

**Review of the
Network Rail licence: consultation**

June 2008



OFFICE OF RAIL REGULATION

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Summary

The obligations in Network Rail's network licence form a vital part of the framework for the company's accountability. As the industry safety and economic regulator, we must ensure that the obligations and the way they stimulate the company to behave complement the other aspects of the framework – contracts, general legal obligations, outputs, incentives, the financial framework, our enforcement policies and the company's corporate governance.

This document explains a package of changes we propose to make to strengthen the obligations in the network licence. Many of these are changes to move away from some of the detailed or procedural obligations in the existing licence that can detract from the effectiveness of the licence. We favour focusing Network Rail's attention on a broad purpose within which the company has the flexibility to manage its business and we have the flexibility to intervene where we believe our action will be most effective and most needed.

We propose to:

- retain the current network stewardship obligation at the heart of the licence and to extend this purposive approach where possible;
- strengthen that obligation to emphasise Network Rail's planning, capacity allocation and asset management roles (removing the existing asset register condition, now that Network Rail has delivered the milestones in the asset register guidelines), and to clarify Network Rail's role in running an efficient and effective industry timetabling process;
- strengthen the current "dependent persons" condition to give Network Rail a more purposive obligation to treat a wider range of stakeholders appropriately;
- increase the transparency of Network Rail's management incentive arrangements; and to
- make the licence clearer and more cohesive, and to delete a condition which may now be redundant.

Detailed proposals on changes related to the periodic review and the financial framework within which Network Rail will operate will follow by letter in July.

In developing these proposals, we have considered the need to set out in sufficient breadth, clearly and purposively Network Rail's obligations, to allow Network Rail the flexibility to manage its business efficiently, to enable its customers to hold it to account, and for us to intervene where the impact of a possible contravention is greatest.

We invite views on all the issues raised by Thursday 4 September 2008. We aim to have the revised licence in place for the start of the next control period on 1 April 2009.

1. Introduction

Background

- 1.1 Network Rail is authorised to operate the main national rail network by a network licence. The Secretary of State for Transport originally granted the licence in 1994. The primary process by which we can change a licence under the Railways Act 1993 is by agreement with the licence holder or by making a reference to the Competition Commission.
- 1.2 Network Rail is a monopoly on which its train operator customers and much of the wider industry depends. So the licence, enforced by us, is a regulatory tool to stimulate the company to operate efficiently, and to meet the needs of its stakeholders. It is a key part of Network Rail's accountability.
- 1.3 We set out here a package of changes we propose to make to the network licence. We also explain the link between the licence, our approach to Network Rail's outputs, our enforcement policy and the industry incentives framework. The changes have been developed alongside the periodic review 2008 (PR08) to ensure that Network Rail's accountability is fit for purpose for the next control period. This document is being published with our draft determinations on Network Rail's outputs and access charges for PR08.
- 1.4 Network Rail has a second licence authorising its operation of 18 stations. We are not making proposals about the station licence, which is in a standard form for all operators of stations. So, when in this document we say "licence", we mean "Network Rail's network licence".
- 1.5 We have taken soundings on our thinking at key stages in our review of the licence. In particular, we held an industry workshop in September last year on both the licence review and the form and structure of Network Rail's outputs for PR08. As we have developed our proposals, we have had a number of informal discussions with key parties, including Network Rail.

Structure of this document

- 1.6 Chapter 2 outlines the current arrangements that make Network Rail accountable and our objectives. Chapter 3 explains our proposals to change the licence to make Network Rail's accountability more effective. This chapter

is divided into four parts dealing with management of the network, stakeholder relationships, governance (including Network Rail's management incentive schemes) and financial issues related to PR08. Chapter 4 summarises our proposals to make the licence clearer and more cohesive. Chapter 5 is a list of the questions we ask in the text.

- 1.7 The annexes contain a table that summarises how the terms in the current licence would change if our proposals were implemented, and a link to a draft licence incorporating the changes we have proposed.

Responses

- 1.8 We welcome your comments on the questions we ask throughout this document, and summarise in chapter 5. We would prefer to receive your responses by email. Please send these to Sukhninder.Mahi@orr.gsi.gov.uk by Thursday 4 September 2008.

- 1.9 You can also post your comments to:

Sukhninder Mahi
Network regulation team
Office of Rail Regulation
One Kemble Street
London
WC2B 4AN

- 1.10 We would like to put your responses on our website, and we may also want to quote from them. We assume we can publish your views. If not, please say which part of your response you want us to keep confidential.
- 1.11 This consultation runs alongside our consultation on our draft determinations for PR08 and has the same closing date.
- 1.12 If you want to discuss any of the issues raised in this document, phone Andy Burgess on 020 7282 2091 or Rob Plaskitt on 020 7282 2072.

