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1 July 2008

Dear Neil,

**APPEAL UNDER REGULATION 29 OF THE RAILWAYS INFRASTRUCTURE
(ACCESS AND MANAGEMENT) REGULATIONS 2005 - RAIL FREIGHT
CHARGING SYSTEM AND LEVEL OF ACCESS CHARGES FOR THE HIGH
SPEED 1 RAILWAY**

Thank you for your letter dated 19 June 2008 containing the representations that the Office of Rail Regulation ('ORR') has received from CTRL (UK) Limited/Union Railways (North) Limited ('HS1'), the Department for Transport ('DfT') and Network Rail (CTRL) Limited ('Network Rail') in respect of the above matter. This response contains the comments of English Welsh & Scottish Railway Limited ('EWS') on each of those representations

HS1

1.1. EWS notes that HS1 considers it appropriate that it, rather than Network Rail, should respond to the appeal in detail even though Network Rail is the designated infrastructure manager. However, EWS understands that Regulation 12 of the Railways Infrastructure (Access and Management) Regulations 2005 ('the Regulations') and more specifically Regulation 12(4), places obligations on the Secretary of State in respect of establishing the charging framework and on the infrastructure manager in respect of establishing the specific charging rules and determining the fees levied. Given that HS1 has decided to contract with Network Rail to undertake the role of infrastructure manager, EWS believes that the relevant obligations under Regulation 12 of the Regulations lie with Network Rail and not HS1.

1.2. As explained in EWS's appeal, before EWS can operate rail freight services on HS1 it will need to undertake and complete essential modification work to its relevant locomotive and wagon fleets to make them compatible with the operating systems used on HS1. These modifications represent a substantial investment and given the time it will take to complete the project design, development and fitment programme, the decision by EWS on whether or not to proceed with its investment is being delayed because EWS currently has no confidence that the access charges for rail freight services on HS1 will be affordable due to the current lack of a proper charging system and an affordable level of infrastructure fees.

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1.3. EWS has carried out significant work and expended much effort on putting in place the necessary funding and development resources needed to take forward the modifications to its locomotives. This includes securing a significant grant from the European Union's Marco Polo fund as well as provisionally allocating some of its own investment budget to meet the remainder of the cost of the modifications. It is likely to take at least 10 months for the modifications to be completed once the project is given the go ahead. However, the decision whether or not to proceed cannot be made, because EWS cannot commit its own money and that of the EU to a project that may turn out to be unnecessary if it transpires that the access charges for rail freight on HS1 are unaffordable.

1.4. The continuing lack of a proper charging system and an affordable level of infrastructure fees is, therefore, delaying the commencement of rail freight operations on HS1. So, whilst EWS's appeal has been made out of frustration, there is a clear and definitive reason as to why EWS requires the relevant information quickly and cannot afford to wait for the process outlined by HS1 in its response to be completed.

1.5. This lack of certainty is already causing EWS to turn away enquiries from potential customers who wish to explore operating traffics on HS1, as EWS cannot respond to such enquiries in detail without knowing whether or not it will be able to afford to operate rail freight services on HS1. Whilst EWS acknowledges HS1's willingness to explore possible interim solutions in the meantime, unfortunately, interim solutions cannot provide the basis for significant long term investment decisions that are required to be made well before rail freight operations can actually commence on HS1. EWS also believes, however, that HS1 is unwilling to discuss interim solutions whilst the appeal process is taking place.

1.6. Turning to HS1's legal arguments, HS1 contends that EWS cannot properly appeal at all at this point and that ORR's function in relation to the charging rules is solely intended to be an *ex post facto* appeal function only. This contention appears to be based on the view that the appeals mechanism in Regulation 29 of the Regulations is intended to provide applicants with a right to seek a review of actions to be taken by HS1 under Regulation 12 of the Regulations only once those actions have actually been taken. HS1 further contends that the Regulations do not contemplate that the ORR will intervene in those processes whilst those processes are taking place.

