WHITE & CASE
LIMITED LIABILITY PARTNERSHIP

RAILWAYS ACT 1993

ACCESS CONTRACT REFORM

19 April 2012

SCOPE OF THIS PAPER

1. This paper concerns ORR's consultation on possible reform of the contractual arrangements for access, dated January 2012. It is a formal response to that consultation and none of it is confidential.

GENERAL

2. The overall tenor and implication of ORR's consultation document is cause for considerable concern. The thesis that regulatory protection is no longer required – or that it should be significantly scaled down – is unsound. Simply because train operators have not used or do not properly understand the need for a measure does not mean its necessity, so firmly and conspicuously established by ORR when it was devised, is no longer extant.

3. ORR knows - or it used to know - that access contracts and the network code have never been given the senior level attention in TOCs that they so clearly warrant. In a very large proportion of cases, access arrangements and network code issues have been significantly under-resourced in TOCs, even though they are the highest value contracts which the TOCs have. For too long, many TOCs have treated access contracts and the network code as things over which they have no control or influence, or things which other more diligent and well-resourced TOCs will attend to, providing a free-rider opportunity. ATOC's engagement on these issues has been under-powered. In your consultation paper, you acknowledge this problem.

4. At its inception in 1994, the CRC was populated by senior TOC management – people at CEO level from the TOCs. Since then, it has been neglected to a significant degree. In too many respects, TOCs appear not to realise just how important the network code is, and their senior management appear to regard it as a technical, rather dull document of a regulatory nature which they have neither the time nor the inclination to try to understand.

5. Even when senior management were compelled to engage in access and network code matters - the regulatory symposium on infrastructure and train performance on

5 December 2003 - it was striking that the chief executives of several of the major railway companies were quite ignorant of critical parts of the network code in relation to the handling of operational disruption.

6. Incompetence of TOCs and their neglect of a material contractual and regulatory code does not make that code – or the supporting access contracts which give it life – unimportant. Indeed these things make it more important that ORR is actively and proactively involved in the development and operation of access arrangements, to ensure that Network Rail – which most certainly does understand their importance – does not by default acquire and misuse the upper hand in this respect.

7. You are therefore correct when you say (in paragraph 5.12) that behavioural and cultural issues cause problems. These problems permeate the entire regulatory and contractual matrix, not just a single part of the network code.

8. ORR should exercise very considerable caution to ensure that it does not strengthen or corroborate the view that, as the regulatory authority for the railways, it has forgotten its purpose and lost its way. ORR needs to regain its institutional memory, which, in some of the most significant respects concerning the regulatory and contractual matrix, has almost entirely disappeared. This is apparent from much, including some of the suggestions in this consultation document for reform of the system back to its original weaknesses.

9. The Railways Act 1993 and subsequent legislation, as interpreted by the courts, make it abundantly clear that the economic regulatory authority for the railways is required and expected to do much more than carry out a price review every five years, and deal with disputed access cases. It has a crucial role in setting the framework for the efficient functioning of the market for railway services at most levels, and ensuring that framework operates correctly, keeping it under review and making or facilitating changes where necessary. It must also monitor compliance with the obligations which ORR enforces. In this respect, ORR's job is harder in relation to the contractual regime when compared with the licensing regime, since ORR does not enforce contractual obligations. It is all the more important therefore that ORR gets things right with the contractual part of the matrix.

10. The architects of the access regime in 1993-95 realised this fundamental fact, and made provision for the access regime to be changed over time, including at the hand of the regulatory authority. That came from (a) the regime for the adjustment of access rights in individual access contracts, originally Part 9 of Schedule 7 and now Part J of the network code; and (b) the mechanisms for change to the network code, both democratically (Part C6) and, after extensive due process and with significant protections, unilaterally (Part C8).

11. In doing all these things, ORR must of course always discharge its statutory duties. It must approach every potential decision – including a decision not to act – with a predisposition to achieve all its statutory objectives, and must balance them according to its margin of appreciation. That balancing function does not permit ORR to act inconsistently with the policy and purposes – and the plain provisions – of its enabling statute. If ORR would prefer not to have to do something which the statute requires it to do, it cannot use illegitimate backdoor means to get out of it, such as exempting significant facilities or activities, or issuing general approvals which amount to abdication of regulatory purpose and frustration of statutory purpose. Legislation cannot be amended in that way.

12. If ORR wishes to jettison some of its statutory functions, it should promote a change to the relevant statutes. It has no power to change the law in any other way, and until the law has been changed and the relevant functions have been amended or taken away, it has an obligation, consistently with its statutory duties, to exercise those functions in accordance with the will of Parliament.

