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To Network Rail, charter train operators and ATOC

Dear colleagues

## **Proposed contractual provisions to implement our draft conclusions on structure of charges and Schedule 8 performance regime for charter operators**

### **Purpose**

The purpose of this letter is to consult you on the contractual drafting we propose to make to charter track access contracts as part of the 2013 periodic review (PR13).

### **Introduction**

On 23 August 2013, we issued our *Draft conclusions on structure of charges and Schedule 8 performance regime for charter operators*<sup>1</sup>. In this, we said we would consult further on the specific changes that we would need to make to charter track access contracts to give effect to these draft conclusions – if we were to implement them.

We set out in the Annex to this letter an overview of the main changes we are proposing to make to the current track access contract provisions for charter operators<sup>2</sup>. We also set out the two process options for how contracts could be amended, following the discussion at the meeting of ORR, Network Rail and charter operators in August 2013.

The specific contractual provisions showing our proposed changes to Schedules 7 and 8, and proposed consequential changes to other parts of the contract are set out on our website at:

<http://www.rail-reg.gov.uk/pr13/consultations/implementing-charter-operators.php>

That page also includes a link to a copy of the proposed Traction Electricity Rules, paragraph 18 of which is relevant to our proposed changes to Schedule 7 of the contract.

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<sup>1</sup> Available at <http://www.rail-reg.gov.uk/pr13/PDF/charter-operators.pdf>.

<sup>2</sup> <http://www.rail-reg.gov.uk/upload/pdf/model-charter-contract-2011-12-06.pdf>.

It is important that the changes that we ultimately make to contracts as part of PR13 correctly reflect our conclusions and also take into account the views of interested parties. Hence, we are particularly keen to have your comments on these proposed changes.

### **Responding to this consultation**

We welcome responses on any aspect of the proposed drafting. This is a six week consultation. Please send your responses in electronic format (or if not possible, in hard-copy format) by **25 October 2013** to:

Alice Jones  
Email: [alice.jones@orr.gsi.gov.uk](mailto:alice.jones@orr.gsi.gov.uk)  
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Our aim is that all documents on our website adhere to certain standards of accessibility. For this reason, we would prefer to receive your correspondence in an editable format such as Microsoft Word. If you do send a PDF document or similar, we would be grateful if you could create it from an electronic file rather than an image scan, and ensure that 'no security' is set in the document properties.

If you send a written response, you should indicate clearly if you wish all or part of your response to remain confidential to ORR. Otherwise, we would expect to make it available on our website and potentially to quote from it. Where your response is made in confidence please can you provide a statement summarising it, excluding the confidential information, which can be treated as a non-confidential response. We may also publish the names of respondents in future documents or on our website, unless you indicate that you wish your name to be withheld.

We will take into account all comments we receive responding to this consultation and, where relevant, our wider consultation on contractual wording for passenger and freight contracts, in the changes that we make to charter contracts as part of PR13.

Yours faithfully

A handwritten signature in black ink that reads "Emily Bulman". The signature is written in a cursive style with a long, sweeping underline.

**Emily Bulman**

## **Annex: Overview of proposed changes to charter track access contracts**

### **Relevant documents**

1. This annex should be read with our proposed changes to contractual wording the charter model contract and Traction Electricity Rules. These can be found at:

<http://www.rail-reg.gov.uk/pr13/consultations/implementing-charter-operators.php>

2. These contractual changes implement our draft conclusions for charter operators, which can be found at: <http://www.rail-reg.gov.uk/pr13/consultations/charter-operators.php>

3. Consultees may find it helpful to be aware that we have also consulted on contractual changes to (non-charter) passenger and freight contracts. This consultation and changes to contractual wording can be found at <http://www.rail-reg.gov.uk/pr13/consultations/pr13-implementation.php>. Many of the changes we are proposing in this consultation are analogous to changes or existing provisions in those contracts. These contractual changes are the implementation of changes on which we concluded in our PR13 draft determination, which can be found at <http://www.rail-reg.gov.uk/pr13/consultations/draft-determination.php>

### **Changes to Schedule 7 of charter track access contracts**

#### *General changes*

4. We are proposing to make a change to the contract that is separate from the policy changes on which we have concluded as part of PR13. In CP4, the charter contract has made reference to the “relevant services” in both its principal formula (Part 2 paragraph 1) and with respect to individual charges. In contrast, the passenger and freight contracts make reference to “relevant year” and “charging period” respectively in the principal charging formula. We are proposing to substitute reference in charter contracts to “relevant services” with that of “relevant year”. We are proposing this change because:

- (a) first, as charges change each year, to adjust for RPI, the charges need to be summed by each year separately, but this is not sufficiently clear in the existing wording; and

- (b) second, we do not see that the concept of “relevant services”, in the way it is currently defined and applied to charter Schedule 7, has any practical purpose.

Please note that we have **not** marked up this change in the draft charter contract – however, we still seek your comments on the proposal.

