators. Since 2005 Network Rail has been progressing with its responsibilities.

Results

The profit before tax was £1,524m (2007/08: profit of £1,597m) and the profit after tax was £609m (2007/08: profit of £1,189m). Further details of the financial results can be found in the financial statements commencing on page 60.

Share capital

50,084,937 ordinary shares of 0.1p and 160,000,000 redeemable shares of £1 of the Company are held by its immediate parent company Network Rail Holdco Limited.

Key future issues and delivery plans

Given the nature of its business and the environment within which it must meet the challenges involved, the key future issues for the Company and remain consistent with those reported in the Annual Report for 2008. Now that its targets and funding for the next five years (CP4) have been settled within the Periodic (on Access Charges) Review 2008 by the Office of Rail Regulation for the period from 1 April 2009 to 31 March 2014 (CP4), Network Rail is able to focus on the delivery of those targets within that funding (CP4 determinations).

Details of Network Rail's plans are contained in the CP4 Delivery Plan published on 31 March 2009 which is available on Network Rail's website: www.networkrail.co.uk. The following sections provide a summary of those delivery plans.

General

Network Rail's key priority remains the delivery of a safe, reliable and efficient railway working with our industry partners to provide acceptable and improving levels of performance. Looking forward it intends to achieve further sustainable improvements for its customers, employees and wider stakeholders. It is also seeking ways to meet the increases in demand for both passengers and freight traffic.

The emphasis of the CP4 determinations is on the delivery of the achievement of outputs in the next control period. This is the first time the new periodic review process has been tested following the Government's Railways Act 2005, that asks governments in England and Wales and Scotland to specify what outputs are to be delivered in CP4 and how much funding is available.

A far wider range of outputs has been specified through this periodic review than those set out in the 2003 Access Charges Review; covering safety, performance, network capability, capacity and availability within a whole industry and system context, as well as specific asset-related measures for stations and depots.

In accepting the CP4 determinations, Network Rail's challenge now is to deliver all the required outputs whilst making further efficiency savings in the cost of operations, delivering its investment programme and sustaining the rail network for the longer term. To meet the challenge of delivering more value to its customers, the plan will evolve and change during the control period as Network Rail identifies more efficient ways of delivering the outputs.

The plan has been developed with the support of Network Rail's customers and other stakeholders. Similarly its delivery requires their support. Its relationship with its customers is one that Network Rail must work hard to sustain and develop. This is a great opportunity to consolidate the rail industry behind a plan. Looking further ahead, this plan will need to be built upon by working more closely with customers to develop plans for Control Period 5 (CP5) and beyond making the best opportunity of the significant business improvements made over the last six years.

Network Rail's aims

Network Rail's challenge is to deliver what passengers, freight-users and its customers, the train operators, expect of it in terms of safety, punctuality, availability and project delivery. See a summary of Network Rail's aims to achieve this in the table on the right. The Company must do this in a way that offers better value for money and affordability. Meeting these expectations requires a strategy that recognises a safe, high-performing and cost-effective railway needs

- reliable infrastructure and excellent operations to eliminate predictable failures and meet demand at an affordable price
- integrated processes that
  - deliver consistent high quality with speed and simplicity
  - operate effectively within functions and across external interfaces
  - are subject to continuous improvement
  - are used as a benchmark for other organisations and industries
- people who
  - live and breathe the Company's values and behaviours
  - are highly engaged, accountable, excellent at leading, managing and delivering
  - are sought after by other organisations.

Managing business performance

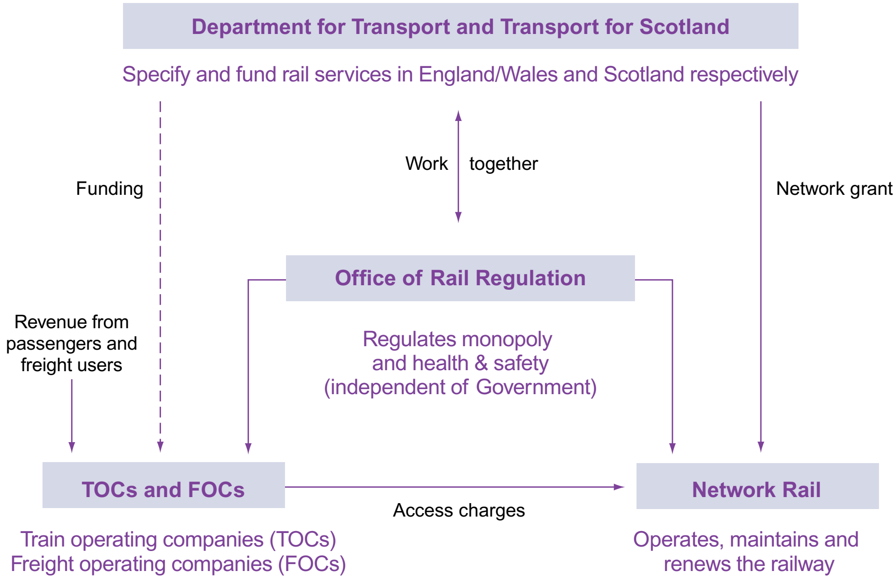
It is vital that Network Rail monitors the right performance measures and manages its business activities to deliver improvements in performance in order to achieve its aims and objectives.

The Company has an established work programme to introduce a new suite of key performance indicators (KPIs) with the explicit objective to provide insights to its leadership team as to what the business is doing on a daily basis to meet the needs of its stakeholders and enable its corporate vision to be achieved through fact-based decision making.

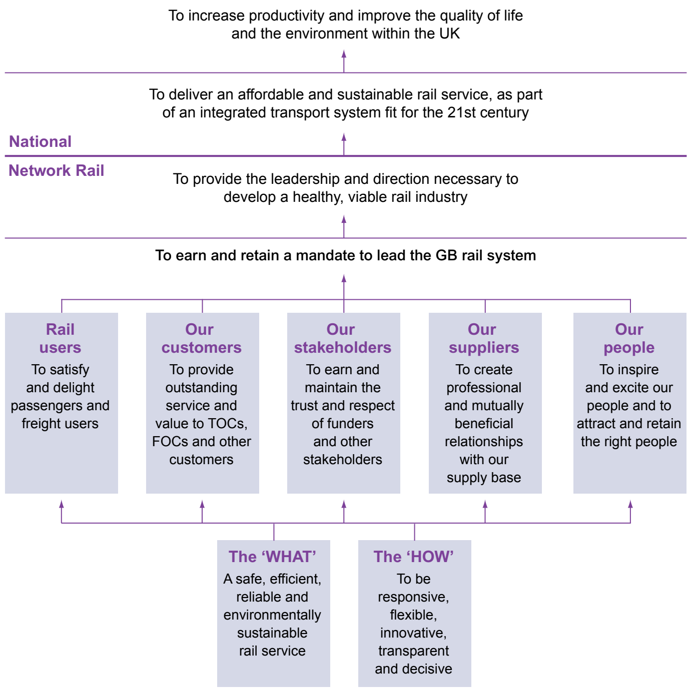
Within this framework Network Rail can set targets that, if achieved, will provide the levels of performance that will translate into customer and wider stakeholder satisfaction, and the achievement of the outputs required of it in CP4. The measures can be cascaded down through functional and operational measures into team and personal objectives in order to drive a consistent and common set of decisions and behaviours.

The KPIs are shown in the table on page 16. The measures selected create a balanced scorecard that addresses all the key aspects of the business. This balanced scorecard was introduced into the business in 2009/10 to inform key Company management processes including Executive and Board meetings, functional management reviews and investment authorisation.

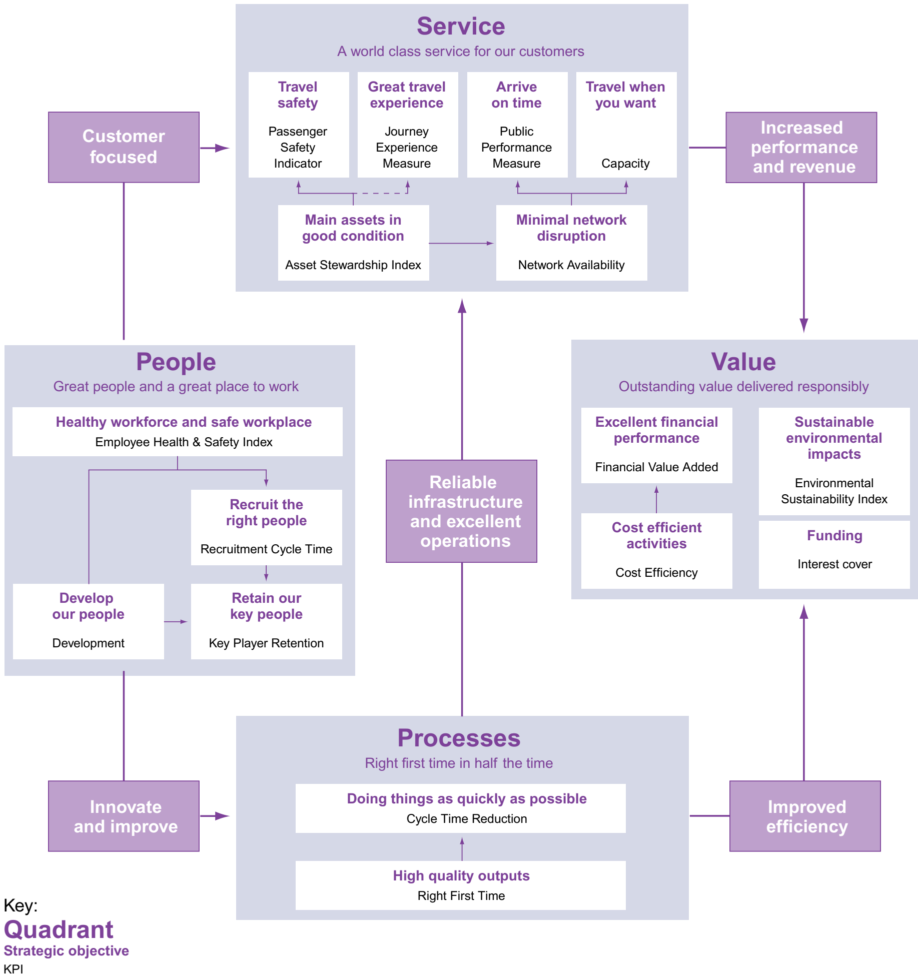
How Network Rail is regulated



Network Rail's aims



Key performance indicators



Key performance indicators

CP4 outputs

The outputs required from Network Rail for CP4 are detailed in the ORR's CP4 determinations. These can be illustrated by the diagram on page 17.

Network Rail's plans for CP4 cover:
- operating and maintaining the network
- renewing the network
- enhancing the network
- deliverability of the investment programme
- delivering the outputs
- income
- financing
- monitoring and change control.

The funding available to Network Rail is insufficient to afford the level of activity and scope contained in its plan at current levels of efficiency. Through its transformation programme, which is described on page 19, the Company is identifying and implementing opportunities that will enable it to deliver the outputs within the funding available and, in doing so, provide opportunities to deliver further benefits in the longer term. The plans for CP4 will be refined and updated as Network Rail progresses through the control period.

In relation to these outputs the key areas of focus are summarised below.

Safety

Whilst rail continues to be the safest form of transport in Britain, the Company's primary focus is for constant vigilance in maintaining safety of the railway.

Continuing improvement has been made in most of the key safety performance indicators. The risk from signals passed at danger is down by 85 per cent since 2001, due largely to the introduction of technology – Train Protection Warning System (TPWS) and TPWS+. The number of broken rails continues to reduce to another all time low.

Tragically there were three workforce fatalities in 2008/09. The workforce accident rate, however, has declined markedly over the last six years. At the end of 2008/09 the rate was down to 0.23 reportable accidents per 100,000 hours worked (previously in 2002/03 it had been 0.6).

Safety on the railway depends largely on the proper design, construction, maintenance and operation of the network. Most safety improvements will come from more effective and efficient development and management of the network rather than from specific safety initiatives. The health and safety plan for CP4 is based, therefore, to a large extent on the impact that Network Rail's asset and route strategies will have on overall safety performance.

The target for CP4 is to achieve a three per cent reduction over the control period in the risk of death or injury from accidents on the railway for passengers and rail workers. The measurement of these risks will be by reference to the Rail Safety and Standards Board's Safety Risk Model.

The largest contributor to the reduction in passenger risk is station-related through improved design, signage and lighting, surveillance and CCTV initiatives, staff training and emergency planning. This is expected to account for just over 90 per cent of the passenger related risk reduction. The second largest contribution (2.4 per cent) is the reduction in track faults including fewer broken rails, improved geometry and fewer gauge faults. The third biggest contributor (two per cent) is the reduction in level crossing risk through renewal including technology improvements, level crossing closure programmes as well as media campaigns.

The biggest contributors to improved workforce safety include improved tools and equipment, risk planning and control, leadership actions, competence management, safety communications and assurance. These account for over 93 per cent of the reduction in workforce safety risk.

CP4 outputs

Performance

Punctuality on the railway has been at record levels during the past year, breaking the 90 per cent barrier for the first time since records began and finishing the year at 90.6 per cent.

Achieving continued improvements in punctuality remains a challenge. Improvements to date are the result of the hard work of everyone involved in the operation and management of the railways – both Network Rail and the train operators. Joint planning and delivery processes between Network Rail and the train operators have contributed to this, as has the introduction of more integrated control centres. Improving productivity and effectiveness of maintenance activities have generally also assisted.

Network Rail is required by the ORR's CP4 determinations to deliver improvements in the public performance measure and also deliver reductions in cancellations and significant lateness at both a national and sector level. In addition, Network Rail is required not to exceed maximum levels, for each year, of passenger train delay minutes for which it is held accountable in England and Wales, and in Scotland. It has similar maxima for the freight train delay minutes for which it is accountable across the network as a whole.

Network Rail will continue to work with train operators to develop plans for the delivery of performance improvements through CP4. However, it is unlikely that it will achieve exactly the level of performance shown for each train operator. Some individual train operator trajectories will be better than the targets and some will not be achieved. This is recognised by the ORR in its CP4 determinations. As such Network Rail does not expect failure to meet an individual train operator trajectory, on its own, to constitute a licence breach. It recognises that it must demonstrate that Network Rail is taking reasonable steps to achieve these targets and to address areas of poor performance. If it was not meeting an individual target it would work with the relevant train operator to understand the cause of this and develop the appropriate remedial actions consistent with Network Rail's obligation to meet the top level targets, taking into account the materiality of the shortfall.

For freight operators Network Rail has published planned trajectories for Network Rail delay minutes per 100 train kilometres which are consistent with each operator's local output commitment document. It is also discussing with freight operators the development of further performance measures for monitoring purposes.

Initiatives to meet these targets include:

- timetabling – accurate and robust timetables are critical to performance. Major timetable changes are proposed over the next few years for several routes. Network Rail will work with the operators on these routes to use this opportunity to carry out a fundamental timetable review with the aim of improving overall route performance
- benchmarking of the performance of maintenance delivery units – a quality league table compares the performance of delivery units' ability to maintain the infrastructure by comparing normalised failures of track, signals, points, track circuits and repeat failures. Local managers will identify and implement a series of small projects and initiatives aimed to close the differential in productivity and reliability performance of delivery units
- remote monitoring – the installation of remote condition monitoring equipment to points, track circuits, power supplies, level crossings and flood telemetry systems. This will reduce the number of asset failures through effective prediction, improved response times and allowing better long term planning
- asset renewals – critical to improved service performance from the asset renewals programme is the renewal of plain line and switches and crossings track. This will deliver benefits on both the primary and secondary routes on the network.

Capacity

Passenger demand increased by nearly 45 per cent between 1996/97 and 2006/07 with substantial growth in all market sectors. This growth has been driven significantly by economic growth, with central London employment contributing to additional commuting, and other cities also experiencing strong growth. Rising fuel price trends, increased environmental awareness and road congestion have also improved the competitive position of rail.

In addition to these external factors, passenger demand has grown as a result of initiatives by train operators to enhance service quality, together with commercial marketing and pricing innovations.

In the freight market, traffic volumes expressed in terms of freight tonnage have grown by 50 per cent in the last 10 years.

In respect of future passenger demand, with train operators, Network Rail has developed service plans to accomodate the levels of passenger crowding and the capacity outputs specified in the Secretary of State's and Scottish Government's High Level Output Specifications (HLOSs). Forecasts of demand are inevitably sensitive to the assumptions used for future Gross Domestic Product growth and the competition from other modes, and are, therefore, subject to considerable uncertainty. The current UK economic situation is very different to the prevailing conditions at the time the HLOSs were specified. However, in the longer term, general economic trends suggest increased demand for rail, driven by underlying economic growth, a trend towards concentration of employment in regional centres, and increased environmental awareness. Network Rail believes, therefore, that the HLOS output requirements and its plans to deliver these will remain generally appropriate, even if demand during CP4 emerges to be lower overall than had been forecast.

Network Rail's own planning assessments suggest that greater capacity is required to deal with peak overcrowding even at current levels of demand, and there is evidence that demand is suppressed in the height of the peak with passengers choosing to travel in the shoulder peaks.

Availability

The rail network needs to be maintained, renewed and enhanced safely and efficiently and this requires engineering possessions. Network Rail has worked with its customers and the ORR to develop new measures of the disruption to passenger and freight customers caused by possessions. One measures the impact of engineering possessions in terms of the economic value of the excess journey time passengers experience, normalised by total train kilometres operated. The other measures the temporary unavailability of track for freight use, weighted by the level of freight traffic operated over each section of track. The Company is required by the CP4 determinations to deliver certain trajectories against these measures.

The implication of these targets is that Network Rail is required to reduce disruption to passengers by 37 per cent by the end of CP4 compared to the level of disruption in 2007/08. At the same time there should be no increase in the level of disruption experienced by freight operators.

There remains considerable uncertainty about the new measures. The ORR will need, therefore, to assess whether the availability targets are reasonable based on actual results as CP4 progresses.

The plan to deliver enhanced network availability is built around a set of activities which change the way in which engineering possessions are planned and implemented. The overall programme to reduce the level of disruption caused by possessions and improve the availability of the network is driven by a set of discrete but interdependent plans which both improve possession productivity and reduce the time required to undertake maintenance and renewals tasks.

During Control Period 3 (CP3) Network Rail made significant progress in moving towards a seven day railway on the West Coast Main Line, enabling the major increase in network availability which was required to operate the December 2008 timetable. A programme is now being developed that will move towards meeting customers' future aspirations for network availability on other routes where benefits can be demonstrated. The industry has been working together to understand what a seven day railway would actually mean for each route, and to define the enabling interventions which would be required.

Capability

Network Rail's obligation is to maintain network capability at the level as at 1 April 2009, in terms of

- track mileage and layout
- line speed
- gauge
- route availability
- electrification types/miles.

Discrepancies between actual and published capability will need to be addressed within existing funding, with proposed changes to published capability subject to the industry network change procedure.

Customer satisfaction

Delivering a specific improvement in stakeholder satisfaction does not form part of the regulated outputs that Network Rail is required to deliver. Nonetheless satisfying its customers, users of the railway and other stakeholders must be at the heart of all Network Rail does. Surveys of customer satisfaction for passenger and freight operators are undertaken for Network Rail each year to monitor this. Similar surveys are produced for Network Rail's other stakeholders. For CP4 this area will continue to be a major focus for the Company. Reflecting this, customer satisfaction is a new performance measure included in the Management Incentive Plan for 2009/10 – see page 34 for details.

Efficiency

In the five years of CP3 which ended on 31 March 2009 efficiency savings of 27 per cent were made with reductions in Network Rail's cost base.

For CP4 the ORR has set a target of another 21 per cent efficiency savings for Network Rail to achieve. Together with a variety of other efficiency measures referred to in this Report, technological innovation continues to be an integral part of improving the business and delivering this level of efficiency.

Sustainability and environment

Transport has a major role to play in supporting economic, environmental and social objectives. Given that rail transport itself is more sustainable than alternative modes for many transport needs, the rail industry should promote rail usage by improving the rail product and its affordability in order for it to contribute to sustainability. Work continues on this front in various areas.

As part of Network Rail's commitment to a policy of sustainable development and to enable measurable improvement in environmental performance, it operates an environmental management system. Projections for key elements of this system have been developed, including those related to CO_2 and recycling. A number of other measures are still under development and will be introduced later in CP4. An environmental stewardship index provides an overall measure of achievement against this suite of targets, identifying the number of individual measures where the target has been met.

Funding and financing

Network Rail's debt issuance programme raised £22.3bn as at 31 March 2009 (projected to rise to £34.2bn by the end of CP4). Further details of funding arrangements are set out in the Notes to the financial statements.

Plans for raising debt without the benefit of the Government indemnity previously reported have now been delayed. Given the nature of the CP4 determinations and its challenges, coupled with current market conditions, Network Rail will not be able to raise corporate debt (debt without the support of the Government indemnities) over the next few years. However, it believes that it is right that it seeks to move away from a reliance on debt supported by these indemnities. It will keep this under review as market conditions and other factors change over the next few years. For the time being, it will continue to finance its business by raising debt supported by the Government financial indemnities.

Funds required for CP4 will be raised through a combination of public and private bonds issued under the Debt Issuance Programme to cover the refinancing of existing debt as well as funding working capital. Hedging arrangements have been put in place to fix the Company's interest costs. In summary, funding is projected to be through
- debt issuance of over £11bn
- capital accretion on inflation linked bonds of £1bn
- the refinancing of at least £6bn of bonds which mature during CP4.

Transformation
Network Rail needs to build on the significant business improvements it has made over the last six years. To assist with this challenge it has developed its business transformation programme around six broad work-streams. These are the key things that need to be improved based on Network Rail's understanding of what its customers and other stakeholders demand of it and an assessment of its strengths and weaknesses in meeting these demands. As shown in the diagram on the right these are
- service culture
- organisational effectiveness
- asset policy
- asset information
- efficient infrastructure delivery
- network operations.

Building on the transformation programme launched in 2006, this seeks to drive the necessary improvements required to be world class and
- deliver the outputs in CP4 within the available funding
- transform how Network Rail does things as well as what it does, increasing the focus on the service provided to rail users, train operators and other stakeholders
- provide a strong foundation for longer term sustainable improvements in affordability and value for money.

2008/09 Performance indicators
The ORR sets certain regulatory financial and non-financial performance targets for Network Rail. The key performance indicators (KPIs) are summarised in the table on page 20.

Safety
Steady progress has been made in most of the key safety performance indicators as shown in the table on page 20.

Train performance
There are two measures relating to train performance – Train Delay Minutes being the number of minutes of delay to revenue earning trains (e.g. passenger and freight trains in service) attributable to Network Rail responsible causes, and the Public Performance Measure (PPM) being the percentage of franchised passenger trains arriving on time at their final destination.

In 2003 the ORR set a target for the Company to improve the reliability of the network by more than 30 per cent by 2008/09. Over the last five years, reliability has improved significantly and total delays caused by Network Rail in 2008/09 reduced to less than nine million minutes for the first time since 1999/2000 and this is reflected by PPM which has improved to 90.6 per cent. There are also widely differing performances between areas directly in Network Rail's control which has been consistently improving in many areas and the impact of external events which has remained more even over recent years.

Asset stewardship
The Asset Stewardship Incentive Index is a basket of measures which are intended to capture the underlying condition of Network Rail's assets. In 2008/09 this index continued to be significantly better than the ORR target and even better than the more challenging targets set in Network Rail's business plans and management incentive plans.

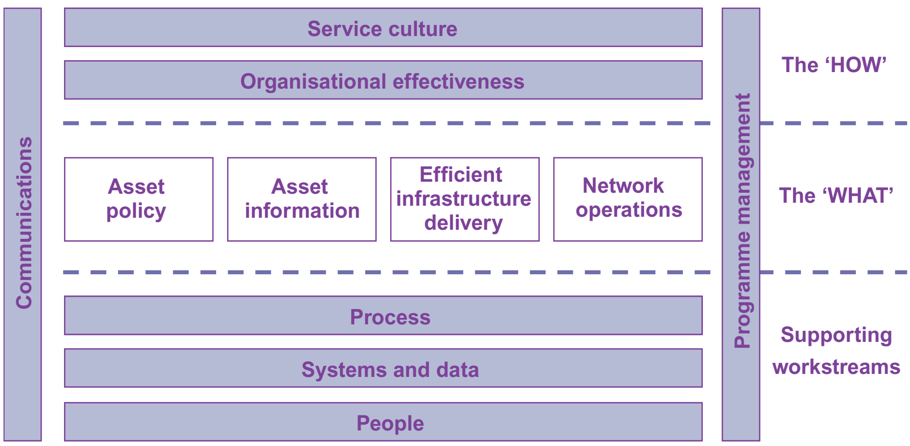
The targets for two elements of this index were revised in 2006/07. As a result of significant improvement in track geometry in 2006/07 and further opportunities to correct underlying causes of track geometry faults, these targets were made tougher for 2007/08 and the following year.

Financial efficiency
The Financial Efficiency Index (FEI) is a measure of how efficiently Network Rail spends on operations, maintenance and track renewals. As efficiency improves the Company should spend less to deliver the same outputs and, therefore, the FEI should reduce. To make the measure more meaningful over time the FEI was turned into an index with the outturn for 2003/04 being equal to 100.

The current measure covers 61 per cent of the total operating, maintenance and renewals expenditure.

Financial instruments
Network Rail uses financial instruments to manage certain types of risks including those relating to foreign currency exchange and interest rates. Indication of these risks is contained in Note 31 of the accounts on pages 86 to 92.

Network Rail's transformation programme structure



Performance indicators	Notes	2008/09	2007/08	2006/07
Safety				
Passenger Safety Indicator*	*1*	0.252	0.276	0.285
Performance				
Train Delay Minutes (million mins.)*	*2*	8.9	9.5	10.5
Public Performance Measure	*3*	90.6%	89.9%	88.1%
Asset stewardship				
Asset Stewardship Incentive Index*	*4*	0.60	0.63	0.72
Financial control				
Financial Efficiency Index*	*5*	75.3	78.1	82.2

* A lower figure represents an improvement.

Notes

1 The Passenger Safety Indicator is the passenger safety risk associated with Network Rail activity, based on the Train Accident Precursor Indicator Model quarterly output, combined with the actual Non-Train Passenger Fatalities and Weighted Injuries at Network Rail managed stations and level crossings normalised per billion passenger kilometres.

2 Train Delay Minutes are the number of minutes of train delays attributable to Network Rail (rather than the train operating companies) as defined in the contractual performance regime with operators. Delays attributed to Network Rail also include externally caused events such as trespass, vandalism, weather related incidents and similar types of disruption.

3 Public Performance Measure is the overall rail industry key performance indicator measuring punctuality and reliability of train performance. It shows the percentage of trains that arrive 'on time' at their final destination compared to the number of trains planned to run on a given day. 'On time' means arrival within 10 minutes of the scheduled arrival at destination time for long distance services and within five minutes for London and south east or regional services.

4 Asset Stewardship Incentive Index is an index proposed by the ORR in its December 2003 access charges review. The components of this index and weightings are: track geometry index (20 per cent), number of broken rails (15 per cent), Level 2 exceedences (15 per cent), total number of signalling failures (15 per cent), wrong side signalling failures – hazard rating 20 or above (15 per cent), structure and earthworks train speed restrictions (10 per cent), and traction power supply failures AC and DC (10 per cent).

5 Financial Efficiency Index is a measure of the efficiency of operations, maintenance, track renewals and other key central expenditure. Prior year figures have been indexed in line with the current year to enable comparison.

Safety indicators	2008/09	2007/08	2006/07
Workforce fatalities	3	2	0
High risk Category A SPADs*	16	19	19
Broken rails	163	181	192
Collisions with vehicles at level crossings	21	8	12
Other potentially high risk train accidents**	23	25	30
Passenger accidental fatalities***	6	10	7

* SPAD = signal passed at danger. The measurement is based on a 100 point scale.

** These are derailments, collisions between trains, train collisions with vehicles and buffer stop collisions (resulting in damage or injury) that occur on or directly affect a passenger line, normalised per one million train miles. The thirteen period average is compared in this measure.

*** One of the passenger fatalities in 2006/07 was caused by a train accident, and none in the other two years.

Health and safety

The health and safety of the Company's employees and the public travelling on the rail network are of great importance to Network Rail. The Company's policies and procedures relating to health and safety at work recognise the requirements of current legislation and are kept under constant review with the aim of providing a safe working environment for all employees. Significant resource is committed to safety, health and environmental matters and Network Rail aspires to continuing improvement of its performance in these areas.

Previous incidents and recent regulatory penalties

The derailment which took place at Potters Bar in May 2002 is the subject of continuing HMRI investigations; the outcome is unknown at present. The derailment in Cumbria in February 2007 has also been the subject of investigation by the British Transport Police which has recently announced that it has completed this investigation and has now passed the matter to HMRI for it to investigate; the outcome of its investigations is unknown at present.

No regulatory penalties have been imposed by the ORR during 2008/09 for any breach by Network Rail of its network licence.

Corporate responsibility

Network Rail is committed to carrying out its activities in a socially responsible manner in respect of customers, stakeholders, employees and local communities. As part of its objective of operating in a transparent and accountable environment, a report on these aspects within its business was published in 2008. This report can be found on Network Rail's website: www.networkrail.co.uk

Details of the Company's Corporate Responsibility Group are set out on pages 56 and 57.

Network Rail also has an environmental policy which was revised in 2008. Details of this policy will be provided in the next Corporate Responsibility Report due to be published in the summer of 2009.

Network Rail's corporate responsibility performance has been independently rated against Business in the Community Corporate Responsibility Index in both 2007 and 2008. In the latest rating in 2008 its performance rating improved with it being awarded a 'silver' rating.

Environment

Network Rail's approach is to focus on the key environmental issues facing it as operator of the rail infrastructure and also the issues facing society as a whole – climate change, waste, bio-diversity and land management. It is committed to the on-going improvement of the railway's existing environmental record.

Network Rail's response to the challenge of managing environmental risk includes improving the line-side environment with a policy of vegetation management that balances the responsibility to provide a safe and reliable railway whilst acknowledging the benefits of minimising the impact on the natural habitat. Waste management is also important with schemes in place to improve responsible waste handling and recycling both by the Company and by its contractors.

Climate change is an ongoing focus with participation in research programmes organised by various specialist bodies. Likewise energy and water usage are subjects of ongoing programmes of reduction.

Environmental, societal and economic impacts are considered with a view to continuing to develop rail as a sustainable form of transport. Key performance indicators have been developed, details of which are referred to on page 16.

Ethics policy

The Company has a business conduct policy in place. Improving on the basis of this policy, the Company is now in the process of adopting an ethics policy which details the Company's expectations of its employees in the ways that Network Rail's business is undertaken.

Research and development

During the year the Company charged £1m to the Income statement (2007/08: £1m) on research and development. Other costs relating to significant development work have been capitalised in tangible fixed assets.

Most of the Group's development activities are applied as capital projects within the investment programme. The remainder is charged against the Income statement.

Directors

The Directors of the Company were appointed on the dates as shown in the table above. These are also Directors of Network Rail Limited.

Under the provisions of the Articles of Association of Network Rail Limited all Directors, except the Special Director (if appointed – there being no Special Director at the time of publication of this report), must retire by rotation, and may stand (together with any new Director appointed since the last general meeting) for re-election or election (as applicable) by the Members of that Company at least every three years. Save as shown in the table above, there were no other changes to the Board during the year.

At the forthcoming Annual General Meeting of Network Rail Limited Ian McAllister, Chairman and Non-Executive Director, and Jim Cornell, Non-Executive Director, will step down from the Board. Executive Directors Patrick Butcher, Robin Gisby, Simon Kirby and Paul Plummer will offer themselves up for election by the Members being the first such meeting after their appointments. Rick Haythornthwaite, Non-Executive Director and Chairman Designate will also offer himself up for election. Iain Coucher, Chief Executive, and Ian Buchan, Non-Executive Director, will retire and, being eligible, will offer themselves for re-election.

David Bailey will be 70 years of age during the next 12 months. There is no legal requirement for a Director over the age of 70 to seek re-election annually. As a matter of good practice, however, in Network Rail a Director reaching this age offers themselves up voluntarily. In line with this, David Bailey will also be voluntarily seeking re-election at Network Rail Limited's AGM in July 2009.

Details of the Executive Directors' service agreements and remuneration are contained in the Directors' remuneration report.

The biographical details of the Directors can be found on pages 24 and 25.

Board members

Current Directors	Position	Date of first appointment	Next due date for re-election
Ian McAllister*	Chairman	3 October 2002	n/a
Iain Coucher	Chief Executive	3 October 2002	July 2009
Patrick Butcher	Group Finance Director	20 April 2009	July 2009
Robin Gisby	Director, Operations & Customer Services	1 October 2008	July 2009
Peter Henderson	Group Infrastructure Director	3 October 2002	July 2010
Simon Kirby	Director, Infrastructure Investment	1 October 2008	July 2009
Paul Plummer	Director, Planning & Regulation	1 October 2008	July 2009
David Bailey**	Non-Executive Director	3 October 2002	July 2010
Ian Buchan	Non-Executive Director	5 February 2006	July 2009
Yvonne Constance	Non-Executive Director	1 May 2005	July 2011
Jim Cornell*	Non-Executive Director	3 October 2002	n/a
Michael Firth	Non-Executive Director	4 December 2004	July 2010
Christopher Green	Non-Executive Director	26 June 2005	July 2010
Rick Haythornthwaite	Non-Executive Director	23 March 2009	July 2009
Steve Russell	Non-Executive Director	19 September 2007	July 2011

* Will be stepping down at the Annual General Meeting in July 2009.
** Will be seeking re-election in July 2009.

Directors' interests

At no time during the year did any Director hold a material or any other interest in any contract with the Company or any of its subsidiaries other than service agreements between Executive Directors and the Company and letters of appointment of Non-Executive Directors by the Company. Network Rail has purchased and maintained throughout the year directors' and officers' liability insurance.

Employees and business performance

Details of the number of employees and related costs are set out in Note 7 to the financial statements on page 69.

Network Rail believes that business performance improvement is influenced significantly by the skills, behaviour and attitude of its employees. Substantial investment is being dedicated by the Company to deliver high quality, accredited training and development programmes as a primary means of stimulating cultural change and management competence. Development programmes from apprenticeship schemes through to leadership skills are used.

Effective communication in raising the level of employee engagement is also important. To do this a wide range of communications media is being used, encompassing local information cascades and briefings, videos, the Company's internal magazine, email news bulletins, electronic data links and briefings by the Directors to reach all employees.

During the annual Business Briefings conducted in January 2009 over 6,000 employees were able to attend the geographically spread briefings at which the Company's safety and operational performance was discussed. Employees had the opportunity to question the Executive Directors and Chairman on any aspect of the business that they chose to raise.

Employees also have the opportunity to voice their opinions and ask questions through Network Rail's intranet site. Face to face briefings and team meetings are actively encouraged and are held in all functions across the Company.

There is a direct link between business performance and engaged employees – they are safer, less likely to leave and more likely to enjoy what they do.