1.7. EWS can see no basis for HS1's contention either from the wording of the Regulations themselves or within the overall aims and objectives of the Regulations as they apply to HS1. Notwithstanding EWS's view that the Regulations place no obligations on HS1 in any case, as HS1 is neither the Secretary of State nor the infrastructure manager for the route, Regulation 29(1), as HS1 itself acknowledges, is *prima facie* cast in wide terms, i.e.

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'An applicant has a right of appeal to the Office of Rail Regulation if it believes that it has been unfairly treated, discriminated against or is in any other way aggrieved, and in particular against decisions adopted by the infrastructure manager, an allocation body, a charging body, a service provider or, as the case may be, a railway undertaking, concerning any of the matters described in paragraph (2).'

1.8. Furthermore, the Regulations transpose into UK Law the provisions of EU Directive 2001/14/EC which are intended to open up access to railway infrastructure in order to facilitate the development of certain types of rail services, including rail freight services. EWS submits that it cannot have been the intention of the Directive and, consequently, the Regulations, that inaction or unreasonable delay on the part of an infrastructure manager or any other relevant party could frustrate the development of open access to HS1 and that such inaction or unreasonable delay could not be made the subject of an appeal to the relevant regulatory body. EWS, therefore, submits that Regulation 29(1) of the Regulations was cast in wide terms to cover such eventualities.

1.9. As stated in its appeal, EWS is clearly aggrieved over matters contained in regulation 29(2) (d) and (e) of the Regulations. In this respect, EWS considers that the continuing delay in establishing and publishing a proper charging regime for rail freight on HS1 is unreasonable given that EWS has been discussing these matters with the relevant parties since 2006. The southern section of HS1 has been open since September 2003 and the northern section has been under construction for a number of years. EWS submits that it is unreasonable that HS1 has only now, within the last year, commenced the necessary detailed work to establish a proper long term charging regime for rail freight using HS1.

1.10. EWS, therefore, contends that its appeal is valid both under the explicit wording of Regulation 29(1) of the Regulations and within the wider aims and objectives of the Regulations as a whole.

1.11. EWS notes HS1's attempt to reinforce its contention that EWS cannot properly appeal at this point by reference to ORR's own published guidance on appeals under the Regulations. In this regard HS1 quotes the first part of paragraph 3.3 of ORR's guidance, i.e.

'We do not have a role under the regulations in respect of establishing the charging framework or rules for other network operators' facilities...'

1.12. However, EWS refers to the second part of paragraph 3.3 of the ORR's guidance which states:

'...although we remain the appeal body if an applicant believes it has been unfairly treated, discriminated against or is in any other way aggrieved...'

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1.13. As stated in paragraph 1.9 above, EWS is clearly aggrieved and thus considers that it is able to properly appeal to ORR at this point. Furthermore, EWS is well aware that Regulation 12(4) of the Regulations places an obligation on the Secretary of State to establish a charging framework for any rail link facility and on the infrastructure manager to subsequently establish the specific charging rules and determine the fees to be charged. In the first limb of its appeal, EWS has, therefore, requested ORR to direct those responsible to carry out their obligations in this regard, rather than, at this stage, requesting ORR to determine the charging regime itself.

1.14. Given that HS1 has stated in its response that:

‘As the ORR will be aware, the ability of HS1 to discharge its obligations under Regulation 12 to establish charging rules (and subsequently, actual infrastructure usage fees) is contingent on the Secretary of State first establishing a charging framework pursuant to Regulation 12(3)’

HS1 appears to see itself in the role of infrastructure manager even though it has stated quite clearly at the start of its response that it has contracted out that role to Network Rail. Therefore, given that HS1 constitutes neither the Secretary of State nor the infrastructure manager, EWS questions whether HS1 has any obligations and responsibilities under Regulation 12 of the Regulations in any case.

1.15. As stated in paragraph 1.13 above, the first limb of EWS’s appeal requests ORR to direct those responsible to establish a proper charging scheme and charging system for rail freight services using HS1. It does not, as HS1 speculates, go further and expects ORR to formulate the substance of the charging rules. However, EWS would, nevertheless, expect ORR to consider what action could be taken in the event that those responsible continued to delay carrying out their obligations in this respect, which EWS suggests, could include ORR formulating the charging rules and fees to be charged.