Next steps

- 1.13 We will write to consultees with our detailed drafting proposals on the financial issues set out at the end of chapter 3 in July.

- 1.14 Subject to Network Rail's consent, we plan to implement any changes made as a result of this consultation in time for the start of the next control period.
- 1.15 We can modify a licence either by agreement with the licence holder or by referring the matter to the Competition Commission. We have discussed our proposals with Network Rail, and it broadly supports the structure and the more outputs based approach proposed. We are continuing to discuss individual changes and will consider responses to this consultation. If agreement cannot be reached with Network Rail on this package of proposals, we will consider referring it to the Competition Commission and the extent to which these modifications could be included in the periodic review notice as modifications to the conditions of a linked licence.

2. The licence and Network Rail's accountability

Network Rail's accountability

2.1 The licence is an important element of the framework within which Network Rail operates. The framework makes the company accountable for its management of the main national rail network (including both track and stations).

2.2 This framework includes accountability through:

- Network Rail's contracts with its customers;
- Network Rail's general legal obligations, in particular those relating to health and safety and the environment;
- the form and structure of outputs we specify in periodic reviews; and
- compliance with the obligations in its licences

in the context of:

- the incentive and financial framework established in periodic reviews;
- our safety and economic enforcement policies, including our economic penalties statement; and
- Network Rail's corporate governance.

2.3 It is vital that these elements fit together. They have all informed our thinking on the review of Network Rail's licence and on PR08 generally.

2.4 The current version of the licence can be found on our website¹. The licence covers a wide range of issues from Network Rail's core obligation to manage the network efficiently and effectively, through how it deals with its

¹ http://www.rail-reg.gov.uk/upload/pdf/netwrk_license.pdf.

stakeholders, to industry-wide arrangements, ring fencing and other constraints on its business.

2.5 The licence has been strengthened several times by this office since the Secretary of State granted it to Railtrack in 1994. For example:

- in 1997, we introduced the purpose and duty of the current condition 7 to fill a critical gap in Railtrack's accountability;
- in 2001, we introduced several new conditions, including obligations to ensure that the licence holder developed an asset register with accurate information about the condition and nature of its assets, to control the disposal of land, and to provide for the appointment of independent regulatory reporters;
- in 2002, we strengthened the existing ring-fencing condition;
- in 2003, we introduced a requirement to establish a new industry safety body (the Rail Safety and Standards Board); and
- in 2005, we introduced obligations to make Network Rail accountable for the development of route utilisation strategies, and to require it to facilitate railway service performance.

Our objectives

2.6 We have reviewed the licence in the light of our work on PR08, the integration of safety and economic regulation, and in the light of practice and experience.

2.7 We believe the licence generally works well because it has been repeatedly strengthened over the past 14 years. But we think there is scope to strengthen it further in several respects.

2.8 We consider that the licence should be more purpose driven ("purposive"), along the lines of the current condition 7. This means setting out the overall objective, within which Network Rail has flexibility about the way in which it delivers. Sometimes some of the specific obligations and procedural requirements in the licence may have led to Network Rail devoting too little attention to the wider purpose of the obligation, and have led us to consider minor potential breaches rather than concentrate resources on more significant issues.

- 2.9 Moving to a more purposive licence would mean that we could intervene where there is the greatest benefit – where the impact or potential impact most affects passengers, freight customers, funders and other stakeholders. In some cases there would be separate guidelines for some of the detailed processes, for example, the processes for exchange of information, in much the same way that the route utilisation strategy (RUS) guidelines sit outside the licence now.
- 2.10 We have also considered whether to make specific reference to health and safety, particularly in the core condition. We are satisfied that managing the network safely is already within the existing purpose and duty of the current condition 7, and that we have powers under health and safety legislation to address safety concerns. We explain our current thinking on obligations on safety standards later.
- 2.11 Our objectives in implementing our review and addressing the areas described above have therefore been that the licence should:
- set out in sufficient breadth, clearly and purposively, Network Rail's obligations (recognising that specific outputs are being set in our PR08 determinations);
 - support our intervention where necessary, in line with our enforcement policy. We expect to focus on serious and systemic failures which have the greatest impact or potential impact; we expect minor day to day failures to be resolved through contractual and other processes; and
 - allow Network Rail the flexibility to manage its business efficiently, and to respond to the changing needs of its customers and funders.
- 2.12 In addition to this, some changes will be needed to implement our determinations for PR08, and some reordering and redrafting will improve clarity and focus.
- 2.13 We expect these changes to result in a licence better able to meet the objectives above and to enable us to focus on those matters that have the greatest impact on passengers, freight customers, funders and other stakeholders. In short, our proposals should make the licence more powerful and fit for the next control period.

- 2.14 We consider that our approach is consistent with the principles of better regulation, to which we are committed. In particular, we consider our proposals ensure a proportionate approach to enforcement, because an increasingly purposive approach allows us to target our intervention where the impact of a possible contravention is greatest.