To monitor progress in developing employee engagement Network Rail conducts an annual independently run survey of its employees specifically on this topic. Each question in the survey is designed by Gallup and is proven to be an accurate measure of the level of employee engagement in an organisation. Every team in the Company is expected to set their own action plan to improve their performance and their next set of scores. This survey is conducted each year, the most recent being in November 2008.

Significant progress has been made with improving the levels of engagement within Network Rail since 2002 when the first of these surveys was conducted. In that time engagement index levels have risen from 3.16 to 3.75 in 2008. Our target is 4.15. The speed of improvement in engagement has slowed recently, however, and plans are being implemented to target key areas of the business where the levels of engagement do not meet the upper quartile of performance measured elsewhere in Network Rail. The next survey is scheduled to be conducted in November 2009 with further surveys planned for subsequent years.

The Board strongly believes in the importance of consultation on issues affecting the workforce. Frequent consultation and information sharing is conducted, therefore, at regular intervals through both national and local procedures with representatives from Network Rail and trades unions. During 2008/09 this has included continuation of discussion with the trade unions on the modernisation of terms and conditions of employees engaged in the Infrastructure Maintenance function. Consultation has also taken place on revision to the benefits and funding under the Railway Pension Scheme.

Employee practice

Network Rail is committed to offering all of its employees a fulfilling and challenging career in an environment free from discrimination, harassment, victimisation and bullying irrespective of their gender, sexual orientation, marital status, race, nationality, ethic origin, disability, age, religion or union membership status. Its policies and procedures in recruitment and selection, training, career development, working arrangements, promotion and performance appraisal support this commitment. Moreover Network Rail continues to work with trades unions in the area of equality of opportunity and development of policy to promote best practice within the business.

The Company's equal opportunities policy is communicated to employees.

Employee review processes are in place to allow every individual manager to discuss key performance issues in a structured, fair and consistent way and to identify training and development needs. Emphasis is placed on performance against the Company's corporate values and personal development opportunities.

Charitable donations and community support

Network Rail continues to support community initiatives and charitable causes. During the year the Company donated £505,000 to charitable organisations (2007/08: £508,000). A further £280,000 (2007/08: £285,000) was used to sponsor charitable and community-related activities.

Network Rail encourages employees to support charities through its charitable giving scheme offering employees up to five days' paid volunteer leave with a supported charity. The Company also matches employees' fundraising and Give as You Earn contributions (up to £1,200 per annum).

In addition Network Rail provides support to a charity chosen by employees. During 2008 the chosen charity was the National Society for the Prevention of Cruelty to Children to which the Company has committed support for two years to 2010.

Network Rail's Community Safety team is responsible for all areas of community engagement relating to route crime and misuse. This includes the education of young people, lineside neighbours, passengers, the public and level crossing users. It is the role of the team to improve safety, raise awareness and reduce costs to the business and society. This is achieved by directly working with the rail industry, public, private and third party sectors, in the development and implementation of community safety strategy and the activation of Network Rail's flagship educational campaigns No Messin'! and Don't Run the Risk.

Network Rail has also increased the number of educational programmes that address crime and irresponsible behaviour by young people, running three new projects in mainstream and non-mainstream education together with restorative and community payback schemes for young offenders.

As part of growing the No Messin'! campaign, it has developed a number of innovative projects in communities that will provide positive pathways into constructive activities in high crime, low amenity areas. This includes a scholarship scheme for young people who have taken up a long term interest in a local club or group as the result of being introduced to that interest via the campaign.

Commonwealth lightweight champion boxer Amir Khan has been involved with No Messin'! since 2006. Amir and Network Rail opened a groundbreaking new boxing and fitness community centre in Bolton in 2008.

Political donations

In line with the Company's policy, no donations to political parties were made in the year.

The Companies Act 1985 (the CA 1985) required companies to obtain shareholders' authority for donations to registered political parties and other political organisations totalling more than £5,000 in any 12 month period, and for any political expenditure, subject to limited exceptions. The definition of donation in this context was very wide and extended to bodies concerned with policy review, law reform and the representation of the business community. It could also have included special interest groups, such as those involved with the environment, which the Company and its subsidiaries might wish to support, even though these activities are not designed to support or influence support for a particular party.

At each of the AGMs from 2004 to 2008 the Members approved a resolution authorising expenditure and donations of this type.

The relevant provisions of the 1985 Act have been replaced by similar provisions in Part 14 of the Companies Act 2006 (the CA 2006) with effect from 1 October 2006. The meaning and implications of this legislation, whilst improved by the CA 2006, still remain somewhat uncertain as to its application. It continues to be extremely wide in scope and could extend to routine activities undertaken by Network Rail as part of its normal day-to-day contacts, such as its active and important policy of providing regular briefings for MPs.

Network Rail needs to work closely with all types of community representatives. As part of this, the Company has a significant amount of contact with a wide range of elected representatives (Members of Parliament, Members of the Scottish Parliament, London Assembly, Welsh Assembly and others) as well as non-governmental organisations, pressure groups and campaigning organisations. This includes meetings to discuss issues facing the Company and those using the railways, both passengers and freight traffic nationally and regionally. Opportunity is also taken each year to explain to elected representatives our business plans, the Company's performance and significant developments within the business. This is sometimes best achieved through the Company organising briefings and similar functions at which presentations are given.

Whilst it remains Network Rail's policy not to make political donations to any political parties, given the uncertainty of the precise meaning of the legislation it considers it prudent to obtain approval from Members of Network Rail Limited to avoid inadvertently breaching the CA 2006.

Accordingly, since it remains vital that Network Rail communicates frequently with the full spectrum of political organisations, the Board annually seeks Members' approval for Network Rail Infrastructure Limited, as the principal subsidiary company running the railway infrastructure, to incur 'political expenditure' and to make 'political donations' to political parties/independent candidates and political organisations (as widely defined in this law).

Creditors payment policy

It is our policy, with respect to payment of our suppliers, to settle the terms of payment when agreeing the terms of each transaction where standard terms are not used, to make suppliers aware of the terms of payment and to abide by the terms of payment.

At 31 March 2009 the Company's creditor days compared with the value of suppliers' invoices received in the year was 47 days (2007/08: 44 days).

Recognising the current economic climate and the importance of its suppliers and contractors for delivery of its business objectives, Network Rail has reviewed its payment policy. Where possible, having regard to prudent business management, Network Rail now seeks to make payments that are due more speedily than its standard terms of payment.

Auditors

At the next Annual General Meeting of Network Rail Limited on 22 July 2009, a resolution will be proposed to reappoint Deloitte LLP as the Group's auditors and to authorise the Directors to fix their remuneration. Details of the fees earned by Deloitte LLP during the period, for both audit and non-audit work, are set out in Note 6 on page 68.

Details of the process for review of the external auditors is set out in the Corporate governance report on page 51.

Directors' responsibilities

The statement of Directors' responsibilities in relation to the financial statements is set out on page 57. The statement by the external auditors on corporate governance matters is contained in their report on pages 58 and 59.

Pursuant to the Companies Act 1985 Section 234ZA, page 5 of the Corporate governance report, each of the Directors in office at the date of this report confirms that, so far as he or she is aware, there is no relevant audit information of which the Company's auditors are unaware and that he or she has taken all reasonable steps in order to make himself or herself aware of any relevant audit information and to establish that the Company's auditors are aware of that information.

Going concern

The Directors are satisfied that the Network Rail Group has adequate resources to continue to operate for the foreseeable future. For this reason they continue to adopt the going concern basis in preparing the accounts. See Note 2 of the Accounts on pages 63 to 67 and page 57 of the Corporate governance report.

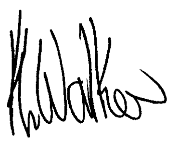
Annual General Meeting

The 2009 Annual General Meeting of Network Rail Limited will be held on 22 July 2009 in Bristol. A separate document accompanying the Annual Report and Accounts contains the Notice convening the meeting and a description of the business to be conducted at that meeting.

Significant events subsequent to 31 March 2009

There have been no significant events subsequent to 31 March 2009 to the date of this report.

By order of the Board



Hazel Walker
Secretary
3 June 2009

Board of Directors








Ian McAllister CBE
Chairman (2, 4)
Ian McAllister, 65, has been the Company's Non-Executive Chairman since 2002 having previously been Chairman and Managing Director of Ford Motor Company Limited. Ian is also Chairman of the Carbon Trust, a Director of the Energy Saving Trust, a Director of UCL Business plc and formerly Senior Independent Non-Executive Director of Scottish & Newcastle plc. Ian is a member of the Institute of Chartered Accountants in England and Wales' Corporate Responsibility Advisory Group. He will be stepping down as Chairman in July 2009.

David Bailey OBE
Non-Executive Director (1, 2, 4, 5)
David Bailey, 69, joined the Board in 2002. David has a procurement and logistics management background. He was formerly Commercial Director for London Transport, having previously held various director-level roles within London Underground. David is Chairman of two charities, Home-Start North East Hampshire and Rushmoor Children and Young People's Partnership.

Ian Buchan
Non-Executive Director (2, 5)
Ian Buchan, 62, joined the Board in 2006 after retiring as Chief Executive of National Express' trains division. He was previously Business Development Director at FirstGroup. Until 2008 he was a director of Manchester School of Flying. Originally an economics graduate, Ian has also been a school governor.

Patrick Butcher
Group Finance Director (3, 6)
Patrick Butcher, 41, joined the Board in 2009 having previously held the position of finance director at English Welsh and Scottish Railway (now DB Schenker) between 2004 and 2008. Before this he was finance director at Mapeley Ltd, London Underground and King's College Hospital. His early career was at Deloitte & Touche as a management consultant and auditor. Patrick is a Member of the Institute of Chartered Accountants (South Africa).

Yvonne Constance OBE, JP
Non-Executive Director (1, 2)
Yvonne Constance, 66, joined the Board in 2005 having previously been Chairman of the National Electricity Consumers' Council between 1995 and 1999, a Non-Executive Director of Innogy plc from 2000 to 2002 and a Non-Executive Director of St Mary's Hospital NHS Trust. Until its cessation in 2005 she was also a member of the Greater London Magistrates' Courts' Authority, as well as being a Justice of the Peace since 1976 and, in the 1980s, practised as a barrister.

Jim Cornell
Non-Executive Director (2, 4, 5)
Jim Cornell, 69, joined British Rail (BR) in 1959 as a student civil engineer before taking up various positions in BR including General Manager of ScotRail, Director of Civil Engineering and latterly Group Managing Director of British Rail Infrastructure Services between 1993 and 1996. He became a Network Rail Board member in 2002. He is also Executive Director of the Railway Heritage Trust. He was appointed the Senior Independent Non-Executive Director of Network Rail in January 2006. He will be retiring from the Board in July 2009.

Iain Coucher
Chief Executive (3, 5, 6)
Iain Coucher, 47, took over as Chief Executive in 2007. Previously, since Network Rail acquired Railtrack plc in October 2002, he was Deputy Chief Executive. Prior to that he was Chief Executive of Tube Lines, which followed working for EDS for 16 years.

His career has included experience in the transportation sector, particularly with London Underground. He was seconded to the TranSys consortium between 1996 and 1998 as its Chief Executive and led the development of the Underground's smartcard ticketing system. Iain is an engineering graduate from Imperial College, London and also has an MBA.

Michael Firth
Non-Executive Director (1, 2, 6)
Michael Firth, 66, joined the Board in 2004 having previously been Head of Corporate Banking at HSBC Bank plc until his retirement in 2002. He is also a Non-Executive Director of Communisis plc and Gartmore European Investment Trust plc.

He was previously a Non-Executive Director of Somerfield plc and First Technology PLC. Michael is an Associate of the Chartered Institute of Bankers.







* Numbers against Directors' names indicate the committees of the Board on which each of them serves as follows:

1 Audit Committee
2 Remuneration Committee
3 Executive Committee
4 Nominations Committee
5 Safety, Health and Environment Committee
6 Treasury Committee

Robin Gisby
Director, Operations & Customer Services (3)
Robin Gisby, 52, joined the Board in 2008, having been employed by Network Rail and its predecessor since 1998 and was appointed Director, Operations and Customer Services for Network Rail in May 2004. Previous roles in the Company include two regional director positions and, prior to these, within Railtrack, Director, Network Development and Director, Freight. Before joining Railtrack he had engineering and operational roles in both the UK and overseas mainly with GKN plc. He has a degree in Engineering Science, an MBA at Manchester Business School and is a Chartered Engineer and a Fellow of the Chartered Institute of Transport.

Christopher Green
Non-Executive Director (2, 5)
Christopher Green, 65, joined the Board in 2005 following his retirement as Chairman of Virgin Rail Group. Chris has over 40 years of railway experience, having joined British Rail upon leaving university. He held various management positions including Managing Director of Network SouthEast and Intercity. He was Chief Executive of Virgin Trains from 1999 to 2004. Chris was also Chief Executive of English Heritage, a Non-Executive Director of Eurotunnel and past Chairman of the Railway Forum. He is a Fellow of the Institute of Logistics and Transport.

Rick Haythornthwaite
Non-Executive Director (2)
Rick Haythornthwaite, 52, was appointed to the Board in 2009 having been chief executive of Invensys plc, from 2001 to 2005. He was also Group Chief Executive of Blue Circle Industries and spent 18 years with BP in various senior roles. He is currently non-executive chairman of MasterCard Inc, a senior advisor to STAR Capital Partners and President of PSA Energy. His previous non-executive roles included Board membership of ICI, Land Securities and Lafarge. In the voluntary sector, he is also chairman of the Southbank Centre and Risk and Regulation Advisory Council.

Peter Henderson
Group Infrastructure Director (3)
Peter Henderson, 55, has responsibility for Engineering, Maintenance, Projects and Logistics. Joining the Board in 2002, he has over 25 years' rail experience. Starting with the construction of the Tyne and Wear Metro, he then spent 16 years with the Hong Kong Mass Transit Railway Corporation as Head of Major Projects. He returned to the UK in 2000 to work for Bechtel where he was Projects and Engineering Director for Rail.

Simon Kirby
Director, Infrastructure Investment (3)
Simon Kirby, 43, joined the Board in 2008, having been with the Company since 2003. He is responsible for delivery of enhancement and renewal infrastructure. He has held positions in the Defence industry involved in a number of Land and Naval Weapons System projects including the Trident Nuclear Submarine Programme. In 1998 he became Operations Director of the two Marconi Shipyards at Glasgow and Barrow-in-Furness. In 2000 he was appointed Managing Director of three BAE Systems shipyards before, in 2002, becoming Managing Director of the BAE Systems Type 45 Prime Contract Organisation. Simon has an MSc in Engineering Business Management from Warwick University.

Paul Plummer
Director, Planning & Regulation (3)
Paul Plummer, 43, joined the Board in 2008, having been with the Company since 2002 when he was appointed Director, Planning & Regulation. He has responsibility for regulation, business planning and long term planning of the network. Previously he was Chief Economist and Director of Economics and Finance at the Office of Rail Regulation from 1999 to 2001. He has also worked at National Economic Research Associates (NERA), NM Rothschild and Accenture advising companies, governments and regulators on utility regulation, restructuring, privatisation, strategy, finance and M&A in the UK and overseas. He has a degree and MSc in Economics.

Steve Russell
Non-Executive Director (2, 4, 6)
Steve Russell, 64, joined the Board in 2007. Previously he was Chief Executive of Boots Group PLC between 2000 and 2003, working there since he started his first job at the company in 1967. He currently holds several Non-Executive Directorships including Barclays PLC – where he is a member of the audit committee (previously having been chairman of this committee) and a member of the board risk committee, nomination committee, governance committee and Business Control Systems Group. He is also a trustee of St John's Ambulance and Tommy's, the baby charity.

Directors' remuneration report

The following report has been prepared in accordance with the Directors' Remuneration Report Regulations 2002 (the Regulations) and the Financial Reporting Council's Combined Code issued in June 2008 notwithstanding that, as reported on page 42, this version of the Combined Code does not formally take effect for Network Rail until it reports next year on 2009/10. In line with its aim for maximum transparency and corporate governance best practice compliance, Network Rail has chosen to adopt the provisions of the latest Combined Code ahead of its applicable date.

Unaudited information

In addition to meeting statutory requirements, in particular the Companies Acts, Network Rail's Remuneration Committee continues to aim to comply with best practice guidelines provided by other sources including guidance published by the Association of British Insurers (ABI) and the National Association of Pension Funds (NAPF) in producing this report.

Moreover, as part of a general review of Network Rail's corporate governance conducted by the Members of Network Rail in 2008/09, Pension Investors Research Consultants (PIRC) was commissioned to review governance disclosure made by the Company against PIRC's guidelines on corporate governance best practice. The report produced by PIRC was supportive of the governance of Network Rail generally and in particular in relation to remuneration matters. Details of some of PIRC's views are referred to later in this report.

The Remuneration Committee

The Remuneration Committee comprises all of the Company's Non-Executive Directors including the Chairman of Network Rail. The following table details who has served on the Committee during 2008/09:

Member	Period from	To
Jim Cornell* (Chairman of Committee from September 2003)	Oct 2002	July 2009
David Bailey	Oct 2002	On going
Ian Buchan	Feb 2006	On going
Yvonne Constance	May 2005	On going
Michael Firth	Dec 2004	On going
Christopher Green	June 2005	On going
Rick Haythornthwaite	Mar 2009	On going
Ian McAllister*	Oct 2002	July 2009
Steve Russell	Sept 2007	On going

* Stepping down from the Board of Directors on 22 July 2009.

The Group Company Secretary is the secretary to the Committee.

The Committee is required under its terms of reference to meet at least once a year and during the year 2008/09 it met five times.

The Committee is responsible for determining all matters concerning incentives and remuneration of the Executive Directors of the Company. This includes:

- making decisions in respect of the framework of the Executive Directors' remuneration and its cost
- determining, on behalf of the Board, specific remuneration packages for each of the Executive Directors
- deciding the remuneration package for the Chairman without the Chairman being present
- deciding upon the form and content of the Executive Directors' Management Incentive Plan (MIP) for each financial year (within the terms of the Incentive Policy)
- determining the framework of certain senior executive employees' remuneration as well as the form and content of their MIP.

In contrast to most listed companies (if not all) the Remuneration Committee of Network Rail is empowered under the Articles of Association of Network Rail Limited to determine remuneration for Directors as opposed to making recommendations to the Board in respect of this. This responsibility reflects the aim of Network Rail to provide independence of the decision making process as appropriate for the highest levels of corporate governance.

Moreover, as reported above, again in contrast to other companies, as a matter of policy all Non-Executive Directors are automatically appointed to the Remuneration Committee reflecting the importance of remuneration and incentive schemes and the aim for independence of decision making in this important area.

The full terms of reference of the Committee are available from the Company Secretary on request and can be found on the Network Rail website www.networkrail.co.uk

Remuneration Committee's activities during 2008/09

During the year the Committee's activities have included the matters set out in the table shown to the right.

Further, in line with Combined Code requirements (as reported in the Corporate governance report on pages 42 to 57), during the year the Board undertook a review of the effectiveness of the Board and its committees (including the Remuneration Committee) supported by Egon Zehnder International.

The Committee also commissioned Hewitt New Bridge Street Consultants LLP to provide independent expert advice on the management incentive schemes and remuneration generally. Hewitt New Bridge Street does not provide other services to Network Rail.

During 2008/09 Watson Wyatt Limited advised the Company in respect of pension related matters included in the remuneration policies.

The Human Resources Director attends the meetings by invitation to assist the Committee in its considerations of market practice and the alignment of incentive arrangements to business strategy as does the Chief Executive (other than when his own remuneration is being discussed or decided). The Human Resources Director is responsible for employees within Network Rail and is not a Board Director nor is he appointed by the Committee.

In addition to the above, during 2008/09 as the Chairman of the Remuneration Committee, Jim Cornell conducted a Members' Forum at which consultants from Hewitt New Bridge Street and PricewaterhouseCoopers explained senior executive remuneration structures and current trends and issues. Jim Cornell and the Human Resources Director then explained the background to and details of the Incentive Policy and the MIP as well as outlining to Members the proposals of the Remuneration Committee for the 2009/10 MIP. Discussion groups of

Meeting	Agenda item
May 2008	• Decision on Executive Directors' awards under the annual and long term elements of the MIP 2007/08 • Setting of targets for the MIP 2008/09 • Approving the content of the MIP 2008/09 statement to be published • Consideration of the nature of the performance measures to be used in the MIPs during Control Period 4 from April 2009 • Review of the contents and wording of the Directors' remuneration report for the 2008 Annual Report.
September 2008	• The annual review of the Executive Directors' remuneration • The annual review of the senior executives' remuneration • Consideration of the nature of the performance measures to be used in the MIPs during Control Period 4 from April 2009.
November 2008	• Consideration of the structure of the MIP for Control Period 4 • Consideration of the nature of the performance measures to be used in the MIPs during Control Period 4 from April 2009 • Consideration of the letter from the Financial Services Authority (FSA) to listed companies' CEOs dated 13 October 2008 setting out the FSA's views on remuneration policies for listed companies • Review of the Executive Directors' standard service agreement.
January 2009	• Consideration of the views of Members on the proposals for the terms of the MIPs for Control Period 4 as expressed at the remuneration forum and subsequently • Consideration of the structure of the MIP for Control Period 4 • Consideration of the nature of the performance measures to be used in the MIPs during Control Period 4 from April 2009 • Review of the Executive Directors' standard service agreement • Approval of the terms of the remuneration for the candidate for the position of Group Finance Director • Consideration of the status of discussions between Network Rail and its trade unions on pension benefits • The annual review of the terms of reference of the Committee, the general effectiveness of the Committee and its composition.
February 2009	• Consideration of the structure of the MIP for Control Period 4 • Consideration of the nature of the performance measures to be used in the MIPs during Control Period 4 from April 2009 • The annual review of corporate governance in relation to remuneration of Directors and senior executives against the Combined Code • Review of the ABI, NAPF and PIRC investor guidelines in relation to remuneration including a review by PIRC of Network Rail's corporate governance and a review by NAPF of the proposed MIP for Control Period 4 • Consideration of media mis-reporting relating to incentive awards for 2008/09.

Members then debated the proposals. The outputs of the Forum were shared with all Members and the Remuneration Committee took views of Members into account in finalising the 2009/10 MIP.

Directors' remuneration policy

Network Rail has a network licence condition requirement to have a MIP for its Executive Directors and senior executives and for that plan to be cascaded throughout the Company whereby incentive awards are available to all employees upon targets being met.

Under this condition Network Rail is required, when formulating its MIP, to have particular regard to

- securing the operation and maintenance, renewal and replacement, improvement, enhancement and development of the network especially operational performance, asset serviceability and condition, efficiency, economy and safety
- infringement by Network Rail of any access contracts and safety factors

- achievement of the licence requirement of dealing with dependent persons with due efficiency and economy and in a timely manner and compliance with Network Rail's Code of Practice for dealings with dependent persons
- the extent to which Network Rail is subject to orders and to statements by the Office of Rail Regulation (ORR) on non-compliance with the licence.

The ORR may also specify other objectives in connection with the MIP.

The Committee considers that the alignment between the Delivery Plans for each Control Period (and beyond) and the remuneration of Network Rail's senior executives is critical. Network Rail's remuneration policy is to attract and retain high quality individuals needed to deliver the challenges facing the Company and to create the potential to reward outstanding performance at a competitive market rate based on individual contribution and the overall success of Network Rail in meeting objectives.

It believes that they should be rewarded (on a market competitive basis) for the delivery of stretching targets beyond those targets set by the ORR. To achieve this alignment Network Rail's remuneration approach is leveraged, with a high percentage of pay 'at risk' against the achievement of those stretching targets. For 2009/10 the use of long term incentive terms is closely tied to the long term value of executive remuneration to the delivery of financial value added requirements.

These priorities are also reflected in the terms of the Management Incentive Policy which can be modified only with the consent of the ORR. Under this policy the objectives and principles are to

- provide strong incentives to deliver the actions and objectives specified in the business plan
- identify specific accountability for the achievement of the actions and objectives laid out in the business plan
- enable Network Rail to recruit, retain and motivate individuals with the right skills, knowledge, experience and competencies
- draw on best practice for listed companies in the UK where appropriate given the unique mission and structure of Network Rail
- recognise that Network Rail is accountable for the public interest as a monopoly owner and operator of an asset of considerable public importance
- recognise that Network Rail Limited is a company limited by guarantee founded on a 'not-for-dividend' principle
- reflect the fact that the Company is unable to offer the traditional benefits of UK listed companies including stock options and other profit-share mechanisms.

These are structured within a total remuneration approach, defined as the sum of base salary, incentives and benefits. The use of variable pay through the availability of incentives to form a significant part of total remuneration is intended to ensure that each individual's reward is clearly linked to the successful delivery of Company objectives.

The composition of remuneration is made up of:

Basic salary

In order for the delivery plans to be accomplished Network Rail needs talented senior executives focused on business performance. Overall remuneration must recognise this dependency to a certain degree in basic salary levels.

Incentive awards

a) Annual: Incentive structures for Network Rail need to reflect, through targets chosen, performance improvement. The incentive opportunities available to the Executive Directors and other senior executives must have strong exposure and focus on achievement of the performance delivery levels expected by stakeholders. Equally the incentive performance measures, used when applied in combination, prevent distorted focus on any one aspect of business performance to the detriment of the overall performance delivery objectives. The Remuneration Committee must assure itself, therefore, that the targets set under the MIP are, firstly, the correct ones to provide true incentive and, secondly, are set at appropriate levels to promote challenge and stretch to performance delivery. The alignment of these within the incentive measures is closely reviewed each year by the Remuneration Committee both in terms of the appropriateness of the measures and also the target levels set. Where areas of poor performance have arisen the Committee has been able to demonstrate that adverse impact on the awards available for the relevant year has resulted. This was demonstrated and reported by the Remuneration Committee in its reports for 2006/07 and 2007/08.

b) Long term: Limitations exist with the lack of availability of share option mechanisms to provide longer term focus within the MIP. Notwithstanding this, past MIPs have provided alternative cash based methods of achieving this type of incentive mechanism. For 2009/10 the Remuneration Committee has included a financial value added measure to enhance this approach. Details are set out on page 37.

The Remuneration Committee considers all three elements, plus pension and other benefits, as a whole. It seeks to create the right balance between each of these elements so that short term success and long term sustainable improvement is recognised.

A range of market data is used to inform decision making taking into account the Company's policy with regard to a combination of comparison data from sizeable companies both regulated and non-regulated with synergies of business type and business drivers. The strategy for Executive Directors' remuneration packages is broadly to reflect the relevant market median.

The following companies have been used as comparator companies for benchmarking purposes:
AMEC plc
Arriva plc
Atkins plc
Balfour Beatty plc
British Energy Group plc
Carillion plc
FirstGroup plc
Go-ahead plc
National Express Group plc
National Grid plc
Northumbrian Water Group plc
Pennon plc
Royal Mail
Scottish and Southern Energy plc
Serco plc
Severn Trent plc
Stagecoach plc
United Utilities plc
VT Group plc

Being mindful of the focus by a wide range of stakeholders on the performance of Network Rail, the Company continues to seek transparency in respect of the principles upon which remuneration of the Directors of the Company has been set through the following means

- publication in 2008 of a statement detailing the contents of the MIP 2008/09 (pursuant to the terms of Network Rail's network licence)
- holding a special forum to explain to and discuss with Network Rail's Members the process for designing the MIP, the principles adopted by the Committee and the proposals for the terms of the MIP 2009/10 – following which in determining the final terms of the MIP 2009/10 the Committee considered points raised by Members
- publication in 2009 of a statement detailing the contents of the MIP 2009/10 (pursuant to the terms of Network Rail's network licence).

Remuneration policy in practice

The table set out below illustrates how Network Rail's remuneration policy, as described above, is reflected in practice.

Remuneration policy in practice

Policy	How delivered
Total remuneration • total remuneration is informed by relevant pay data, in particular the median range of comparator companies regulated and un-regulated • these reference points are selected to reflect Network Rail's size of business and comparability to other business environments and the positioning of Network Rail within that group.	• basic salary • annual incentive element of MIP • long term element of MIP • pension • benefits
Basic salary • benchmarked as for total remuneration • positioning and progression taken account of for the individual executive • basic salaries of Network Rail work force – increased by 4.2 per cent on average in 2008 • recognition of guidelines from ABI and NAPF on specific issues relating to basic salaries.	• cash paid on 4-weekly cycle • reviewed annually in September with changes made effective from 1 July
Annual element of MIP • incentive award being a function of the degree of achievement of the corporate performance targets set out in the relevant year's MIP.	• annual cash awards if award given
Long term element of MIP • a deferred incentive award, based upon achievement of corporate performance targets set out in the relevant year's MIP.	• annual cash awards subject to performance conditions being met
Pension • Railway Pension Scheme (RPS) – participation in the RPS (after qualifying period of five years' service if joined Network Rail after 31 March 2004); benefit is normally payable from age sixty to sixty-five and accrues at a rate of one-sixtieth of final year's pensionable pay (less 1.5x single person's basic state pension), capped at £117,600 in 2008/09 for each year of membership; contribution to the RPS at the same rate as other members of the Network Rail section • Network Rail Defined Contribution Pension Scheme (DCPS) – this is available to all employees joining from April 2004, providing Company contributions of up to seven per cent of pensionable pay, capped at £117,600 in 2008/09 • Network Rail Career Average Revalued Earnings Pension Scheme (CARE) – this was introduced as an alternative for all employees to the RPS and DCPS in November 2008. It provides a pension from age sixty-five of one-sixtieth of capped pensionable pay in each year of membership; contributions to CARE are at the same rate as for other members of the scheme • some Directors are also entitled to additional pension benefits that are provided through the DCPS.	• deferred cash payable on retirement payable in the form of lump sum/ 4-weekly payments
Other benefits • other benefits provided on a market competitive, affordability basis.	• cash car allowance • private medical insurance • discounted rail travel • life assurance

Executive Directors' reward package

The current package for Executive Directors under their service agreements comprises the following elements:

Base salary

This is a fixed cash sum payable over 13 periods during the financial year.

The Committee reviews salaries annually as part of the total reward package recognising market levels and personal contribution.

Current salaries for the Executive Directors, following the most recent salary review effective from 1 July 2008 are:

Annual base salary as at 31 March 2009

Executive Directors	£
Iain Coucher	613,000
Patrick Butcher*	350,000
Robin Gisby**	330,000
Peter Henderson	440,000
Simon Kirby**	330,000
Paul Plummer**	310,000

* Appointed to the Board of Directors on 20 April 2009.
** Appointed to the Board of Directors on 1 October 2008.

Incentive arrangements

The purpose of the MIP is to place additional emphasis on the delivery of the objectives of the business plan.

As reported above, in 2008 PIRC was asked by Members of Network Rail to review the Company's corporate governance against PIRC's published guidelines for best practice. In relation to the MIP 2008/09 PIRC considered the inclusion of the Public Performance Measure (PPM), being a non-financial measure, to be best practice and that the targets for each set of performance measures to be laid out clearly and discussed in the Strategic Business Plan 2007 and Update 2008. It also reported that in PIRC's view the total potential awards under all the incentive schemes were not excessive. PIRC awarded to the MIP for 2008/09 a status of compliance of 'BBB' which the Committee understands to be a high rating given infrequently by PIRC.

The Remuneration Committee is also confident that the development of the incentive arrangements introduced for the future MIP, including those relating to the long term element of the MIP on which Members will vote at the Annual General Meeting of Network Rail Limited in July 2009, amount to further improvement in governance against PIRC's guidelines and also those of ABI and NAPF published at the time of finalising the MIP.

In particular the Remuneration Committee reviewed the proposals for the future MIP in detail against the guidelines of NAPF. Following discussion with external advisers and having regard to the corporate structure of Network Rail (and in particular its lack of shares and thus share option incentive arrangements), the conclusion was that the future MIP will also be compliant with NAPF guidelines applicable in 2008.

MIP 2008/09 – annual incentive

As detailed in last year's Annual Report, participants under the MIP 2008/09 were eligible to receive incentives based again on demanding business performance measures and targets. The annual incentive for 2008/09 used key performance indicators (KPIs) based upon those contained in the Strategic Business Plan 2007 but in certain respects more stretching.

The business and individual performance measures related directly to the objectives set out by the ORR in paragraph 3 of Condition 28 of the network licence of Network Rail Infrastructure Limited (including the achievement of the purpose of Condition 7 (stewardship) and Condition 25 (code of practice on dealing with dependent persons)), compliance with other licence conditions and with conditions of access agreements.

Business performance measures

The annual incentive for 2008/09 was calculated measuring actual Company performance against the three equally-weighted targets set in the MIP 2008/09. These were Reliability Index, Asset Stewardship Incentive Index (ASII) and Financial Efficiency Index (FEI):

Reliability (weight one-third) – this is the index established to measure improvements in train performance, comprising of separate elements for passenger reliability and freight reliability weighted according to their respective traffic volumes. It comprises both Train Delay Minutes and PPM (weighted two thirds/one-third). For Train Delay Minutes this is expressed as an index per 100 train kilometres, to ensure that the impact of the volume of trains is correctly reflected.

Financial Efficiency Index (weight one-third) – this is a measure of the efficiency of operating, maintenance and renewal expenditure, normalised to take account of changes in the volume of work required. The coverage of the FEI is 61 per cent of total operating, maintenance and renewals expenditure.

Asset Stewardship Incentive Index (weight one-third) – this is an index proposed by the ORR in its December 2003 Access Charges Review. The components of this index and weightings are: track geometry index (20 per cent), number of broken rails (15 per cent), Level 2 exceedences (15 per cent), total number of signalling failures (15 per cent), wrong side signalling failures – hazard rating 20 or above (15 per cent), structure and earthworks train speed restrictions (10 per cent), and traction power supply failures AC and DC (10 per cent).

Each of the above performance measures stood alone and was calculated independently. The total potential incentive award payable was then the sum of the outcomes of each measure.

The structure of the MIP scheme for 2008/09 also incorporated a taper principle. This allowed significant performance to be recognised against a background of continued year on year stretch performance targets. The specific targets and taper trigger points were decided by the Remuneration Committee, taking into account regulatory targets.

Payments under each of the three measures could only be made if performance met or exceeded the trigger performance as determined by the Remuneration Committee in accordance with the taper principle. If target levels were achieved payments would be calculated for above-target performance on a straight line basis up to maximum target level; the maximum incentive could be earned by achieving a level of performance at least equal to delivering one year early the 2009/10 performance on each measure as contained in the Strategic Business Plan 2007.

The following level of incentives became payable under the terms of the MIP 2008/09:

	Taper Target	Target	Maximum Target	Actual
Reliability Index	1.380	1.408	1.436	1.406
FEI	76.5	75.3	73.0	75.3
ASII	0.635	0.610	0.585	0.596

The resultant total potential award was 56.2 per cent of basic salary.

In accordance with the terms of the MIP, the Committee then considered whether to use its discretion by reducing the overall incentive award for the Executive Directors. It had regard to a variety of considerations including Network Rail's safety performance, the extent to which the key objectives of the business plan over the performance period have been achieved and the requirements of Network Rail's network licence.

