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Dear Ms Reed and Mr Edwards

Approval of a connection contract at New Cross Gate

Introduction

1. On 20 July 2011, the Office of Rail Regulation approved under section 18 of the Railways Act 1993 (the Act) the terms of a track connection contract between Network Rail Infrastructure Limited (Network Rail) and Rail for London Limited (RfL). Following the issue of directions by ORR, the parties entered into this contract on 28 July 2011.

2. The approved contract sets out the rights and obligations of the parties in respect of the maintenance of the connection at New Cross Gate between Network Rail's network and the East London Railway owned by RfL. This letter sets out the reasons for our decision.

Background

3. We held a number of pre-application discussions with the parties prior to the submission of their application. During these discussions, it was recognised that the model connection contract that we had published in 2005¹ had been developed primarily with freight and heritage connections in mind. As the connection at New Cross Gate would be between two busy passenger networks over which at least eight trains per hour in each direction would be operating (these being London Overground services), the parties

¹ *Model Connection Contract – final conclusions*, July 2005, available at <http://www.rail-reg.gov.uk/upload/pdf/242.pdf>.



considered that a number of changes would be required to the model connection contract to ensure it reflected the particular circumstances of the connection. We agreed that some departures from the model contract would be appropriate and necessary and the parties developed a bespoke contract to reflect this.

4. In December 2009, the parties submitted a proposed connection contract to us seeking approval under section 18 of the Act. This followed an industry consultation by Network Rail to which there had been no material responses.

The contract and issues arising from our review

5. Alongside the more significant departures from the model contract, the parties made a number of relatively minor changes including making the provisions more consistent with the East London Railway track access option. As these changes were not contentious or significant, we are not commenting on them in this letter. The more material changes are described below.

Timetabling integration and minimisation of operational disruption

6. In pre-application discussions, both we and the parties were conscious that the relatively high frequency of scheduled passenger services passing over the connection would make it likely that operational disruption would be transferred across the networks. This could impact on other train operators and passengers. In addition, as there would be two facility owners responsible for timetabling on their own networks, it would be important for the timetabling of the services that crossed the connection to be done in an integrated manner.

7. The parties therefore included a provision in the contract that obliges them to cooperate to produce an integrated timetable for train movements across the connection. They also included a provision requiring them both to use reasonable endeavours to minimise the likelihood of any disruption arising and to minimise any disruption that does arise. Both provisions are set out in clause 5.

Applicable procedures

8. The parties have included a requirement that they maintain and follow a set of applicable procedures for relevant matters relating to the connection.

9. The parties have also bespoke the rights and obligations of both Network Rail and RfL principally to reflect the more equal relationship between them – as operators of passenger networks – as compared to the standard relationship between Network Rail and an adjacent facility owner that is set out in the model contract.

Network Code Modifications

10. As the timetabling integration provision in clause 5.3 includes references to the Network Code, we advised the parties to include a “Network Code Modifications” schedule based on the one in Schedule 10 to the model passenger track access contract. This provides a process for the contract to be amended to reflect any changes to provisions in the Network Code. This process is set out in Schedule 5 to the contract.

Dispute resolution provisions

11. The parties have included an ‘internal resolution procedure’ process in the dispute resolution arrangements in the contract (clause 12). This is consistent with what Transport for London (TfL) and Network Rail included in the North London Railway track access option. This provision requires that, for most types of dispute arising from the contract, before following the usual dispute resolution process, there first be a process of escalation within Network Rail and RfL to try to resolve the dispute.

12. More generally, the Access Dispute Resolution Rules (ADRR) were substantially amended in 2010 to make the dispute resolution process in access contracts more effective. All access agreements (and our model contracts) still need to be amended to reflect the revised ADRR provisions. Therefore, the provisions in the approved contract still reflect the previous version of the ADRR.

13. In due course, we will initiate the Network Code Modification process for all relevant track access contracts (including this connection contract) to make the dispute resolution provisions consistent with the revised ADRR provisions.

Termination provisions

14. The terms of the model connection contract provide both Network Rail and the adjacent facility owner (AFO) with a right to terminate the contract by giving three months notice to the other party. There is a protection for the AFO which provides that if Network Rail gives notice that it is terminating the contract, the termination cannot take effect if:

- (a) the AFO makes an application to ORR under section 17 of the Act for directions for a new contract for the continued connection of its network to Network Rail’s network; and
- (b) ORR does not refuse the section 17 application.

15. RfL felt that these model provisions would not give it sufficient certainty, given that its parent company, TfL, was sponsoring services through the London Rail Concession to

operate over the connection on a relatively long-term basis. It was concerned about the potential risk that Network Rail might seek to terminate the contract and sever the connection even though TfL still wished for passenger services to continue to operate over the connection. Given this, RfL had negotiated different terms with Network Rail which would prevent Network Rail from unilaterally terminating the contract except in very limited circumstances.

16. When we reviewed the contract, we were concerned at the strictness of these terms. Our policy on connection contracts states that, as these contracts are evergreen (i.e. without an expiry date), it is important that both parties should have the ability to extricate themselves from the contract².

17. Given that the connection at New Cross Gate is relatively significant and on a busy part of the national network, we were particularly concerned that it would be impossible for either party (and in particular Network Rail) to extricate itself from the contract if an issue developed relating to the efficient operation of the connection. In such circumstances, it might be expedient for the contract to be amended to place additional obligations or requirements on either or both of the parties to address any problems e.g. relating to operational performance. Under the proposed drafting, if the parties were unable to agree on an amendment, they would both be locked into the existing terms even though this could lead to the perpetuation of a problem that adversely affected other train operators and passengers.