3. Increasing Network Rail's accountability

- 3.1 We have pursued the objectives set out in chapter 2 in developing changes to the licence. A link to the full revised licence we are consulting on is included at annex B. In this chapter, we describe the most important changes we are proposing to make with the overall aim of making Network Rail's accountability more effective.

Management of the network

The core role

- 3.2 Network Rail's core role is to manage the main national rail network, including the track, structures, and station infrastructure. The way it does this is mainly covered in the current condition 7 of the licence.

- 3.3 Condition 7 starts with a purpose:

"The purpose is to secure –

- a) the operation and maintenance of the network;
- b) the renewal and replacement of the network; and
- c) the improvement, enhancement and development of the network,

in each case in accordance with best practice and in a timely, efficient and economical manner so as to satisfy the reasonable requirements of persons providing services relating to railways and funders in respect of:

- i. the quality and capability of the network; and
- ii. the facilitation of railway service performance in respect of services for the carriage of passengers and goods by railway operating on the network."

- 3.4 The condition then imposes a general duty on Network Rail:

“The licence holder shall take such steps as are necessary or expedient so as to achieve the purpose to the greatest extent reasonably practicable having regard to all relevant circumstances including the ability of the licence holder to finance its licensed activities.”.

- 3.5 We consider that the purpose and general duty are well drafted and fit with our objectives. In particular, they set out the overall framework within which Network Rail must manage the infrastructure, while giving Network Rail an appropriate level of flexibility to choose how best to deliver its obligations. They also give us a wide discretion to intervene where it is most appropriate, and to focus on systemic problems and those with the greatest impact on passengers, freight customers, funders and other stakeholders.
- 3.6 We propose to retain these obligations at the heart of an updated licence, subject to one detailed drafting change to reflect our approach to enforcement of the condition. This change is to remove the words “take such steps as are necessary or expedient so as to” in the duty. In the past, it has been suggested to us that these words might be interpreted to mean that the licence holder is complying with condition 7 so long as it is taking steps to achieve the purpose. However we have made it clear that this is not the case, particularly in our decision to find Network Rail in breach of this condition in relation to infrastructure capability. Compliance means delivering the purpose, not just taking steps to do so. We therefore consider that these words add little to the duty. The rest of the duty clearly recognises that the circumstances of the individual case affect how Network Rail has to meet the purpose of the condition.
- 3.7 We propose to extend this purposive approach to other areas where possible.

Question 1 Do you agree the purposive approach is sensible and should be extended where possible?

Question 2 Do you agree the network management obligation set out in paragraphs 3.3 and 3.4 should remain at the heart of the licence, with the amendment mentioned in paragraph 3.6?

Emphasising key aspects of network management

- 3.8 The purpose of the current condition 7 is sufficiently broad to encompass all of Network Rail’s network management activities. However, we believe it is

helpful to emphasise some areas because of their importance now and for the next control period.

- 3.9 So we propose to strengthen the core condition to emphasise key aspects of the network management obligation on which we expect Network Rail to focus in order to deliver its obligations to its stakeholders. In delivering these specific obligations (outlined below), Network Rail will still need to ensure it achieves the overall purpose of the core condition.

Planning, capacity allocation and asset management

- 3.10 Although the purpose of condition 7 is very wide-ranging, there are three areas where we think we should emphasise Network Rail's role.
- 3.11 First, we consider a different approach is needed to business planning. At present Network Rail has an obligation to produce a business plan each year. We do not believe that this has helped its stakeholders plan their own businesses, as the plan can change every twelve months.
- 3.12 In reviewing the licence we have distinguished between planning for delivery and wider, more strategic industry planning.
- 3.13 As we say in our draft determinations for PR08, Network Rail should produce a delivery plan for the control period when it knows what outputs it must deliver and what funds it will have to deliver them. This plan will serve as an essential reference document for Network Rail's stakeholders during the control period, and delivery of the commitments in it would be ultimately enforceable under the licence. It is therefore important that we are able to ensure that the plan adequately reflects our PR08 determinations. The changes we propose give effect to these requirements and provide for us to object to aspects of the delivery plan for a control period. We see the delivery plan as "short term" planning in the context of the network management condition.
- 3.14 We also consider that the industry should give more thought to effective longer term planning to address the needs of the railway and those who use it. Network Rail is at the centre of the industry and has a key role in taking this forward. But for the plan to serve its purpose Network Rail must engage effectively with its customers. Longer term planning will help the industry and its funders understand the needs of the railway. It will help inform both action

that should be taken now and the development of governments' high level output specifications for future control periods.