In considering whether to exercise its discretion, the Remuneration Committee recognises the incentive scheme as an important variable element of the Executive Directors' (and senior managers') remuneration to be used appropriately and proportionally.

To be effective, reward under the scheme must be based on clear, visible and demonstrable measures in order to act successfully as a reliable incentive mechanism. The overriding discretion held by the Committee must be used, therefore, on an equally consistent and proportionate basis with significant emphasis being placed on the three measurable criteria set out in the MIP. These have been carefully designed to balance the competing aspects of delivering a successful rail infrastructure performance. The use of the discretion must not undermine the confidence of the Executive Directors in the achievability of incentive awards.

It is still important, however, that the Committee does consider each year whether there are other factors which should influence the decision on whether the full award is payable under the scheme for the year in question. To assist in its review of performance of the Executive Directors, the Remuneration Committee considers a wide range of performance indicators beyond the three set measurements contained within the MIP. These include

- safety performance – including workforce fatalities and accident frequency rate, passenger accident fatalities, the safety index, significant train incidents and Category A signals passed at danger (SPADs)
- compliance with regulatory matters including regulatory recovery plans, compliance with licence conditions, whether there have been any breaches of the network licence (whether or not this has been followed by a performance order) and compliance with any other regulatory objectives imposed
- breach of major contracts
- operational performance impact of possession overruns
- additional financial performance including investment spend profiles, level of net debt of the Company
- significant environmental incidents.

The views of the ORR and in particular such views expressed by the ORR to the Remuneration Committee Chairman, Jim Cornell, are considered. Industry relationships and end-user reputation are also very important to Network Rail and the Remuneration Committee pays particular consideration to these. Moreover, in 2009 Jim Cornell sought the opinions of all Members by inviting them to express their views in relation to potential award of incentive payment under the MIP for 2008/09. These were then carefully considered by the Committee in its decision-making process.

Examples of previous exercise of discretion:

2002/03 awards: The Committee exercised its discretion having determined that it would be inappropriate to make awards under the MIP for 2002/03 to any of the Executive Directors due to the relatively poor train performance even though other targets within the MIP were achieved. No annual incentive awards under the Network Rail scheme were made for that year.

2003/04 awards: The total potential award for 2003/04 was 32 per cent of basic salary. This included the impact of the non-use of a £50m contingency sum within the budget on the performance achievement level. The Remuneration Committee chose to use its discretion by adjusting the FEI performance to include the £50m contingency thereby reducing the level of achievement. As a consequence the overall incentive award for the Executive Directors reduced to 24 per cent of their basic salary.

2006/07 awards: The total potential award for 2006/07 was 20 per cent of basic salary. The Remuneration Committee exercised its discretion taking into account the overall performance of the Company during that year. The Committee was mindful that the failure to meet the FEI target was due to the impact of the Cumbrian incident. In addition it took into account the many areas of performance, including safety, where there had continued to be significant improvement in the last year. In order to underline the importance of the Company's commitment to continuing focus on operational excellence, however, the Committee decided to exercise its right to reduce the award for 2006/07 by 15 per cent.

2007/08 awards: The Committee recognised the disruption caused to Network Rail customers and passengers as a result of the Christmas 2007 overruns. It concluded in relation to the awards for that financial year that the inconvenience and disruption were already reflected in the outturn of the reliability performance measure of the MIP. The FEI measure was also adversely affected by the ORR's fine levied. In combination the awards payable under these two measures (which comprise two thirds of the incentive measures) were automatically impacted by the overruns reducing them by a significant percentage. This reduction also represented an important validation of the robustness of the MIP performance measurement structure as having relevant and effective mechanisms reflecting the significance of performance failures to TOCs, FOCs, passengers and freight customers.

Notwithstanding this, the Committee believed that the adverse reputational impact to the Company of the overruns had been significant. Consistent with the Company's commitment to continuous focus on operational excellence, therefore, the Committee concluded that in addition to the resulting automatic reductions in incentive awards it would exercise its discretion to reduce the awards further. The awards in total were reduced by the Committee, therefore, by a further significant percentage over and above the initial reduction under the terms of the MIP.

Decision for 2008/09 awards

In considering what awards would actually be made the Committee conducted the same thorough and careful consideration of the numerous performance indicators measured by Network Rail, the ORR and Passenger Focus. It also considered the views of Network Rail's customers and other stakeholders expressed in a variety of forms including the regularly conducted surveys referred to in the Corporate governance report on page 56. Further, as mentioned earlier, in April 2009 the Chairman of the Remuneration Committee sought the views of Members on the exercise of the Committee's discretion in relation to the awards for 2008/09. All the views expressed formed part of the consideration by the Committee in reaching its conclusions detailed below.

Key to the Committee's review of performance this year was acknowledging the fact that the targets for 2008/09 were designed to be stretching and even more challenging than the targets set by the ORR in most areas. The Committee then turned to key aspects of both performance against those targets and also performance more generally. In so doing particular weight and attention was given to the regulatory requirements in the network licence and to the ORR's comments on the Company's performance made to the Chairman of the Remuneration Committee. This formed a valuable contribution to the Remuneration Committee's deliberations and the Committee believes that this should continue as an important part of the process for the future. This year the Committee was pleased to note the focus given by the ORR to good performance by Network Rail. It also took very careful note of those areas of performance which the ORR highlighted that had not gone so well. Each specific comment raised by the ORR, together with the views of Committee members on business outturns were debated very thoroughly and carefully.

Of the specific performance indicators reviewed, the Remuneration Committee noted that the financial efficiency target for 2008/09 had been met. Notwithstanding this, the Committee decided to remove from the calculation of the FEI performance certain items. An amount of £20m contained within the 2008/09 budget relating to the cost of standardisation of terms and conditions of employment within the Infrastructure Maintenance function was not utilised since negotiations with the trade unions on this have not yet concluded. In relation to the Edinburgh Waverley project Network Rail earned a contractual bonus for early completion of the project supplementing the FEI by £5m. The Remuneration Committee considered that both items should be excluded from the calculation of FEI performance for the purpose of the MIP awards as theoretically neither represented financial efficiency of the type relevant for the MIP awards. The level of achievement of this measure was halved by these exclusions.

On safety performance in 2008/09 the Remuneration Committee strongly endorsed the Company's view that any workforce death on the rail network is a tragedy and that the Company's commitment to improving safety must be its priority. In the rail industry's history there has been only one year – 2006/07 – in which there was no workforce fatality. Management needs to continue its focus on attaining this record consistently. It was deeply saddening, therefore, that, as reported in the Directors' report, 2008/09 saw three workforce fatalities. This was despite continuing trends in improved performance against a variety of safety performance indicators (including train and passenger safety) used within the business. The Remuneration Committee concluded that the evidence of on-going commitment of management to improving safety, combined with the overall improving safety record, supported its views not to exercise its discretion this year due to safety performance. In reaching this view the Remuneration Committee also took into consideration the need to apply consistent assessment of safety performance against other years, as well as the use by the ORR as the safety regulator during the year of its various powers in relation to safety matters. As reported on page 16, safety improvements for CP4 have been drawn up against tight targets. The Remuneration Committee will continue to monitor delivery of these plans together with safety performance generally over the coming years.

On train performance the Committee noted that, against the significant improvement since 2002, PPM at year end reached a record of 90.6 per cent. Against this important milestone the Remuneration Committee also reflected upon the disruption to passengers and freight on the West Coast route. It noted that, whilst the Company should always seek to minimise disruption, the scale of the delivery of the modernisation project should not be overshadowed completely. Management had made changes to the engineering possession regime and had demonstrated significant commitment to this issue. It had been recognised too that management also had to make a difficult decision between a) taking extra possessions to achieve the benefits to both train operators and passengers that the December 2008 timetable provided or b) delaying that timetable change in order to reduce the immediate disruption. The Non-Executive Directors supported the executives' decision to manage the project to deliver the former. This decision was recognised by the ORR at the time as being in the best interest of passengers overall. This was reflected in the Company's plans for the year and the Committee noted the support which was received from the rest of the industry in implementing these plans.

Whilst measurement of passenger satisfaction has also shown sizeable improvement, Network Rail's customer satisfaction levels have not shown the same progress. Customer service is at the heart of Network Rail's business focus. This is why going forward the Remuneration Committee has introduced further incentives on management through inclusion in the MIP 2009/10 of customer and passenger satisfaction measures (see page 35). The Remuneration Committee considered it to be premature to apply the outputs of the recent surveys directly in relation to exercising its discretion in 2008/09. The current transformation programme's focus on service culture must be given the opportunity to become embedded before the management is judged through the

MIP on the survey outputs. Judgement on these will form, however, part of the MIP considerations in 2009/10.

The efficiency outturn for CP3 was always challenging. The Remuneration Committee shared the disappointment of the executive team that the 31 per cent improvement as set by the ORR was not achieved in all parts of the business. That said, the outturn of 27 per cent improvement represented a significant achievement. Reducing track renewal unit costs continued to challenge the executive management. The Remuneration Committee considered it important to recognise that major steps were taken during 2008/09 to continue the focus on this issue. Moreover, in relation to efficiency achievements made in the year rather than the whole of CP3, the Committee put weight upon the fact that significant progress was achieved in 2008/09 against a challenging annual target. Management was not able, however, to recover the shortfall in certain efficiencies targets set for earlier years in order to deliver the full 31% by 31 March 2009. It was considered relevant too that the benefits of the strategy adopted by management for reducing renewal unit costs need to be given an opportunity to deliver the results. The Committee also noted that reduced efficiency automatically reduced the FEI outturn and there was a knock on incentive award reduction on the LTIP. Further reduction through the exercise of the Committee's discretion, therefore, was not considered to be appropriate.

Other experiences of 2008/09, whilst providing valuable lessons to inform future improvements, in the views of the Committee do not warrant negative reflection at this time in relation to the incentive awards. For example the provision of gauging information is not as yet complete but has improved. On timetabling it is vital to recognise the importance of Network Rail maximising the availability of the network and the collective roles of the train operators, Network Rail and the ORR in achieving this. Significant investment has already been made by Network Rail and continuing focus has been demonstrated by the executive management. The number of asset failures due to signalling or power failure has not improved as much as Network Rail had hoped, but the Committee does not believe that, against the delivery of many other asset performance improvements, the automatically inbuilt reducing effect of these failures on the MIP needs further reflection.

The ORR also commented on Network Rail's readiness for the CP4 challenge. From the issue by the DfT and Transport Scotland of the HLOSs there has been considerable work and focus placed by the Company on the iterative process concluding in the publication of the CP4 determinations. Particular progress was made on the level of engagement with customers and other stakeholders on the development of plans for the railway. The business has also set out an extremely ambitious transformation programme for CP4 delivery. The Committee did not agree with the ORR, therefore, that Network Rail delayed its consideration of how to deliver these.

The Remuneration Committee also reviewed each element of the ORR's assessment on a number of other aspects of the Company's performance. It recognised the importance of these issues both in terms of the delivery of commitments and the impact on the reputation of the business and the industry as a whole. The Committee emphasised, therefore, the need for the executive team and the Board to reflect as to what further action should be taken to address these issues. Against this, it was noted that attention had clearly been demonstrated by management on addressing the legacy of asset condition and other issues with overall performance in this area showing favourable trends. Other points of importance to Network Rail's future as well as its past performance (including reputational issues) were also reviewed.

The Committee concluded, however, that these wider issues including the issues identified by ORR did not warrant the exercise of the Remuneration Committee's discretion in relation to the incentive awards for 2008/09. In reaching this view the Committee noted that the impact of those areas where performance was not as high as had been sought was largely already reflected in the MIP measures. It noted that there were areas of strong performance which were not reflected in the calculation of the potential bonus award. It also noted that there were no notifications of breaches of the network licence or relevant breaches of the access agreements in 2008/09.

There remain areas on which further management focus is appropriate, but the Remuneration Committee felt very strongly that it is important when deciding whether to exercise the Remuneration Committee's discretion under the MIP to continue to take success as well as lesser achievement into consideration. This power must be used judiciously and consistently from year to year and against the facts relevant to Network Rail. In this context, the Committee noted that it had used its discretion to reduce bonuses on four of the last six years.

The MIP is designed to allow the Remuneration Committee flexibility through its discretion to respond to significant events not automatically designed into its mechanisms. This includes more general matters. The Committee decided that reaction this year to reflect public concern about other industry sectors' failures would, however, wrongly detract from the structure of the carefully balanced MIP. In reaching this view, the Committee took particular account of the views expressed by Members. It also noted that other companies' incentive schemes have been heavily criticised for not benefiting from checks and balances such as those already woven into Network Rail's MIP whereby only sustainable success is rewarded. The work of Network Rail's employees has brought benefit to all from customer and end user to taxpayer. The mechanisms within the MIP measures automatically reduce management's financial reward where performance is below that required from Network Rail.

The Committee recognised the importance of acknowledging the current wider economic environment prevailing in the UK generally and Network Rail's responsibilities in this regard. It concluded that the achievement in CP3 of significant efficiency goals amounted to a major response to these responsibilities. And where some of these goals have not been as successful as had been hoped the MIP has already penalised the awards payable in each of the years of CP3. Likewise the efficiencies set for CP4 and the role of the MIP going forward continue this responsibility. With very long term planning required to deliver the rail network that the future will need beyond the immediate economic situation, the Remuneration Committee firmly believed further reactive response at this time to be inappropriate.

The total potential annual award for 2008/09 was 56.2 per cent of basic salary. With the discretionary reduction to the FEI target the annual award dropped to 49.3 per cent. After careful and thorough reflection of all of the above the Remuneration Committee considered that, when taken "in the round", there continues to be significant progress made in key areas of performance. The Committee concluded that for 2008/09 it was not appropriate to adjust the potential awards further beyond the reduction in achievement against the FEI target. The Remuneration Committee remains committed to monitoring all aspects of performance going forward and will continue to recognise the importance of the use of its discretion when appropriate and the need to take account of the views of stakeholders in deciding whether to apply this discretion.

Details of the resulting incentive payments awarded to each Director are set out below.

Incentives 2008/09 (audited)

Name	Annual incentive	LTIP for three years to 31 March 2009 Amount earned
Iain Coucher	Nil	150,255
Patrick Butcher*	Nil	Nil
Robin Gisby**	81,345	57,887
Peter Henderson	216,920	112,107
Ron Henderson***	206,567	112,107
Simon Kirby**	81,345	55,752
Paul Plummer**	76,415	65,151

* Appointed to the Board of Directors on 20 April 2009.
** Appointed to the Board of Directors on 1 October 2008.
*** Retired from the Board of Directors on 19 April 2009.

Asset Categories included in the Asset Stewardship Indicator for MIP 2009/10

Asset Categories	Factors Included in this Asset Category	Weighting
Track	Good track geometry; poor track geometry; rail breaks; intervention and immediate action faults	40%
Signalling	Condition assessment; signalling failures causing over ten minutes' delay to trains	25%
Electrification and plant	Substation and contact system condition; power supply incidents causing train delays	7%
Telecoms	Telecoms condition	3%
Operational property	Station stewardship; depot stewardship	10%
Structures	Assets subject to special investigation or inspection; temporary speed restrictions	15%

Personal performance measures

There are no individual performance measures set for the Executive Directors. The Committee continues to believe that collective accountability of the Directors necessitates a focus on collective performance incentives without individual performance measures. Other senior executives do have individual performance measures in addition to the business performance measures.

MIP 2009/10 – annual incentive

Participants under the MIP 2009/10 will be eligible to receive bonuses based again on demanding business performance measures and targets. The MIP 2009/10 has been updated to take account of the particular requirements for Control Period 4, revisions to the Network Licence and a wider review introducing new key performance indicators (KPIs).

The business and individual performance measures relate directly to the objectives set out by the ORR in Condition 16 of the Network Licence of Network Rail Infrastructure Limited, compliance with other licence conditions and with conditions of access agreements.

Business performance measures

The amount payable to Executive Directors will be calculated by reference to performance against two key groups of measures.

1 Four key 'mechanistic' measures. These are objective measures which reflect network performance
   - Public Performance Measure
   - Asset Stewardship Indicator
   - Cost Efficiency Measure
   - Passenger Satisfaction.

The first three of these measures are similar in purpose to the three measures used in previous years' MIPs; the fourth is a new measure reflecting the importance of passenger satisfaction.

These four measures are equally weighted.

2 Two judgemental elements. These important elements are ones where no single formal index exists
   - Customer Satisfaction
   - Renewals Progress.

These two elements are also equally weighted.

The sum of the mechanistic elements and the judgemental elements make up the total 'derived' bonus payment. However, the Remuneration Committee continues to have discretion and will determine whether the amounts payable might be reduced through the application of discretion.

Details of the mechanistic measures are described below:

Public Performance Measure (weight 20 per cent) The Public Performance Measure (PPM) used in this MIP incorporates the PPM for passenger journeys and an equivalent measure for freight journeys, with weightings which reflect the relative traffic flows of passenger and freight.

Asset Stewardship Indicator (weight 20 per cent) The Asset Stewardship Indicator measures the quality of Network Rail's asset stewardship, based on asset condition, reliability and performance across Network Rail's key asset categories. This is calculated by measuring relevant asset stewardship measures across the key asset categories using the weightings detailed in the table on page 34.

Each of the above performance measures stands alone and is calculated independently. The total potential incentive award payable is then the sum of the outcomes of each measure.

Cost Efficiency Measure (weight 20 per cent) The Cost Efficiency Measure is defined as the annual cost of Network Rail, normalised by the capacity provided and adjusted by renewals activity. This is then compared to a baseline. This measure reflects, therefore, the savings made by Network Rail through unit cost and scope efficiencies.

The Cost Efficiency Measure tracks the efficiency savings for operating, maintenance and renewals costs. The measure is expressed as a percentage and reflects expenditure compared with the ORR pre-efficiency assumptions. The measure covers all operations, maintenance and renewals activities and measures total expenditure adjusted by the network capacity provided, as measured by vehicle miles and freight gross tonne miles.

Each year, the Cost Efficiency Measure will measure cumulative efficiency across the whole of CP4 and the efficiency compared to the previous year. The targets for this MIP are expressed on an annual basis.

Passenger Satisfaction (weight 20 per cent) Passenger Satisfaction is measured through the National Passenger Survey (NPS) commissioned by Passenger Focus which provides a network-wide picture of customers' satisfaction with rail travel. The target used in this MIP is based on the 'overall satisfaction' rating in that survey.

The NPS measures satisfaction twice a year, and the ratings used as 'actuals' for the purpose of the MIP will be the average of the two ratings in the relevant plan year.

The structure of the MIP for 2009/10 incorporates a taper principle in respect of the four mechanistic measures. This allows significant performance to be recognised against a background of continued year on year stretch performance charges. The specific targets and taper trigger points are decided by the Remuneration Committee, taking into account regulatory targets.

Payments under each of the four measures can only be made if performance meets or exceeds the trigger performance as determined by the Remuneration Committee in accordance with the taper principle. If target levels are achieved, payments are calculated for above-target performance on a 'straight line' basis up to 'maximum' target level; the maximum incentive could be earned by achieving a level of performance at least equal to delivering one year early the 2010/11 performance on each measure as contained in the 2009 CP4 Delivery Plan.

The Committee may exercise its discretion and reduce the amounts payable if, over the year, the overall business performance of Network Rail, including the level of safety performance and net debt, is deemed by the Committee to be unsatisfactory.

The potential annual incentive entitlement if all three measures achieve target level is 50 per cent. The maximum possible entitlement is 100 per cent of salary, achievable only if all three measures hit maximum performance, by achieving a level of performance equal to or better than the 2010/11 performance described in the 2009 CP4 Delivery Plan.

Details of the judgemental measures are described below:

Customer Satisfaction (weight 10 per cent) Customer Satisfaction is an assessment of how well Network Rail engages with its key customers (principally train and freight operating companies). The assessment of payments under this measure will be made by the Remuneration Committee, taking account of the ORR's quarterly performance reports and principally the results of the Customer Satisfaction Survey carried out by a third party.

An improving result would produce a potential payment, the size of which would be determined by the Remuneration Committee, taking account of this and any other relevant information that may be available.

Renewals Progress (weight 10 per cent) An annual report on the degree of achievement against progress on delivering major enhancement and renewal schemes is produced by Network Rail. In determining the extent to which a payment will be made under this measure, the Remuneration Committee will make an overall judgement after reviewing this annual report.

No payment will be made under this measure if a number of milestones are not achieved or authorised project costs are overspent.

If most milestones are achieved and authorised project costs are met, a payment around target level could be awarded. If all milestones are met and some authorised project costs are underspent, a payment around maximum level could be awarded.

The Remuneration Committee will produce a statement by July of each year explaining the rationale for the payments under the two judgemental measures.

Personal performance measures

Again there are no individual performance measures set for the Executive Directors for the reasons set out on page 34.

Long term incentive (L-TIP)

Under the terms of the Management Incentive Policy there is a requirement to have a long term incentive element within the MIP.

As Network Rail Limited, being the ultimate parent of the Company, is a company limited by guarantee it is not possible to use traditional long term incentives due to the absence of shares as the reward method. The L-TIP is based, therefore, on a deferred additional cash award in which awards are made after each three-year period triggered by relevant long term improvement in business performance targets. The Remuneration Committee has designed this to incentivise the organisation to work together as a team and with external parties throughout the industry over the long term to achieve the key business objectives of the Company.

At the 2007 Annual General Meeting of Network Rail Limited its members approved the proposal by the Committee that the long term incentive for each of the three years (starting 1 April 2008) be calculated on the basis of the average of the awards made in each year of the three-year performance period 2008/09 to 2010/11.

The third performance period for the long term incentive ended on 31 March 2009 and payments under that L-TIP have been calculated, based on the two targets for the scheme.

L-TIP for three-year period 1 April 2006 to 31 March 2009

Public Performance

Maximum Target	Minimum Target	Actual
87.6%	86.6%	89.4%

ORR cost reduction targets

Maximum Target	Minimum Target	Actual
£12,580m	£13,484m	£13,101m

Consequently payments were made at a level of 70 per cent to participants in this long term plan, based on a maximum amount equivalent to the annual incentive earned in 2005/06 (as described in previous years' remuneration reports).

Potential L-TIP awards (audited)

	Performance Period							
	1 April 2006 to 31 March 2009 £	1 April 2007 to 31 March 2010 £			1 April 2008 to 31 March 2011 £			1 April 2009 to 31 March 2012 £
Director		2007/08	2008/09	2009/10	2008/09	2009/10	2010/11	2011/12
Iain Coucher	214,650	305,581	302,209	a	302,209	a	b	613,000
Patrick Butcher*	Nil	Nil	Nil	Nil	Nil	Nil	Nil	350,000
Robin Gisby**	82,696	78,354	130,185	a	130,185	a	b	330,000
Peter Henderson	160,153	219,391	216,920	a	216,920	a	b	440,000
Simon Kirby**	79,646	121,676	160,215	a	160,215	a	b	330,000
Paul Plummer**	93,073	128,288	149,575	a	149,575	a	b	310,000
Past Director								
Ron Henderson***	160,153	208,944	206,567	–	206,567			
Total	790,371	1,062,234	1,165,671		1,165,671			2,373,000

* Appointed to the Board of Directors on 20 April 2009.
** Appointed to the Board of Directors on 1 October 2008 – includes potential award amounts relating to previous position within the Company before appointment to the Board of Directors.
*** Retired from the Board of Directors on 19 April 2009.

Notes
1 For performance period 1 April 2007 to 31 March 2010 and 1 April 2008 to 31 March 2011 the L-TIP will be calculated on an average of three annual award payments subject to performance conditions.
2 To assist in describing this calculation the above table has been annotated with a, b and c to represent the appropriate unknown annual payments.
3 2007/10: The maximum L-TIP payment for the performance period 1 April 2007 to 31 March 2010 is equal to the average of the annual payments received for the years 2007/08, 2008/09 and 2009/10. For example, for Iain Coucher the calculation to set the maximum award will be: L-TIP maximum = (£305,581+£302,209 +a)/3.
4 2008/11: The maximum L-TIP payment for the performance period 1 April 2008 to 31 March 2011 is equal to the average of the annual payments received for the years 2008/09, 2009/10 and 2010/11. For example, for Iain Coucher the calculation to set the maximum award will be: L-TIP maximum = (£302,209 +a+b)/3.
5 2009/12: The maximum L-TIP payment for the performance period 1 April 2009 to 31 March 2012 is equal to the the maximum value the Director is eligible to receive under the relevant MIP award. For example the calculation for Iain Coucher will be: L-TIP maximum = 100 per cent of basic salary as at 1 April 2009 (£613,000).
6 These maximum sums will only be paid if the performance measures outlined on page 28 are met in full.

The maximum potential value of the long term incentives receivable by each Executive Director at the end of the respective performance periods of the other three-year periods is as shown in the table on page 36.

Performance measure

Following further consultation in 2008 and a review of current market practice, it has been decided to modify the approach on potential awards under the long term incentive to one which expresses the potential amounts to be earned as a percentage of base salary at the outset of the relevant three-year period. This change will be subject to approval at the Network Rail Limited's AGM in July 2009.

With effect from the three-year period running from 2009/10 to 2011/12, a new single measure for the long term incentive is being introduced; this is 'Financial Value Added'. This single measure (FVA) is defined as the value added in the relevant three-year period, over and above the amount determined by the ORR for the relevant period.

The formula for FVA is the differences between the ORR's income and expenditure determinations and Network Rail's actual income and expenditure.

FVA is expressed in £m. Thus, if Network Rail outperforms the ORR determinations by £100 million over the relevant three-year period, the FVA Index is expressed as +£100m.

Regulatory MIP statement

As required under the network licence of Network Rail, a statement was published in May 2009 detailing the contents of the Executive Directors' MIP 2009/10.

Pensions

Executive Directors are entitled to a pension provided from one of the three Company pension schemes on the same terms as for other employees. In addition, a pension supplement is paid either into the Defined Contribution Pension Scheme or as a cash alternative. Details are set out on page 40.

Directors' service terms

Executive Directors

The Executive Directors of the Company are also the Executive Directors of Network Rail Limited but their contractual service agreements are with this Company. No other contractual provisions or remuneration arrangements exist in relation to their directorships of the Company or any other company within the Network Rail Group.

At the time of drawing up each service agreement the Committee takes into consideration the UK Listing Authority's corporate governance code and the recommendations published at that time by certain bodies, for example statements of the ABI and the NAPF on best practice on executive contracts and severance. These are applied as far as practicable and appropriate having regard to the nature of the business, the corporate structure of the Company and current practice of the time.

All the Executive Directors' service agreements provide for notice periods of no greater than one year, to reflect current corporate governance best practice. Executive Directors are required to give not less than six months' notice if they wish to leave.

The Chief Executive's service agreement (and the letter of appointment of the Chairman) also contains provisions for termination of his appointment without compensation upon the occurrence of certain significant financial failures of the Network Rail Group unless a majority of the Board of the Company and the DfT (in its role as provider of credit facilities) decide that these appointments should not be terminated.

Taking the principles contained within current corporate governance best practice relating to compensation in the event of early termination of a director's service agreement, each such agreement contains an express provision requiring the departing director to exercise their duty to mitigate their loss. Network Rail will have regard to that duty and contractual requirement on a case by case basis when assessing the appropriate level of compensation which may be payable, including using phased payments.

Executive Directors	Effective date of contract
Iain Coucher*	1 August 2007
Patrick Butcher	20 April 2009
Robin Gisby	1 October 2008
Peter Henderson	3 October 2002
Simon Kirby	1 October 2008
Paul Plummer	1 October 2008

* Previously held the position of Deputy Chief Executive under a service agreement effective from 3 October 2002.

Non-Executive Directors

Non-Executive Directors are appointed by the Board on the recommendation of the Nominations Committee. Their appointment is for an initial term of three years, subject to election by the members of Network Rail Limited at the first AGM following their appointment. They do not have service agreements. Instead the terms of their engagement are set out in a letter of appointment and their appointments may be terminated at any time on six months' notice without compensation. Further, as mentioned above, the letter of appointment of the Chairman also contains provisions for termination of his appointment without compensation upon the occurrence of certain significant financial failures of the Network Rail Group unless a majority of the Board of the Company and the DfT (in its role as provider of credit facilities) decide that these appointments should not be terminated.

Non-Executive Directors	Effective date of original contract
Ian McAllister	3 October 2002
David Bailey*	3 October 2002
Ian Buchan	5 February 2006
Yvonne Constance	1 May 2005
Jim Cornell**	3 October 2002
Michael Firth	4 December 2004
Christopher Green	26 June 2005
Rick Haythornthwaite	23 March 2009
Steve Russell	19 September 2007

* David Bailey's appointment in 2002 was as Special Director; upon conversion of his appointment a new letter of appointment was issued in 2005. He then sought election by the Members at the Network Rail Limited AGM in July 2005.

** Jim Cornell had previously an appointment letter dated 14 December 2001.

External appointments

It is recognised that Executive Directors may be invited to become non-executive directors of other companies or hold positions in other organisations or bodies and that such appointments can broaden their knowledge and experience to the benefit of the Company. An individual Executive Director will normally be required to account to Network Rail for all fees received in respect of such directorships unless otherwise approved by the Committee.

None of the Executive Directors currently holds any such positions other than those associated with the performance of their duties within Network Rail. No fees are received by them for any such positions.

None of the Executive Directors are a non-executive director on the board of any listed company.

Non-Executive Directors' remuneration

As stated above, the Non-Executive Directors of the Company are also the Non-Executive Directors of Network Rail Limited but their letters of appointment are with this Company covering both positions.

No other contractual provisions or remuneration arrangements exist in relation to their directorships (if any) of any other company within the Network Rail Group. For the purpose of this Directors' remuneration report and the Directors' remuneration report for Network Rail Limited, therefore, the following provisions of this report also appear in the Annual Report of that company. The letters of appointment are available for inspection at the Company's registered office.

Non-Executive Directors do not receive any benefits from the Company or from the Network Rail Group.

The key terms of the Non-Executive Directors' appointments are set out in the table above.

Non-Executive Director's terms of appointment

Provision	Policy
Period	Three year term which can be extended by mutual consent
Termination	By the director or the Company giving the other six months' written notice without compensation
Fees	As described on page 38
Expenses	Reimbursement of expenses reasonably and properly incurred in attending meetings of the Board or otherwise in the performance and discharge of their duties and responsibilities
Time commitment	Varying dependent on Board and Board committee duties
Special terms	None

Disclosure of Directors' remuneration for 2008/09 (audited)

This section of the report sets out the remuneration paid or payable to the Directors in respect of the financial year to 31 March 2009. The following sections headed Directors' emoluments and Executive Directors' pensions along with their associated footnotes have been subject to external audit.

Current annual fees (audited) for the Non-Executive Directors

Non-Executive Directors	Fee £
David Bailey	50,000
Ian Buchan	50,000
Yvonne Constance	50,000
Jim Cornell*	71,000
Michael Firth**	65,000
Christopher Green	50,000
Rick Haythornthwaite***	50,000
Ian McAllister	275,000
Steve Russell	50,000

* Includes additional fees paid for his chairmanship of Board committees and membership of the Membership Selection Panel.

** Includes additional fees paid for his chairmanship of Board committees.

*** Joined the Board of Directors in March 2009.

Since January 2005, in view of the additional responsibilities and time commitment placed upon the chairmen of Board committees, and in line with the recommendations of the Higgs Report and good corporate governance practice, it was decided that additional fees would be paid to a Non-Executive Director who chairs any of the following of the Board committees:

Safety Health & Environment Committee Chairman	£9,000 pa
Audit Committee Chairman	£9,000 pa
Remuneration Committee Chairman	£6,000 pa
Treasury Committee Chairman	£6,000 pa

With the exception of the fee for the Chairman (which is determined by the Remuneration Committee), the fees of the Non-Executive Directors are agreed by the Executive Directors of the Board. These fees are designed to recognise the significant responsibilities of Non-Executive Directors and to attract individuals with the necessary high quality experience and ability to make an important contribution to the Company's business.

Directors' remuneration comparison 2008/09 against 2007/08 (£000s)

	Basic salary/fees†		Bonuses+		Benefits		Supplementary Company pension contributions/AVC payments by the Company		Total	
	2008/09	2007/08	2008/09	2007/08	2008/09	2007/08	2008/09	2007/08	2008/09	2007/08
Chairman										
Ian McAllister	265	250	–	–	–	–	–	–	265	250
Executive Directors										
Iain Coucher	605	539	150	511	15	25	177	169	947	1,244
Patrick Butcher *	Nil	Nil	Nil	Nil	–	Nil	Nil	Nil	–	Nil
Robin Gisby**	150	–	139	–	72	–	–	–	361	–
Peter Henderson	434	399	329	372	15	15	125	131	903	917
Simon Kirby**	150	–	137	–	7	–	74	–	368	–
Paul Plummer **	141	–	142	–	68	–	2	–	353	–
Non-Executive Directors										
David Bailey	47	42	–	–	–	–	–	–	47	42
Ian Buchan	47	42	–	–	–	–	–	–	47	42
Yvonne Constance	47	42	–	–	–	–	–	–	47	42
Jim Cornell	68	63	–	–	–	–	–	–	68	63
Michael Firth	62	57	–	–	–	–	–	–	62	57
Christopher Green	47	42	–	–	–	–	–	–	47	42
Rick Haythornthwaite***	1	–	–	–	–	–	–	–	1	–
Steve Russell	47	21	–	–	–	–	–	–	47	21
Past Director										
Ron Henderson****	413	385	319	362	118	126	–	–	850	873
Total emoluments of Directors	2,524	1,882	1,216	1,245	295	166	378	300	4,413	3,593

* Joined the Board of Directors on 20 April 2009 having joined Network Rail on 2 March 2009.
** Joined the Board of Directors on 1 October 2008. Prior to this, they received remuneration as senior executives in Network Rail but, for the purpose of requirements on reporting on Directors' remuneration, these early sums are not included. Bonus values represent full L-TIP payment and annual incentive payment awarded to a Board Director.
*** Joined the Board of Directors on 23 March 2009.
**** Retired from the Board of Directors on 19 April 2009.
† Executive Directors receive salaries and Non-Executive Directors receive fees.
\+ Given his overall leadership position, Iain Coucher and the Remuneration Committee mutually agreed that he would not be considered for any annual bonus for 2008/09. Value of £150k represents L-TIP payment only.

Notes
1 'Benefits' – all Executive Directors received life assurance benefits during such part of the year as they were employed by the Company that relate to the cost incurred by the Company of insuring the directors' life assurance and spouses' benefits which, had they died during the year, could not have been wholly paid by the relevant pension scheme and would therefore have been met by the Company's insurer. The disclosure also includes the cost of private medical insurance, car benefits. All the numbers disclosed include the tax charged on the benefits. No Director received an expense allowance during the year.
2 No compensation payment for loss of office was made to any Director or past Director during the year.
3 For the purpose of disclosure required by Schedule 6 of the Companies Act 1985 the total aggregate emoluments of the Directors in respect of 2008/09 was £4.5m (2007/08: £4.1m). For 2007/08 this figure covers emoluments for three Executive Directors and eight Non-Executive Directors. Whereas the figure for 2008/09 includes the emoluments of the three additional Executive Directors appointed in October 2008, being a total of six Executive Directors and one additional Non-Executive Director.
4 The supplementary Company pension contributions/AVC payment by the Company reflect values for the full year.