1.16. EWS, therefore, considers that this limb of its appeal is warranted given that HS1 states that it is not possible for it to establish charging rules within a particular timeframe as that timeframe is contingent on actions by the Secretary of State over which HS1 has no control.

1.17. On the other hand, DfT in its representations, which EWS responds to later in this response, states that the Secretary of State has already established a charging framework in Schedule 19 of the Development Agreement made between the Secretary of State and London & Continental Railway (‘LCR’) and, therefore, it is concerned, both from a regulatory and from a freight policy perspective, that HS1 has neither completed its assessment nor published rates which are a necessary precursor to EWS gaining access to operate rail freight services on the fixed link. DfT then goes on to state that under the Regulations, HS1 has a duty to maintain an up to date network statement which, *inter alia*,

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describes the charging principles and tariffs and that the DfT expects that to happen without further delay.

1.18. EWS is, therefore, seeking from the first limb of its appeal, for ORR to identify which parties have which obligations in respect of the charging regime for HS1 under Regulation 12 of the Regulations and, where they have not already done so, direct those parties to carry out those obligations to committed timescales as soon as possible.

1.19. In respect of the requests contained in the second limb of EWS's appeal, as set out in paragraphs 3.10, 3.14 and 3.18 of that appeal, HS1 again states that EWS's appeal is premature and it would be inappropriate for ORR to make any directions at this stage so this element of EWS's appeal simply must be dismissed. HS1's contention appears to be based on the premise that as HS1 has not yet set the usage charges EWS cannot, therefore, appeal. EWS firmly disagrees with HS1's contention.

1.20. Whilst HS1 may not have set the level of usage charges for rail freight services using HS1 itself, Network Rail, as infrastructure manager, and therefore the party with the obligations under Regulation 12 of the Regulations, has issued indicative usage charges for rail freight services using HS1 which EWS understands have been derived from Version 2 of AEA's EMGTPA model. Network Rail has also stated that a 10% 'mark-up' on those usage charges will apply until December 2009 (see attachments 7 to 9 of EWS's appeal).

1.21. EWS responded to Network Rail's proposals referred to in paragraph 1.20 above, on 20 & 24 April 2007 (see attachments 10 & 11 of EWS's appeal). Network Rail's subsequent responses to EWS (see attachments 12 & 13 of EWS's appeal) did not indicate that these charging proposals were conditional on the subsequent consultations undertaken by HS1 and the Secretary of State. EWS can only assume, therefore, that these proposals remain in place until any other charging regime has been agreed in accordance with the Regulations and published in the Network Statement.

1.22. Accordingly, and despite HS1's views to the contrary, EWS submits that ORR does have something against which to properly judge questions such as those posed by EWS in the second limb of its appeal. EWS strongly believes its requests for ORR to determine (a) whether the usage charges for rail freight using HS1 have been set at the cost that is directly incurred as a result of operating such services and (b) that a 'mark up' on those usage charges is inappropriate, are reasonable and valid and should not be dismissed by ORR as HS1 contends.

1.23. HS1 also states in its response that EWS has acknowledged that its appeal on these matters is essentially a matter of speculation and quotes from the notes of the 16 April 2008 meeting between EWS and ORR in support of its view. EWS

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believes that HS1 may have misinterpreted EWS's comments in this respect and, therefore, arrived at an incorrect conclusion.

1.24. EWS's remarks to ORR that it would be difficult for EWS to provide any evidence to support its appeal on the level of the proposed usage charges being too high were not, as HS1 contends, expressed because EWS considered that such usage charges had not yet been published. Rather, these remarks were intended to convey the message that as a freight operator EWS does not have the detailed information or knowledge about the infrastructure and the cost model. In cases where EWS considers that charges may be set at the incorrect level, EWS requires the assistance of the independent regulator to determine whether or not those costs and charges have been correctly assessed and calculated.