- 3.15 So we propose to include in the licence a new obligation on Network Rail to plan how it will comply with the duty in the network management condition over the short, medium and long term to meet reasonably foreseeable future demand for railway services. We also propose to make explicit a requirement to consult with, and take account of the views of, service providers and funders to facilitate effective industry wide planning.
- 3.16 The changes we propose also provide for us to require Network Rail to produce additional plans and to amend plans to reflect changes in circumstances.
- 3.17 The second area we propose to emphasise is access planning. Given the experience of some new operators, we consider more should be done by Network Rail to plan future access to the railway and to be ready to respond effectively to substantive enquiries from those seeking to operate new services. This would help ensure it facilitates the development of new services that could benefit passengers and freight customers.
- 3.18 We think a new obligation to cooperate with the funders and providers of potential new services to find paths on the network will help focus Network Rail's attention on solving the problems identified by open access operators in particular. Although access planning is implicit in meeting the purpose of condition 7, there are no specific obligations in this area at present.
- 3.19 The third area is asset management. At present Network Rail has licence obligations in relation to asset information in condition 24 ("the asset register"). These obligations were introduced to address the failure of Network Rail's predecessor, Railtrack, to have adequate information about its assets. Specific requirements and deadlines were included in guidelines.
- 3.20 Given Network Rail's progress in meeting the milestones in the current asset register guidelines², we propose to move to a wider-ranging obligation to develop, publish and apply asset management policies and criteria, and to keep appropriate, accurate and accessible asset information. This maintains

² See letter from ORR to Network Rail of 14 May 2008:
<http://www.rail-reg.gov.uk/server/show/nav.145>

the general obligation on asset information while creating a specific obligation to strive for best practice in asset management generally.

Question 3 Should we emphasise Network Rail's planning, capacity allocation and asset management activities in the licence in this way? Is it appropriate to remove the existing asset register licence condition in the light of this?

Timetabling

- 3.21 Network Rail, along with passenger train operators, already has licence obligations about the provision of information for the passenger timetable. We have reviewed the obligations on Network Rail in the light of experience and are proposing some changes.
- 3.22 The current obligations in the licence cover three different aspects of timetabling. These are:
- an obligation to publish the national passenger train timetable. This is the timetable now published electronically twice a year in December and in late May or June;
 - an obligation to provide train operators with timetable information twelve weeks in advance (commonly known as T-12, so train operators can in turn provide information to passengers by T-9); and
 - an obligation to make timetabling information available to enquiry bureaux approved by the Secretary of State.
- 3.23 Establishing the timetable is part of the infrastructure manager's core role and is implicit in the purpose of the current condition 7. But we consider we should make a clearer statement in the licence about Network Rail's role to ensure that sufficient attention is given to making the timetabling process work in the most effective way. We therefore propose to introduce an obligation on Network Rail to run an efficient and effective industry timetabling process, which allows service providers to plan their businesses with a reasonable degree of assurance and enables passengers to plan their journeys. This condition would stress Network Rail's role in initiating changes to industry processes, where necessary and appropriate.

- 3.24 In addition to the obligations described above, which form part of the core network management condition, we are also proposing a separate condition which focuses on the purpose of advance information and why T-12 and T-9 are important. We propose to introduce a general duty on Network Rail to provide access to appropriate, accurate and timely information that enables railway passengers to plan their journeys.
- 3.25 We want to emphasise Network Rail's role in getting information about short-term disruption to the timetable due to maintenance, renewals or enhancements through to train operators, so that they can in turn advise their customers. The obligation we propose would have two parts:
- an obligation to establish and maintain efficient and effective processes reflecting best practice; and
 - an obligation to apply those processes to the greatest extent reasonably practicable having regard to all relevant circumstances.
- 3.26 The obligation we propose would expressly provide that Network Rail would be in compliance where it provided the information to holders of passenger licences by T-12. If Network Rail failed to do this, but still provided information in time for train operators to inform passengers by T-9, Network Rail would also be in compliance. This would focus Network Rail's attention on the needs of passengers.
- 3.27 We recognise that there may sometimes be good reasons why this will not be possible and have encompassed this in the drafting of the relevant licence condition. In particular, we propose that Network Rail would not be in breach of its obligations where two tests were met. These would be that:
- it provides access to information about relevant changes to holders of passenger licences as soon as is reasonably practicable having regard to all relevant circumstances; **and**
 - providing the information nine weeks or more before the relevant changes are to have effect would conflict, to a significant degree, with its duty under the network management condition.
- 3.28 We have considered whether, in addition to the requirements set out above, there should be a third test relating to satisfying the interests of passengers.

On balance, we have taken the view that satisfying the duty in this condition and the two tests above should ensure that the interests of passengers are addressed. We would however be grateful for views on this.

- 3.29 We also propose to broaden Network Rail's obligation to provide timetabling information to any enquiry bureaux and to reflect the increased use of the internet for accessing rail service information. We have therefore redrafted the current obligation in paragraph 9.5 of condition 9 to refer to enquiry services generally.