The fees are reviewed bi-annually by the Executive Directors with a range of market data being used to inform decision making, including a combination of comparison data from sizeable companies both regulated and under-regulated with synergies of business type and business drivers. The strategy for Non-Executive Directors' fees is broadly to reflect the relevant market median. Account is also taken of the time commitment required in preparing for and attending meetings. The fees were last reviewed with effect from August 2008.

The Chairman of the Board and the Non-Executive Directors do not receive benefits in additions to their fees nor do they participate in any incentive scheme or pension arrangements (save that due to their previous employment within the rail industry, Jim Cornell and Chris Green receive pensions from other sections of the industry-wide Railway Pensions Scheme (RPS) that are not associated with Network Rail).

Directors' emoluments

The fees, which are neither performance related nor pensionable, are benchmarked and periodically reviewed against, and are in line with those paid by other comparable companies taking into account time commitment and competition for similar positions in other companies.

The total amount of Directors' emoluments for services provided solely to the Company during the year was £4,413,000 (2007/08: £4,155,000, this figure included John Armitt's emoluments

Core pension benefits (audited)

Current Directors	Gross increase in accrued RPS pension £ (A)	Increase in accrued RPS pension net of inflation £ (B)	Total accrued RPS pension at 31 March 2009 £ (C)	Transfer value of accrued RPS pension at 31 March 2008 £ (D)	Transfer value of accrued RPS pension at 31 March 2009 £ (E)	Total change in transfer value during period £ (F)	Value of net increase in accrual over period £ (G)
Iain Coucher	2,399	1,883	12,705	105,697	139,097	21,951	9,169
Patrick Butcher*	91	91	91	–	642	510	510
Robin Gisby**	2,859	1,803	23,976	278,578	329,147	44,718	18,896
Peter Henderson	2,399	1,883	12,705	170,059	193,532	12,024	17,238
Simon Kirby**	2,340	1,893	11,277	78,070	104,025	20,103	11,615
Paul Plummer**	2,579	1,852	17,130	225,341	253,230	22,037	21,521
Past Director							
Ron Henderson***	2,412	1,881	13,043	218,565	229,218	796	21,604

* Joined the Board of Directors on 20 April 2009 and having joined Network Rail on 2 March 2009 a member of the CARE Pension Scheme from that date.

** Joined the Board of Directors on 1 October 2008. Being employed by Network Rail prior to that date the figures shown include pension benefits relating to prior service as required under the Companies Act 1985.

*** Retired from the Board of Directors on 19 April 2009.

Notes
1 Pension accruals shown are the amounts which would be paid annually on retirement (or earlier leaving) based on service to the end of the year. The net inflation adjustment reflects the annual increase in RPI to 30 September 2008.
2 Transfer values as at 31 March 2008 (D) and 31 March 2009 (E) have been calculated in accordance with version 8.1 of guidance note GN11 issued by the actuarial profession.
3 The change in the transfer value (F) includes the effects of fluctuations in the transfer value due to factors beyond the control of the Company and Directors, such as stock market movements. It is calculated after deducting the Director's contribution.
4 The value of net increase (G) represents the incremental value to the Director of their service during the year, calculated on the assumption that service terminated at the year end. It is based on the accrued pension increase (B) after deducting the Director's contribution.

Additional pensions benefits (audited)

Current Directors*	Company contributions to additional pension provision or optional salary supplement whilst a Director during the year ** £	Company payments to additional pension provision** in respect of prior year £	Matching Company additional voluntary contributions whilst a Director during the year £
Iain Coucher 1	176,611	168,638	–
Patrick Butcher 2	–	–	–
Robin Gisby 3, 4	63,956	–	–
Peter Henderson 1	125,111	131,164	–
Simon Kirby 3	74,126	–	–
Paul Plummer 3, 4	59,913	–	2,422
Past Director			
Ron Henderson 1, 4, 5	103,648	110,652	–

* None of the Non-Executive Directors are members of any Network Rail pension arrangement nor do they have other pension entitlements save that Jim Cornell and Chris Green receive a pension from the RPS relating to his previous employement – see page 44 for details.

** Where a Director is entitled to additional pension benefits they can choose the payment as salary supplement, less a deduction for national insurance or a pension contribution to the DCPS.

Notes
1 These Directors were Directors for the whole year.
2 This Director was appointed on 20 April 2009.
3 These Directors were appointed Directors on 1 October 2008.
4 This Director elected to receive an equivalent additional allowance in 2008/09 in lieu of additional pension contributions. This payment is included in the benefit figure reported on page 39.
5 This Director retired on 19 April 2009.

as Chief Executive as well as Rob den Besten's and Charles Hoppe's emoluments during that year). The number of Executive Directors increased from three to six in October 2008.

Executive Directors' pensions

The table on page 40 shows the pension entitlement from the respective Network Rail pension scheme for each Executive Director of the Company during the year ended 31 March 2009, together with the increases in those benefits during the year, calculated using the accrued benefit basis.

The increases in RPS benefits during the year represent the amount of the extra annual pension entitlement earned resulting from additional length of service or changes in salary.

The increase in accrued approved benefit during the year is shown in the table on page 40. Values are shown before (column A) and after (column B) the exclusion of the effect of inflation. All benefit values shown exclude the effect of any additional voluntary contributions made by the Director.

Executive Directors participate in either the RPS or the CARE Scheme and benefit accrues at a rate of one-sixtieth of capped final pensionable pay (RPS) or capped average pay (CARE) for each year of membership. They contribute at the same rate as other members of the respective scheme. In addition, some Directors are entitled to additional pension benefits that are provided through the Network Rail Defined Contribution Pension Scheme (DCPS).

The following sections describe the pension benefits received by Executive Directors in 2008/09:

- unless otherwise indicated Executive Directors are members of the RPS. In normal circumstances the earliest age at which they are entitled to receive their defined benefit pension without actuarial reduction is age 60 in the RPS or age 65 in the CARE Scheme. However, the Directors can retire early on the same terms and conditions that apply to other members of the respective scheme from the age of 50 in the RPS or 55 in the CARE Scheme. The actuarial reduction factors that apply under the RPS are a two per cent per annum reduction between the ages of 60 and 55 and a three per cent per annum reduction for ages below 55, although for RPS members not covered by the Protection Order under the Railways Act 1993 cost neutral early retirement terms are being introduced for pension benefits accrued from July 2009. In keeping with other members of the RPS scheme, the right to take early retirement benefits from the RPS is at the option of the individual, subject only to having left the Company's employment. In the CARE Scheme, the employer's consent is required and the pension is then subject to cost neutral early retirement terms
- in addition to members' benefits, dependants' pensions are payable after the death of the member, in line with those payable to all members of the RPS and CARE Schemes. These are at the rate of half the pension the member would have received at normal retirement age on death in service or half the member's basic pension on death in retirement or after leaving service. Basic pension is pension before commutation for cash and excluding any benefits arising from Additional Voluntary Contributions. In addition, under both schemes pensions are payable to surviving children based on a proportion of the dependants' pension. The RPS provides guaranteed increases to all pensions in payment and deferment in line with the retail prices index. In the CARE Scheme the same terms apply subject to a maximum annual increase of five per cent.

Additional pension benefits

As described on page 40, some Directors are entitled to additional pension benefits in which case the Director could choose the extent to which the gross payment was made to the pension arrangement, or taken as cash. Future contributions are at a pre-determined level, and the amount has been notified to each Director.

The contributions made during the year together, where appropriate, with contributions in respect of benefits accrued prior to the year under review are shown on page 40.

The RPS scheme also operates a matching additional voluntary contribution facility, whereby voluntary contributions paid by scheme members are matched by equivalent payments from the Company, up to certain limits. These matching arrangements were frozen for all scheme members of the Network Rail section of the RPS at the levels applicable on 6 November 2003, and this limit was applied to Directors as to other scheme members. Matching payments made in 2008/09 are shown on page 40.

Performance graph

As the Company has no listed shares total shareholder return cannot be illustrated.

Directors' interests

As the Company has no listed shares Directors have no interests in shares of the Company.

On behalf of the Remuneration Committee

Jim Cornell
Chairman, Remuneration Committee
3 June 2009

Corporate governance report

Corporate governance principles

The Board considers that good corporate governance is central to achieving the Company's objectives and to the principle of safeguarding stakeholders' interests in the rail infrastructure. The Company is committed to high standards of business behaviour and has an established governance framework which comprises an organisational structure, internal control systems and business conduct policies. These form the framework for effective decision-making and delivery of the quality rail infrastructure this country needs.

It is also a condition of Network Rail's network licence that, from 3 October 2002, it complies with the governance principles contained in the code annexed to the UK Listing Authority's listing rules (the Code). The Code sets out guidance in the form of principles and provisions on how companies should be directed and controlled to follow good corporate governance. The Financial Services Authority requires companies listed in the UK to disclose, in relation to Section 1 of the Code, how they have applied its principles and whether they have complied with its provisions throughout the accounting year. Where the provisions have not been complied with companies must provide an explanation for this.

The Code was amended on 1 June 2008 taking effect from April 2009. Given the timing of its year end, this new version of the Code does not apply to Network Rail until 2010. Notwithstanding this, the Board of Network Rail has chosen to report against this latest version of the Code on a voluntary basis.

Having reviewed the requirements of the Code, the Directors consider that Network Rail has complied throughout the financial year ended 31 March 2009 with the provisions set out in Section 1 of the Code. This Corporate Governance Report, coupled with the Directors' remuneration report, explains how the Company has applied the governance principles set out in the Code. Details of the Company's internal controls are set out on pages 50 to 51.

Board of Directors

The Board is responsible to Members and other stakeholders for the appropriate overall management of Network Rail and for the Company achieving its objectives. In particular the Board must govern the strategic direction of the business, supervising its operational management and providing leadership within a governance framework which it oversees. This responsibility extends to taking overall responsibility for financial performance, internal controls and risk management of the Company.

The information on pages 24 and 25 shows that at the date of this report the Company is led and controlled by a Board currently comprising six Executive Directors and nine Non-Executive Directors. The Board believes its composition possesses wide experience both within the rail industry and generally as well as the necessary range of qualities, skills and experience to lead the Company effectively.

Directors

Directors are appointed by the Board and are also the Directors of Network Rail Limited. Under the provisions of the Articles of Association of the Company the Directors are not subject to retirement by rotation due to it being a wholly-owned subsidiary of Network Rail Limited. Under the provisions of the Articles of Association of Network Rail Limited, however, all Directors (other than the Special Director – see below) must retire by rotation, and may stand (together with any new Director appointed since the last general meeting) for re-election or election (as the case may be) by the Members of the Company at least once every three years. Four new Executive Directors have been appointed since the Annual General Meeting (AGM) in 2008 – Patrick Butcher who joined the Board in April 2009 and Robin Gisby, Simon Kirby and Paul Plummer joined the Board in October 2008. One new Non-Executive Director has been appointed since the AGM in 2008 – Rick Haythornthwaite joined the Board in March 2009.

The names of the Directors due to stand for re-election at Network Rail Limited's AGM in July 2009 are set out on page 21 of the Directors' Report and further information will be given in the documents accompanying the Notice of the AGM to be sent to Members of Network Rail Limited. Each Director being proposed for election or re-election at the 2009 AGM has been subject to and took part in formal performance evaluation including a peer evaluation review in January 2009 (excluding Patrick Butcher and Rick Haythornthwaite who joined after this time). Further details of the evaluation are set out on pages 54 and 55. Biographical details of all of the Directors are set out on pages 24 and 25.

None of the Directors have served on the Board for nine years or more. There are currently no Directors aged 70. David Bailey will be 70 years of age during the next 12 months. There is no legal requirement for a Director over the age of 70 to seek re-election annually. As a matter of good practice, however, in Network Rail a Director reaching this age offers themselves up voluntarily for re-election. In line with this David Bailey will be voluntarily seeking re-election at Network Rail Limited's Annual General Meeting in July 2009. The Board of Directors support his re-election in recognition of the continuing valuable contribution he makes to the activities and responsibilities of the Board. Also the Board considers continuity of Board membership to be important in the coming year given the various changes to its composition during recent months. With effect from 22 July 2009, David Bailey will be the only remaining Non-Executive Director who joined the Board at inception of the Company's acquisition of Railtrack.

The Board's responsibilities

Certain matters are formally reserved for decision by the Board and its duly authorised committees. These include approval of

- the Group's overall strategy and annual operating budget
- the interim and year-end financial statements of the Company
- the business plan
- material changes to the network licence
- key pension matters
- appointments to the Board
- adequacy of internal control systems
- major capital investments and expenditure
- review of the performance of the Board and its committees.

Matters delegated to the Executive Committee or below are also subject to financial and other risk limits above which Board approval is required. Further details on the Board committee structure are set out on pages 45 and 46.

Chairman

The responsibilities of the non-executive Chairman include leading the Board and ensuring its effectiveness. He is responsible for the workings and leadership of the Board. Working closely with the Group Company Secretary, he sets the agenda for the meetings of the Board and arranges for a timely, accurate and clear information flow to the Board members both at board meetings and also through updates on issues arising between meetings. Supporting papers for scheduled meetings are distributed the week before each meeting. Access to documents is also available through the Group Company Secretary. Directors unable to attend a Board or Board committee meeting are provided with the papers for that meeting and encouraged to raise with the Chairman or chairman of the Board committee points they may have in advance of the meeting.

The roles of the Chairman and the Chief Executive are distinct and separate and their responsibilities are clearly established being set out in writing and having been agreed by the Board. The Chairman's Statement of Responsibility is published on Network Rail's website.

Summarising the Chairman's role it comprises:

General

- the running of the Board and the effectiveness of its role
- providing leadership of the Board, including, in conjunction with the Chief Executive, representing the Company with key stakeholders
- being the pivotal role in creating the conditions for overall Board effectiveness
- setting the Board's agenda for approving the Company's safety, operational and financial strategies
- promoting high standards of corporate governance and seeking compliance with the provision of the Financial Services Authority's Combined Code wherever applicable and appropriate
- seeking to uphold the highest standards of integrity and probity of the Board as a collective body.

Board

- chairing Board and general meetings of the Company
- running the Board to promote effective decision-making and constructive debate with the agendas of Board meetings focusing on strategic matters and being forward looking
- managing the process by which the Board receives information to enable the Board to promote the success of the Company
- managing the Board to allow sufficient time for discussion of key issues
- actively encouraging Board members to contribute fully in addressing and agreeing all major strategic issues
- addressing the development needs of the Board as a whole.

Directors

- establishing a close and effective working relationship with the Chief Executive and other Directors
- encouraging active engagement by each of the members of the Board and an effective relationship and open communication between Directors
- facilitating the effective contribution of Non-Executive Directors to the responsibilities of the Board
- taking the lead in the design, implementation and monitoring effectiveness of the induction and on-going development of the individual directors.

Stakeholders

- promoting the provision of effective communication with Members and other stakeholders
- maintaining sufficient contact with Members and other key stakeholders to understand their issues and concerns, in particular relating to governance and strategy, whilst respecting executive responsibilities for management of stakeholder relationships
- managing the process by which the Board has an understanding of the views of stakeholders.

Chief Executive

The Chief Executive is responsible for leading and managing the business on a day-to-day basis within the authorities delegated by the Board and is accountable to the Board for the financial and operational performance of the Group.

As stated above, the roles of the Chairman and the Chief Executive are distinct and separate and their responsibilities are clearly established being set out in writing and having been agreed by the Board. The Chief Executive's Statement of Responsibility is also published on Network Rail's website.

Summarising the Chief Executive's role it comprises:

General

- creating, maintaining and regularly reviewing the organisational structure for the business of the Company
- leading and managing the Executive Directors and senior executives in the day-to-day running of the Company
- leading the development, delivery and regular review of the Company's safety, operational and financial strategies and actions
- developing an effective senior management team including establishing and maintaining effective succession planning for the senior executives of the Company
- managing the effective implementation of the principles of corporate governance within the Company
- leading the communications programme with stakeholders including, in conjunction with the Chairman, representing the Company
- creating the conditions for overall Executive Director effectiveness, both inside and outside the Boardroom.

Board

- being accountable to the Board for managing the creation and maintenance of proper financial and operational stewardship of the assets of the Company including internal controls, the implementation of the Board's decisions and the effectiveness with which the organisation works in accordance with the strategic objectives of the Company
- running the executive function of the Board
- developing and maintaining a close and effective working relationship with the Chairman, consulting regularly with him/her and keeping the Chairman advised of key issues relating to the Company
- addressing the development needs of each of the Executive Directors with a view to achieving and maintaining

their effectiveness as a member of the management team
- maintaining the integrity of the Company by requiring that the Board's executive committees are properly structured and run and that all corporate governance matters are properly addressed.

Directors
- leading and managing the executive function of the Board including seeking effective performance of each of the Executive Directors
- establishing and managing an effective relationship with each of the Non-Executive Directors
- providing support and advice to each Executive Director while respecting executive responsibility.

Stakeholders
- developing and maintaining regular and effective communication and relationships with the Company's stakeholders including Network Rail Members and employees
- establishing and managing effective and consistent delivery of the communication policy, strategies and statements of the Company as agreed by the Board to the stakeholders including Network Rail Members and employees.

Senior Independent Director

Under the Code the Board appoints one of the Non-Executive Directors to act as Senior Independent Director. The main responsibility of the Senior Independent Director is to be available to Members and other stakeholders should they have concerns that they are unable to resolve through normal channels of the Chairman or Chief Executive, or where these channels are inappropriate. The Senior Independent Director also leads discussion by Board members on the Chairman's performance and the appointment of a new chairman.

The current Senior Independent Director is Jim Cornell. He is available to Members as an additional point of contact to the Chairman and the Chief Executive. Jim Cornell retires in July 2009 at which time he will be superseded as Senior Independent Director by another Non-Executive Director as yet to be announced.

During 2008/09 Jim Cornell kept the Members advised of the recruitment process being adopted to find the current Chairman's successor through letters to Members and the giving of a presentation to a meeting of Members.

A Statement of Responsibility of the Senior Independent Director is published on Network Rail's website.

Non-Executive Directors and their independence

The Non-Executive Directors combine broad business and commercial experience (both from the rail industry and from other industry sectors) to enable them to challenge and contribute constructively to the development of the strategy of the Group. They also scrutinise the performance of management in meeting agreed goals and objectives and monitor operational performance of the business.

A Statement of Responsibility of the Non-Executive Directors is published on Network Rail's website.

Succession planning is important for all Board and senior executive management positions including Non-Executive Director positions. Recognising the possibility of planned or unexpected departure from Network Rail's Board by any of the existing Non-Executive Directors, the Nominations Committee has an active and continuous search process whereby potential candidates are identified. This process includes the regular review of skills of the existing Non-Executive Directors, anticipated timescale of office and the skill sets appropriate for the future. Consultants are retained to assist with the search programme for relevant candidates.

The Board considers that each of the Non-Executive Directors is independent of the Company. With regard to the guidelines on the meaning of 'independence' as set out in the Code, however, it is appropriate to disclose that:

1 Jim Cornell was, until 1996, a (non-Board) Director of British Rail. He currently receives a pension from the Network Rail section of the Railways Pension Scheme. This pension scheme was created at privatisation of the rail industry and is a scheme participated in by over 100 companies from this industry. The scheme is run by independent trust managers with trustees drawn from across the membership of the scheme (including from other companies within the scheme).

Jim Cornell is also Executive Director of the Railway Heritage Trust, an independent trust dedicated to supporting with grants the conservation and restoration of historic railway buildings and structures. This trust receives funding from various sources including Network Rail.

The Board considers, however, that as a Non-Executive Director of Network Rail, Jim Cornell is independent as he has not been an employee or Executive Director of Railtrack PLC. Moreover, Network Rail's membership of the Railway Pension Scheme is not considered to compromise Jim Cornell's independence given the structure of the scheme of which Network Rail is only one of many contributing companies. Furthermore the corporate structures of this Company and of Network Rail Limited, being a not-for-dividend company, eliminate any potential or perceived conflicts between his being a Non-Executive Director of the Company and receiving a pension from the Network Rail section of the scheme.

2 David Bailey was previously the Special Director appointed to the Board of Network Rail Limited by the Strategic Rail Authority (SRA) pursuant to its then rights under the Articles of Association of that company. Following the changes under the Railways Act 2005 with the responsibilities of the SRA passing principally to the Department for Transport (DfT), the DfT has not exercised its right to appoint a Special Director.

The Board considered that David Bailey makes a valuable contribution to the Company in his Non-Executive Director role. His wide ranging commercial experience has enabled him to provide additional perspective on issues and the Company wished to retain him as it moved into its new roles. At the Annual General Meeting of Network Rail Limited in 2005 his appointment as a Non-Executive Director was approved by the Members of Network Rail.

3 Christopher Green currently receives a pension from the Railway Pension Scheme. The Board considers, however, that, for the reasons set out above in relation to Jim Cornell, as Non-Executive Director of Network Rail Christopher Green is independent. Moreover he was never an employee of Railtrack PLC.

As part of a general review of Network Rail's corporate governance conducted by the Members of Network Rail in 2008/09, Pension Investors Research Consultants (PIRC) was commissioned to review governance disclosure made by the Company against PIRC's guidelines for corporate governance best practice. The report produced by PIRC was supportive of the governance of Network Rail generally and in particular in relation to remuneration matters. Details of some of PIRC's views are referred to in the Directors' remuneration report. In relation to the Non-Executive Directors in office for 2008/09, PIRC reported that all met its independence guidelines.

None of the Non-Executive Directors are members of more than three committees of the Board except David Bailey, who is a member of the Nominations, Remuneration, Audit and Safety, Health and Environment Committees (originally at the request of the Strategic Rail Authority). Upon the conversion of his appointment in June 2005 to Non-Executive Director, he has continued to be a member of these committees due to the valuable contribution he is able to make to each of these.

Board meetings

The Board met formally nine times in 2008/09. There is a schedule of items to be brought to the Board throughout the year including those listed on page 42. A format for each meeting is prepared and agreed which enables the Directors to review corporate strategy regularly together with the operations and results of the business units within the Group and to discharge their other duties. Each meeting includes reports on the safety, health and environmental performance of the Group as well as on operational and financial performance against the Business Plan and targets. There are also periodical risk management reviews of the key strategic risks to the Group and the Board receives regular presentations from senior management on both current issues as well as future plans.

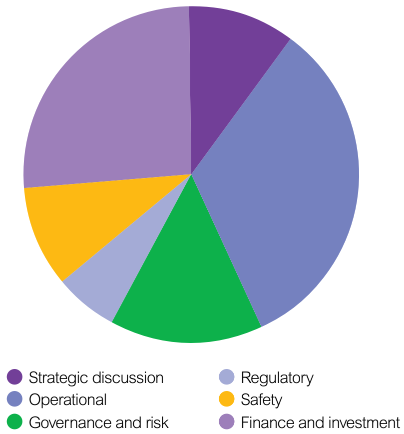
Upon acquisition of the business in 2002 the demands on the Board's management skills in the early days focused on the need for significant overview of immediate day to day management. As the Company has developed the demands on the Board have moved to high level management of the overall strategic development of the business for the future.

Following the annual review of the workings of the Board and its committees in February 2007, therefore, the Board concluded that the number of scheduled meetings and the format of its meetings would be adjusted accordingly to reflect the maturing state of Network Rail's business. With effect from January 2008 the Board adopted a timetable of eight scheduled Board meetings each year. The format of these meetings enabled even greater focus on and opportunity to debate future strategic issues facing the rail industry in addition to reviewing current performance of the business. Facility was also made for special Board meetings should the need arise. In 2008 there was an additional meeting of the Board to consider the terms of the draft Determinations of the ORR.

Annually the Chairman holds meetings with the Non-Executive Directors without the Executive Directors present to discuss the performance of the Company under the executive leadership. In 2008/09 the Non-Executive Directors met separately from the Executive Directors on five occasions. These meetings are now scheduled. In addition, periodically a meeting of the Non-Executive Directors chaired by the Senior Independent Director is held without the Chairman present.

A table detailing the individual Directors' attendance at each of the Board and committee meetings is set out on page 54.

The allocation of agenda items in Board meetings during 2008/09 is illustrated below:



Organisational structure

The Board has established an organisational structure which is designed to allow for effective and efficient decision-making across the business. The Board has delegated authority to the committees described on the following pages on specific matters, which are set out in their terms of reference. These authorities are reviewed regularly. The terms of reference of the Safety, Health and Environment, Audit, Remuneration, Nominations and Treasury Committees are published on Network Rail's website. Minutes of all committee meetings are made available to Directors.

The composition of each committee is designed to maximise the range of skills and experience of Board members with the aim of not placing undue reliance on any one individual. Each committee may request any information from the executive management necessary to discharge its functions and may, if it considers necessary, seek independent advice and counsel.

There are five standing Board committees with defined terms of reference and scheduled meetings through each year. The committee membership is as set out on page 46 (dates in brackets indicate appointment date to committee or chairman position as appropriate).

Committee membership

Committee	Committee chairman	Committee members
Safety, Health and Environment	Jim Cornell (February 2003)	David Bailey (February 2003) Ian Buchan (September 2007) Iain Coucher (August 2007) Christopher Green (September 2005)
Audit	Mike Firth (January 2006)	David Bailey (October 2002) Yvonne Constance (September 2005)
Remuneration	Jim Cornell (September 2003)	Ian McAllister (October 2002) David Bailey (October 2002) Ian Buchan (April 2006) Yvonne Constance (September 2005) Michael Firth (December 2004) Christopher Green (September 2005) Rick Haythornthwaite* (March 2009) Steve Russell (January 2008)
Nominations	Ian McAllister (October 2002)	David Bailey (October 2002) Jim Cornell (October 2002) Steve Russell (November 2008)
Treasury	Mike Firth (December 2004)	Iain Coucher (August 2007) Steve Russell (July 2008)

* Joined the Board of Directors on 23 March 2009.

The Safety, Health and Environment Committee

Composition This Committee comprises three Non-Executive Directors and the Chief Executive and has been chaired by Jim Cornell. The Director, Safety & Compliance attends the meetings by invitation.

Upon Jim Cornell's retirement in July 2009 this Committee will be chaired by another Non-Executive Director yet to be named.

Role The Committee's role is to monitor the integrity of the methods of discharge of the safety, health and environmental responsibilities of the Company and to satisfy itself as to the adequacy and effectiveness of the safety, health and environment policies and strategies within the Company. It also reviews the principles, policies and practices adopted in complying with all statutory, sub-statutory, standards and regulatory requirements in respect of safety, health and environmental matters affecting the activities of the Group.

Process The Committee conducts its responsibilities through a series of scheduled meetings with forward agendas set each year to meet the responsibilities of the Committee.

The Committee members are notified of any serious safety, health or environmental issues arising between meetings and they also receive safety reports between the scheduled meetings.

The Committee chairman reports on the Committee's activities to the Board meeting immediately following a Committee meeting.

Its work in fulfilling its responsibilities includes

- monitoring of the Group's safety, health and environment policies and strategies
- considering the areas of significant corporate and individual safety, health and environment risk and whether management is managing these effectively
- reviewing the structure, adequacy and effectiveness of safety, health and environment managerial committees within the Company including review of any terms of reference for the same
- reviewing the scope and results of any safety, health and environment audit on the effectiveness of the Company's safety, health and environment audit policies and strategies and such audit's cost effectiveness and the independence and the objectivity of the audit body
- considering the major findings of internal and external investigations and management's response thereto and, where necessary, with a view to the making of recommendations to the Board in respect of the same.

In addition to this Committee, and reflecting the recommendations in the Cullen Report, two executive committees have been set up, dealing with strategic and tactical safety matters. Moreover, the Board receives a report on safety, health and environment matters at each of its scheduled meetings.

Activities in 2008/09 During the year ended 31 March 2009, this Committee met six times and set out on pages 47 and 48 are its principal activities.

The Safety, Health and Environment Committee's activities in 2008/09

Meeting	Agenda item
May 2008	• Review of the safety, health and environment performance of Network Rail during the two preceding periods • Receiving an update on where the current principal safety risks lie within the Operations & Customer Services function and how the risks are being mitigated and managed • Considering a briefing on the development and baseline of a Network Rail Safety Assurance Map • Review of the trends emerging from safety assurance activity and themes arising from significant accidents and incidents • Receiving an update on the implementation of recommendations from investigations into the Grayrigg incident (February 2007) and the management process adopted for this incident • Considering a report regarding recent freight displacements incidents • Receiving a report on the actions to date reviewing Network Rail's systems safety and safety assurance initiatives.
June 2008	• Review of the safety, health and environment performance of Network Rail during the preceding period • Receiving updates on investigations into and actions relating to two incidents in earlier periods • Receiving an update on where the principal safety risks lie within the Engineering function and how the risks are being mitigated and managed • Considering a report on progress with implementation of the Railways & Other Guided Transport Systems (Safety) Regulations 2006 • Reviewing a further briefing on progress on understanding the recommendations of the Baker Report and how these may be relevant and applied in the context of Network Rail's system safety • Considering an update on the trends emerging from CIRAS reports* submitted to Network Rail in the year 2007/08 • Receiving a report on the recent activities of the Strategic Safety Group and Tactical Safety Group** • Considering a report on a recent incident on the network – the initial views on its cause, the investigations underway, the emerging issues and the actions being taken.
September 2008	• Review of the safety, health and environment performance of Network Rail during the preceding periods • Receiving an update on where the principal safety risks lie within the Infrastructure Maintenance function and how the risks are being mitigated and managed • Considering a progress report on the implementation of a major organisational change within the Infrastructure Maintenance function • Review of an update on the Network Rail Safety Assurance Map • Receiving a report on the Corporate Manslaughter Act • Considering a further update on the progress against each of the recommendations from the Grayrigg Formal Investigation report (Part 1) and an update on RAIB's investigation into Grayrigg (Part 2) • Receiving a report on the recent activities of the Strategic Safety Group and Tactical Safety Group** • Review of recent trends in Category 'A' signals passed at danger (SPADs) • Considering progress made in completing the review of the Baker Report in the context of Network Rail and System Safety.
November 2008	• Review of the safety, health and environment performance of Network Rail during the preceding periods • Considering the key points from the recently published annual reports of the Rail Safety & Standards Board, the Office of Rail Regulation and the Rail Accident Investigation Branch • Reviewing a report into a recent incident on the rail network including the background to the incident, the investigation undertaken and its conclusions and the actions resulting • Considering an update on where the principal safety risks lie within the Infrastructure Investment function and how the risks are being mitigated and managed • Considering the process for embedding of the safety assurance mapping within the business • Viewing an example of DVD incident re-construction techniques being developed to assist learning from incidents.
January 2009	• Review of the safety, health and environment performance of Network Rail during the preceding periods • Reviewing the recent trends in Category 'A' signals passed at danger (SPADs) • Considering an update on an organisational action plan ORG5 Assessment-in-the-Line • Receiving a report on the contribution that the Strategic Sourcing function to the effective management of safety, health and environmental risk.

* CIRAS (Confidential Incident Reporting & Analysis System) is an independent body to which workers in the UK rail industry can report safety concerns which is in addition to each rail industry company's own safety channels.

** The Strategic Safety Group and Tactical Safety Group are two Network Rail senior executive management committees, reflecting the recommendations in the Cullen Report, dealing with strategic and tactical safety matters.

The Safety, Health and Environment Committee's activities in 2008/09 continued

Meeting	Agenda item
February 2009	• Review of the safety, health and environment performance of Network Rail during the preceding period • Considering a presentation providing an update on implementation of recommendations emerging from the Grayrigg incident • Reviewing reports into three recent incidents on the network including the background to the incident, the investigation undertaken, its conclusions and the actions resulting • Considering a presentation on switches and crossings points inspection regime and design initiatives • Considering a report on recent road vehicle incursion incidents at and the recent trend in this type of incident • Reviewing a report on Category 'A' signals passed at danger (SPADs) and the actions being taken to reduce these incidents • Receiving an update on the recent work of the Safety & Compliance function • Review of the safety risk map and the status of associated risk managements plans and introducing the revised corporate risk matrix • Considering progress in regard to Network Rail's safety assurance activities • The annual review of the terms of reference of the Committee, its general effectiveness of the Committee and its composition.

* CIRAS (Confidential Incident Reporting & Analysis System) is an independent body to which workers in the UK rail industry can report safety concerns which is in addition to each rail industry company's own safety channels.

** The Strategic Safety Group and Tactical Safety Group are two Network Rail senior executive management committees, reflecting the recommendations in the Cullen Report, dealing with strategic and tactical safety matters.

The Audit Committee

Composition This Committee is comprised of three Non-Executive Directors and is chaired by Michael Firth who has a financial background and has experience at chairing a listed company's audit committee. The Chief Executive, the Group Finance Director, the Group Financial Controller and the Head of Internal Audit normally attend meetings of the Committee. Two partners from the external auditors also normally attend each of the Audit Committee's meetings and periodically meet with the Committee without executive management present.

The Board continues to be satisfied that the composition of the Committee fulfils the Code's requirement that at least one member of the Committee has recent and relevant financial experience. It also considers that it complies with the Smith Guidance on Audit Committees in all material respects.

Role The main responsibilities of this Committee are to monitor the integrity of the financial reporting and the audit process and to monitor that an effective management and internal control system is maintained. The Committee has a structured programme of activities including receipt of regular detailed reports on relevant aspects of management, focused to coincide with key events of the annual financial reporting cycle.

Its work in fulfilling its responsibilities includes

- reviewing the internal control framework and the register of financial and non-financial risks (so far as these are not reviewed by other Board committees such as the Safety, Health and Environment Committee)
- monitoring financial reporting practices including considering accounting policies and practices and compliance with accounting standards
- reviewing significant accounting estimates and judgements
- reviewing interim and annual financial statements before publication
- considering and making recommendations to the Board in relation to the appointment, re-appointment and removal of the external auditors following its assessment of their independence and objectivity (including the safeguards that are in place to maintain such independence) and their terms of engagement and remuneration
- reviewing the internal and external audit process including the scope of its planned audit and subsequently its audit findings
- reviewing the policy and procedure whereby employees can raise, in confidence, concerns about possible improprieties.

Process The Committee conducts its responsibilities through use of a series of scheduled meetings with a defined set of items of business for each meeting. The Committee chairman reports on the Committee's activities to the Board meeting immediately following a Committee meeting. Between meetings, the Committee chairman reviews emerging issues as appropriate with the Group Finance Director and other senior managers.

Activities in 2008/09 During the year ended 31 March 2009, this Committee met four times and set out on page 49 are its principal activities.