13. ORR is not the shop steward for the railway industry. Its statutory duties require it to consider things which are much wider than the interests of the railway companies which it regulates. It is entirely unsurprising that regulated companies wish to convince the regulatory authority that they should be regulated less, or more lightly, or that they should be left to make their own arrangements between themselves, with the regulatory authority intervening only if one of them complains about unfairness. This flies in the face of the decision of the Court of Appeal in 2002, and would be an illegal abdication of ORR's statutory functions and duties. ORR should not be consulting on actions which are in themselves illegal.

14. It is quite wrong for ORR to adopt the stance that it is acceptable for Network Rail and the TOCs to determine their own access arrangements without regulatory scrutiny in any cases other than the most trivial. This is quite contrary to the explicit terms of the Railways Act 1993 and the decision of the Court of Appeal.

15. This is not a self-regulating environment. Parliament has decided that ORR is in charge of the access regime, not the regulated companies. This was affirmed in the plainest terms by the Court of Appeal in 2002 . ORR reinforces the point in paragraph 2.29 of its document on criteria and procedures for the approval of station access contracts (December 2010), where it says:

> "It is for ORR to determine the fair and efficient terms of access, regardless of whether or not the parties have reached agreement on all pertinent points in negotiations. We will base our decision on the public interest as defined by our statutory duties. We are required, if appropriate, to put the public interest above the private commercial interests of the facility owner and the applicant. For instance, we may have to take into account considerations that

may be of little or no concern to the parties, but which affect the interests of third parties, for example rail users, funders or other potential users of the facility."

16. It is not appropriate for ORR to allow the narrow interests of some of the incumbent railway companies to usurp its supervisory and proactive role in the establishment of access contracts. Sections 17-22, Railways Act 1993, do not allow that, and ORR should not acquiesce in it. ORR has been given a much wider role, and ORR has no power to abdicate that role to anyone, least of all the facility owners whose power ORR has been established to check and restrain. That would be an inversion of the regulatory function (as also stated in the 2002 Court of Appeal case).

17. The notion that ORR might issue a general approval allowing Network Rail and TOCs to enter into access arrangements unsupervised by ORR is, for these reasons, unlawful. ORR is correct when it says that it may be legally challenged if it were to do this. It is remarkable, to say the least, that ORR considers it appropriate to consult on a step which, if taken, would be illegal. ORR should demonstrate conspicuously its sound understanding of the legal framework in which it is required to operate.

18. On policy grounds too, a 'drawing back'[1] from one of ORR's primary regulatory functions is entirely objectionable. Those functions were given to ORR by the legislature for a serious purpose. If ORR needs more or better resources to do its job, it should acquire them using legitimate means. Drawing back from its primary functions is unsustainable and insupportable.

19. ORR refers, in paragraph 3.5 of the consultation document, to cultural and behavioural differences and approaches of Network Rail and TOCs in relation to access arrangements, and says "this is not something on which we are in a position to become involved". This is quite wrong. Condition 8 of Network Rail's network licence explicitly deals with the dealings which Network Rail has with stakeholders, and was devised because those dealings were, in so many respects, so poor and, in some cases, abusive. Sections 16 – 22 of the Railways Act 1993 requires ORR to be involved in the differences between Network Rail and the TOCs.

[1] See paragraph 2.13 of the consultation document, which uses this phrase.

SPECIFIC QUESTIONS

Question 3 – difficulties with the timetable process

20. The experience of the companies involved in the struggle for track capacity on the East Coast main line in 2009 is probably the starkest recent example of how bad the process can get, and how materially it was mismanaged by Network Rail and ORR.

21. The notion that ORR had the power to make a split decision on the competing applications, dealing with capacity first and the remaining terms of the contracts later, was striking in its illegality as well as its objectionability on policy grounds. Moreover, the extent to which ORR acquiesced in Network Rail's incompetent measurement of capacity was highly unsatisfactory. ORR lacked – and probably still lacks – the tools it needs objectively to challenge Network Rail's capacity measurement assessments and projections, contrary to the decision taken by ORR in June 2004.

22. ORR cannot rationally – or lawfully – make a decision on capacity allocation until it fully understands the capacity which is available, and the developed competing cases for the allocation of that capacity. In paragraph 4.20 of its criteria and procedures document, ORR says: "We believe Network Rail should be in a position to know what capacity exists and what it has sold". The same is doubly true of the regulatory authority which takes the ultimate decision on capacity allocation.