Question 4 Have we identified the issues in relation to Network Rail's role in the timetabling process? Do you agree we should clarify Network Rail's roles in timetabling in this way? Are the tests described in paragraph 3.27 sufficient?

Stakeholder relationships

- 3.30 Given Network Rail's monopoly position, it is vital that its obligations to those dependent on it are fit for purpose. We have examined this throughout our review of the licence.
- 3.31 Network Rail's relationships with its stakeholders are currently covered in different parts of the licence.
- 3.32 It has an obligation to meet the reasonable requirements of persons providing services relating to railways³ under condition 7. We propose to retain that obligation in the core condition, and it is a fundamental part of Network Rail's accountability and the framework for the form and structure of outputs in our draft determinations for PR08.
- 3.33 The licence also provides other mechanisms to protect the interests of Network Rail's stakeholders. For example:
- a broad obligation on Network Rail not to discriminate unduly between persons in its licensed (or related) activities;

³ Broadly defined to include railway services, the provision or maintenance of rolling stock, the development, maintenance or renewal of a network, station or light maintenance depot and the development, provision or maintenance of information systems related to railway services.

- an obligation to have and comply with an approved code of practice which sets out how Network Rail will deal with prospective customers and funders efficiently; and
- a specific obligation to attend meetings with passenger representatives and to share information.

- 3.34 We propose to strengthen these arrangements to broaden the focus of Network Rail's attention to its relationships with its stakeholders. In particular, we think we should develop the current "dependent persons" code condition to give Network Rail a more purposive obligation to treat a wider range of stakeholders appropriately.
- 3.35 We propose the new obligation will replace and extend the current licence conditions that deal with Transport *for* London (TfL), the Mayor of London and passenger representatives. We think it should also apply to current service providers (although, as now, it would not apply where contractual arrangements are already in place).
- 3.36 We propose to remove the current obligation on Network Rail to attend up to two meetings a year with passenger representatives. This is because we consider the wider, purposive approach we are proposing will be more effective. Under our proposals, Network Rail would have to meet with passenger representatives where necessary to achieve the purpose.
- 3.37 The more purposive structure will enable stakeholders to challenge Network Rail where engagement is lacking and contractual remedies are not available.
- 3.38 We will step back from approving a detailed code of practice. This will bring our role more into line with the network statement arrangements⁴. In these, we do not approve the statement published by Network Rail, but we consider appeals from train operators about the statement and related matters. These include being treated unfairly.

⁴ Regulation 11 of the Railways Infrastructure (Access and Management) Regulations 2005 obliges Network Rail to publish a network statement. The latest statement can be accessed here: [Network Rail - Network Statement](#). ORR has an appeal function under regulation 29. The Regulations are available at: [The Railways Infrastructure \(Access and Management\) Regulations 2005](#).

- 3.39 But we propose to retain an obligation on Network Rail to publish appropriate information about how it will deal with its stakeholders. Network Rail will have the flexibility to choose how it does this, whether by a code of practice or through documents like the network statement or otherwise, according to each stakeholder's particular needs. We would be able to require a change if the information published was inadequate to enable it to meet the purpose.
- 3.40 We propose to retain Network Rail's current obligation not to unduly discriminate between persons in its licensed (or related) activities. Although competition law might apply to some of the behaviour covered by this condition, we consider that this obligation would address other behaviour where it is difficult or not possible to determine an adverse effect on markets. We also consider that use of the licence may provide a swifter remedy than competition law.
- 3.41 This means that Network Rail's stakeholders will often have multiple protections under different parts of the licence. TfL, for example, would be protected under the network management condition as a funder and (through its concessionaire) as a service provider, and also under a revised and extended stakeholder condition, under the non-discrimination obligation, and through individual contracts.

Question 5 Do you agree the existing dependent persons code obligation should be strengthened in this way and the two licence conditions that deal with Transport for London, the Mayor of London and passenger representatives should be replaced?

Governance

- 3.42 Two conditions in Network Rail's licence deal with governance issues, including its staff incentive arrangements.
- 3.43 The current condition 27 concerns Network Rail's corporate governance generally.
- 3.44 The current condition 28 requires Network Rail to implement and comply with an incentives policy, and to align any staff incentive schemes with that policy. Network Rail is required to publish a summary of its incentive arrangements for senior managers known as the Management Incentive Plan (MIP). In formulating those arrangements, Network Rail must have particular regard to:

- the achievement of the purpose of its network stewardship and dependent persons code obligations (current licence conditions 7 and 25);
- licence enforcement orders made by ORR, and compliance with its access agreement obligations;
- any other objectives set by ORR.

3.45 We are reviewing Network Rail's corporate governance and are examining how it compares to that of other companies. We will consider separately and at a later date whether any changes are needed to the corporate governance obligations in the licence.