The Audit Committee's activities in 2008/09

Meeting	Agenda item
May 2008	• Review of the key issues and areas of judgement relating to the financial statement of Network Rail Limited and Network Rail Infrastructure Limited for the year ended 31 March 2008 • Receiving a report from Network Rail's external auditors on the 2008 audit including the key audit matters identified • Considering a report by the internal audit manager on the basis and rationale to support the internal control section of the Network Rail corporate governance statement for inclusion in the annual report and accounts for the year ended 31 March 2008 • Considering proposals on review of the external auditors in readiness for the Committee making recommendations regarding their reappointment • Review of drafts of sections of the Annual Report and Accounts for 2008 applicable to the Audit Committee • Review of the current status of risk management across Network Rail • Receiving a report on the output from the Internal Audit function's recent programme of work • Receiving a presentation on property yields • (in the absence of the executive management from the meeting) seeking the views of the external auditors as to whether there were any other issues arising from the audit for 2007/08 or relating to the management of the Company that they wished to raise with the Committee.
September 2008	• Review of the external auditors' annual management letter in respect of the financial year ended 31 March 2008 • Considering the external auditors' interim review plan for the period ending 30 September 2008 • Review of risk management of Network Rail including the current risk profile, a summary of the findings from the recent review and an update on progress with aligning the corporate risk matrix with the emerging corporate objectives and balanced scorecard • Receiving a report on the output from the Internal Audit function's recent programme of work • Considering an internal audit plan for the next two years • (in the absence of the external auditors) considering the process for review of the external auditors including possible re-tendering of the appointment.
November 2008	• Review of the key issues and areas of judgement relating to the interim financial statements of Network Rail Limited and Network Rail Infrastructure Limited for the six months ended 30 September 2008 • Considering the external auditors' report on the 2008/09 interim review • Considering a report on risk management including the current risk profile, a summary of the findings from the recent review of the Company's strategic risk SR7 and progress with aligning the corporate risk matrix with the emerging corporate objectives and balanced scorecard • Receiving a report on the output from the Internal Audit function's recent programme of work.
February 2009	• Review of the proposed timetable for production of the 2008/09 statutory accounts • Considering the external auditors' year end audit plan, the proposed fees and the scope of the audit including the key business risks to be the focus of the audit • Review of the findings of the external auditors in relation to their review of operating effectiveness of specific areas of the Company's activities • Receiving a report on the output from the Internal Audit function's recent programme of work • Considering the findings from the recent review of certain key risks and an overview of the current status or risk management across the Company • Reviewing considerations in relation to financial reporting including the change of regulation relating to preliminary statements and interim management statements and the use of Limited Liability Agreements • The annual review of the terms of reference of the Committee, its general effectiveness of the Committee and its composition.

Internal control

The Board is responsible for the Group's system of internal control and for reviewing its effectiveness. Such a system is designed to manage, rather than eliminate, the risk of failure to achieve business objectives. It can only provide reasonable (rather than absolute) assurance against material misstatement or loss.

The Board considers the management of risk and internal control to be fundamental to achievement of the Company's objectives and has formally established a policy, strategy and process for identification, evaluation and on-going review of the significant risks faced by the Group which accords with the Revised Turnbull Guidance. During the year the Executive Directors have formally reviewed the key risks faced by the Group. The Directors keep the effectiveness of the system of internal control under review and have done so throughout the year.

The risk management process is now well established and forms an integral part of the Network Rail planning and review activity. Risk types actively managed include safety, reputation, performance and financial risks. Risk management processes incorporate

- the identification of risks to the achievement of business objectives by all business units and major projects together with the likelihood/impact analysis and the development of mitigation actions to manage risks at the desired levels
- a Company Standard for risk management to provide consistency of approach across business units
- a self certification process which requires function heads to confirm that risk management processes are being complied with and that their risk data is accurate and complete
- the capture and recording of risks, risk scoring and action plans in a company wide risk management system
- the regular reporting and review of business unit and major project risks by the Executive Directors at monthly business reviews
- the peer review of causal risk maps which provide an overview of strategic risk interaction across functions and support regular review of the risk profile by the Audit Committee and the Board
- the inclusion of risk assessment into investment planning processes using the corporate risk matrix scoring system.

During the year the risk likelihood/impact matrix analysis has been updated to reflect both the Company's five year funding settlement and the current economic climate.

There are established internal control procedures for managing the risks faced by the Group. The key elements are

- a Business Conduct Policy, supported by Human Resources procedures, that defines expected standards of behaviour
- regular structured reviews of all business units and major projects by the Executive Directors assessing progress against objectives with action being taken as required
- a framework of delegated authority and accountability based on a templated organisation structure
- board approval of business strategies and objectives, together with plans, annual budgets and targets
- the monthly reporting of financial results, safety and other operational KPIs
- procedures for planning, approving and managing all investment expenditure including the use of the Guide to Railway Investment Projects (GRIP) specifying the requirement and timings for approvals sought by the Investment Panel and, where above its delegated financial level, by the Executive Committee and the Board
- a suite of Financial Regulations governing the accounting and stewardship of all financial transactions (during 2007/08 the Financial Regulations were fully revised and re-issued)
- centralised treasury operations acting within defined limits and overseen by the Treasury Committee
- monthly accounting reviews to scrutinise financial data and increase confidence in the integrity of the accounts
- a Sourcing and Purchasing Policy framework which sets out governance standards for contracting and procurement
- continuous monitoring by the Legal Services function within the Company, of claims and litigation issues affecting the Group
- governance of all business change initiatives through the Executive Committee (and its predecessor – the Executive Management Group)
- commitment to continuous improvement in levels of competence via leadership, competency and training programmes
- insurance assessment and appropriate cover for residual risks
- business continuity and disaster recovery plans for key operational assets, corporate offices and IT applications.

Internal audit

The Company has an independent Internal Audit team that is affiliated to the Institute of Internal Auditors. Its primary role is to provide objective and independent assurance regarding the adequacy of the Group's internal control framework and compliance with policies, laws and regulations. Internal Audit is also responsible for reviewing the effective operation of the Company wide risk management system as well as improving processes, providing advice and proliferating best practice.

The work of Internal Audit is focused on the areas of priority as identified by risk and materiality analysis and is in accordance with an annual audit plan which is approved by the Audit Committee. The Audit Committee receives regular reports on audit findings from the Head of Internal Audit, who has direct access to the Chairman of the Audit Committee. Recommendations to improve the internal control framework are reported to the Audit Committee through this process.

Internal Audit work closely with the External Auditors and other assurance providers to encourage co-ordination of audit plans and optimisation of audit resources. The Head of Internal Audit and the External Audit Partner meet on a regular basis.

The Company also has an established process by which staff may, in confidence, raise concerns about possible improprieties. Matters arising from the investigation of fraud are reported to the Audit Committee by the Head of Internal Audit. There is an ongoing programme undertaken by Internal Audit to raise awareness of fraud issues with management.

During the course of its review of the system of internal control, the Board has not identified nor been advised of any failings or weaknesses which it has determined to be significant. Nevertheless, the Board recognises that there is still an ongoing need to build on the above framework and uses the opportunity to review internal control processes against incidents when they arise in order to promote continual improvement of the internal control system.

External auditors

Independence and objectivity of the external auditors is of great importance to the Committee. A policy is in place to assist this whereby employment of the external auditors on work for Network Rail other than audit services or tax consulting services is prohibited without prior approval by the Audit Committee. Furthermore, and in line with established auditing standards, a new lead partner is appointed every five years, with other key audit principals rotating every seven years.

The Committee has responsibility for advising the Board on the appointment, re-appointment and the remuneration of the external auditors. Deloitte LLP (Deloitte) have been the Company's external auditors since 2002 (and prior to that to Railtrack plc since 1996).

Each year the Audit Committee conducts an assessment of the effectiveness of Deloitte, the firm's independence and objectivity and assessing the work of the audit team. In addition periodically it conducts a more detailed review. In 2008 the Committee again conducted this more detailed review, having previously done so in 2005. A lengthy questionnaire was completed by the external auditors detailing their procedures, training and audit processes as well as more detail of how independence and objectivity is maintained. Consultation within the Company as to the performance of the external auditors was also carried out. As a result of the assessment, the Audit Committee has recommended to the Board that at the AGM in July 2009 it proposes the re-appointment of Deloitte as auditors until the conclusion of the AGM in 2010.

Being mindful of the length of engagement of this firm as the Company's external auditors, in September 2008 the Committee considered whether this service should be tendered in 2009. It concluded, however, that, with the combination of the commencement of Control Period 4 and the retirement of the existing Group Finance Director scheduled for April 2009 and his replacement joining the Company at that time, it was not in the Company's best interest to conduct a tender at this time. It has recommended to the Board of the Company, however, that a tender process for the role of external auditor be considered during late 2009 in readiness for 2010.

The Remuneration Committee

Details of this Committee's work is reported separately in the Directors' remuneration report on pages 26 to 41.

Composition This Committee comprises all of the Company's Non-Executive Directors and is currently chaired by Jim Cornell. Upon his forthcoming retirement in July 2009 a new chair of this committee will be appointed.

Role It determines appropriate levels of Directors' and senior executives' remuneration including their incentive scheme.

Process The Committee conducts its responsibilities through use of a series of scheduled meetings with a defined set of items of business for each meeting. The Committee chairman reports on the Committee's activities to the Board meeting immediately following a Committee meeting.

Activities in 2008/09 During the year ended 31 March 2009, this Committee met five times. Details of the activities during the year are set out in the Directors' remuneration report.

The Nominations Committee

Composition This Committee is chaired by Ian McAllister as the Chairman of the Board and comprises three further Non-Executive Directors.

Role The role of the Committee includes

- reviewing regularly the size, structure and composition of the Board (including use of suitable periodic performance evaluation processes) and making recommendations to the Board on any adjustments that may be deemed necessary and feasible (including on matters such as succession planning)
- evaluating the balance of skills, knowledge and experience of the Board
- identifying and nominating candidates for appointment as Director for approval by the Board
- satisfying itself that appropriate succession plans and processes are in place for the appointments to the Board and to senior management positions.

Process The Committee conducts its responsibilities through meetings held as appropriate. The Committee chairman reports on the Committee's activities to the Board meeting immediately following a Committee meeting. Between meetings, the Committee chairman discusses matters of succession and recruitment with the other members of the Committee as required.

Activities in 2008/09 During the year ended 31 March 2009, this Committee met six times and set out on page 52 are its principal activities.

As a result of the recruitment process referred to in the table on page 50, Rick Haythornthwaite was recommended by the Committee to the Board for appointment as a Non-Executive Director to succeed Ian McAllister as Chairman of the Company in July 2009. Upon receipt of this recommendation the Board invited Network Rail's Members to meet Rick Haythornthwaite on 26 February 2009 as the Board's choice of Chairman Designate prior to his appointment to the Board. Having received highly supportive response from Members as to its selection, the Board proceeded to appoint Rick Haythornthwaite to the Board with effect from March 2009. In accordance with the Articles of Network Rail Limited, Rick Haythornthwaite will be seeking election at the Annual General Meeting of that company in July 2009 at which Ian McAllister will be stepping down. It is planned that Rick Haythornthwaite will become Chairman at that point.

More generally for succession purposes the Company reviews internal executive skills regularly including through the use of a 'talent pool' that uses assessment testing and other data to identify suitable candidates for succession

The Nominations Committee's activities in 2008/09

Meeting	Agenda item
April 2008	• Review of the status of the search for new Non-Executive Directors and the current expertise/experience spread of the existing Non-Executive Directors • Receiving a report from Egon Zehnder International on its review of the effectiveness of the Board of Network Rail • The annual review of the terms of reference of the Committee, its general effectiveness of the Committee and its composition.
August 2008	• Review of proposals for the selection criteria, recruitment process, timetable and a sample advertisement in relation to the recruitment of a successor to Ian McAllister as Chairman of the Board • Further review of the skill base of the existing Non-Executive Directors and a revised selection criteria for future Non-Executive and Executive Director positions • Considering proposals for re-organisation of the executive management team and the promotion of three senior executives as Directors on the Board.
September 2008	• Review of the status of the search for new Non-Executive Directors
November 2008	• Considering potential candidates for the position as Chairman • Review of the status of search for a successor to Ron Henderson as Group Finance Director upon his retirement • Receiving a report on the status of the search for new Non-Executive Directors positions • Considering the process for conducting the next Board performance evaluation review for 2009 • Receiving an update on the status of review by Board members of draft revised statements of responsibilities for the Chairman and Chief Executive.
December 2008	• Further consideration of candidates for the position as Chairman • Review of status of the search for new Non-Executive Directors positions.
February 2009	• Review of the status of appointment of the Chairman designate and the future Group Finance Director • Receiving a report on the status of the search for new Non-Executive Directors positions • Review of the current status regarding succession planning for senior positions within Network Rail • Receiving a report detailing the findings from the Egon Zehnder International review on the Board's performance evaluation conducted in January 2009 • The annual review of the terms of reference of the Committee, its general effectiveness of the Committee and its composition.

opportunities. Individuals identified with senior management potential also attend focused leadership development training at the Company's own centre which provides courses in collaboration with Warwick Business School (a part of Warwick University).

The Treasury Committee

Composition This Committee comprises three directors, with Michael Firth as Chairman. The Director of Funding and other senior funding managers attend the meetings.

Role The Committee's role is to review and satisfy itself as to the appropriateness of proposed treasury transactions including banking, cash management, debt raising and management and investment management.

Process The Committee conducts its responsibilities through a series of scheduled meetings. The Committee chairman reports on the Committee's activities to the Board meeting immediately following a Committee meeting. Between meetings, the Group Finance Director updates and discusses with the Committee chairman matters relating to the treasury activities.

Activities in 2008/09 During the year ended 31 March 2009, this Committee met four times and its principal activities included the following shown in the table on page 53.

The Executive Committee

Composition At executive level in the Company the Executive Committee is chaired by the Chief Executive, and comprises all the Executive Directors and a number of senior executives.

Following review of this Committee's responsibilities and activities in 2008 and with effect from October 2008 its name was changed from the Executive Management Committee to the Executive Committee and its composition was revised to enable greater focus by a smaller number of senior executives on the key strategic issues facing the Company.

Role This Committee manages the functions of the business and implements the operational and financial objectives within limits set by the Board.

Process The Committee conducts its responsibilities through a series of scheduled meetings.

Activities in 2008/09 During the year ended 31 March 2009, the Executive Management Group/Executive Committee met 12 times and its principal activities included approval (within its delegated authority) and review of operational issues and activities of the Company including:

- the operational, financial and safety, health and environment performance of Network Rail
- reports into significant rail incidents
- Network Rail's budget for 2009/10
- investment projects and contract awards
- progress reports on significant projects and programmes
- route utilisation strategies
- the regulatory periodic review process

The Treasury Committee's activities in 2008/09

Meeting	Agenda item
May 2008	• Review of the current status of discussions on corporate debt and the CP4 regulatory review • Considering the strategy for hedging Network Rail's CP4 interest rate exposure • Review of the current status of the Debt Issuance Programme • Review of the 2008/09 Investment Strategy and details of pre-funding commitments in 2008/09 • Considering the recent internal audit review of Treasury procedures including the content of review's key findings and recommendations and status of close out of the recommendations • The annual review of the terms of reference of the Committee, its general effectiveness of the Committee and its composition.
July 2008	• Review of the status of discussions on corporate debt, the CP4 regulatory review and hedging • Review of the current status of the Debt Issuance Programme including the size of corporate debt programme, market conditions, the implications of any new network licence condition restricting further use of the existing financial indemnity and the assumptions in the Strategic Business Plan of use of unsupported funding • Review of the current status of investments and hedging activity.
November 2008	• Review of the current status of the Debt Issuance Programme and investment portfolio • Considering a progress report on the hedging of the CP4 interest rate exposure and a valuation of the existing hedging portfolio • Considering preliminary findings from an initial review undertaken of the ORR's determinations for CP4 and financial modelling sensitivities related to this.
March 2009	• Review of corporate debt in the light of the CP4 determinations including the criteria needed for Network Rail to consider raising un-supported debt in the future and proposals for the debt funding strategy to be adopted in CP4 • Considering an update on the Debt Issuance Programme and investment portfolios • Review of a progress report on the hedging of the CP4 interest rate exposure and a valuation of the existing hedging portfolio • Considering a report on review of the Treasury Risk Register and the Treasury Policy Manual and recommended changes • Considering a proposal for review of Network Rail's current banking group in the light of banking requirements for CP4 • Review of the current status of the Network Rail Infrastructure Limited/Network Rail Holdco Limited inter-company loan and proposals relating to this • Discussion on the financial status of the TOCs/FOCs, the process for review of Network Rail's financial exposure and extent of its likely exposure if a customer failed • The annual review of the terms of reference of the Committee, its general effectiveness of the Committee and its composition.

- development and content of the Delivery Plan
- Network Rail's risk management
- development of corporate key performance indicators
- Network Rail's industrial relations activities
- human resources policies and strategic plans
- the status and activities of the Transformation Programme
- Network Rail's response to regulatory consultation documents.

Other management meetings
Additionally there is a defined structure of other executive steering groups and panels with terms of responsibilities focusing on specified aspects of the operational needs of the business with prescribed levels of authority.

Meetings during 2008/09
The table on page 54 identifies the number of meetings held between 1 April 2008 and 31 March 2009 of the Board, the five main Board committees, the Executive Management Group (until its replacement by the Executive Committee in October 2008) and the Executive Committee as well as the attendance record of individual Directors.

There may be occasions when circumstances arise which prevent a Director from attending a meeting in person. It is usual practice in these circumstances for the Director concerned to review the papers and convey any views to the Chairman of the meeting in advance.

Information about the Directors' remuneration is given in the Directors' remuneration report on pages 26 to 41 of this Report. Details of how the Board reviews financial and operational controls and risk management generally are shown on pages 50 and 51.

Board effectiveness
Induction There is a comprehensive programme of induction for new Directors aimed at ensuring that they are fully conversant with their responsibilities as a Director and with the business of Network Rail. This includes provision of a manual of key documents and background information relating to Network Rail and the industry, guidance on Board procedures and corporate governance matters. Thorough briefings on their responsibilities are given with site visits and one-to-one meetings with each of the Directors, key senior managers and key stakeholders also held.

Development Directors are then encouraged to update their skills, knowledge and familiarity with the Group through their on-going participation at Board and committee meetings, and through regular occasions for them to meet senior managers, other employees and Members. Briefings are given to Board members by key members of senior management on key projects, organisational functions and governance or assurance processes adopted within Network Rail including Thameslink Project, Crossrail Project,

Board and Board committee meetings in 2008/09

	Board	Safety, Health & Environment Committee	Nominations Committee	Remuneration Committee	Audit Committee	Executive Committee#	Treasury Committee
Number of meetings held	9	6	6	5	4	12	4
Directors							
Patrick Butcher*	n/a	–	–	–	–	n/a	–
David Bailey	9	6	6	5	4	–	–
Ian Buchan	9	6	–	5	–	–	–
Yvonne Constance	9	–	–	4	2	–	–
Jim Cornell	9	6	6	5	–	–	–
Iain Coucher	9	6	–	5†	4†	12	4
Michael Firth	9	–	–	5	4	–	4
Robin Gisby**	4	–	–	–	–	9	–
Christopher Green	8	6	–	4	–	–	–
Rick Haythornthwaite***	n/a	–	–	n/a	–	–	–
Peter Henderson	9	6†	–	–	–	12	–
Ron Henderson****	9	–	–	–	4†	12	4
Simon Kirby**	4	–	–	–	–	8	–
Ian McAllister	9	–	6	5	–	–	–
Paul Plummer**	4	–	–	–	–	12	–
Steve Russell*****	8	–	2	3	–	–	1

Attendance shows combination of Executive Management Group (and Executive Committee following its conversion in October 2008).
* Appointed to the Board on 20 April 2009.
** Appointed to the Board on 1 October 2008.
*** Appointed to the Board on 23 March 2009.
**** Retired from the Board on 19 April 2009.
***** Appointed to Treasury Committee on 16 July 2008.
† As attendee.

route performance and risk management. Site visits are regularly scheduled for Non-Executive Directors to enable them to view first hand operational aspects of the business and to meet employees.

In 2008/09 Non-Executive Director visits were arranged to Network Rail's National Delivery Service operation at Holgate Depot, the Apprenticeship Scheme at Gosport, the Engineering Examination Centre at Derby, the East Midlands re-signalling project and the Infrastructure Maintenance Training Centre at Paddock Wood.

Training Ongoing professional development is provided to Directors each year. During the past 12 months the Directors received briefings on relevant issues including new developments relating to corporate governance, company law and other new legislation. Directors are also encouraged to attend externally organised seminars. Additional personal development is available to all Directors.

Board evaluation review

The effectiveness of the Board is vital to the success of Network Rail. The Nominations Committee is charged by the Board to review annually the performance of the Board, its principal committees and individual Directors. The policy adopted by the Nominations Committee is for external assistance also to be provided in conducting the review on a bi-annual basis. In the interim year the review is to be conducted internally by the Group Company Secretary.

In line with this policy, consultants, Egon Zehnder International, were engaged to assist with the process for 2007/08. For 2008/09 the Nominations Committee chose to appoint Egon Zehnder International again to conduct the review given that Control Period 4 was commencing in April 2009, there had been appointment of three new Executive Directors in 2008 and in 2009 the Group Finance Director was retiring and the current Chairman stepping down from office. This latest review was conducted in January 2009.

The review was achieved through a formal process whereby guidelines to areas of focus had been drawn up with the assistance of external consultants. These guidelines formed the basis for the evaluation process.

Each review focused on matters such as Company strategy, performance, delegation and accountability, corporate responsibility, succession, relationships with stakeholders, Board and committee composition, Board communication and the contribution and effectiveness of individual Directors. The consultants interviewed each of the Directors who are also required to complete a questionnaire based upon the guidelines. The findings of the review and the consultants' conclusions and recommendations were considered and discussed by both the Nominations Committee and then the Board. The review of individual Directors was also considered by the Chairman of the Board. Each Director received personal feedback given by the consultants.

The performance of the Chairman was included in this review process and took into account the views of Executive and Non-Executive Directors. Feedback to the Chairman was provided by the consultants.

This latest review has led the Board to conclude that generally it and its committees continue to operate effectively and they are meeting the needs of Network Rail. Opportunities were also identified for enhancement of such effectiveness which are being developed. A meeting of the Directors was also held in April 2009 to focus on the key conclusions drawn from the review.

The Nominations Committee has also concluded that each Director is continuing to contribute to the overall effectiveness and success of Network Rail and that each of the Directors who is proposed for election or re-election at the AGM of Network Rail Limited in July 2009 demonstrates the necessary commitment to Network Rail and to be a fully effective member of the Board.

Company Secretary

The Group Company Secretary is the secretary to the Board and all of the above Board committees and is responsible for advising each of these, through their chairman, on all governance matters. All Directors have access to the Group Company Secretary for advice on corporate governance, Board procedure and compliance matters. As well as supporting the Chairman with his responsibility for management of the Board and Board matters, the Group Company Secretary is also responsible for facilitating the induction and professional development of Board members and good flow of information within the Board, its Committees and between the Non-Executive Directors and senior management. The appointment and removal of the Group Company Secretary is a matter for the Board as a whole.

Advice

There is a procedure whereby Directors, wishing to do so in furtherance of their duties, may take independent professional advice at Network Rail's expense. No such advice was sought by any Director during 2008/09.

Conflict of interest management

The Directors have not had need to consider exercising their powers to authorise any conflict of interest of any Director pursuant to Article 20 of the Articles of Association of Network Rail Limited during 2008/09.

Relations with Members and other stakeholders

Delivering a specific improvement in stakeholder satisfaction does not form part of the regulated outputs that Network Rail is required to deliver. Notwithstanding this, the Board of Network Rail is extremely committed to, and recognises the importance of, developing and maintaining an ongoing relationship based on regular communication and dialogue with its wide range of stakeholders. Satisfying customers, users of the railway and other stakeholders must be at the heart of Network Rail's business delivery.

To monitor performance in this important area surveys of customer satisfaction for passenger and freight operators are undertaken each year. Similar surveys are produced for Network Rail's other stakeholders. Various approaches are used to monitor the satisfaction of customers, rail users and other stakeholders within an overall performance management framework.

In summary the key relationship management activities are:

Members

A variety of forms of contact with Members of Network Rail Limited is used to help Members hold the Board to account for the performance of the Group and to help Members to be aware of and understand developments within the business. Opportunities are also arranged on a frequent basis to enable discussion by the Members to take place at which Members' views can be aired and taken into consideration. The various forms of communication include:

- publication of full Annual Reports and Accounts
- publication of Interim and Preliminary Results
- the Annual General Meeting and other meetings of Network Rail Limited as required
- supply of key press releases, business documents and other material
- copies of the staff magazine
- regular meetings with Directors and senior Network Rail staff
- periodical local briefings and site visits
- regular presentations on key issues
- copies of documents published by other bodies e.g. the ORR's quarterly monitor on Network Rail, key ORR consultation documents and other reports
- the services of a staff member dedicated to responding to enquiries and issues raised by Members
- a dedicated website for Members containing information about Network Rail and its governance, presentation material given by Network Rail to Members' meetings and a discussion forum facility for Members to share views.

More general information is contained on Network Rail's website which is updated frequently with key business documents, information and announcements – www.networkrail.co.uk

In addition, a series of special meetings – in the form of forums – has been arranged during 2008/09 on a variety of specific topics at which Members have received briefings and general enhancement of their knowledge on key aspects of Network Rail or their role. The topics at these forums have included CP4 issues and the draft ORR determinations, remuneration and proposals for the MIP 2009/10 and the Members selection process and planned changes to this. Presentation material used at these forums was also posted on the Members' website for all Members to access.

Members are encouraged to raise matters throughout the year by channelling their queries or comments through the dedicated Network Rail staff member. They are also invited to propose topics for briefing or discussion. Members have the opportunity to meet the Board both before and after the formal general meetings as well as to ask questions at the AGM (including by submission of written questions in advance). Before the AGM Members are also encouraged to request areas of the business on which they would like presentations.

Members are invited to a meeting with the ORR, the rail industry's regulating body, at which they discuss the ORR's views on the current performance of Network Rail against its regulatory obligations.

In line with best corporate governance practice, Network Rail separates out the business of the AGM into single resolutions as required under the Code. The level of proxy votes received for the AGM of Network Rail Limited is disclosed together with details of the votes for, against and the abstentions for each resolution. The chairmen of the Board committees are also available at the AGM to answer questions in relation to their committee's area of responsibility. The chairman of the Members Selection Panel also attends the AGM for the same purpose of answering questions relating to the selection of new Public Members.

In addition and in line with best practice, the Notice of the AGM and any related papers are sent out to Members to arrive at least 20 business days before the date of the meeting to ensure that Members have sufficient time in which to consider the items of business. The next AGM will be held on 22 July 2009.

At the AGM in 2008 a resolution was requisitioned by a number of Members seeking to establish a temporary group of 12 Members to review the effectiveness of the corporate governance of Network Rail. This resolution gained sufficient support at the AGM to be passed. Subsequently an election was held amongst Members to appoint the 12 members of the group known as the Members' Review Group (MRG). The MRG then conducted a number of activities considering the corporate governance of Network Rail including commissioning a survey by PricewaterhouseCooper of stakeholders, conducting a comparative analysis of the corporate structure of Network Rail with other corporate structures and appointing Pension Investors Research Consultants (PIRC) to review Network Rail's governance against its published guidelines on corporate governance best practice.

The resulting PIRC report demonstrated that Network Rail has a high standard of governance including rating the Management Incentive Plan (MIP) for 2007/08 as BBB which Network Rail believes is rarely awarded by PIRC. Likewise the comparative analysis with other governance structures supported the view that Network Rail's governance is good. The survey revealed a diverse range of views between stakeholders and usefully identified areas on which Network Rail could focus in terms of improving its stakeholder relationships and further understanding of the needs of its stakeholders.

The MRG then reported back to all Members of Network Rail making a number of recommendations for further enhancement of the governance of the company. At the time of writing this report these recommendations are the subject of discussion between Members and Network Rail to identify which should be progressed and how to implement them. This process is schedule to continue through to and after the AGM in July 2009.

Other stakeholders

The Company also recognises the importance of good relationships with its wider stakeholder base especially its customers – the passenger and freight train operators, its suppliers, funders and its own employees. Emphasis is placed, therefore, on developing existing relationships as well as expanding the breadth of relationships.

This includes the Chief Executive, other Executive Directors and Functional Directors (together with many other senior managers) having regular meetings with representatives of the ORR (as both economic and safety regulator), passenger and freight train operators and other rail stakeholders. Scheduled meetings are held with the Department for Transport and train operators to discuss industry wide issues.

Network Rail needs to work closely with all types of community representatives and so, as part of its normal day-to-day routine activities, Network Rail regularly briefs many different bodies and individuals. This includes the Company having a significant amount of contact with a wide range of elected representatives (Members of Parliament, Members of the Scottish Parliament, London Assembly and Welsh Assembly, Members of the European Parliament and others) as well as non-governmental organisations, pressure groups and campaigning organisations. This includes meetings to discuss issues facing the Company and those using the railways, both passengers and freight traffic nationally and regionally. Opportunity is also taken each year to explain to elected representatives business plans, the Company's performance and significant developments within the business. This is sometimes best achieved through the Company organising briefings and similar functions at which presentations are given as well as site visits.

Independent relationship surveys are conducted regularly with each of the Company's customers (the train operators), passengers and freight end users, suppliers and its employees (using an employee engagement survey – see page 22 of the Directors' report for more detail).

In addition various forms of formal consultation with key stakeholders takes place on many aspects of Network Rail's activities, run either directly by Network Rail, by the ORR or others.

Arrangements are also made for new Directors coming into Network Rail to meet with key stakeholders as part of their induction programme.

Corporate responsibility

Corporate responsibility is also an important aspect of the role of Network Rail which it takes seriously. A report on its corporate responsibility priorities and activities during the year will again be published in 2009.

Sustainability in Network Rail

Community
Lineside neighbours and visual intrusion

Social Commitment

Community relationships

Heritage

Workplace – our people
Employee relations

Employee health

Employee development

Social inclusion

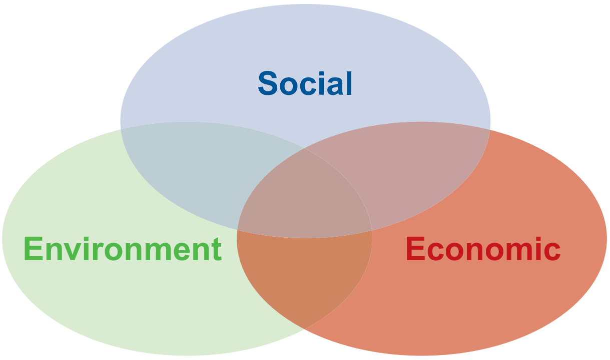
Marketplace – passengers
Train service performance

Safety and personal security

Priorities, perception and experience

Accessibility

Travel information



Environment
Air quality

Noise and vibration

Waste and pollution

Land use and biodiversity

Water and material use

Climate change (including energy use)

Marketplace – Customers, suppliers and funders
Capacity

Government policy and subsidy

Purchasing and procurement

Asset management (including climate change adaptation)

Regional economic development

Affordability and external cost/benefits to society

There is also an executive Corporate Responsibility Group chaired by the Chief Executive which has responsibility for providing focus and co-ordination for delivery of the Company's sustainability strategy. This group's remit includes:
- agreeing the aims, strategy and objectives necessary to deliver Network Rail's sustainability goals
- agreeing the measurable targets for sustainability and the specific activities and initiatives to deliver these targets
- monitoring the progress and success of these activities.

A summary of key aspects of sustainability in Network Rail is set out above.

Statement of Directors' responsibilities
The Directors are responsible for preparing the Annual Report and the financial statements. The Directors are required to prepare financial statements for the Group in accordance with International Financial Reporting Standards (IFRSs) and have also elected to prepare financial statements for the Company in accordance with IFRS. Company law requires the Directors to prepare such financial statements in accordance with International Financial Reporting Standards, the Companies Act and Article 4 of the IAS Regulation.

International Accounting Standard 1 requires that financial statements present fairly for each financial year the Company's financial position, financial performance and cash flows. This requires the faithful representation of the effects of transactions, other events and conditions in accordance with the definitions and recognition criteria for assets, liabilities, income and expenses set out in the International Accounting Standards Board's Framework for the Preparation and Presentation of Financial Statements. In virtually all circumstances, a fair presentation will be achieved by compliance with all International Financial Reporting Standards.

Directors are also required to
- select applicable accounting policies and apply them properly
- present information, including accounting policies, in a manner that provides relevant, reliable, comparable and understandable information
- provide additional disclosures when compliance with the specific requirements in IFRS is insufficient to enable users to understand the impact of particular transactions, other events and conditions on the entity's financial position and financial performance
- prepare the accounts on a going concern basis unless, having assessed the ability of the Company to continue as a going concern, management either intends to liquidate the entity or to cease trading, or has no realistic alternative but to do so.

The Directors are responsible for keeping proper accounting records which disclose with reasonable accuracy at any time the financial position of the Company and Group, for safeguarding the assets, for taking reasonable steps for the prevention and detection of fraud and other irregularities and for the preparation of a Directors' report and the Directors' remuneration report which comply with the requirements of the Companies Act.

The Directors are responsible for the maintenance and integrity of the Company website. Legislation in the United Kingdom governing the preparation and dissemination of financial statements differs from legislation in other jurisdictions.

Independent auditors' report to the Members of Network Rail Infrastructure Limited

We have audited the Group and parent Company financial statements (the 'financial statements') of Network Rail Infrastructure Limited for the year ended 31 March 2009 which comprise the consolidated Income statement, the Group and individual Company Statements of recognised income and expense, the consolidated and individual Company Balance sheets, the consolidated and individual Company Cash flow statements, and the related Notes 1 to 33. These financial statements have been prepared under the accounting policies set out therein. We have also audited the information in the Directors' remuneration report that is described as having been audited.

This report is made solely to the Company's members, as a body, in accordance with section 235 of the Companies Act 1985. Our audit work has been undertaken so that we might state to the Company's members those matters we are required to state to them in an auditors' report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the Company and the Company's members as a body, for our audit work, for this report, or for the opinions we have formed.

Respective responsibilities of Directors and auditors

The Directors' responsibilities for preparing the Annual Report, the Directors' remuneration report and the financial statements in accordance with applicable law and International Financial Reporting Standards (IFRSs) as adopted by the European Union are set out in the Statement of Directors' Responsibilities.

Our responsibility is to audit the financial statements and the part of the Directors' remuneration report to be audited in accordance with relevant legal and regulatory requirements and International Standards on Auditing (UK and Ireland).

We report to you our opinion as to whether the financial statements give a true and fair view and whether the financial statements and the part of the Directors' remuneration report to be audited have been properly prepared in accordance with the Companies Act 1985 and, as regards the Group financial statements, Article 4 of the IAS Regulation. We also report to you whether in our opinion the information given in the Directors' Report is consistent with the financial statements. The information given in the Directors' report includes that specific information presented in the Group Finance Director's review that is cross referred from the Directors' report.