Question 4 – commercial purpose clause

23. This was rejected by ORR in 2002 as introducing too much uncertainty into the contracts. However, it does assist in the interpretation of the contract, and worked well in the 1998 contract for the upgrade of the West Coast main line between Network Rail and Virgin.

Question 8 – monitoring of applications

24. Public information about the access applications which are in the course of processing is highly desirable. It should not be limited to existing industry players, as is implied with the idea that there should be a weekly email from ORR to Network Rail and TOCs. Prospective entrants to the market need to know how capacity may be consumed and when. ORR should publish a detailed progress statement on its website, in much the same way as Parliament does on its website showing the progress of Bills.

Question 9 – review of the proportionate approach

25. ORR is under a public law obligation always to be proportionate; that is a function of the requirement to act reasonably.

26. The idea that ORR should be 'stepping back' from the access regime in any appreciable respect is criticised earlier in this paper. Regulatory abdication is objectionable on both policy and legal grounds.

Question 10 – extension of general approvals

27. The Railways Act 1993 empowers ORR to issue general approvals to deal with trivial cases. It would be wholly objectionable and illegal for ORR to issue general approvals effectively exempting all – or substantially all – agreed access contracts from regulatory scrutiny. That is completely contrary to the purposes and policy of the statute, and was reinforced by the Court of Appeal in 2002. Has ORR forgotten what the Court of Appeal said? ORR cannot change the law – in this or any other respect – by the issue of a policy statement, or the unlawful use of a statutory measure with a quite different purpose.

28. The objectionability of allowing the infrastructure manager and a single user to agree on the consumption of capacity as between themselves was very starkly shown in the first access case in 1995 when Great Western Railway Co Ltd agreed its access contract with Railtrack. That contract consumed capacity so comprehensively – apparently without Railtrack realising it – that effectively GWR could shut out all prospect of competition from any rival. It was necessary then for ORR to intervene and correct the situation. With a network which is today much more intensively used, the case for ORR scrutiny and supervision in this respect is even greater.

Question 12 – stations

29. There are significant areas in which station and depot access arrangements could and should be improved. We will respond separately on ORR's recent document on stations.

30. The loss of the stations code – simply because some of the affected companies would prefer to regulate themselves – is a severe one. That would have simplified and streamlined a very great deal, and ORR was quite wrong to drop it at the insistence of the companies who lobbied against it.

Question 14 – depots

31. ORR and the affected railway companies should rediscover the depot work plan regime in the earlier depot access conditions. These plans required a full and proper assessment of depot capacity and its consumption, and first introduced the concept of defeasible access rights in cases where capacity was inefficiently used.

32. It is certainly the case that the facility owner should always understand how capacity of his facility is consumed, and how much of it has already been consumed, and is likely in

the foreseeable future to be consumed. Network Rail is the facility owner in respect of few if any depots. This is a responsibility of the facility owner, not the landlord.

33. Capacity consumption of all railway facilities should be properly measured and published in a continuously updated easily accessible format. Modern technology makes this simple. The railway industry can do it, and it should do it. This would save a great deal of time, effort and money when capacity is sought, or the efficiency of its consumption is being assessed. It would also greatly assist ORR.

Question 15 – asset protection agreements

34. ORR is wrong to say that leases are outside the terms of the regulated environment. The tripartite station access structure – which explicitly incorporated the Station Access Conditions into leases – achieved significant regulatory jurisdiction in this respect. That is why the tripartite structure was devised in 1993-4.

35. A template APA for stations is unnecessary for the reasons given in this firm's detailed representations on the issue of APAs. The change regime is all that is needed for the considerable majority of cases.

36. If there are to be template APAs for stations, they should be significantly different from the ones established under the network code, in their policy, the commercial balance between the parties, the allocation of risks, the degree of regulatory protection they provide, and their overall quality. ORR should not repeat the material errors it made with the existing APAs, which fall far short of ORR's own standards for contracts requiring regulatory approval, and in too many respects raise rather than lower barriers to investment, including in respect of transaction costs. Our earlier representations explain in what respects these deficiencies are found, and ORR is referred to them for the detail. Network Rail should emphatically not be given the task of drafting these contracts.

37. The network code APAs represent one of the worst failures of ORR to discharge its fundamental purpose of regulatory protection.

Question 16 – Part C

38. We have already commented in the significant need for the industry to understand and take far more seriously the development of the network code. For a long as the industry neglects it, efficiency and economy in the provision of railway services will suffer.