3.46 However, we think there are some changes that should be made now to increase the transparency of the development and implementation of the MIP. These changes do not raise any major policy issues about Network Rail's incentive arrangements and are relatively straightforward. But we consider that it is often unclear to Network Rail's stakeholders how the company has addressed performance issues in the MIP and the bonuses that stem from it. The additional transparency which would result from our changes would increase the accountability of Network Rail's remuneration committee in dealing with the MIP and its implementation.

3.47 We propose:

- to broaden the range of factors Network Rail⁵ must consider when formulating its incentive schemes to include compliance with the whole licence;
- to clarify that Network Rail should again consider those factors when applying its incentive schemes; and
- to require Network Rail to explain how it has balanced all the factors considered when setting the bonuses of its senior managers in a public statement.

⁵ In particular, its remuneration committee.

Question 6 Do you agree we should modify Network Rail's management incentive licence condition in these ways to increase transparency?

Changes to financial conditions for the next control period

- 3.48 Part C of our draft determinations for PR08 explains our conclusions on Network Rail's financial framework. As part of the financial framework, and in conjunction with the overall licence review, we are reviewing the financial conditions included in the licence. In our February 2008 advice to Ministers, we identified three general issues for this review. These are described below.
- 3.49 First, we need to take appropriate account of Network Rail's corporate/industry status and relationship with government. The proposed benefit sharing arrangements discussed in Part E of our draft determinations for PR08 contemplate payments being made by Network Rail. We will review the drafting of the licence and ensure that it is clear that these payments can be made, either in accordance with our policy on this issue or with our explicit consent to the appropriate payments. We are also considering the detailed mechanics of the indebtedness part of the financial ring-fence condition and how the government is referred to – for example in the definition of a cross-default obligation.
- 3.50 Second, we will reflect in the licence any appropriate changes required as a result of Network Rail's unsupported debt policy – for example, the restriction of the financial indemnity mechanism (FIM).
- 3.51 Network Rail benefits from a government guarantee of its debt through the FIM. Part C of the draft determinations explains in detail our policy in this area. In summary, we support Network Rail's intention to restrict the use of the FIM from the start of the next control period, which will mean that any additional debt will need to be raised on an unsupported basis. Our proposals on modifications to the financial conditions will include the modifications to Network Rail's licence necessary to support this policy.
- 3.52 We are considering what other related changes will be required. For example, we may want to strengthen further the directors' statements on the adequacy of resources and consider whether we should relax the current limits on indebtedness in the licence.

- 3.53 Third, in our February 2008 advice to Ministers we said that, where appropriate, we would update the financial ring-fence to reflect best practice. Having reviewed the licence conditions used by the other regulators, we consider that Network Rail's current financial ring-fence is largely in line with best practice. However there are some areas that could be improved or clarified. These include:
- (a) the current rules for the de minimis limit and how it is calculated, which are not as clear as they could be. We are considering revising the rules so that it is clear that the investment test is cumulative. We are also considering including a test related to turnover, which would enable activities that do not need a large investment but can create a large risk to be covered by the restriction. In order to ensure that the de minimis limit remains appropriate between access charges reviews, we are also considering either adjusting the limit for inflation or converting the limit to a percentage based test – for example to a percentage of capital and reserves or RAB; and
 - (b) the requirements of the sufficiency of resources part of the condition. We are considering tightening up, for example, the definition of resources, the definition of the obligations of the licence that Network Rail needs to be in compliance with and the audit of the sufficiency of resources certificate.
- 3.54 We will publish detailed drafting on these changes to the financial licence conditions in July.

4. A clearer, more cohesive licence

4.1 We consider that the structure of Network Rail's licence could be simplified to make it easier to read and understand. In part, the current structure reflects the licence's evolution with new conditions being gradually added to solve particular problems.

4.2 First, we propose to restructure the licence into six parts. This would bring together related obligations currently scattered throughout the licence, and would involve renumbering. The effect of our proposed changes would be to make the licence more cohesive and easier for Network Rail's stakeholders to use. The six parts deal with:

- network management – based on the current licence condition 7, but including those aspects which amplify the purpose of that condition;
- restrictions on activities – bringing together ring fencing, land disposal, debt and other conditions which control the scope of Network Rail's business;
- dealings with third parties – conditions dealing with stakeholder relations and non-discrimination;
- information requirements – consolidating conditions relating to reporters, the annual return, regulatory accounts and similar provisions;
- corporate matters – including governance and incentive schemes; and
- standard industry obligations – with conditions relating to insurance, standards and environmental policy.

Question 7 Do you agree that restructuring the licence in this way would be helpful?