In addition we report to you if, in our opinion, the Company has not kept proper accounting records, if we have not received all the information and explanations we require for our audit, or if information specified by law regarding Directors' remuneration and other transactions is not disclosed.

The Directors have asked us to review whether the Corporate governance report on page 42 reflects the Company's compliance with the nine provisions of the 2006 Combined Code specified for our review as if the Listing Rules of the Financial Services Authority applied, and we report if it does not. We are not required to consider whether the Board's statements on internal control cover all risks and controls, or form an opinion on the effectiveness of the Group's corporate governance procedures or its risk and control procedures.

We read the other information contained in the Annual Report as described in the contents section and consider whether it is consistent with the audited financial statements. We consider the implications for our report if we become aware of any apparent misstatements or material inconsistencies with the financial statements. Our responsibilities do not extend to any further information outside the Annual Report.

Basis of audit opinion

We conducted our audit in accordance with International Standards on Auditing (UK and Ireland) issued by the Auditing Practices Board. An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the financial statements and the part of the Directors' remuneration report to be audited. It also includes an assessment of the significant estimates and judgments made by the Directors in the preparation of the financial statements, and of whether the accounting policies are appropriate to the Group's and Company's circumstances, consistently applied and adequately disclosed.

We planned and performed our audit so as to obtain all the information and explanations which we considered necessary in order to provide us with sufficient evidence to give reasonable assurance that the financial statements and the part of the Directors' remuneration report to be audited are free from material misstatement, whether caused by fraud or other irregularity or error. In forming our opinion we also evaluated the overall adequacy of the presentation of information in the financial statements and the part of the Directors' remuneration report to be audited.

Opinion

In our opinion:

- the Group financial statements give a true and fair view, in accordance with IFRSs as adopted by the European Union, of the state of the Group's affairs as at 31 March 2009 and of its profit for the year then ended
- the individual Company financial statements give a true and fair view, in accordance with IFRSs as adopted by the European Union as applied in accordance with the provisions of the Companies Act 1985, of the state of the parent Company's affairs as at 31 March 2009
- the financial statements and the part of the Directors' remuneration report to be audited have been properly prepared in accordance with the Companies Act 1985 and, as regards the Group financial statements, Article 4 of the IAS Regulation
- the information given in the Directors' report is consistent with the financial statements.

Deloitte LLP

Deloitte LLP
Chartered Accountants and
Registered Auditors

London, United Kingdom
3 June 2009

Income statement for the year ended 31 March 2009

	Notes	Results pre debt and derivative revaluations 2009 Group £m	Debt and derivative revaluations (Note 9) 2009 Group £m	2009 Group £m	2008 Group £m
Revenue	*3*	**6,160**	**–**	**6,160**	5,960
Net operating costs	*5*	**(3,616)**	**–**	**(3,616)**	(3,548)
Operating profit		**2,544**	**–**	**2,544**	2,412
Revaluation movements and profits on disposal of properties		**(138)**	**–**	**(138)**	34
Total profits from operations	*6*	**2,406**	**–**	**2,406**	2,446
Investment revenue	*8*	**136**	**–**	**136**	132
Other gains and losses	*9*	**–**	**(72)**	**(72)**	33
Finance costs	*10*	**(946)**	**–**	**(946)**	(1,014)
Profit before tax		**1,596**	**(72)**	**1,524**	1,597
Tax	*11*	**(935)**	**20**	**(915)**	(408)
Profit for the year attributable to equity shareholders		**661**	**(52)**	**609**	1,189

All amounts in the current and prior years relate to continuing operations.

Under section 230 of the Company's Act 1985 the Group has elected to take the exemption with regard to disclosing the Company Income statement. The Company's net profit for the year was £593m (2008: £1,212m).

Statements of recognised income and expense at 31 March 2009

	2009 Group £m	2008 Group £m	2009 Company £m	2008 Company £m
Recognised income and expense in the year				
(Losses)/gains on revaluation of the railway network	**(113)**	403	**(113)**	403
Gains/(losses) on cash flow hedges	**44**	370	**(291)**	(32)
Exchange differences on retranslation of foreign currency debt taken to hedging reserve	**(391)**	(393)	**–**	–
	(347)	(23)	**(291)**	(32)
Actuarial losses on defined benefit pension schemes	**(281)**	(133)	**(281)**	(133)
Tax on items taken directly to equity	**208**	(69)	**192**	(67)
Impact of change in corporation tax rate	**–**	134	**–**	135
Net (charge)/income recognised directly in equity	**(533)**	312	**(493)**	306
Transfers				
Transferred to the Income Statement on cash flow hedges	**4**	4	**4**	4
Tax on items transferred from equity	**(1)**	(1)	**(1)**	(1)
	3	3	**3**	3
Profit for the year	**609**	1,189	**593**	1,212
Total recognised income and expense for the year attributable to equity shareholders	**79**	1,504	**103**	1,521

Balance sheets at 31 March 2009

	Notes	2009 Group £m	2008 Group £m	2009 Company £m	2008 Company £m
Assets					
Non-current assets					
Intangible assets	12	**73**	74	**–**	–
Property, plant and equipment – the railway network	13	**34,925**	31,443	**34,925**	31,443
Investment property	14	**700**	949	**700**	949
Investment in subsidiaries	15	**–**	–	**49**	49
Loan to immediate parent company	19	**388**	368	**388**	368
Loan to other group company	19	**–**	–	**–**	91
Derivative financial instruments	22	**768**	98	**1**	19
Finance lease receivables	18	**10**	12	**10**	12
Interest in joint venture	15	**5**	–	**5**	–
Total non-current financial assets		**1,171**	478	**404**	490
		36,869	32,944	**36,078**	32,931
Current assets					
Inventories	17	**88**	64	**88**	64
Finance lease receivables	18	**3**	3	**3**	3
Trade and other receivables	19	**805**	680	**995**	788
Derivative financial instruments	22	**630**	307	**61**	55
Held-to-maturity investments	16	**–**	8	**–**	–
Available-for-sale financial assets	16	**–**	47	**–**	–
Cash and cash equivalents	28	**1,723**	543	**–**	–
		3,249	1,652	**1,147**	910
Total assets		**40,118**	34,596	**37,225**	33,841
Current liabilities					
Trade and other payables	20	**(3,675)**	(2,388)	**(2,644)**	(2,423)
Bank loans and overdrafts	21	**(1,773)**	(5,077)	**(861)**	(4,412)
Derivative financial instruments	22	**(73)**	(69)	**(5)**	(24)
Short term provisions	23	**(9)**	(12)	**(9)**	(12)
		(5,530)	(7,546)	**(3,519)**	(6,871)
Net current liabilities		**(2,281)**	(5,894)	**(2,372)**	(5,961)
Non-current liabilities					
Bank loans	21	**(21,192)**	(15,255)	**(20,288)**	(15,227)
Derivative financial instruments	22	**(406)**	(60)	**(390)**	–
Other payables	20	**(1,619)**	(1,429)	**(1,616)**	(1,429)
Retirement benefit obligation	32	**(664)**	(370)	**(664)**	(370)
Deferred tax liabilities	24	**(3,463)**	(2,765)	**(3,475)**	(2,768)
Obligations under finance leases	25	**(3)**	(9)	**(3)**	(9)
		(27,347)	(19,888)	**(26,436)**	(19,803)
Total liabilities		**(32,877)**	(27,434)	**(29,955)**	(26,674)
Net assets		**7,241**	7,162	**7,270**	7,167
Equity					
Share capital	26	**160**	160	**160**	160
Share premium account	27	**85**	85	**85**	85
Revaluation reserve	27	**4,298**	4,511	**4,298**	4,511
Other reserve	27	**1,458**	1,458	**1,458**	1,458
Hedging reserve	27	**(318)**	(72)	**(260)**	(54)
Retained earnings	27	**1,558**	1,020	**1,529**	1,007
Total shareholders' funds and equity attributable to equity holders of the parent company		**7,241**	7,162	**7,270**	7,167

The financial statements were approved by the Board of Directors and authorised for issue on 3 June 2009.

They were signed on its behalf by:

Iain Coucher Director

Patrick Butcher Director

Cash flow statements for the year ended 31 March 2009

	Notes	2009 Group £m	2008 Group £m	2009 Company £m	2008 Company £m
Net cash generated from operating activities	*28*	**2,811**	2,434	**2,850**	2,486
Investing activities					
Interest received/(paid)		**78**	90	**(24)**	10
Purchases of property, plant and equipment – the railway network		**(4,601)**	(3,544)	**(4,601)**	(3,544)
Proceeds on disposal of investment property		**72**	63	**72**	63
Capital grants received		**191**	328	**191**	328
Capital element of finance leases' receipts		**3**	3	**3**	3
Sale/(purchase) of financial investments		**55**	(53)	**–**	–
Acquisition of joint venture		**(5)**	–	**(5)**	–
Net cash used in investing activities		**(4,207)**	(3,113)	**(4,364)**	(3,140)
Financing activities					
Repayments of borrowings		**(4,853)**	(4,414)	**(4,853)**	(4,822)
Repayments of obligations under finance leases		**(7)**	(1)	**(7)**	(1)
New loans raised		**6,374**	5,444	**6,374**	5,464
Collateral received from counterparties		**1,062**	–	**–**	–
Net cash generated from financing activities		**2,576**	1,029	**1,514**	641
Net increase/(decrease) in cash and cash equivalents		**1,180**	350	**–**	(13)
Cash and cash equivalents at beginning of the year		**543**	193	**–**	13
Cash and cash equivalents at end of the year		**1,723**	543	**–**	–

Notes to the financial statements for the year ended 31 March 2009

1 General information

Network Rail Infrastructure Limited is a company incorporated in Great Britain and registered in England and Wales under the Companies Act 1985.

The Company registration number is 20904587.

The Company's registered office is situated at Kings Place, 90 York Way, London, N1 9AG.

The Company's principal activities are detailed in the Directors' report on pages 14 to 23.

Details of the Group's business activities, key events and changes during the year and likely future developments are contained in the Chairman's statement, the Chief Executive's review and the Group Finance Director's review. These financial statements should also be read in conjunction with the Corporate governance report and the Directors' remuneration report.

The Company's parent is Network Rail Holdco Limited, a company incorporated in Great Britain and registered in England and Wales. The Company's ultimate parent company is Network Rail Limited, a company limited by guarantee incorporated in Great Britain and registered in England and Wales.

Presentation of income statement: exceptional debt and derivative revaluations

The income statement has been presented in a three-column format in order to allow users to appreciate the impact on the results for the year of gains and losses including those from the revaluation of debt and derivatives. See Note 9 for further information.

2 Significant accounting policies

Basis of accounting

The financial statements have been prepared in accordance with International Financial Reporting Standards (IFRS) adopted for use in the European Union, and therefore comply with Article 4 of the EU IAS regulation.

The financial statements have been prepared on the historical cost basis, except for the revaluation of the railway network to the lower of its same state replacement cost and value in use, the revaluation of investment properties, financial assets and liabilities measured at fair value through profit and loss (FVTPL) and derivative financial instruments to fair value.

The principal accounting policies adopted by the Directors are set out below.

Adoption of new and revised standards

In the current year, two Interpretations issued by the International Financial Reporting Interpretations Committee are effective for the current period. These are: IFRIC 11 *IFRS 2 – Group and Treasury Share Transactions* and IFRIC 14 *IAS 19 – The Limit on a Defined Benefit Asset, Minimum Funding Requirements and their Interaction*. The adoption of these Interpretations has not led to any changes in the Group's accounting policies.

At the date of authorisation of these financial statements, the following Standards and Interpretations which have not been applied in these financial statements were in issue but not yet effective (and in some cases had not yet been adopted by the EU):

IFRS 1 (amended)/IAS 27 (amended)	*Cost of an Investment in a Subsidiary, Jointly Controlled Entity or Associate*
IFRS 2 (amended)	*Share-based Payment – Vesting Conditions and Cancellations*
IFRS 3 (revised 2008)	*Business Combinations*
IFRS 8	*Operating Segments*
IAS 1 (revised 2007)	*Presentation of Financial Statements*
IAS 23 (revised 2007)	*Borrowing Costs*
IAS 27 (revised 2008)	*Consolidated and Separate Financial Statements*
IAS 32 (amended)/IAS 1 (amended)	*Puttable Financial Instruments and Obligations Arising on Liquidation*
IFRIC 12	*Service Concession Arrangements*
IFRIC 15	*Agreements for the Construction of Real Estate*
IFRIC 16	*Hedges of a Net Investment in a Foreign Operation*
Improvements to IFRSs (May 2008)	

The Directors anticipate that the adoption of these Standards and Interpretations in the future periods will have no material effect on the financial statements of the Group.

Going concern

The Group's business activities, together with the factors likely to affect its future development, performance and position are set out in the Directors' report on pages 14 to 23. The financial position of the Group, its cash flows, liquidity position and borrowing facilities are described in the Group Finance Director's review on pages 10 to 13. In addition Note 31 to the accounts includes the Group's objectives, policies and processes for managing its capital; its financial risk management objectives; details of its financial instruments and hedging activities; and its exposures to credit, liquidity and foreign exchange risk.

The Group has considerable financial resources together with long term contracts with a number of customers and suppliers. As a consequence, the Directors believe that the Group is well placed to manage its business risks successfully despite the current uncertain economic outlook.

After making enquiries, the Directors have a reasonable expectation that the Company and the Group have adequate resources to continue in operational existence for the foreseeable future. Accordingly, they continue to adopt the going concern basis in preparing the annual report and accounts.

2 Significant accounting policies continued

Basis of consolidation
The consolidated financial statements incorporate the financial statements of the Company and entities controlled by the Company. This includes special purpose financing companies which are not members of the Network Rail Group but are treated as subsidiaries in the Consolidated accounts of Network Rail Infrastructure Limited. All intra-group transactions, balances, income and expenses are eliminated on consolidation.

Revenue recognition
Revenue is measured at the fair value of the consideration received or receivable. Revenue represents amounts derived from the management and provision of assets for the use in the operation of the railway, property rental income, and the sale of commercial and development properties net of value added tax, and takes account of any performance penalties or bonuses in respect of the year.

Supplements to the access charges and bonuses receivable from, less penalties payable to, customers are included in revenue. Additional contract amounts and bonuses payable to, less penalties receivable from, suppliers and the Office of Rail Regulation are included in operating expenditure.

Interest income is accrued on a time basis, by reference to the principal outstanding and at the effective interest rate applicable, which is the rate that exactly discounts estimated future cash receipts through the expected life of the financial asset to that asset's net carrying amount.

Grants
Grants and other contributions received towards the cost of property, plant and equipment are included in trade and other payables as deferred income and released to the Income statement over the estimated useful economic life of the railway network. Revenue grants earned for the management and provision of railway network assets are credited to the Income statement in the period to which they relate.

Leasing
Leases are classified as finance leases whenever the terms of the lease transfer substantially all the risks and rewards of ownership to the lessee. All other leases are classified as operating leases.

The Group as lessor
Amounts due from lessees under finance leases are recorded as receivables at the amount of the Group's net investment in the leases. Finance lease income is allocated to accounting periods so as to reflect a constant periodic rate of return on the Group's net investment outstanding in respect of the leases.

Rental income from operating leases, and initial direct costs are recognised on a straight line basis over the term of the relevant lease.

The Group as lessee
Assets held under finance leases are recognised as assets of the Group at their fair value or, if lower, at the present value of the minimum lease payments, each determined at the inception of the lease. The corresponding liability to the lessor is included in the Balance sheet as a finance lease obligation. Lease payments are apportioned between finance charges and reduction of the lease obligation so as to achieve a constant rate of interest on the remaining balance of the liability. Finance charges are charged to the Income statement, unless they are directly attributable to qualifying assets, in which case they are capitalised in accordance with the Group's general policy on borrowing costs (see below).

Rentals payable under operating leases are charged to income on a straight-line basis over the term of the relevant lease.

Foreign currencies
Monetary assets and liabilities expressed in foreign currencies are translated into sterling at rates of exchange prevailing at the Balance sheet date. Individual transactions denominated in foreign currencies are translated into sterling at the exchange rates prevailing on the dates payment takes place. Gains and losses arising on retranslation are, with the exception of items that form part of a designated cash flow hedge relationship, included in the Income statement for the period and are classified as either operating or financing depending on the nature of the monetary item giving rise to them.

Borrowing costs
Borrowing costs directly attributable to the construction of qualifying assets which are assets that necessarily take a substantial period of time to get ready for their intended use are added to the cost of those assets, until such time as the assets are substantially ready for their intended use.

All other borrowing costs are recognised in the Income statement in the period in which they are incurred.

Operating profit
Operating profit is stated before investment income, finance costs other gains and losses and revaluation movements and profits on disposal of properties.

Retirement benefit costs
Payments to the defined contribution retirement benefit scheme are charged as an expense as they fall due.

For the defined benefit scheme, the cost of providing benefits is determined using the Projected Unit Credit Method, with full actuarial valuations being carried out at least every three years and updates to these valuations carried out in intervening years.

The Group's share of the actuarial gains and losses are recognised in full in the period in which they occur. They are recognised outside the Income statement and presented in the Statement of recognised income and expense (see Note 32).

2 Significant accounting policies continued

Retirement benefit costs continued

Past service cost is recognised immediately to the extent that the benefits are already vested, and otherwise is amortised on a straight line basis over the average period until the benefits become vested.

The retirement benefit obligation recognised in the Balance sheet represents the present value of the defined benefit obligation, as adjusted for unrecognised past service cost, and as reduced by the fair value of scheme assets. Any asset resulting from this calculation is limited to past service cost, plus the present value of available refunds and reductions in future contributions to the plan.

Tax

The tax expense represents the sum of the current tax payable and deferred tax. The Group's current tax liability is calculated using the tax rates that have been enacted or substantively enacted by the Balance sheet date.

Current taxes are based on the taxable results of the Group and calculated in accordance with tax rules in the United Kingdom.

Deferred tax is the tax expected to be payable or recoverable on the temporary differences that arise when tax authorities recognise and measure assets and liabilities with rules that differ from those of the consolidated accounts. Deferred taxes are calculated under the Balance sheet liability method at the rate of tax expected to prevail, subject to the rate being enacted or substantively enacted by that date, when the temporary differences reverse. Deferred tax is not discounted.

Deferred tax liabilities are recognised for all taxable temporary differences; and deferred tax assets are recognised on all deductible temporary differences to the extent that it is probable that there will be taxable profits available against which the temporary timing differences can be utilised.

Deferred tax assets/liabilities are not recognised if the temporary differences arise from the initial recognition of goodwill, non deductible goodwill or from initial recognition (other than business combination) of other assets and liabilities in a transaction that affects neither the taxable profit or loss nor the accounting profit or loss.

Deferred tax is charged or credited in the Income statement, except when it relates to items charged or credited directly to equity, in which case the deferred tax is also dealt with in equity.

Property, plant and equipment – the railway network

The railway network is valued at depreciated replacement cost. This is calculated at the lower of its same state replacement cost and its value in use. The value in use is based on a discounted future cash flow that assesses the value to the business of the net income stream of the railway network.

The railway network is depreciated on a straight-line basis over its estimated remaining weighted average useful economic life. The estimated remaining weighted average useful economic life of the network is currently 30 years (2008: 25 years). The remaining weighted average useful economic lives are estimated annually, with external verification of the valuation and asset lives carried out where required.

Investment property

Investment property, which is property held to earn rentals and/or for capital appreciation, is stated at its fair value at the Balance sheet date. Gains and losses from changes in the fair value of investment property are included in the Income statement for the period in which they arise.

Research and development

Research and general development expenditure is charged to the Income statement as incurred. Expenditure on the development of specific projects is recognised only if all of the following conditions are met:

- an asset is created that can be identified
- it is probable that the asset created will generate future economic benefits
- the development cost of the asset can be measured reliably.

Intangible fixed assets

An intangible asset is only recognised if it is probable that future economic benefits will flow to the Group and its costs can be measured reliably. Intangible fixed assets are measured initially at purchase cost and are amortised on a straight-line basis. Licenses are amortised over the length of their contractual agreement. Intangible fixed assets are tested for impairment at each Balance sheet date by comparing their carrying value and the expected discounted cash flows expected to arise from them over their contractual agreements. If the carrying value exceeds the discounted cash flows expected to arise from the assets, the carrying value would be impaired accordingly.

Inventories

Inventories are stated at the lower of cost and net realisable value. Cost comprises direct materials, direct labour costs and those overheads that have been incurred in bringing the inventories to their present location and condition. Cost is calculated using the weighted average method.

Financial instruments

Financial assets and financial liabilities are recognised on the Group's Balance sheet when the Group becomes party to the contractual provisions of the instrument.

Financial assets

Financial assets are recognised and derecognised on a trade date where a purchase or sale of an investment is under contract whose terms require delivery of the investment within the timeframe established by the market concerned, and are initially measured at fair value, plus transaction costs, except for those investments classified as at fair value through profit or loss, which are initially measured at fair value.

2 Significant accounting policies continued

Financial assets continued

Financial assets are classified as financial assets at fair value through profit or loss (FVTPL), held-to-maturity investments, available-for-sale (AFS) financial assets, and trade and other receivables. Trade receivables do not carry any interest and are stated at their nominal value as reduced by appropriate allowances for estimated irrecoverable amounts, recognised in the income statement. The remaining assets are measured at subsequent reporting dates at fair value.

Financial assets at FVTPL

Financial assets are classified as at FVTPL where the asset is either held for trading or it is designated at FVTPL. Gains and losses arising from changes in fair value of these assets are recognised in the Income statement for the period. A financial asset is classified as held for trading if:
- it has been acquired principally for the purpose of selling in the near future or
- it is part of an identified portfolio of financial instruments that the Group manages together and has a recent actual pattern of short term profit taking or
- it is a derivative that is not designated and effective as a hedging instrument.

Held-to-maturity investments

Investments with fixed or determinable payments and fixed maturity dates that the Group has the positive intent and ability to hold to maturity are classified as held-to-maturity investments. These investments are recorded at amortised cost less any impairment, with revenue recognised on an effective yield basis.

Available-for-sale financial assets

Gains and losses from changes in fair value of these assets are recognised directly in equity until the security is disposed of or is determined to be impaired. At this point the cumulative gain or loss previously recognised in equity is included in the Income statement for the period.

Impairment of financial assets

Financial assets, other than those at FVTPL, are assessed for indicators of impairment at each Balance sheet date. Financial assets at FVTPL are stated at fair value with any resultant gain or loss recognised in the Income statement. Financial assets are impaired where there is objective evidence that, as a result of one or more events that occurred after the initial recognition of the financial asset, the estimated future cash flows of the investment have been impacted.

The carrying amount of the financial asset is reduced by the impairment loss directly for all financial assets with the exception of trade receivables, which are reduced by appropriate allowances for irrecoverable amounts. If, in a subsequent period, the amount of the impairment loss decreases and the decrease can be related objectively to an event occurring after the impairment was recognised, the previously recognised impairment loss is reversed through the Income statement to the extent that the carrying amount of the investment at the date the impairment is reversed does not exceed what the amortised cost would have been had the impairment not been recognised.

Cash and cash equivalents

Cash and cash equivalents comprise bank balances held by the Group and money market deposit investments all denominated in sterling at varying rates. The carrying amount of these assets approximates their fair value.

Joint ventures

The results and assets and liabilities of joint ventures are incorporated in these financial statements using the equity method of accounting. Investments in joint ventures are carried in the Balance sheet at cost as adjusted by post acquisition changes in the Group's share of net assets of joint ventures, less any impairment in the value of individual investments. Losses of a joint venture in excess of the Group's interest in a joint venture are not recognised.

Financial liabilities and equity instruments

Financial liabilities and equity instruments are classified according to the substance of the contractual arrangements entered into. An equity instrument is any contract that evidences a residual interest in the assets of the Group after deducting all of its liabilities.

Financial liabilities at FVTPL

Financial liabilities are classified as at FVTPL where the financial liability is either held for trading or it is designated at FVTPL. A financial liability is classified as held for trading if:
- it has been incurred principally for the purpose of disposal in the near future or
- it is a part of an identified portfolio of financial instruments that the Group manages together and has a recent actual pattern of short term profit-taking or
- it is a derivative that is not designated and effective as a hedging instrument.

A financial liability other than a financial liability held for trading may be designated as at FVTPL upon initial recognition if:
- such designation eliminates or significantly reduces a measurement or recognition inconsistency that would otherwise exist or
- he financial liability form a part of a group of financial assets or financial liabilities or both, which is managed and its performance is evaluated on a fair value basis or
- it forms part of a contract containing one or more embedded derivatives and IAS 39 permits the entire combined contract to be designated as at FVTPL.

The Group derecognises financial liabilities when, and only when, the Group's obligations are discharged, cancelled or they expire.

Debt

Debt instruments not designated at FVTPL are initially measured at fair value, net of discount and direct issue costs. Finance charges, including premiums payable on settlement or redemption and direct issue costs are accounted for on an accrual basis to the Income statement using the effective interest rate method and are added to the carrying value of the debt instrument to the extent that they are not settled in the period in which they arise.

2 Significant accounting policies continued

Financial liabilities and equity instruments continued

Trade payables

Trade payables are ordinarily not interest bearing and are stated at cost.

Derivative financial instruments and hedge accounting

The Group's activities expose it primarily to the financial risks of changes in interest rates and foreign currency exchange rates. The Group uses interest rate swaps and foreign exchange forward contracts to hedge these exposures. The use of financial derivatives is governed by the Group's policies approved by the Treasury Committee of the Board, which provide written principles on the use of financial derivatives.

Derivatives are initially recognised at fair value at the date a derivative contract is entered into and are subsequently remeasured to their fair value at each Balance sheet date.

The Group designates certain hedging instruments as either cash flow hedges or fair value hedges. Hedges of interest rate risk on firm commitments are accounted for as cash flow hedges. At the inception of the hedge relationship, the entity documents the relationship between the hedging instrument and the hedged item, along with its risk management objectives and its strategy for undertaking various hedge transactions. Furthermore, at the inception of the hedge and on an ongoing basis, the Group documents whether the hedging instrument that is used in a hedging relationship is highly effective in offsetting changes in fair values or cash flows of the hedged item.

Some derivatives, while complying with the Group's financial risk management policies, do not qualify for hedge accounting and are therefore classified as held for trading. Changes in the fair value of derivative financial instruments that do not qualify for cash flow hedge accounting are recognised in the Income statement as they arise.

Hedge accounting is discontinued when the hedging instrument expires or is sold, terminated, exercised, or no longer qualifies for hedge accounting. At that time, any cumulative gain or loss on the hedging instrument recognised in equity is retained in equity until the forecasted transaction occurs. If a hedged transaction is no longer expected to occur, the net cumulative gain or loss recognised in equity is transferred to the Income statement in the year.

Derivatives embedded in other financial instruments or other host contracts are treated as separate derivatives when their risks and characteristics are not closely related to those of host contracts and the host contracts are not carried at fair value, with gains or losses are reported in the Income statement.

Note 22 sets out details of the fair values of the derivative instruments used for hedging purposes. Movements in the hedging reserve in equity are detailed in the Statement of recognised income and expense and in Note 27.

Fair value hedges

Changes in the fair value of derivatives that are designated and qualify as fair value hedges are recorded in the Income statement immediately, together with any changes in the fair value of the hedged item that is attributed to the hedged risk. The change in the fair value of the hedging instrument and the change in the hedged item attributable to the hedged risk are recognised in the Income statement and is included in other gains and losses.

Cash flow hedges

Changes in the fair value of derivative financial instruments that are designated and effective as hedges of future cash flows are recognised directly in equity and the ineffective portion is recognised immediately in the Income statement, and is included in other gains and losses. If the cash flow hedge of a firm commitment or forecasted transaction results in the recognition of an asset or a liability, then, at the time the asset or liability is recognised, the associated gains or losses on the derivative that had been previously recognised in equity are included in the initial measurement of the asset or liability.

Provisions

Provisions are recognised when the Group has a present obligation as a result of a past event, and it is probable that the Group will be required to settle that obligation. Provisions are measured at the Directors' best estimate of the expenditure required to settle the obligation at the Balance sheet date, and are discounted to present value where the effect is material.

Key sources of uncertainty

(i) Property, plant and equipment – the railway network: the estimate of the value in use of the railway network is based on the Regulatory Asset Base, which is, in effect, a discounted future cash flow calculation adjusted for the net present value of any variances from the Office of Rail Regulation's determination included in the Group's business plan. Further details are set out in Note 13.

(ii) Investment property – the investment property portfolio valuation is determined using an external valuation of the 14 largest properties in the portfolio, comprising 11 per cent of the total valuation. Jones Lang LaSalle provide their assessment of yields for each of these properties. These are then used to produce income multipliers and applied to the rental streams from each of the individual properties in the portfolio to form an overall valuation.

(iii) Retirement benefit obligation: the Group recognises and discloses its retirement benefit obligation in accordance with the measurement and presentational requirement of IAS 19 Employee Benefits. The calculations include a number of judgements and estimations in respect of the expected rate of return on assets, the discount rate, inflation assumptions, the rate of increase in salaries and life expectancy amongst others. Changes in these assumptions can have a significant effect on the value of the retirement benefit obligation. The key assumptions made are set out in Note 32.

(iv) Provisions – Provisions are measured at the Directors' best estimate of the expenditure required to settle the obligation at the balance sheet date, and are discounted to present value where the effect is material.

3 Revenue

	2009 Group £m	2008 Group £m
Franchised track access and grant income	**5,799**	5,584
Freight revenue	**93**	90
Property rental income	**215**	219
Other income	**53**	67
	6,160	5,960

The net effect of the performance regimes on the results of the Group and Company was net income of £56m (year to 31 March 2008: £68m).

4 Segmental analysis

No segmental analysis is provided because the Group operates one class of business, that of managing the national rail infrastructure, and undertakes that class of business in one geographical segment, Great Britain.

5 Net operating costs

	2009 Group £m	2008 Group £m
Employee costs (see Note 7)	**1,656**	1,536
Own costs capitalised	**(662)**	(575)
Other external charges (including infrastructure maintenance costs)	**1,701**	1,603
Other operating income	**(232)**	(175)
Net operating costs before depreciation	**2,463**	2,389
Depreciation and other amounts written off non-current assets	**1,198**	1,195
Capital grants amortised	**(45)**	(36)
Net operating costs	**3,616**	3,548

6 Profit from operations

Profit from operations is stated after charging/(crediting):

	2009 Group £m	2008 Group £m
Research and development costs expensed	**1**	1
Depreciation and other amounts written off property, plant and equipment	**1,198**	1,195
Amortisation of intangible fixed assets	**1**	1
Amortisation of capital grants	**(45)**	(36)
Profit on sale of properties	**(70)**	(62)
Decrease in the fair value of investment properties	**208**	28
Cost of inventories recognised as an expense	**192**	184
Employee costs (see Note 7)	**1,656**	1,536
Amounts payable to auditors		
Fees payable to the Company's auditors for the audit of the Company's annual accounts	**0.37**	0.35
Fees payable to the Company's auditors for other services to the Group		
– The audit of the Company's subsidiaries pursuant to legislation	**0.04**	0.03
Total audit fees	**0.41**	0.38
Other services pursuant to legislation		
– Regulatory accounts and interim review	**0.12**	0.12
– Other	**0.02**	0.01
Total non-audit fees	**0.14**	0.13
Total amounts payable to auditors	**0.55**	0.51

7 Employee costs

The average number of employees (including Executive Directors) was:

	2009 Group Number	2008 Group Number
Management and operation of the railway	**36,138**	34,770

	2009 Group £m	2008 Group £m
Their aggregate remuneration comprised:		
Wages and salaries	**1,415**	1,297
Social security costs	**121**	113
Defined contribution pension costs (see Note 32)	**18**	15
Defined benefit pension costs – current service costs (see Note 32)	**102**	111
	1,656	1,536

8 Investment revenue

	2009 Group £m	2008 Group £m
Interest receivable from immediate parent company	**28**	26
Interest receivable on investments and deposits	**107**	85
Interest receivable on finance leases	**1**	2
Expected return on assets less interest on liabilities in respect of defined benefit pension scheme	**–**	19
	136	132

Investment revenue earned on financial assets analysed by category of asset, is as follows:

	2009 Group £m	2008 Group £m
Available-for-sale financial assets	**1**	21
Loans and receivables (including cash and bank balances)	**135**	75
Held-to-maturity investments	**–**	17
	136	113

9 Other gains and losses

	2009 Group £m	2008 Group £m
Gains arising from ineffective portion of cash flow hedges	**21**	25
Losses arising from ineffective portion of cash flow hedges	**(109)**	(12)
Gain on disposal of cash flow hedge	**–**	8
Fair value losses on interest rate swaps transferred from equity	**(4)**	(4)
(Losses)/gains arising from cash flow hedge accounting	**(92)**	17
Increase in fair value of fair value hedges	**597**	105
Increase in fair value of fair value hedged debt	**(569)**	(111)
Gains/(losses) arising from fair value hedge accounting	**28**	(6)
Increase in fair value of derivatives not hedge accounted	**169**	58
Increase in fair value of non-hedge accounted debt	**(83)**	(33)
Decrease in fair value of derivatives not hedge accounted	**(94)**	(5)
Decrease in fair value of non-hedge accounted debt	**–**	1
Increase in fair value of non-hedge accounted investments	**–**	1
(Losses)/gains arising from non-hedge accounting	**(8)**	22
Total other (losses) and gains	**(72)**	33

9 Other gains and losses continued

No other gains and losses have been recognised in respect of loans and receivables or held-to-maturity investments other than those disclosed in Note 8 and impairment losses recognised/reversed in respect of trade receivables (see Notes 5 and 19). No gains and losses have been recognised on financial liabilities measured at amortised cost other than those disclosed in Note 10.

The gain/loss arising on adjustment for the hedged item in a designated fair value hedge accounting relationship, the change in fair value of debt designated as fair value through profit and loss, and the exchange differences on retranslation of foreign currency debt forms part of the net gains/losses on other financial liabilities carried at amortised cost and relates to debt issuances disclosed in Note 21.

The overall size of the debt and derivative movements will be significantly affected by the real interest rate hedging activities with regard to future index-linked debt issuances. This hedge of the real interest rate does not qualify for hedge accounting under International Accounting Standard 39 and a 1 per cent move in the real rate will cause a change in the valuation of these hedge instruments by approximately £230m.

Debt and derivative revaluations

The income statement has been presented in a three-column format in order to allow users to appreciate the impact of the revaluation of debt and derivatives on the results for the year. Not all hedging strategies qualify for hedge accounting and the Directors believe that, by separating gains and losses arising from applying the valuation requirements of International Accounting Standard 39, the users of this financial information will better understand the underlying performance of the Group.

Those items that have been identified for disclosure as changes in debt and derivative valuations are explained above.