1.25. EWS also contends that the issue of whether or not investment recovery charges can be levied on rail freight using HS1 does not depend upon whether or not or when HS1 determines its charging rules. Paragraph 3(2) of Schedule 3 to the Regulations provides that an infrastructure manager may only set higher charges on the basis of the long-term costs of a specific investment project where:

(a) the effect of the higher charges must be to increase the efficiency and cost effectiveness of the project; and (our emphasis)

(b) the project could not otherwise have been undertaken without the prospect of such higher charges.

1.26. From these provisions of the Regulations, EWS has concluded that whether or not infrastructure recovery charges could be levied on rail freight services using HS1 must relate to decisions made at the outset of the project and, therefore, should be a matter of fact. EWS submits that unless it can be demonstrated that the project could not have been undertaken without the prospect of such higher charges, HS1's, or indeed any other party's subsequent views on whether or not an infrastructure recovery charge should be levied on rail freight are, therefore, irrelevant.

1.27. In this respect, EWS continues to believe that an investment recovery charge levied on rail freight would not satisfy either of the pre-conditions set out in paragraph 1.25 above. In respect of sub-paragraph 3(2)(a) of the Regulations, EWS considers that this does not apply to freight on HS1 and in respect of sub-paragraph 3(2)(b), EWS considers that there would need to be evidence to indicate that the project could not have been undertaken without the prospect of the higher charges for freight. EWS has seen no such evidence nor has any been proffered thus far by HS1, DfT or Network Rail. EWS, therefore, considers that its request for ORR to determine that an investment recovery charge for freight services using HS1 is inappropriate is a proper and valid request that should not be dismissed as HS1 contends.

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1.28. In addition to its legal arguments, EWS notes that HS1 sets out in the last part of its response, details of its progress towards adoption of the charging rules in relation to freight services using HS1. HS1 commences this part of its response by contending that EWS's perception seems to be that HS1 and DfT have previously indicated that the work on setting the charging framework and charging rules for HS1 would be completed in a shorter time frame than is actually occurring which, HS1 considers, is not the case.

1.29. HS1's consultation document (see attachment 14 of EWS's appeal) indicated at paragraph 52 that the second stage of its consultation on the charging regime for HS1 was expected to take place during the 1st Quarter of 2008. HS1 also indicated to both DfT and EWS in January 2008 that the work would be completed sometime after March 2008 and that HS1 would provide a programme outlining its work in this regard and the timescales for its completion (see attachment 20 of EWS's appeal). The second stage of its consultation was not issued during the 1st quarter of 2008 and HS1 informed EWS that its Draft Final Report would not be submitted to DfT until the end of April 2008 (see attachment 24 of EWS's appeal). HS1 indicated at the same time that further consultation would be driven by HS1's proposed overall restructuring programme (see also attachment 24 of EWS's appeal) which is now expected to be by September.

1.30. EWS contends that the timing of the obligations on the Secretary of State and the infrastructure manager in Regulation 12 of the Regulations to establish the charging framework, the charging rules and determine fees for HS1 are not conditional upon the restructuring of the route owners (i.e. HS1). The route is now open and there should be in place a Network Statement containing the charges for use of HS1 by rail freight so that EWS, and indeed any other freight operator contemplating using HS1 can plan its business with a reasonable degree of assurance and certainty.

DfT

2.1. EWS makes no representations on the DfT's comments entitled '*Brief background and structure of HS1*' as these appear to be matters of fact which are not contested by EWS.

2.2. In respect of the next section entitled '*Nature of the Department's interest in the Appeal*', EWS welcomes DfT's reassurance that it wishes to encourage the maximum use of the railway by open access operators (both passenger and freight) on a non-discriminatory and sustainable basis and that it acknowledges EWS's efforts in considering investments in order to facilitate the operation of rail freight services on HS1.

2.3. EWS also acknowledges DfT's recognition that the Secretary of State has a number of regulatory roles and duties associated with the charging regime for HS1 under the Regulations and that these include the establishment of the

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charging framework for HS1 to ensure charges imposed by the infrastructure manager comply with the requirements of the Regulations and to supervise negotiations between an applicant and infrastructure manager about the level of infrastructure charges. EWS particularly notes that DfT refers to the 'infrastructure manager' (i.e. Network Rail) in respect of these obligations rather than the 'infrastructure owner' (i.e. HS1).