4.3 Second, we are concerned that some of the detail in the current licence may detract from the focus on the overall purpose of the obligations. We propose to move some details about key processes from the licence into guidelines or notices. This will make the core requirements in the licence clearer and provide more flexibility to adjust processes as needed. Compliance with such

guidelines and notices would still be enforceable through the licence, and we would need to approve any changes.

- 4.4 For example, processes for establishing RUSs and Network Rail's business plan are currently set out in detail in the licence. We propose to move these details into guidelines or notices (as appropriate).
- 4.5 We do not currently propose to change the arrangements which apply now. For example, the 60 days we have in which to object to a RUS before it is established would remain. We will, however, need to update the relevant guidelines – in the case of RUSs with the assistance of the rail industry planning group. We will also take the opportunity to clarify process issues, such as when representations need to be with us to be properly considered within the 60 day period.
- 4.6 We propose to adopt a similar approach with Network Rail's delivery plan for a control period. This would include an ability for us to object to the delivery plan which would be time limited to reduce potential uncertainty about the status of the delivery plan. We would expect Network Rail to have worked with its stakeholders in developing the plan.

Question 8 Do you have any views on whether we should move some details about key processes from the licence into guidelines or notices?

- 4.7 We propose to remove the systems code provisions currently set out in licence condition 20. The systems code was established in 1996 to ensure that interfaces between key operational and timetabling systems were maintained. However, the obligation only applies to Network Rail and not to other industry parties, and we are not aware of the code being used in recent years. In view of this, we are unsure whether there is any benefit in retaining the obligation. We therefore propose to remove this condition, subject to your views.

Question 9 Do you agree the systems code provisions can be removed from the licence? If so, do you think there is a need to maintain the systems code in some form?

- 4.8 We have considered whether changes are needed to the safety and standards condition (current licence condition 6) in the light of developments since its introduction. These developments include an increasing number of

European interoperable standards (technical specifications for interoperability) and changes in our role both as a result of European law and of the merger of economic and safety regulation. These changes give rise to complex issues that we wish to consider separately. We have therefore asked for views on the application of standards⁶ and will consider whether any changes are needed to licences following this review at a later stage.

- 4.9 We are not proposing any changes to the drafting of the environmental matters condition (current condition 8). This condition is included in all operator licences in a standard form. It was considered in our review of how we discharge our sustainable development and environmental duties in October 2006. We concluded in April 2007 that we would not seek to change the condition. Work has instead focused on updating associated guidance and developing industry Key Performance Indicators⁷.
- 4.10 Finally, we have reordered and used plainer English in some parts of the licence where this improves clarity.

Question 10 Do you have any other suggestions for improving the clarity or effectiveness of the licence?

⁶ See http://www.rail-reg.gov.uk/upload/pdf/cons-stndrds_reg_160508.pdf

⁷ See <http://www.rail-reg.gov.uk/upload/pdf/324.pdf>

5. List of questions

- Question 1 Do you agree the purposive approach is sensible and should be extended where possible?
- Question 2 Do you agree the network management obligation set out in paragraphs 3.3 and 3.4 should remain at the heart of the licence, with the amendment mentioned in paragraph 3.6?
- Question 3 Should we emphasise Network Rail's planning, capacity allocation and asset management activities in the licence in this way? Is it appropriate to remove the existing asset register licence condition in the light of this?
- Question 4 Have we identified the issues in relation to Network Rail's role in the timetabling process? Do you agree we should clarify Network Rail's roles in timetabling in this way? Are the tests described in paragraph 3.27 sufficient?
- Question 5 Do you agree the existing dependent persons code obligation should be strengthened in this way and the two licence conditions that deal with Transport for London, the Mayor of London and passenger representatives should be replaced?
- Question 6 Do you agree we should modify Network Rail's management incentive licence condition in these ways to increase transparency?
- Question 7 Do you agree that restructuring the licence in this way would be helpful?
- Question 8 Do you have any views on whether we should move some details about key processes from the licence into guidelines or notices?
- Question 9 Do you agree the systems code provisions can be removed from the licence? If so, do you think there is a need to maintain the systems code in some form?
- Question 10 Do you have any other suggestions for improving the clarity or effectiveness of the licence?