10 Finance costs

	2009 Group £m	2008 Group £m
Interest on bank loans and overdrafts	**66**	71
Interest on bonds issued under the Debt Issuance Programme	**681**	672
Interest on debt issued under Medium Term Note Programme	**180**	253
Interest on Commercial Paper	**–**	12
Interest on obligations under finance leases	**14**	16
Expected return on assets less interest on liabilities in respect of defined benefit pension schemes	**15**	–
Other interest	**102**	82
Total borrowing costs	**1,058**	1,106
Less: amounts included in the cost of qualifying assets	**(112)**	(92)
Total finance costs	**946**	1,014

Borrowing costs are included in the costs of qualifying assets to the extent that the asset is financed by the Group. The average rate used during the year was 5.0 per cent (2008: 5.0 per cent).

11 Tax

	2009 Group £m	2008 Group £m
Current tax:		
UK Corporation tax at 28% (2008: 30%):		
Corporation tax charge	**(10)**	(19)
Less advance corporation tax (ACT) set-off	**9**	13
Corporation tax liability	**(1)**	(6)
Group relief payable to Network Rail Holdco Limited	**(8)**	(8)
Total current tax	**(9)**	(14)
Deferred tax:		
Deferred tax at 28% (2008: 28%)		
Current year charge	**(414)**	(440)
Abolition of Industrial Buildings Allowances	**(524)**	–
Change of corporation tax rate	**–**	28
Prior year credit	**32**	18
Total deferred tax	**(906)**	(394)
Total tax	**(915)**	(408)

The tax charge for the year can be reconciled to the profit per the Income statement as follows:

	2009 Group £m	2008 Group £m
Profit before tax	**1,524**	1,597
Tax at the UK corporation tax rate of 28% (2008: 28%)	**426**	447
Adjustments in respect of prior years	**(32)**	(18)
Change of corporation tax rate	**–**	(28)
Abolition of Industrial Building Allowances	**524**	–
Permanent differences	**6**	20
Advance corporation tax previously written off	**(9)**	(13)
Tax charge for the year	**915**	408

In addition to the amounts charged to the Income statement, deferred tax relating to the revaluation of the railway network amounting to £31m has been credited directly to equity (2008: £113m charge). Movements on the hedging reserve amounting to £98m (2008: £7m), movements relating to retirement benefit obligations amounting to £79m (2008: £37m).

Deferred tax is calculated at a rate of 28 per cent (2008: 28 per cent).

UK corporation tax is calculated at 28 per cent (2008: 30 per cent).

The Company and the Group have £34m (2008: £26m) of surplus ACT carried forward. No deferred tax asset has been provided in respect of this amount as it is uncertain that it can be utilised against tax liabilities in the foreseeable future.

The legislation introducing the abolition of Industrial Buildings Allowances was enacted in the year and this liability has therefore been fully reflected in the accounts, as shown above. The types of asset which qualified as industrial buildings were stations, embankments, sea walls, depots and goods yards.

12 Intangible assets

Group	Concessions £m
Cost	
At 1 April 2007	**83**
Fully written down licenses de-recognised in the year	(5)
At 1 April 2008 and 31 March 2009	**78**
Amortisation	
At 1 April 2007	(8)
Charge for the year	(1)
Fully written down licenses de-recognised in the year	5
At 1 April 2008	**(4)**
Charge for the year	(1)
At 31 March 2009	**(5)**
Carrying amount	
At 31 March 2009	**73**
At 31 March 2008	74

The intangible assets above are held by the Company's wholly owned subsidiary Network Rail (CTRL) Limited.

The concession to run the operations, maintenance and renewal business of the Channel Tunnel Rail Link is being amortised over 84 years, to 2086.

13 Property, plant and equipment – the railway network

	Group and Company £m
Valuation	
At 1 April 2007	28,304
Additions	3,952
Depreciation charge for the year	(1,195)
Transfers to investment property	(21)
Revaluation in the year	403
At 1 April 2008	**31,443**
Additions	4,743
Depreciation charge for the year	(1,198)
Transfers from investment property	50
Revaluation in the year	(113)
At 31 March 2009	**34,925**

In the current year Ove Arup and Partners has reviewed Network Rail Infrastructure Limited's engineering assessment of the replacement cost, depreciated replacement cost and serviceable economic lives of the major categories that comprise the railway network and confirmed, in writing, to the Directors that the basis upon which the assessment had been prepared is appropriate and that the resultant valuations and estimates were reasonable.

The unimpaired depreciated replacement cost of the network (after excluding the replacement cost of embankments, cuttings and tunnels) is estimated at £75bn (2008: £63bn).

As the depreciated replacement cost of the railway network significantly exceeds its value in use, it is impaired down to its value in use at each reporting date. Given the interdependency of the assets comprising the railway network, the Group has concluded that the railway network is a single cash generating unit and that its value in use is the estimated future cash flows that will be generated in perpetuity, discounted at the Group's pre-tax cost of capital, as set by the Office of Rail Regulation (ORR) in its Access Charges Review. The estimate of the value in use is based on the Regulatory Asset Base which is, in effect, a discounted future cash flow calculation adjusted for the net present value of any variances from the ORR's determination included in the Group's business plans.

13 Property, plant and equipment – the railway network continued

The depreciation charge for any year is calculated using the average carrying value for the year and the estimated weighted average remaining useful economic life of the railway network. The estimated remaining weighted average useful economic life of the network is currently 30 years (2008: 25 years). The change in estimated useful economic lives was made halfway through the financial year based on the findings of the Ove Arup Partners' review of Network Rail Infrastructure Limited's engineering assessment.

As at 31 March 2009 the comparable valuation of the railway network according to the historic cost convention is £29,273m (2008: £25,748m).

As at 31 March 2009 and 31 March 2008 it is not possible to identify the undepreciated capitalised interest or the undepreciated finance leases within the net book value of fixed assets. The undepreciated interest capitalised since the date of adoption of the network value as deemed cost on 1 April 2002 was £376m (2008: £278m). No finance leased assets have been acquired since 1 April 2002.

At 31 March 2009, the Group had entered into contractual commitments in respect of capital expenditure amounting to £1,667m (2008: £1,130m).

14 Investment property

	Group and Company £m
Fair value	
At 1 April 2007	948
Additions	9
Transfers from property, plant and equipment	21
Disposals	(1)
Decrease in fair value in the year	(28)
At 1 April 2008	**949**
Additions	12
Transfers to property, plant and equipment	(50)
Disposals	(3)
Decrease in fair value in the year	(208)
At 31 March 2009	**700**

The fair value of the Group's investment properties at 31 March 2009 is based on a valuation carried out at that date by Jones Lang LaSalle, external valuers not connected with the Group, and by a chartered surveyor working for Network Rail.

The valuation, which conforms to International Valuation Standards, was arrived at by, firstly, the external valuation of the 14 largest properties amounting to 11 per cent of the total valuation. Secondly, the balance of the estate, amounting to 6,420 properties, was valued using the Beacon method. The portfolio was analysed into 12 homogenous classes of property and areas. Jones Lang LaSalle independently assessed the appropriate yield to be adopted within each of the portfolio classes/areas in order to enable the Directors to estimate market values by applying the adopted yields to the net rental income in accordance with a traditional UK investment property valuation.

The property rental income earned by the Group from its investment property, all of which is leased out under operating leases, amounted to £75m (2008: £74m). Direct operating expenses arising on the investment properties in the year amounted to £4.2m (2008: £4.4m).

The Group's investment properties are let on a tenant repairing basis. The Group's maintenance obligations are limited to common areas and vacant property units.

15 Investment in subsidiaries: Company

	At cost £m
Investment in subsidiaries at 1 April 2007, 1 April 2008 and 31 March 2009	**49**

The Company's subsidiaries are set out below:

Directly owned	Country of incorporation	Proportion of all classes of issued share capital owned by the Company	Principal activity
Network Rail Insurance Limited	Guernsey	100%	Insurance
Network Rail (CTRL) Limited	Great Britain	100%	Holds St Pancras concession and CTRL Railway Services Agreement
Network Rail (Spacia) Limited	Great Britain	100%	Dormant
Network Rail (Stations) Limited	Great Britain	100%	Dormant
Network Rail (Projects) Limited	Great Britain	100%	Dormant
Network Rail (Property) Limited	Great Britain	100%	Dormant
Spacia (2002) Limited	Great Britain	100%	Dormant
Network Rail Pension Trustee Limited	Great Britain	Company limited by guarantee	Administration of defined contribution pension scheme
Shares held by a trustee			
Network Rail MTN Finance PLC	Great Britain	Shares held by HSBC Trustee (C.I.) Limited	Administration of Medium Term Note Programme
Network Rail Infrastructure Finance PLC	Great Britain	Shares held by HSBC Trustee (C.I.) Limited	Administration of Debt Issuance Programme

The shares in Network Rail MTN Finance PLC and Network Rail Infrastructure Finance PLC are held by HSBC Trustee (C.I.) Limited for charitable purposes. The sole activity of these companies is to act as a special purpose funding vehicle, including issuing debt under the Medium Term Note Programme and Debt Issuance Programme respectively. The companies are treated as subsidiaries for accounting purposes as proceeds from the Medium Term Note Programme and Debt Issuance Programme are on-lent to Network Rail Infrastructure Limited and are used to finance the activities of the Company and to refinance the existing debt of the Group.

The Company's joint venture is set out below:

Joint Venture	Country of incorporation	Proportion of all classes of issued share capital owned by the Company	Principal activity
Solum GP Limited	Great Britain	50%	Property development

Aggregated amounts relating to joint ventures

	2009 £m	2008 £m
Current assets	**5**	–

16 Investments

	2009 Group £m	2008 Group £m	**2009 Company £m**	2008 Company £m
Held-to-maturity investments carried at amortised cost	**–**	8	**–**	–
Available-for-sale financial assets carried at fair value	**–**	47	**–**	–
Total investments	**–**	55	**–**	–

The Group has not designated any financial assets that are not held for trading as financial assets at fair value through profit and loss.

Neither the Group nor the Company held any held-to-maturity investments at the balance sheet date. The fixed rate of return on these investments in 2008 was 5.6 per cent.

There were no available-for-sale financial assets at the balance sheet date. In 2008 the maturity profile of these assets was between 103 and 341 days of that balance sheet date. All available-for-sale financial assets carried a fixed rate of return. The weighted average interest rate in 2008 was 4.1 per cent.

17 Inventories

	2009 Group and Company £m	2008 Group and Company £m
Raw materials and consumables	**88**	64

At 31 March 2009 a provision of £13m was held in respect of inventories (2008: £14m).

18 Finance lease receivables

	Minimum lease payments		Present value of minimum lease payments	
	2009 Group and Company £m	2008 Group and Company £m	**2009 Group and Company £m**	2008 Group and Company £m
Amounts receivable under finance leases:				
Within one year	**4**	5	**3**	3
In the second to fifth years inclusive	**9**	10	**7**	8
After five years	**3**	5	**2**	4
	16	20	**12**	15
Less: unearned finance income	**(3)**	(4)	**n/a**	n/a
Present value of minimum lease payments receivable	**13**	16	**12**	15
Analysed as:				
Current finance lease receivables (recoverable within one year)	**3**	4	**3**	3
Non-current finance lease receivables (recoverable after one year)	**10**	12	**9**	12
	13	16	**12**	15

The Group has entered into finance lease arrangements with third parties for various types of telecommunications equipment. Leases are due to expire in 2017/18.

The interest rate inherent in the leases is fixed at the contract date for all of the lease term. The average effective interest rate contracted is approximately 8.4 per cent (2008: 8.4 per cent) per annum.

Finance lease receivable balances are secured over the equipment leased. The Group is not permitted to sell or repledge the collateral in the absence of default by the lessee.

The fair value of the Group's finance lease receivables at 31 March 2009 is estimated at £11m (2008: £13m) using a 4.8 per cent (2008: 5.0 per cent) discount rate based on the current average cost of capital.

19 Other financial assets

Trade and other receivables

	2009 Group £m	2008 Group £m	2009 Company £m	2008 Company £m
Trade receivables	**368**	318	**469**	313
Capital grants receivable	**110**	77	**110**	77
Other receivables	**55**	63	**159**	194
Prepayments and accrued income	**272**	222	**257**	204
	805	680	**995**	788

Trade receivables include an allowance for estimated irrecoverable amounts from the supply of services of £14m (2008: £5m). This allowance has been made by reference to past default experience. Average debtor days were 53 days (2008: 44 days).

The Directors consider that the carrying value of trade and other receivables approximates their fair value. All balances are non-interest bearing and denominated in sterling. The Group provides fully for receivables overdue by over six months because historical experience is that such receivables are generally not recoverable. All other trade receivables are provided for on the basis of estimated irrecoverable amounts, determined by reference to past default experience.

The Group's and Company's credit risk is primarily attributable to its trade receivables. Around 94 per cent of the Group's income is received from train operating companies (TOCs) and in the form of revenue grants from Government. Franchises are issued to TOCs by the Department for Transport (DfT) in England and Wales and Transport Scotland in Scotland. The Group believes that amounts receivable from Government and the TOCs represent a high level of credit quality. This is because in the extraordinary circumstance that a TOC was financially distressed and unable to meet its obligations then provisions in the franchise agreements allow the DfT to take over services at any time. Before accepting any other new customer, the Group uses an external credit scoring system to assess the potential customer's credit quality.

19 Other financial assets continued

Included in the Group's trade receivable balance are debtors with a carrying value of £22m (2008: £24m) which are past due at the reporting date for which the Group has not provided as there has not been a significant change in the credit quality and the amounts are still considered recoverable. The Group does not hold collateral over these balances. The average age of these receivables is 57 days (2008: 85 days).

The following table shows the age of financial assets for the Group and Company which are past due and for which no specific provision has been raised:

	2009 Group £m	2008 Group £m	2009 Company £m	2008 Company £m
Past due by 1–28 days	**15**	10	**15**	10
Past due by 29–56 days	**2**	4	**2**	4
Past due by 57–84 days	**1**	4	**1**	4
Past due by 85–180 days	**4**	6	**4**	6
	22	24	**22**	24

Loan to immediate parent company

The loan to the immediate parent company is receivable in full in 2052. Interest is charged on an arm's length basis.

Loan to other Group company

The loan to other Group company (Network Rail (CTRL) Limited) is receivable in full in 2022. Interest is charged on an arm's length basis.

20 Trade and other payables

Current liabilities: Trade and other payables

	2009 Group £m	2008 Group £m	2009 Company £m	2008 Company £m
Trade creditors	**738**	594	**725**	584
Collateral held from banking counterparties	**1,062**	–	**–**	–
Payments received on account	**18**	17	**18**	17
Taxation and social security	**24**	31	**23**	31
Other creditors	**332**	358	**330**	358
Other interest accruals	**302**	252	**258**	292
Other accruals and deferred income	**1,199**	1,136	**1,290**	1,141
	3,675	2,388	**2,644**	2,423

The average credit period taken for trade purchases is 47 days (2008: 44 days).

Before accepting new suppliers, and upon letting significant contracts, The Company evaluates suppliers creditworthiness using external credit scoring systems and other relevant data.

The Directors consider that the carrying value of trade and other payables approximates to their fair value. All balances are ordinarily non-interest bearing and denominated in sterling.

Non-current liabilities: Other payables

	2009 Group £m	2008 Group £m	2009 Company £m	2008 Company £m
Deferred development income	**38**	39	**34**	39
Capital grants deferred income	**1,456**	1,276	**1,456**	1,276
Other payables	**125**	114	**126**	114
	1,619	1,429	**1,616**	1,429

21 Bank overdrafts and loans

	2009 Group £m	2008 Group £m	2009 Company £m	2008 Company £m
Bank loans and overdrafts	**1,311**	1,398	**346**	349
Bonds issued under the Debt Issuance Programme (less unamortised discount and fees)	**21,469**	14,662	**–**	–
Debt issued under Medium Term Note Programme (less unamortised discount and fees)	**–**	4,072	**–**	–
Kreditanstalt für Wiederaufbau working capital facility	**185**	200	**–**	–
Loans from subsidiaries	**–**	–	**20,803**	19,290
	22,965	20,332	**21,149**	19,639
The borrowings are repayable as follows:				
On demand or due within one year	**1,773**	5,077	**861**	4,412
Due within one to two years	**2,159**	1,158	**1,923**	1,188
Due within two to five years	**3,807**	2,783	**3,346**	2,762
Due in more than five years	**15,226**	11,314	**15,019**	11,277
	22,965	20,332	**21,149**	19,639
Less: amounts repayable within one year (shown under current liabilities):				
Bank loans and overdrafts	**–**	(100)	**–**	(20)
Bonds issued under the Debt Issuance Programme (less unamortised discount and fees)	**(1,588)**	(705)	**–**	–
Debt issued under Medium Term Note Programme (less unamortised discount and fees)	**–**	(4,072)	**–**	–
Kreditanstalt für Wiederaufbau working capital facility	**(185)**	(200)	**–**	–
Loans from subsidiaries	**–**	–	**(861)**	(4,392)
Amounts repayable within one year	**(1,773)**	(5,077)	**(861)**	(4,412)
Amounts repayable after more than one year	**21,192**	15,255	**20,288**	15,227

All borrowings are denominated in or swapped into sterling.

21 Bank overdrafts and loans continued

Bonds issued under the Debt Issuance Programme are analysed as follows*:

	2009 Group £m	2008 Group £m	2009 Company £m	2008 Company £m
1.085% sterling index linked bond due 2052	**102**	102	**–**	–
0% sterling index linked bond due 2052	**101**	101	**–**	–
1.003% sterling index linked bond due 2051	**20**	–	**–**	–
0.53% sterling index linked bond due 2051	**100**	–	**–**	–
0.517% sterling index linked bond due 2051	**101**	–	**–**	–
0% sterling index linked bond due 2051	**103**	101	**–**	–
0.678% sterling index linked bond due 2048	**98**	–	**–**	–
1.125% sterling index linked bond due 2047	**1,303**	509	**–**	–
0% sterling index linked bond due 2047	**66**	62	**–**	–
1.5646% sterling index linked bond due 2044	**227**	217	**–**	–
1.2219% sterling index linked bond due 2040	**226**	217	**–**	–
4.6535% sterling bond due 2038	**100**	100	**–**	–
1.375% sterling index linked bond due 2037	**3,514**	1,012	**–**	–
7.05% US dollar bond due 2036	**21**	12	**–**	–
6.91% US dollar bond due 2036	**21**	12	**–**	–
4.75% sterling bond due 2035	**1,218**	1,221	**–**	–
1.6492% sterling index linked bond due 2035	**341**	328	**–**	–
4.375% sterling bond due 2030	**869**	868	**–**	–
1.75% sterling index linked bond due 2027	**2,010**	1,545	**–**	–
4.57% Norwegian krone bond due 2026	**16**	13	**–**	–
4.615% Norwegian krone bond due 2026	**58**	47	**–**	–
1.9618% sterling index linked bond due 2025	**288**	276	**–**	–
4.75% sterling bond due 2024	**724**	722	**–**	–
4.3775% sterling bond due 2023	**–**	200	**–**	–
2.28% Japanese yen bond due 2021	**71**	51	**–**	–
2.315% Japanese yen bond due 2021	**71**	54	**–**	–
2.15% Japanese yen bond due 2021	**70**	51	**–**	–
2.76% Swiss franc bond due 2021	**173**	140	**–**	–
4.625% sterling bond due 2020	**994**	995	**–**	–
5.0575% US dollar bond due 2017	**–**	25	**–**	–
4.4% Canadian dollar bond due 2016	**291**	254	**–**	–
6% Australian dollar bond due 2016	**248**	217	**–**	–
4.875% sterling bond due 2015	**989**	989	**–**	–
3.5% US dollar bond due 2013	**865**	–	**–**	–
4.875% sterling bond due 2012	**994**	–	**–**	–
2% US dollar bond due 2012	**692**	–	**–**	–
4.375% sterling bond due 2011	**449**	447	**–**	–
5.25% US dollar bond due 2011	**742**	545	**–**	–
3% US dollar bond due 2011	**697**	502	**–**	–
5.5% Australian dollar bond due 2010	**410**	391	**–**	–
5.125% sterling bond due 2010	**499**	498	**–**	–
3.875% US dollar bond due 2009	**698**	504	**–**	–
4.875% US dollar bond due 2009	**889**	654	**–**	–
4.46% sterling bond due 2008	**–**	50	**–**	–
4.125% US dollar bond due 2008	**–**	630	**–**	–
4.50% sterling bond due 2008	**–**	–	**–**	–
	21,469	14,662	**–**	–

*Amounts are shown net of unamortised discount and fees.

Debt issued under the Medium Term Note Programme is analysed as follows*:

	2009 Group £m	2008 Group £m	2009 Company £m	2008 Company £m
4 7/8% Sterling Medium Term Note due 2009	**–**	2,084	**–**	–
3 1/8% Euro Medium Term Note due 2009	**–**	1,988	**–**	–
	–	4,072	**–**	–

*Amounts are shown net of unamortised discount and fees.

21 Bank overdrafts and loans continued

Bank loans are analysed as follows:

	2009 Group £m	2008 Group £m	2009 Company £m	2008 Company £m
Index-linked European Investment Bank due 2037	**383**	369	**–**	–
Royal Bank of Scotland (novated from HSBC Bank) due 2019 repayable by instalments	**206**	206	**206**	206
Barclays Bank due 2017 repayable by instalments	**53**	55	**53**	55
Royal Bank of Scotland due 2017 repayable by instalments	**69**	68	**69**	68
5.57% European Investment Bank due 2013	**200**	200	**–**	–
5.77% European Investment Bank due 2012	**300**	300	**–**	–
6.42% European Investment Bank due 2011	**100**	100	**–**	–
6.42% European Investment Bank due 2009	**–**	100	**–**	–
	1,311	1,398	**328**	329

The weighted average interest rates on borrowings at 31 March 2009 and 31 March 2008 were as follows:

	2009 Group %	2008 Group %	2009 Company %	2008 Company %
Bank loans and overdrafts	**5.04%**	5.24%	**4.64%**	4.29%
Debt issued under the Debt Issuance Programme	**4.63%**	4.93%	**–**	–
Debt issued under the Medium Term Note Programme	**–**	5.18%	**–**	–

At 31 March 2009 and 2008 the Group had the following undrawn committed borrowing facilities:

	2009 Drawn £m	2009 Undrawn £m	2009 Total £m	2008 Drawn £m	2008 Undrawn £m	2008 Total £m
Working capital facility	**–**	**1,000**	**1,000**	–	1,000	1,000
Standby facility A	**–**	**4,000**	**4,000**	–	4,000	4,000
	–	**5,000**	**5,000**	–	5,000	5,000

Undrawn committed facilities expire as follows:

	2009 £m	2008 £m
Within one year	**1,000**	1,000
Within one to two years	**–**	–
Within two to five years	**4,000**	4,000
	5,000	5,000

In addition the Secretary of State for Transport has provided support facilities in respect of the facilities listed below:

- Unlimited financial indemnity in respect of borrowings under the Debt Issuance Programme
- Medium Term Note Programme
- £1,050m European Investment Bank
- £185m Kreditanstalt für Wiederaufbau

The support facilities provided by the Secretary of State for Transport cover amounts payable under the relevant facilities.

22 Derivative financial instruments

	2009 Group Fair value £m	2009 Group Notional amounts £m	2009 Company Fair value £m	2009 Company Notional amounts £m
Cash flow hedges				
Cross-currency swaps to hedge debt issued under the Debt Issuance Programme	**586**	**2,044**	**–**	**–**
Cross-currency swaps to hedge debt issued under the Medium Term Note Programme	**–**	**–**	**–**	**–**
Interest rate swaps	**10**	**1,122**	**10**	**1,122**
Fair value hedges				
Cross-currency swaps to hedge debt issued under the Debt Issuance Programme	**569**	**2,444**	**–**	**–**
Forward starting cross-currency swaps	**47**	**547**	**–**	**–**
Embedded derivatives in the inter-company borrowings	**–**	**–**	**42**	
Non-hedge accounted derivatives				
Cross-currency swaps to hedge debt issued under the Debt Issuance Programme	**100**	**198**	**–**	**–**
Forward starting real interest rate swaps and gilt locks	**76**	**1,823**	**–**	**–**
Forward starting cross-currency swaps	**10**	**66**	**10**	**66**
	1,398	**8,244**	**62**	**1,188**
Included in non-current assets	**768**	**3,603**	**1**	**6**
Included in current assets	**630**	**4,641**	**61**	**1,182**
Derivative financial instrument assets	**1,398**	**8,244**	**62**	**1,188**
Cash flow hedges				
Interest rate swaps	**(113)**	**1,844**	**(113)**	**1,844**
Forward starting interest rate swaps	**(282)**	**7,000**	**(282)**	**7,000**
Non-hedge accounted derivatives				
Cross-currency swaps to hedge debt issued under the Debt Issuance Programme	**(11)**	**30**	**–**	**–**
Forward starting real interest rate swaps and gilt locks	**(73)**	**2,912**	**–**	**–**
	(479)	**11,786**	**(395)**	**8,844**
Included in current liabilities	**(73)**	**3,290**	**(5)**	**603**
Included in non-current liabilities	**(406)**	**8,496**	**(390)**	**8,241**
Derivative financial instrument liabilities	**(479)**	**11,786**	**(395)**	**8,844**

	2009 Group Fair value £m	2009 Group Notional amounts £m	2008 Group Fair value £m	2008 Group Notional amounts £m
Cash flow hedges				
Cross-currency swaps to hedge debt issued under the Debt Issuance Programme	**586**	**2,044**	(55)	2,029
Cross-currency swaps to hedge debt issued under the Medium Term Note Programme	**–**	**–**	289	1,990
Forward starting interest rate swaps	**(282)**	**7,000**	(4)	1,575
Interest rate swaps	**(103)**	**2,966**	19	1,890
Fair value hedges				
Cross-currency swaps to hedge debt issued under the Debt Issuance Programme	**569**	**2,444**	(22)	1,762
Forward starting cross-currency swaps	**47**	**547**	25	750
Non-hedge accounted derivatives				
Cross-currency swaps to hedge debt issued under the Debt Issuance Programme	**89**	**228**	20	267
Forward starting interest rate swaps	**76**	**1,823**	–	–
Forward starting cross-currency swaps	**10**	**66**	4	61
Forward starting real interest rate swaps and gilt locks	**(73)**	**2,912**	–	–
	919	**20,030**	276	10,324

22 Derivative financial instruments continued

	2009 Company Fair value £m	2009 Company Notional amounts £m	2008 Company Fair value £m	2008 Company Notional amounts £m
Interest rate swaps	**(103)**	**2,966**	19	1,890
Forward starting interest rate swaps	**(282)**	**7,000**	(2)	1,000
Forward starting cross-currency swaps	**10**	**66**	4	61
Embedded derivatives in the inter-company borrowings	**42**	**9,998**	29	7,373
	(333)	**20,030**	50	10,324

23 Provisions: Group and Company

	£m
At 1 April 2007	33
Additional provision in the year	2
Utilisation of provision	(23)
At 1 April 2008	**12**
Additional provision in the year	2
Utilisation of provision	(5)
At 31 March 2009	**9**
Included in current liabilities	9

The Group has provided against a number of commercial claims from third parties included in other provisions for which settlement is expected to be achieved in the next year.

24 Deferred tax

The following are the major deferred tax liabilities and assets recognised by the Group and Company and movement thereon during the current and prior years.

Group	Accelerated tax depreciation £m	Revaluation of railway network £m	Short term timing differences including retirement benefit obligations £m	Derivatives £m	Tax losses £m	Total £m
At 1 April 2007	2,601	1,819	(83)	(29)	(1,873)	2,435
Charge to income	49	–	12	8	325	394
Charge/(credit) to equity	42	(65)	(37)	(4)	–	(64)
At 1 April 2008	**2,692**	**1,754**	**(108)**	**(25)**	**(1,548)**	**2,765**
Charge/(credit) to income	623	–	(4)	3	284	906
Charge/(credit) to equity	–	(31)	(79)	(98)	–	(208)
At 31 March 2009	**3,315**	**1,723**	**(191)**	**(120)**	**(1,264)**	**3,463**

Company	Accelerated tax depreciation £m	Revaluation of railway network £m	Short term timing differences including retirement benefit obligations £m	Derivatives £m	Tax losses £m	Total £m
At 1 April 2007	2,601	1,819	(83)	(32)	(1,870)	2,435
Charge to income	49	–	12	19	320	400
Charge/(credit) to equity	42	(65)	(37)	(7)	–	(67)
At 1 April 2008	**2,692**	**1,754**	**(108)**	**(20)**	**(1,550)**	**2,768**
Charge/(credit) to income	623	–	(4)	–	279	898
Charge/(credit) to equity	–	(31)	(79)	(81)	–	(191)
At 31 March 2009	**3,315**	**1,723**	**(191)**	**(101)**	**(1,271)**	**3,475**

24 Deferred tax continued

Certain deferred tax assets and liabilities have been offset. The following is the analysis of the gross deferred tax balances:

	2009 £m	2008 £m
Deferred tax liabilities	**4,918**	4,446
Deferred tax assets	**(1,455)**	(1,681)
	3,463	2,765

Network Rail Infrastructure Limited has a potential deferred tax asset relating to the disposal of the track bed which is carried at zero in the accounts. It is not possible to determine reliably the tax base of the asset which would be determined by negotiation with HM Revenue and Customs and therefore it has not been possible to reliably quantify the potential deferred tax asset.

25 Obligations under finance leases

	Minimum lease payments		Present value of minimum lease payments	
	2009 Group and Company £m	2008 Group and Company £m	**2009 Group and Company £m**	2008 Group and Company £m
Amounts payable under finance leases:				
Within one year	**–**	1	**–**	–
In the second to fifth years inclusive	**2**	4	**2**	2
After five years	**2**	9	**1**	7
	4	14	**3**	9
Less: future finance charges	**(1)**	(5)	**n/a**	n/a
Present value of lease obligations	**3**	9	**3**	9
Less: amounts repayable within one year (shown under current liabilities)	**–**	–	**–**	–
Amounts repayable after more than one year	**3**	9	**3**	9

The Group leases certain fixtures and fittings under finance leases from third parties. All lease obligations are denominated in sterling. The fair value of the Group's lease obligations approximates their carrying amount. The Group's obligations under finance leases are secured by the lessors' charges over the leased assets. For the year ended 31 March 2009, the effective borrowing rate was 7.4 per cent (2008: 5.1 per cent). Interest rates are fixed at contract date. All leases are on a fixed repayment basis and no arrangements have been entered into for contingent rent payments.

26 Share capital

	2009 Group and Company £m	2008 Group and Company £m
Authorised:		
50,200,000 ordinary shares of 0.1p each	**–**	–
500,000,000 redeemable shares of £1 each	**500**	500
	500	500
Issued and fully paid:		
50,084,937 ordinary shares of 0.1p each	**–**	–
160,000,000 redeemable shares of £1 each	**160**	160
	160	160

The Company has the option to repurchase any or all of the redeemable shares at any date after 31 March 2003. No premium is repayable on such redemption and the option to repurchase has no expiry date. The redeemable shareholders have no right to redemption at their instigation. Redeemable shares do not carry voting rights, or rank for dividend, but may do so if the Company passes a resolution to that effect.

27 Reconciliation of changes in equity

Group	Share capital £m	Share Premium £m	Revaluation Reserve £m	Other Reserve (*) £m	Hedging Reserve £m	Retained Earnings £m	Total £m
At 1 April 2007	**160**	**85**	**4,247**	**1,451**	**(57)**	**(228)**	**5,658**
Impact of change in tax rate	–	–	121	7	(2)	8	134
Revaluation of the railway network	–	–	403	–	–	–	403
Transfer of deemed cost depreciation from revaluation reserve	–	–	(204)	–	–	204	–
Increase in deferred tax liability on the railway network	–	–	(56)	–	–	(57)	(113)
Actuarial losses on defined benefit pension schemes	–	–	–	–	–	(133)	(133)
Deferred tax on actuarial losses	–	–	–	–	–	37	37
Increase in fair value of hedging derivatives	–	–	–	–	370	–	370
Exchange differences on retranslation of foreign currency debt	–	–	–	–	(393)	–	(393)
Deferred taxation on all hedging reserve movements/retained earnings	–	–	–	–	7	–	7
Transfers							
Recycling of balances in hedging reserve to other gains and losses in the income statement	–	–	–	–	4	–	4
Deferred tax on transfers	–	–	–	–	(1)	–	(1)
Net profit for the year	–	–	–	–	–	1,189	1,189
At 31 March 2008	**160**	**85**	**4,511**	**1,458**	**(72)**	**1,020**	**7,162**
Revaluation of the railway network	–	–	(113)	–	–	–	(113)
Transfer of deemed cost depreciation from revaluation reserve	–	–	(182)	–	–	182	–
Increase in deferred tax liability on the railway network	–	–	82	–	–	(51)	31
Actuarial losses on defined benefit pension schemes	–	–	–	–	–	(281)	(281)
Deferred tax on actuarial losses	–	–	–	–	–	79	79
Deferred taxation on all hedging reserve movements/retained earnings	–	–	–	–	98	–	98
Increase in fair value of hedging derivatives	–	–	–	–	44	–	44
Exchange differences on retranslation of foreign currency debt	–	–	–	–	(391)	–	(391)
Transfers							
Recycling of balances in hedging reserve to other gains and losses in the income statement	–	–	–	–	4	–	4
Deferred tax on transfers	–	–	–	–	(1)	–	(1)
Net profit for the year	–	–	–	–	–	609	609
At 31 March 2009	**160**	**85**	**4,298**	**1,458**	**(318)**	**1,558**	**7,241**

27 Reconciliation of changes in equity continued

Company	Share capital £m	Share Premium £m	Revaluation Reserve £m	Other Reserve (*) £m	Hedging Reserve £m	Retained Earnings £m	Total £m
At 1 April 2007	**160**	**85**	**4,247**	**1,451**	**(33)**	**(264)**	**5,646**
Impact of change in tax rate	–	–	121	7	(1)	8	135
Revaluation of the railway network	–	–	403	–	–	–	403
Transfer of deemed cost depreciation from revaluation reserve	–	–	(204)	–	–	204	–
Increase in deferred tax liability on the railway network	–	–	(56)	–	–	(57)	(113)
Actuarial losses on defined benefit pension schemes	–	–	–	–	–	(133)	(133)
Deferred tax on actuarial losses	–	–	–	–	–	37	37
Deferred taxation on all hedging reserve movements/retained earnings	–	–	–	–	(32)	–	(32)
Decrease in fair value of hedging derivatives	–	–	–	–	9	–	9
Transfers							
Recycling of balances in hedging reserve to other gains and losses in the income statement	–	–	–	–	4	–	4
Deferred tax on transfers	–	–	–	–	(1)	–	(1)
Net profit for the year						1,212	1,212
At 31 March 2008	**160**	**85**	**4,511**	**1,458**	**(54)**	**1,007**	**7,167**
Revaluation of the railway network	–	–	(113)	–	–	–	(113)
Transfer of deemed cost depreciation from revaluation reserve	–	–	(182)	–	–	182	–
Increase in deferred tax liability on the railway network	–	–	82	–	–	(51)	31
Actuarial losses on defined benefit pension schemes	–	–	–	–	–	(281)	(281)
Deferred tax on actuarial losses	–	–	–	–	–	79	79
Deferred taxation on all hedging reserve movements/retained earnings	–	–	–	–	82	–	82
Decrease in fair value of hedging derivatives	–	–	–	–	(291)	–	(291)
Transfers							
Recycling of balances in hedging reserve to other gains and losses in the income statement	–	–	–	–	4	–	4
Deferred tax on transfers	–	–	–	–	(1)	–	(1)
Net profit for the year	–	–	–	–	–	593	593
At 31 March 2009	**160**	**85**	**4,298**	**1,458**	**(260)**	**1,529**	**7,270**

* Other reserves of £1,458m (2008: £1,458m) include the vesting reserve on privatisation.