Question 17 – Part F

39. Part F is not only about technical and route acceptance of trains. Its primary purpose is regulatory protection of the commercial interests of TOCs and the infrastructure manager. Network Rail's acceptance panel processes are not regulated, and are no substitute for the regulatory protection which Part F should provide.

40. ORR must understand that changes to railway vehicles – whether at the instance of the company paying for the change or imposed by an external party or agency – may have a material commercial effect on other railway interests. That is why Part F contains a mechanism by which these effects may be balanced, with resort to dispute resolution and ultimate appeal to ORR, to ensure that protection. That protection must not be lost.

41. Merging Parts F and G would misunderstand the distinct purposes and protections of Part F. There will undoubtedly be some cases where both Parts F and G are engaged, in which cases they should be run in parallel. But in many cases it will be only Part F, and it would add to industry confusion and uncertainty if the matter were muddled in with Part G.

42. If Network Rail is to be permitted to propose vehicle change, the need for regulatory protection in that respect is at its highest. It is all too easy for infrastructure costs to be exported into higher train specifications which the TOCs and rolling stock owners must pay for. This is the thin end of a very dangerous wedge for TOCs and owners. That hazard was fully recognised when Part F was devised in 1993-4. It has not diminished.

Question 18 – Part G

43. It is highly unlikely that there is anyone sufficiently senior in the industry who has a detailed understanding of the operation of Part G and who will be willing and available to do this work. It is ORR's responsibility for supervise the development of the network code, and it should discharge it. Section 21 of the Railways Act 1993 requires as much.

Question 20 – Part K

44. Those who say that Part K adds little value and may be safely dispensed with do not understand it. This lack of comprehension is endemic in the railway industry, so these remarks are unsurprising.

45. The policy reasons of ORR in the establishment of Part K are as sound today as they were when ORR devised it. Nothing has changed to diminish its importance. Just because some TOCs do not understand it is not a case for the loss of a significant instrument of regulatory protection. Information is the oxygen of accountability, and a protector not only of commercial interests. Quite simply, if Part K had been in force in October 2000, and

GNER had been using it as it should have, it is highly likely that the Hatfield crash would not have taken place. ORR will dilute or acquiesce in the repeal of Part K not only at its own peril.

Question 21 – LOCs

46. LOCs should be retained, for all the regulatory policy reasons given at the time they were devised. The franchise owners made a material mistake in giving in to DfT pressure to move to JPIPs, and open access operators were right not to do so.

47. JPIPs are not enforceable, and LOCs are. A right without a remedy is no right at all. It is as simple as that. If ORR wishes to maintain its mistaken policy of disempowering TOCs, it will abolish LOCs for the few remaining companies which have them. The correct approach would be to reverse that policy, and abolish JPIPs and re-establish LOCs for all. Only Network Rail will celebrate the completion of the abolition of LOCs.

Question 23 – other issues

48. For the reasons given at the beginning of this paper, education for TOCs and engagement by TOCs is essential. It is time that TOCs understood their most important, highest value contractual arrangements and stopped pushing them down to junior employees whose understanding and authority in these respects is minimal.

Question 24 – forms

49. The existing forms are far from confusing. They impose on applicants a discipline in summarising their proposed contracts, and facilitate ORR's review of their material terms. The fact that TOCs would prefer not to complete them is no case for their dilution.

Question 25 – ORR website

50. Improvement of the ORR website is long overdue. It is hard to navigate and to find documents, even when you know they are there and you are only trying to find them.

51. The search engine is probably the worst of any government website we have encountered.

52. ORR should take seriously its duty to explain, and part of that duty is to make its processes and information about its use of its powers as accessible as possible. That means accessible to everyone, not just the closed community of the railway companies. We repeat and emphasise that ORR is there for the protection of the public interest, not just the

commercial interests of the companies it is supposed to regulate. It should be communicating with everyone who is interested, not just its regular correspondents.

Questions 26 and 27 – quality of model contracts

53. ORR should not hand any degree of control over the revision of the model contracts, the network code or any proposed APAs to Network Rail or anyone else. The former two are ORR's documents, and the latter should be subject to the same high standards.

54. Section 21 of the Railways Act 1993 makes access contracts ORR's, and says that ORR "may prepare and publish" and "shall" encourage their use. The access regime cannot be subcontracted or, worse, abandoned to the companies ORR regulates.

55. ORR should rediscover the standards which it applied in 1999-2004 to contracts requiring regulatory approval, and actively apply them. Network Rail and the TOCs will not do so, as was seen so starkly when ORR acquiesced in the appallingly low standards of the network code APAs. That was very much a case of a fox being placed in charge of the henhouse. It should not be repeated.

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