Annex A Summary of current licence conditions and proposed changes

Current licence condition		New condition number and main changes proposed	
1	Insurance	20	No changes proposed.
2	Claims allocation and handling	21	No changes proposed.
3	Not used	-	-
4	Not used	-	-
5	RPC and LTUC	8	The definition of stakeholders in the new condition is extended to include passenger representatives. The detailed obligation to attend meetings and provide information is replaced by a wider obligation to cooperate with passenger representatives.
6	Safety and standards	22	No significant changes proposed. We will consider the role of Railway Group Standards as part of the standards project in our 2008-09 business plan (see paragraph 4.8 and footnote 6 above).
7	Stewardship of the network	1	<p>The purpose and general duty now form the core of a new condition 1.</p> <p>In the general duty, the reference to taking “such steps as are necessary or expedient” has been deleted to reflect better our approach to enforcement of the condition.</p> <p>Detailed arrangements concerning criteria, RUSs, and business planning have been replaced with a new obligation to carry out effective planning in consultation with stakeholders, to meet the general duty in the short, medium and long term. Provision is made for specific documents to be prepared, including a delivery plan, RUSs and any other documents we require. There is a new general provision for detailed requirements to be set out in notices/guidelines as appropriate.</p> <p>We have introduced new arrangements for planning which focus on both a delivery plan for a control period and longer term strategic planning.</p> <p>We have included a new high level asset management obligation with a specific requirement for the licence holder to have fit for purpose asset information.</p> <p>A new high level obligation to cooperate to help find paths on the network to meet reasonable requirements has been included. This will fill the gap between shorter-term timetable planning and longer term RUSs, and help reduce obstacles experienced by open access operators.</p> <p>We have also included a more general obligation to run an efficient and effective timetabling process (see also below under timetabling).</p>
8	Environment	23	No changes proposed.

Current licence condition		New condition number and main changes proposed	
9	Timetabling	1	The obligations have been redrafted and split between two new conditions. A clearer high-level obligation to run an efficient and effective timetabling process that reflects best practice and allows service providers and other participants in the timetabling process to plan their businesses with reasonable assurance. This replaces conditions 9.1 to 9.3 in the current licence.
		2	A new general duty to provide access to timetable information to enable passengers to plan their journeys. The current obligation to publish a timetable is retained but with an additional requirement that this is at least 9 weeks in advance. The obligation to provide information to enquiry bureaux is extended to all enquiry services. Network Rail's role in getting information to customers (via train operators) about short-term disruption is emphasised, with specific references to T-12 and T-9 timescales. The drafting acknowledges there will sometimes be good reasons why this will not be possible.
10	Non-discrimination	9	No changes proposed.
11	Prohibition of cross-subsidy	6	No changes proposed.
12	Ring-fencing and accounting records	4	Some changes will be required for PR08 (see paragraphs 3.48 to 3.54).
13	Restriction on interests in train operating and rolling stock companies	5	No significant changes proposed.
14	Cooperation with the Mayor of London and TfL	8	The new condition 8 is extended to include the Mayor of London and TfL. Explicit reference to Network Rail's obligation to cooperate with the Mayor and TfL is retained, for the purpose of ensuring efficient service provision and coordinating anticipated investments.
15	Provision of information to ORR	10	The condition has been split between general arrangements for providing information to ORR and those dealing with the annual return. No changes proposed.
		12	The detailed list of examples of what shall be in the annual return has been deleted for clarity. The existing requirement for two years notice to be given of changes to statistical data required has been amended to allow the licence holder and ORR to agree changes without 2 years notice.
16	Not used.	-	-
17	Payment of fees	18	No changes proposed.
18	Restriction on use of certain information	14	No changes proposed.
19	Change of control	19	No changes proposed.
20	Systems code	-	We propose to delete this condition (see paragraph 4.7).
21	Not used.	-	-
22	Regulatory accounts	11	Some redrafting has been made to improve clarity. Further changes may be necessary for PR08.
23	Appointment and role of reporters	13	The condition has been redrafted to improve clarity. Detailed examples of what may be covered by guidelines have been deleted.

Current licence condition		New condition number and main changes proposed	
24	Asset register	1	Specific condition removed. Condition 1 now contains a high-level obligation to develop, publish and apply asset management policies and criteria, and to keep appropriate, accurate and accessible asset information.
25	Dependent persons	8	Reorganised and strengthened as a more purposive obligation to treat a wider range of stakeholders appropriately, given their particular requirements, and to publish how this will be done. We will step back from detailed approval of any code of practice, but would retain the power to direct Network Rail to review and revise arrangements if they prove inadequate. This is consistent with the way the network statement works, where we have an appeal function. The condition has specific references to RPC/LTUC and Mayor of London/TfL given their special needs. The list of stakeholders is extended to include current (rather than just prospective) service providers and funders. The exception for contractual matters is retained.
26	Disposal of land	7	No changes proposed.
27	Corporate governance	15	No changes proposed.
28	Management incentive plan	16	The condition has been reordered for clarity. References to licence conditions 7 and 25 and to enforcement orders have been replaced by a general reference to compliance with the licence. Other changes designed to improve transparency are: to clarify the criteria are to be considered both when formulating and applying incentives schemes; and a new obligation on Network Rail to explain how it has balanced all the factors considered when setting bonuses.
29	Level of financial indebtedness	3	Significant changes will be required for PR08.

Annex B Link to draft licence including proposed modifications

See http://www.rail-reg.gov.uk/upload/pdf/netlic_draft_050608.pdf.