2.4. In the section entitled '*The Current Position in relation to charging*', EWS notes DfT's confirmation that a charging framework for HS1 has already been established by the Secretary of State and included in Schedule 19 of the Development Agreement between the Secretary of State and LCR. EWS also acknowledges and supports DfT's concern both from a regulatory and from a freight policy perspective, that HS1 has neither completed its assessment nor published rates which are a necessary precursor to EWS gaining access to operate freight services on the fixed link. In this regard, EWS welcomes DfT's statement that HS1 has a duty to maintain an up to date network statement which, *inter alia*, describes the charging principles and tariffs and that DfT expects that to happen without further delay.

2.5. It appears to EWS from the section entitled '*The future charging framework*' that DfT wishes to revise the current charging framework that is set out in Schedule 19 of the Development Agreement between the Secretary of State and LCR and that these revisions to the current charging framework is tied to the restructuring of LCR. EWS considers that the timing of the obligations in Regulation 12 of the Regulations is not subject to the restructuring of the infrastructure owner. DfT has confirmed that a charging framework currently exists, therefore, EWS submits that the infrastructure manager should establish the specific charging rules and determine the fees to be charged under the current charging framework in accordance with Regulation 12(4) of the Regulations and, accordingly, publish the relevant details in the network statement without delay.

Network Rail

3.1. Whilst Network Rail has left both HS1 and DfT to make substantive responses on EWS's appeal, EWS submits, that as infrastructure manager, Network Rail, not HS1, is required to fulfil the relevant obligations under Regulation 12 of the Regulations. In this respect, DfT confirmed in its response the existence of a current charging framework which is set out in Schedule 19 of the Development Agreement between the Secretary of State and LCR. Given that Network Rail has issued indicative usage charges for rail freight using HS1 along with a proposed 'mark up' on those usage charges, EWS submits that there appears to be no reason why ORR should not hear the second limb of EWS's appeal in respect of those indicative usage charges and associated 'mark up'.

Conclusion

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4.1. After considering the responses to EWS's appeal from HS1, DfT and Network Rail, EWS continues to believe very strongly that the entirety of its appeal should be taken forward by ORR. In this respect, EWS wishes to draw out from its representations made above, the following key observations and remarks:

- The obligations to establish the specific charging rules and determine the fees to be charged under the charging framework for HS1 in accordance with Regulation 12(4) of the Regulations are placed on the infrastructure manager (i.e. Network Rail) and not on the infrastructure owner (HS1).
- DfT has confirmed that a charging framework currently exists for HS1 as set out in Schedule 19 the Development Agreement between the Secretary of State and LCR. Whilst DfT is currently considering revisions to that charging framework tied in with LCR's restructuring, the current framework remains valid.
- The infrastructure manager has issued indicative usage charges and a proposed 'mark up' to apply to rail freight services using HS1.
- DfT expresses concern both from a regulatory and from a freight policy perspective, that HS1 has neither completed its assessment nor published rates which are a necessary precursor to EWS gaining access to operate freight services on the fixed link. DfT has also stated that HS1 has a duty to maintain an up to date network statement which, *inter alia*, describes the charging principles and tariffs and that DfT expects that to happen without further delay.
- HS1's legal view that EWS's appeal should be dismissed on the basis that ORR only has an '*ex post facto*' appeal function is rejected by EWS for the reasons given in paragraphs 1.7 to 1.16 above.
- The timing of the obligations in Regulation 12 of the Regulations is not subject to the restructuring of the infrastructure owner. DfT has confirmed that a charging framework currently exists, therefore, the infrastructure manager should establish the specific charging rules and determine the fees to be charged under the current charging framework in accordance with Regulation 12(4) of the Regulations and, accordingly, publish the relevant details in the network statement without delay.

If you require any further information please do not hesitate to contact me.

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Yours sincerely

Nigel Oatway
Access Manager