18. We suggested to the parties three possible ways to provide RfL with the certainty that it desired whilst ensuring that there was a way to address any potential deadlock arising from the parties being unable to agree necessary changes to the contract. We set out the following options for the parties to consider.

- (a) A revised termination provision: This would provide for unilateral termination with notice of at least one timetable period. However, if Network Rail were to seek to terminate the contract, RfL would be able to lodge an objection to this. Where this occurred and Network Rail and RfL were unable to agree whether or not the contract should be terminated (after following the internal resolution procedure set out in clause 12.1 of the contract), Network Rail would be able to refer the matter to ORR to determine. ORR, after consulting RfL, would then make its decision having regard to its statutory duties and the representations received.

² Paragraph 5.5, Model connection contracts – final conclusions, July 2005, available at <http://www.rail-reg.gov.uk/upload/pdf/242.pdf>.

If the contract was to be terminated, RfL would be able to apply to ORR for directions to require Network Rail to enter into a new contract under section 17 of the Act. This would give both parties the opportunity to argue their case for changes from the previous contractual terms and ORR would consider the position of both parties before making its decision;

- (b) Inclusion of a contractual modification process: This would involve retaining the restricted termination provisions that the parties had negotiated but including a process for amendments to be made to the contract. This would provide that, where the parties were unable to agree an amendment (after following the internal resolution process), either party could refer the matter to ORR. ORR would then consider the matter and, having regard to its statutory duties and after consulting with the parties, would be able to determine the issue and (if it deemed it appropriate) make amendments to the contract; or
- (c) A combination of the proposals under paragraphs (a) and (b) above: The adoption of a revised termination procedure with an appeal mechanism for RfL and inclusion of a contractual modification process.

19. The parties decided to adopt (c) and amended the draft contract accordingly. Clause 8 of the approved contract sets out an improved termination process providing RfL with an appeal mechanism to ORR, whilst Schedule 6 sets out a provision for the parties to make amendments to the contract, and for either of them to appeal to ORR if no agreement with the other party can be made, should this be necessary.

Confidentiality

20. The parties have departed from the model contract provisions relating to the retention, divulgence, return and destruction of confidential information in clause 13 to reflect the possibility of requests under the Freedom of Information Act 2000.

Novation and assignment

21. The parties have included provisions to enable either of them to novate, transfer or assign their rights and obligations under the contract to an affiliate without the consent of the other party. However, the contract requires that the assigning party procure that, if the affiliate ceases to be an affiliate, the rights and obligations shall be transferred back to it. Given that TfL, as a public body, might wish to restructure its subsidiaries, we had no issues to raise with this provision. In any case, all novations, transfers and assignments remain subject to ORR approval.

The charges

22. We noted during our review that the proposed charge that RfL would pay to Network Rail for the costs arising from the connection did not correspond to the breakdown of the charge that Network Rail had provided to us. Following the identification of this discrepancy, Network Rail reduced the charge from £80,000 to £76,500.

Liability cap

23. In the draft of the contract originally submitted to us, the parties had proposed an annual liability cap of £80,000. This was based on the then proposed annual charge. We were concerned that this cap was very low given the busy nature of the connection and the level of financial impact that could arise from a contractual breach.

24. Our policy on connection contracts states that, as a default, liability caps should be set at £1m. However, the policy acknowledges that the parties to a connection contract may wish to depart from this default but makes clear that we would need to ensure that both parties understand the impact of the chosen liability cap on the level of risk that they are each taking on.

25. After considering this, the parties first proposed to increase the cap to £1m and then, in April 2011, after further consideration, agreed that the cap should be set at £5m to reflect more accurately the liabilities that would exist to both parties.

The Plan

26. During our review we noted that there were material inconsistencies between the Plan and the corresponding provisions in the contract. The original draft of the Plan also did not indicate the southbound connection. We raised this with the parties who then submitted a revised the Plan and corrected contractual provisions.

Other changes

27. Aside from the matters set out above, we made a number of drafting comments to the parties. These were mostly concerned with ensuring that the provisions would operate effectively. Similarly, over the course of the application, the parties themselves identified some improvements to the drafting. The final version of the draft contract reflected both our comments and the changes proposed by the parties.

Our decision and directions

28. Following the resubmission of a revised contract in July 2011 we were satisfied that all regulatory issues had been addressed. We approved this version of the contract on 20 July 2011 and directed Network Rail (as facility owner of network to which section 18 of the Act applied) to enter into the connection contract with RfL by 25 August 2011³. The parties then duly entered into the contract on 28 July 2011.

Our conclusions

29. We were satisfied that our approval of this connection contract was consistent with our statutory duties.

Public register

30. In accordance with section 72(5) of the Act, we will place a copy of the approved connection contract on our public register. We will also place a copy of the contract and this letter on our website. In line with section 71(2), when we issued directions on the contract, we asked the parties if they wished us to consider excluding from publication any elements of the contract on the grounds that to do so would or might seriously and prejudicially affect their interests. The parties did not make any such requests and accordingly we will publish the contract in its entirety.

31. I am copying this letter electronically to Steven Saunders at Network Rail and Charles Ritchie and Matthew Ross and RfL.

Yours sincerely

Richard Gusanie

³ Normally, as connection contracts are between two facility owners (who are both also beneficiaries to each other), we direct both parties (as facility owners) to enter into the contract. However, as RfL's network is exempt from the access provisions of the Act by virtue of the Railways (London Regional Transport)(Exemptions) Order 1994, we did not formally direct it (in its capacity as a facility owner) to enter into the contract with Network Rail.