28 Notes to the cash flow statement

	2009 Group £m	2008 Group £m	**2009 Company £m**	2008 Company £m
Operating profit from operations	**2,544**	2,412	**2,533**	2,408
Adjustments for:				
Depreciation of the railway network	**1,198**	1,195	**1,198**	1,195
Amortisation of capital grants	**(45)**	(36)	**(45)**	(36)
Amortisation of intangible assets	**1**	1	**–**	–
Decrease in provisions	**(3)**	(21)	**(3)**	(21)
Operating cash flows before movements in working capital	**3,695**	3,551	**3,683**	3,546
Increase in inventories	**(24)**	(15)	**(24)**	(15)
Increase in receivables	**(85)**	(10)	**(166)**	(201)
Increase/(decrease) in payables	**138**	(202)	**254**	(76)
Cash generated from operations	**3,724**	3,324	**3,747**	3,254
Income taxes paid	**(9)**	(4)	**(9)**	(4)
Interest paid	**(904)**	(886)	**(888)**	(764)
Net cash generated from operating activities	**2,811**	2,434	**2,850**	2,486

Cash and cash equivalents

Cash and cash equivalents (which are represented as a single class of assets on the face of the Balance sheet) comprise cash at bank, collateral and money market deposit investments, all of which are on call with the exception of £58m of short term deposits with an average term of six days from the Balance sheet date. In 2008/09 cash and money market deposits had an average maturity of 29 days from the Balance sheet date.

29 Analysis of changes in net debt

	At 1 April 2008 £m	Cash flows £m	Non cash movements £m	Capital accretion £m	Amortisation of discount £m	Fair value remeasurements £m	Foreign exchange movements £m	**At 31 March 2009 £m**
Cash and cash equivalents*	543	118	–	–	–	–	–	**661**
Borrowings due within one year	(5,077)	4,853	(1,061)	–	(5)	(235)	(248)	**(1,773)**
Borrowings due after one year	(15,255)	(6,374)	1,061	(54)	(10)	(417)	(143)	**(21,192)**
Obligations under finance leases	(9)	6	–	–	–	–	–	**(3)**
Financial investments	55	(55)	–	–	–	–	–	**–**
	(19,743)	**(1,452)**	**–**	**(54)**	**(15)**	**(652)**	**(391)**	**(22,307)**

	At 1 April 2007 £m	Cash flows £m	Non cash movements £m	Capital accretion £m	Amortisation of discount £m	Fair value remeasurements £m	Foreign exchange movements £m	At 31 March 2008 £m
Cash and cash equivalents	193	350	–	–	–	–	–	543
Borrowings due within one year	(2,862)	2,914	(4,746)	–	(20)	(1)	(362)	(5,077)
Borrowings due after one year	(15,715)	(3,944)	4,746	(151)	(18)	(142)	(31)	(15,255)
Obligations under finance leases	(10)	1	–	–	–	–	–	(9)
Financial investments	–	53	–	–	1	–	1	55
	(18,394)	(626)	–	(151)	(37)	(143)	(392)	(19,743)

* Excludes collateral held of £1,062m (2008: £nil).

30 Operating lease arrangements

The Group and Company as lessee

	2009 Group £m	2008 Group £m	2009 Company £m	2008 Company £m
Minimum lease payments under operating leases recognised in income statement in the year	**62**	49	**62**	49

At the Balance sheet date, the Group and Company had outstanding commitments for future minimum lease payments under non-cancellable operating leases, which fall due as follows:

	2009 Group £m	2008 Group £m	2009 Company £m	2008 Company £m
Within one year	**33**	49	**33**	49
In the second to fifth years inclusive	**62**	103	**62**	103
After five years	**62**	42	**62**	42
	157	194	**157**	194

Operating lease payments largely represent rentals payable by the Group and Company for certain of its office properties. Leases are negotiated for an average term of seven years and rentals fixed for an average of three years. In addition rentals are paid for land adjacent to the railway as required for maintenance and renewal activities.

The Group and Company as lessor

Operating lease rentals earned in the year by the Group and Company was £551m (2008: £542m). The majority of this income is earned from station and depot leases to train operating companies. Further rentals are earned from investment properties, other station lettings, advertising, telecoms and rail contractors.

At the Balance sheet date, the Group and Company had contracted with customers for the following future minimum lease payments:

	2009 Group £m	2008 Group £m	2009 Company £m	2008 Company £m
Within one year	**442**	409	**442**	409
In the second to fifth years inclusive	**1,148**	1,162	**1,148**	1,162
After five years	**1,365**	1,459	**1,365**	1,459
	2,955	3,030	**2,955**	3,030

31 Funding and financial risk management

Introduction

The Company's ultimate parent company is Network Rail Limited, a company limited by guarantee without shareholders. The Group is almost entirely debt funded. Debt is issued through special purpose financing companies (Network Rail Infrastructure Finance PLC and Network Rail MTN PLC) which are not members of the Network Rail Limited Group but are treated as subsidiaries for accounting purposes. The majority of the Group's debt is issued by Network Rail Infrastructure Finance PLC under the Debt Issuance Programme (DIP) which has been highly rated (AAA by Standard and Poors, Aaa by Moody's and AAA by Fitch). The DIP is supported by a financial indemnity from the Secretary of State for Transport which expires in 2052.

The DIP allows access, through a single platform, to the widest possible sources of funding, at the lowest possible cost, including the long term capital markets. This gives Network Rail a stable base for funding a continuing programme of long term investments in the national rail network. Debt is issued in a number of currencies and a range of maturities which gives rise to interest rate, foreign currency and inflation risk. Financial risk management aims to mitigate these risks (see below).

Externally imposed capital requirements

The Regulatory Asset Base (RAB) is the regulator's valuation of Network Rail's assets. This is an important business ratio because the value of the RAB and the amount of debt that the business can sustain are, generally speaking, closely related: Network Rail's debts cannot exceed the value of the RAB; a debt to RAB ratio of significantly less than 100 per cent indicates that the business is more robust to future cost shocks (because it is more likely to be able to sustain the additional debt that would arise from any losses incurred).

The Company owns and operates Britain's rail network under license from the Office of Rail Regulation (ORR). The license imposes conditions on the Company with regard to its net debt. Should the value of the Company's qualifying net debt exceed 85 per cent of the ORR's RAB then the ORR will be formally notified.

The Company's debt to RAB ratio at 31 March 2009 and 2008 were as follows:

	2009	2008
Debt: RAB ratio	**70.0%**	69.4%

31 Funding and financial risk management continued

Significant accounting policies

Details of the significant accounting policies and methods adopted, including the criteria for recognition, the basis of measurement and the basis on which income and expenses are recognised, in respect of each class of financial asset, financial liability and equity instrument are disclosed in Note 2 to the financial statements.

Summary table of financial assets and liabilities

The following table presents the carrying amounts and the fair values of the Group's and Company's financial assets and liabilities at 31 March 2009 and 31 March 2008.

The fair values of the financial assets and liabilities are included at the amount at which the instrument could be exchanged for in a current transaction between willing parties, other than in a forced or liquidation sale. The following methods and assumptions were used to estimate the fair values:

- cash and cash equivalents – approximates to the carrying amount
- working capital facility – approximates to the carrying value because of short maturity of these instruments
- bank loans and overdraft – based on market data at the Balance sheet date and the net present value of discounted cash flows
- bonds issued under the Debt Issuance Programme – based on market data at the Balance sheet date. Where market data is not
- available valuations obtained from dealing banks
- debt issued under Medium Term Note Programme – based on market data at the Balance sheet date
- loans and receivables and payables – approximates to the carrying value
- lease receivables/obligations – approximates to the carrying value
- derivatives – based on market data at the Balance sheet date.

Group	2009 Carrying value £m	2009 Fair value £m	2008 Carrying value £m	2008 Fair value £m
Financial assets				
Cash and cash equivalents	**1,723**	**1,723**	543	543
Other non-derivative financial assets				
Loan to immediate parent company	**388**	**388**	368	368
Finance lease receivables	**13**	**13**	15	15
Held-to-maturity investments	**–**	**–**	8	8
Available-for-sale financial assets	**–**	**–**	47	47
Trade and other receivables	**533**	**533**	590	590
Derivatives				
Derivatives designated as cash flow hedging instruments	**596**	**596**	332	332
Derivatives designated as fair value hedging instruments	**616**	**616**	47	47
Other derivatives	**186**	**186**	26	26
Total derivatives	**1,398**	**1,398**	405	405
Total financial assets	**4,055**	**4,055**	1,976	1,976
Financial Liabilities				
Financial liabilities held at amortised cost				
Obligations under finance leases	**(3)**	**(3)**	(9)	(9)
Working capital facility	**(185)**	**(185)**	(200)	(200)
Bank loans and overdrafts	**(1,311)**	**(1,425)**	(1,398)	(1,464)
Bonds issued under the Debt Issuance Programme*	**(18,107)**	**(18,693)**	(13,254)	(13,743)
Debt issued under Medium Term Note Programme*	**–**	**–**	(4,072)	(4,065)
Financial liabilities designated as fair value through profit and loss				
Bonds issued under the Debt Issuance Programme*	**(3,362)**	**(3,362)**	(1,408)	(1,408)
Total borrowing	**(22,968)**	**(23,668)**	(20,341)	(20,889)
Trade and other payables	**(3,800)**	**(3,800)**	(2,502)	(2,502)
Derivatives				
Derivatives designated as cash flow hedging instruments	**(395)**	**(395)**	(83)	(83)
Derivatives designated as fair value hedging instruments	**–**	**–**	(44)	(44)
Other derivatives	**(84)**	**(84)**	(2)	(2)
Total derivatives	**(479)**	**(479)**	(129)	(129)
Total financial liabilities	**(27,247)**	**(27,947)**	(22,972)	(23,520)

* Amounts are shown net of unamortised discount and fees.

31 Funding and financial risk management continued

Company	2009 Carrying value £m	2009 Fair value £m	2008 Carrying value £m	2008 Fair value £m
Financial assets				
Other non-derivative financial assets				
Loan to immediate parent company	**388**	**388**	368	368
Loan to other Group company	**–**	**–**	91	91
Finance lease receivables	**13**	**13**	15	15
Trade and other receivables	**738**	**738**	716	716
Derivatives				
Derivatives designated as cash flow hedging instruments	**10**	**10**	19	19
Derivatives designated as fair value hedging instruments	**42**	**42**	51	51
Other derivatives	**10**	**10**	4	4
Total derivatives	**62**	**62**	74	74
Total financial assets	**1,201**	**1,201**	1,264	1,264
Financial Liabilities				
Financial liabilities held at amortised cost				
Obligations under finance leases	**(3)**	**(3)**	(9)	(9)
Bank loans and overdrafts	**(346)**	**(346)**	(349)	(349)
Loans from subsidiaries*	**(20,803)**	**(20,803)**	(19,290)	(19,290)
Total borrowing	**(21,152)**	**(21,152)**	(19,648)	(19,648)
Trade and other payables	**(2,770)**	**(2,770)**	(2,537)	(2,537)
Derivatives				
Derivatives designated as cash flow hedging instruments	**(395)**	**(395)**	(2)	(2)
Derivatives designated as fair value hedging instruments	**–**	**–**	(22)	(22)
Total derivatives	**(395)**	**(395)**	(24)	(24)
Total financial liabilities	**(24,317)**	**(24,317)**	(22,209)	(22,209)

* Amounts are shown net of unamortised discount and fees.

Derivatives

The Group and Company use derivative financial instruments to reduce exposure to foreign exchange risk and interest rate movements. The Group and Company do not use derivative financial instruments for speculative purposes. Certain derivatives are designated as hedges, and those derivatives that are not hedge accounted are fair valued immediately through the Income statement. The Group and Company has a comprehensive risk management process.

The Board of Network Rail Limited (the ultimate parent company of NRIL) through a treasury sub-committee (the Treasury Committee) have approved and monitor the risk management processes, including documented treasury policies, counterparty limits, controlling and reporting structures.

The use of derivative instruments can give rise to credit and market risk. Market risk is the possibility that future changes in foreign exchange rates and interest rates may make a derivative more or less valuable. Since the Group and Company use derivatives for risk management, market risk relating to derivative instruments will principally be offset by changes in the valuation of the underlying assets, liabilities or transactions being hedged.

Credit risk

The credit risk for all classes of derivative financial instruments and other funds is limited because counterparties are banks with high credit ratings assigned by international credit-rating agencies. The Treasury Committee authorises the policy for setting counterparty limits based on credit ratings. The Group and Company spreads its exposure over a number of counterparties, and have strict policies on how much exposure can be assigned to each counterparty. The concentration and amount of the Group's investments varies depending on the level of surplus liquidity the Group chooses to hold at any point in time. However, because of the strict criteria governing counterparty suitability the risk is mitigated. The Treasury Committee also authorises the investment and borrowing instruments that can be used.

For debt designated as fair value through profit and loss there has been no change as a result of credit risk changes. The losses in the Income statement arising from the re-measurement of FVTPL debt items of £83m (2008: £32m) are all attributable to changes in market risk.

The credit risk with regard to all classes of derivative financial instruments is limited because Network Rail has arrangements in place which limit each bank to a threshold (based on credit ratings), which if breached requires the bank to post cash collateral. The thresholds were reviewed by the Treasury Committee in the year and the banking group are required to post collateral on positive mark to market swaps. At 31 March 2009 the fair value of collateral held was £1,062m (2008: £nil). The Group is the beneficial owner of this collateral. The Group is free to invest or otherwise utilise the collateral at its discretion, subject to acting within the authority sanctioned by the treasury committee.

31 Funding and financial risk management continued

Receivables consist of a small number of counterparties. The Group does not have any significant credit risk exposure to any single counterparty and has considered the creditworthiness of debtors. For further detail on the creditworthiness of customers and suppliers, see Notes 19 (Trade and other receivables) and 20 (Trade and other payables).

Foreign exchange risk

Network Rail is exposed to currency risks from its investing, financing and operating activities. Foreign exchange risk for all currencies is managed by the use of forward exchange contracts, and currency swaps to limit the effects of movements in exchange rates on foreign currency denominated liabilities.

It is estimated that a general increase of ten percentage points in the value of any currency against sterling would have no material effect on the Group or Company's profit before tax or equity due to all currency positions being 100 per cent hedged.

Interest rate risk

The Group and Company is exposed to changes in interest rates as funds are borrowed at both fixed and floating interest rates. The hedging strategy approved by the Treasury Committee defines the appropriate mix between fixed and floating borrowings. Cross-currency and interest rate swap contracts are used to manage the fixed/floating ratio.

Debt with a carrying value of £22,311m (2008: £20,092m) is arranged at or swapped into fixed interest rates and exposes the Group to fair value interest rate risk. Other borrowings were arranged at floating rates, thus exposing the Group to cash flow interest rate risk.

The maturity of interest rate swaps is shown in the derivative maturity table on page 92.

The Group and Company have £7bn of forward starting interest rate swaps which hedge Control Period 4. The average rate on these swaps is 5.03 per cent. The Group also has £325m of real rate swaps with an average rate of deflation of 0.28 per cent and £4,410m of gilt locks with an average rate of inflation of 1.10 per cent.

The sensitivity analysis below have been determined based on the exposure to interest rates for both derivative and non-derivative instruments at the Balance sheet date. A 1 per cent increase or decrease represents management's assessment of the reasonably possible changes in average interest rates.

Sensitivity analysis

If average interest rates had been 1 per cent higher and all other variables were held constant, the Group's profit before tax for the year ended 31 March 2009 would increase by £10m (2008: decrease of £10m) comprised of increased finance costs on the Group's debt of £6m (2008: £6m) and increased interest receivable on the Group's cash balances of £16m (2008: decrease of £14m).

If average interest rates had been 1 per cent higher and all other variables were held constant, the Company's profit before tax for the year ended 31 March 2009 would decrease by £6m (2008: £5m) due to increased finance costs on the Group's debt.

The Group and Company's sensitivity to interest rates has decreased during the period as all new long term debt raised in the year were issued at fixed or inflation-linked interest rates.

Inflation rate risk

The Group and Company have certain debt issuances which are index-linked and so are exposed to movements in inflation rates. The Group and Company do not enter into any derivative arrangements to hedge its exposure to inflation in relation to its index-linked debt, but rather to mitigate the effects of inflation on the Group's retail price index-linked revenue streams.

The sensitivity analysis below have been determined based on the exposure to inflation rates for both derivative and non-derivative instruments at the Balance sheet date. A 1 per cent increase or decrease represents management's assessment of the reasonably possible changes in inflation rates.

Sensitivity analysis

If RPI had been 1 per cent higher and all other variables were held constant, the Group's finance costs for the year ended 31 March 2009 would increase by £69m (2008: £52m) and other than a corresponding movement in the profit and loss reserve there would be no impact upon equity.

If RPI had been 1 per cent higher and all other variables were held constant, the Company's finance costs for the year ended 31 March 2009 would increase by £69m (2008: £52m) and other than a corresponding movement in the profit and loss reserve there would be no impact upon equity.

The Group and Company's sensitivity to inflation rates has increased during the period due to further issuances of index-linked debt instruments.

The Group and Company believes that the above analysis is unrepresentative of the risks inherent in issuing index-linked debt. Franchised track access and grant income constitute £5,799m (2008: £5,584m) of revenue which is far in excess of an index-linked interest expense of £64m (2008: £137m). Currently, these sources of income are contractually index-linked and whilst there is no absolute contractual guarantee for future regulatory control periods that this will continue the Group and Company are highly confident that this will remain to be the case. Therefore, the natural hedge that exists between finance costs and revenue mitigates the risk of Retail Price Index movements.

31 Funding and financial risk management continued

Embedded derivatives

The obligations and rights of Network Rail Infrastructure Limited under the inter-company loan agreement with its financing companies give rise to embedded derivatives in that agreement which reflects the external currency and interest rates risks to which the financing companies are exposed. The embedded derivatives are treated as separate derivatives and accounted for in accordance with the accounting policy disclosed in Note 2.

Liquidity risk management

The ultimate responsibility for liquidity risk management rests with the Board of Directors. The policy manual ratified by the Treasury Committee includes an appropriate liquidity risk management framework covering the Group's short, medium and long term funding and liquidity management requirements. Treasury is subject to regular internal audits. Group policy is to ensure that there are sufficient facilities and short term investments to cover, as a minimum, the next 12 months' funding requirements. Treasury ensures sufficient liquidity is available to meet the Group and Company's needs, while reducing financial risks and prudently maximising interest receivable and credit risk on surplus cash.

The Group manages liquidity risk by maintaining sufficient banking facilities to cover at lease one year's working capital requirement by continuously monitoring forecast and actual cash flows and matching maturity profiles of financial assets and liabilities. Included in Note 21 is a description of additional undrawn facilities that the Group has at its disposal to further reduce liquidity risk.

The following table details the Group and Company's remaining contractual maturity for its financial liabilities. The table has been drawn up on the undiscounted cash flows of financial liabilities based on the earliest date on which the Group or Company can be required to pay and, therefore, differs from both the carrying value and the fair value. The table includes both interest and principal cash flows.

Group	Within 1 year £m	1-2 years £m	2-5 years £m	5+ years £m	**Total £m**
31 March 2009					
Sterling denominated DIP bonds	327	1,277	1,748	7,824	**11,176**
Sterling denominated index-linked bonds	124	127	404	22,773	**23,428**
Effect of interest rate swaps on sterling denominated bonds	7	–	–	20	**27**
	131	127	404	22,793	**23,455**
Foreign currency denominated bonds	1,808	1,261	2,601	1,359	**7,029**
Effect of foreign currency swaps on foreign currency denominated bonds	(399)	(783)	(458)	(437)	**(2,077)**
	1,409	478	2,143	922	**4,952**
Bank loans and overdrafts	54	155	623	1,436	**2,268**
Effect of interest rate swaps on bank loans and overdrafts	1	–	–	–	**1**
	55	155	623	1,436	**2,269**
Working capital facility	189	–	–	–	**189**
Finance lease liabilities	–	–	1	2	**3**
Trade and other payables	3,373	125	–	–	**3,498**
	5,484	**2,162**	**4,919**	**32,977**	**45,542**
Effect of discount/financing costs/derivatives	(338)	122	(1,112)	(17,751)	**(19,079)**
	5,146	**2,284**	**3,807**	**15,226**	**26,463**

Company	Within 1 year £m	1-2 years £m	2-5 years £m	5+ years £m	**Total £m**
31 March 2009					
Inter-company loan	2,055	2,538	4,827	32,757	**42,177**
Effect of embedded derivatives on inter-company loan	(42)	–	–	–	**(42)**
	2,013	2,538	4,827	32,757	**42,135**
Bank loans and overdrafts	15	16	48	373	**452**
Finance lease liabilities	–	–	1	2	**3**
Trade and other payables	2,386	126	–	–	**2,512**
	4,414	**2,680**	**4,876**	**33,132**	**45,102**
Effect of discount/financing costs/derivatives	(637)	(837)	(1,540)	(18,427)	**(21,441)**
	3,777	**1,843**	**3,336**	**14,705**	**23,661**

31 Funding and financial risk management continued

Liquidity risk management continued

Group	Within 1 year £m	1-2 years £m	2-5 years £m	5+ years £m	Total £m
31 March 2008					
Sterling denominated DIP bonds	339	287	1,720	8,348	10,694
Sterling denominated index-linked bonds	66	68	219	12,695	13,048
Foreign currency denominated bonds	831	1,283	1,634	1,180	4,928
Effect of foreign currency swaps on foreign currency denominated bonds	93	70	32	(235)	(40)
	924	1,353	1,666	945	4,888
Medium Term Notes	4,412	–	–	–	4,412
Effect of foreign currency swaps on Medium Term Notes	(285)	–	–	–	(285)
	4,127	–	–	–	4,127
Bank loans and overdrafts	147	56	548	1,757	2,508
Effect of interest rate swaps on bank loans and overdrafts	–	–	–	1	1
	147	56	548	1,758	2,509
Working capital facility	221	–	–	–	221
Finance lease liabilities	1	1	3	9	14
Trade and other payables	2,136	114	–	–	2,250
	7,961	1,879	4,156	23,755	37,751
Effect of discount/financing costs/derivatives	(748)	(607)	(1,371)	(12,434)	(15,160)
	7,213	1,272	2,785	11,321	22,591

Company	Within 1 year £m	1-2 years £m	2-5 years £m	5+ years £m	Total £m
31 March 2008					
Inter-company loan	5,781	1,732	4,085	23,515	35,113
Effect of embedded derivatives on inter-company loan	(29)	–	–	–	(29)
	5,752	1,732	4,085	23,515	35,084
Bank loans and overdrafts	36	16	50	395	497
Finance lease liabilities	1	1	3	9	14
Trade and other payables	2,224	114	–	–	2,338
	8,013	1,863	4,138	23,919	37,933
Effect of discount/financing costs/derivatives	(1,470)	(561)	(1,374)	(12,635)	(16,040)
	6,543	1,302	2,764	11,284	21,893

31 Funding and financial risk management continued

Cash flow hedges

The following table shows the contractual maturities of payments under cash flow hedges for the Group and Company:

Cash flow hedging reserve	2009 Group £m	2009 Company £m	2008 Group £m	2008 Company £m
Less than one year	**73**	**6**	24	15
One to two years	**(204)**	**–**	3	2
Two to five years	**(197)**	**4**	2	(9)
More than five years	**280**	**280**	43	46
	(48)	**290**	72	54

Borrowings

Details of the Group's undrawn committed facilities and types of debt instrument used can be found in Note 21.

Hedge ineffectiveness

At 31 March 2009 the Group has recognised £88m (2008: £13m) of ineffectiveness arising from the Groups' cash flow hedges in the Income statement.

Derivative maturity

The interest rate and foreign exchange derivatives have the following maturities:

	2009 Group		2008 Group	
Group	Fair value £m	Notional amounts £m	Fair value £m	Notional amounts £m
Interest rate derivatives				
Less than one year	**12**	**6,135**	(2)	1,825
One to five years	**(48)**	**658**	17	1,640
More than five years	**(345)**	**7,908**	–	–
	(381)	**14,701**	15	3,465
Foreign exchange derivatives				
Less than one year	**547**	**1,802**	240	2,914
One to five years	**494**	**2,718**	(17)	3,075
More than five years	**260**	**809**	38	870
	1,301	**5,329**	261	6,859

32 Retirement benefit scheme

Defined contribution schemes

With effect from 1 April 2004 the Company introduced a defined contribution pension scheme, the Network Rail Defined Contribution Pension Scheme (NRDCPS). This scheme is the only Company-sponsored pension offered to all new employees of Network Rail, except those who have the legal right to join the Railway Pension Scheme (RPS). Any employee who wishes to transfer from the Network Rail Section to the NRDCPS is entitled to do so.

At 31 March 2009, the NRDCPS has 10,418 members (2008: 10,163) and the average employer contribution rate in the year was 5.9 per cent (2008: 5.7 per cent).

Defined benefit schemes

The principal pension scheme in which the Group participates is the Railway Pension Scheme (RPS), which was established by statutory instrument, commenced on 1 October 1994 and is a funded defined benefit arrangement. The assets and liabilities under the predecessor scheme, the British Rail Pension Scheme (BRPS), were transferred to the RPS on that date. The RPS is an industry-wide scheme for all eligible employees within the railway industry. There are different sections within it for different employers. The assets and liabilities of each section are identified separately from those of the other sections. The Group has its own section, the Network Rail Shared Cost Section. This scheme, the assets of which are held separately from the Group, is contributory and provides pensions related to pay at retirement.

The assets transferred to the RPS from the BRPS on 1 October 1994 were apportioned amongst the various sections of the RPS in accordance with the methods and assumptions specified in The Railways Pensions (Transfer and Miscellaneous Provisions) Order 1994 (the Transfer Order) which effected the transfer. The amount credited to the Network Rail Section included a share of the surplus at that time.

Since 1 April 2004, new members can only join the Network Rail Section of the RPS after completing five years' service. Benefits for existing members and employees joining up to and including 31 March 2004 were not affected by the revised eligibility rules of the Network Rail Section. In addition to closing the scheme to new entrants the Company announced its decision to cap its contribution to British Railways Additional Superannuation Scheme (BRASS) matching at current levels for existing employees and to dispense with matching for new employees. The Company will continue to match regular contributions but will not increase them in cash terms in the future.

On 1 November 2008 Network Rail launched a third defined benefit scheme – the Career Average Revalued Earnings (CARE) Scheme, which is available to all employees. The CARE Scheme will run alongside the existing RPS and NRDC schemes.

Qualified actuaries Watson Wyatt have valued the schemes on an IAS 19 basis at 31 March 2009 and 31 March 2008.

The total contribution rate payable under the RPS and the CARE scheme is normally split in the proportion 60:40 between the Group and the members. The Group reflects its share of the contribution in the financial statements.

The Group and members pay contributions of 17.0 per cent (2008: 16.2 per cent) and 11.4 per cent (2008: 10.8 per cent) of section pay respectively as at 31 March 2009 to RPS. The equivalent rates for the CARE Scheme are 10.8 per cent and 7.2 per cent.

If a surplus or deficit arises, the provisions in the rules mean that the Group and members benefit from or pay for this respectively in the proportion 60:40.

	2009 %	2008 %
Key assumptions used:		
Discount rate	**6.70**	6.90
Expected return on equity assets	**8.10**	8.50
Expected return on bond assets	**3.40**	4.10
Expected return on property assets	**5.80**	6.30
Expected rate of price inflation	**3.20**	3.70
Future earnings increases*	**4.70**	5.20
Future pension increases	**3.20**	3.70

* Inclusive of a promotional salary scale of 0.5 per cent per annum.

32 Retirement benefit scheme continued

Defined benefit schemes continued

	2009 Males	2009 Females	2008 Males	2008 Females
Average life expectancy for mortality tables used to determine defined benefit obligations:				
Member aged 65 now (pension under £8,500 pa or pensionable pay under £30,000 pa)	**19.8**	**21.7**	20.5	23.2
Member aged 65 now (others)	**21.5**	**22.7**	20.5	23.2
Member aged 65 in 20 years' time (pension under £8,500 pa or pensionable pay under £30,000 pa)	**22.2**	**23.2**	24.4	27.0
Member aged 65 in 20 years' time (others)	**23.7**	**24.2**	24.4	27.0

Amounts recognised in income in respect of the Group's pension arrangements are as follows:

	2009 £m	2008 £m
Current service cost	**120**	126
Interest cost	**153**	116
Expected return on scheme assets	**(138)**	(135)
Past service costs	**–**	–
	135	107

The current service cost has been included in employee costs, the expected return on scheme assets less interest on liabilities has been included in finance costs.

Amounts recognised in the Statement of recognised income and expense in respect of the Group's pension arrangements are as follows:

	2009 £m	2008 £m
Gain on Defined Benefit Obligation	**(350)**	(95)
Loss on scheme assets	**631**	228
Total loss recognised in the Statement of recognised income and expenditure	**281**	133

The amount included in the Balance sheet arising from the Group's obligations in respect of its defined benefit schemes is as follows:

	2009 £m	2008 £m
The defined benefit obligation is made up as follows:		
Active members	**(2,242)**	(2,550)
Deferred pensioner members	**(242)**	(282)
Retired members	**(833)**	(740)
Present value of defined benefit obligation	**(3,317)**	(3,572)
Fair value of scheme assets	**2,211**	2,955
Deficit in the scheme	**(1,106)**	(617)
Company's share (60%) of the scheme deficit recognised in the Balance sheet	**(664)**	(370)

This amount is presented in the Balance sheet as follows:

	2009 £m	2008 £m
Included in non-current liabilities	**(664)**	(370)
	(664)	(370)

Cumulative gains or losses are recognised in equity.

32 Retirement benefit scheme continued

Defined benefit schemes continued

Movements in the present value of defined benefit obligations (including members' share) in the current year were as follows:

	2009 £m	2008 £m
At 1 April	**(3,572)**	(3,424)
Current service cost including members' share	**(183)**	(194)
Interest cost	**(254)**	(193)
Actual benefit payments	**104**	75
Actuarial gains	**588**	164
Past service cost		–
At 31 March	**(3,317)**	(3,572)

Movements in the present value of fair value of scheme assets in the current year were as follows:

	2009 £m	2008 £m
At 1 April	**2,955**	3,010
Expected return on scheme assets	**231**	225
Actuarial gains and losses	**(1,051)**	(380)
Contributions from scheme members	**58**	57
Contributions from employer	**122**	118
Actual benefit payments	**(104)**	(75)
At 31 March	**2,211**	2,955

The analysis of the scheme assets and the expected rate of return at the Balance sheet date was as follows:

	Expected return		Fair value of assets		Percentage of assets	
	2009 %	2008 %	**2009 £m**	2008 £m	**2009 %**	2008 %
Equity instruments	**8.10**	8.50	**1,675**	2,266	**75.76**	76.68
Debt instruments	**3.40**	4.10	**305**	388	**13.79**	13.13
Property	**5.80**	6.30	**225**	291	**10.18**	9.85
Other	**4.00**	4.70	**6**	10	**0.27**	0.34
			2,211	2,955		

The expected return on assets assumption was determined as the average of the expected returns on the assets held on the accounting date. The rates of return for each class are set out in the table above and were determined as follows:

- equities and property: The rate adopted is consistent with the median assumption used in Watson Wyatt's Asset Liability Modelling work
- bonds: The overall rate has been set to reflect the yields on the bond holdings
- other assets: This class is mostly made up of cash holdings and the rate adopted reflects short term returns on such deposits.

32 Retirement benefit scheme continued

Actuarial assumption sensitivity

The discount rate is set by reference to market conditions at the reporting date, and can vary significantly between periods.

The mortality assumptions used are set by considering the experience of the scheme's members, and by making an allowance for possible future improvements in longevity. Mortality assumptions are difficult to set accurately, and forecasting rates of future mortality improvement is inevitably speculative.

The following table shows the effect of changes in these assumptions upon the defined benefit obligation:

	2009 £m	2008 £m
Discount rate		
Change in defined benefit obligation at year end from a 25 basis points increase	**153**	156
Change in defined benefit obligation at year end from a 25 basis points decrease	**161**	164
Mortality		
Change in defined benefit obligation from a one year increase in longevity	**80**	71
Change in defined benefit obligation from a one year decrease in longevity	**83**	77

The history of experience adjustments is as follows:

	2009 £m	2008 £m	2007 £m	2006 £m	2005 £m
Present value of defined benefit obligations	**(3,317)**	(3,572)	(3,424)	(3,234)	(2,527)
Fair value of scheme assets	**2,211**	2,955	3,010	2,635	1,849
Deficit in the scheme	**(1,106)**	(617)	(414)	(599)	(678)
Company's share (60%) of the scheme deficit recognised in the Balance sheet	**(664)**	(370)	(248)	(359)	(414)
Experience adjustments on scheme liabilities					
Amount (£m)	**151**	(114)	(14)	(67)	(217)
Percentage of scheme liabilities	**4.55%**	3.19%	0.41%	2.07%	8.59%
Experience adjustments on scheme assets					
Amount (£m)	**(631)**	(222)	52	229	79
Percentage of scheme assets	**(28.54)%**	(7.51)%	1.73%	8.69%	4.27%

The estimated amounts of contributions expected to be paid by the Group and members to the scheme during the year ended 31 March 2010 are £140m and £76m.

33 Related party transactions

Transactions between the Company and its subsidiaries, which are related parties, have been eliminated on consolidation and are not disclosed in this note.

The Company considers its key management personnel to be its directors. Details of their remuneration can be found in the Directors' remuneration report (see page 26).

The Company's ultimate parent company and controlling entity is Network Rail Limited, a company limited by guarantee without shares. The Company's immediate parent company is Network Rail Holdco Limited. Both parent companies are incorporated in Great Britain and registered in England and Wales. The largest group of undertakings of which the Company is a member and for which Group accounts are drawn up is Network Rail Limited. Copies of the parent companies' financial statements can be obtained by contacting the Company Secretary at Kings Place, 90 York Way, London, N1 9AG.

Company information

Calendar 2009/10

5 February 2009	Network Rail accepted ORR's Determination for Control Period 4 Access Review
31 March 2009	Year End
31 March 2009	Publication of Control Period 4 Delivery Plans
3 June 2009	Preliminary results announcement for full year to 31 March 2009
22 July 2009	Annual General Meeting of Network Rail Limited
November 2009	Results for half-year announcement to 30 September 2009
31 March 2010	Year End

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Produced at a mill accredited with the ISO14001 standard
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CDS011/June 2009