5. We have moved the rates for all charges (including the slot charge) from the contract (old Appendix 7D) to the relevant price lists. This is consistent with all other track access contracts and is more transparent. Network Rail publishes the price lists, and will prepare price lists in a format consistent with the contracts in October 2013. The draft prices for charter are given in our 23 August 2013 draft conclusions.

#### *Capacity charge*

6. We have included provisions to apply a capacity charge to charter services.

7. In our 23 August 2013 draft conclusions, we said that we would introduce a capacity charge for charter operators in CP5. We said that we would do this in a manner consistent with our proposals in relation to the capacity charge for all other operators, as outlined in our draft determination.

8. In the draft determination, we proposed for CP5 to either retain the CP4 capacity charge rates (and, in the case of new charges, methodology), or implement a version of a proposal put forward by the Rail Freight Operators' Association (RFOA), using the rates derived by Arup. In the draft Schedule 7, we have included wording in relation to the capacity charge consistent with retaining the CP4 approach for levying the charge, as is currently the position in other operators' contracts.

9. In paragraphs 16.110-16.117 of the draft determination, we discussed the RFOA's proposal for an alternative approach for calculating the capacity charge for freight operators. As part of the draft determination, we have sought views on this and whether, if adopted for freight, this approach should also apply to other services<sup>3</sup>. If we were to decide to implement some form of this arrangement, it would necessitate changes to the section of charter Schedule 7 which deals with the capacity charge. We will consult in due course on contractual wording that would implement such changes.

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<sup>3</sup> As part of this process we published a letter which can be found at: <http://www.rail-reg.gov.uk/pr13/consultations/capacity-charge.php>; and RDG has prepared an alternative proposal which was submitted to us by Network Rail as part of the responses to our draft determination.

### *Traction electricity*

10. In our 23 August 2013 letter, we agreed with Network Rail's conclusion that charter would pay the actual unit electricity prices paid by Network Rail, consistent with those paid by passenger operators. We have also concluded on this change for freight operators as part of PR13. To implement this change, we have incorporated contractual wording, similar to that in the passenger contract and our proposed CP5 freight contract, relating to the charge formula and procurement strategy. A charter operator may wish to agree an electricity procurement strategy with Network Rail if it also runs a large number of other electrically powered schedule services. We recognise, however, that it would be disproportionate for a small operator to agree anything but the simplest form of procurement strategy with Network Rail, in which case our presumption is that it would simply pay the market rate as charged to Network Rail by its electricity supplier.

11. In our 23 August 2013 letter, we said that we considered charter services should be included in the volume and cost reconciliation (wash-up) for traction electricity. However, we also said that we wished to understand both the administrative complexity that this might entail (e.g. from the incorporation of the Traction Electricity Rules into the contracts) and the implications for Network Rail's billing system before proceeding. We have now considered both these elements further.

- (a) With respect to contractual complexity, we note that most of the Traction Electricity Rules relate to on-train metering. There is only one substantive paragraph (paragraph 18) of the Traction Electricity Rules would be of relevance to charter operators<sup>4</sup> (as they are currently billed on the basis of modelled consumption rates). Therefore, the increase in contractual complexity would not be significant. Network Rail would calculate the wash-up in accordance with this paragraph, just as it would do for all other modelled train services.
- (b) Whilst Network Rail has advised that, in principle, its billing system can accommodate this change, it is currently discussing with us how proportionate this would be. Should we conclude that there are disproportionate costs to Network Rail associated with this, we propose that the alternative approach would be to exempt charter services from the year-end cost and volume reconciliations (and hence from the Traction Electricity Rules), because these reconciliations form part of the billing

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<sup>4</sup> Paragraph 18 sets out how the volume and cost reconciliation processes work. As currently drafted, paragraph 18 only cross-refers to freight and passenger operators' Schedule 7s, but this could be amended to accommodate the inclusion of charter operators in the Traction Electricity Rules.

system. In both cases, charter operators would be billing on the basis of their modelled EC4T rates.

12. Assuming that we conclude that the billing process would not be disproportionate, and noting that no party objected to moving towards more cost reflective billing for traction electricity in Network Rail's consultation<sup>5</sup>, we propose that the same arrangements that apply to other operators should apply to charter operators for the billing of traction electricity. Our proposed revised Schedule 7 reflects this.

#### *Indexation provisions*

13. In the amended Schedule 7, we have included provisions that would apply our proposed 'true-up' approach to adjusting charges for RPI each year. This is consistent with what we proposed for other train operators in chapter 7 of our July 2013 consultation<sup>6</sup>. We have not yet had time to consider fully the comments on our indexation proposals. However, we will take these comments and any other comments made by respondents to this charter consultation into account when we produce the finalised contractual provisions.

#### *Other changes to Schedule 7*

14. We have made changes to reflect our decisions on the electrification usage asset charge and variable usage charge (including the application of a charge for light locomotive movements).

15. The revised Schedule 7 also reflects some other minor changes (such as changes to paragraph 9 of part 2 relating to supplements to the price lists), consistent with those proposed in our July 2013 implementation consultation for other train operators. Please see that document for further details of these.

#### **Changes to Schedule 8 of charter track access contracts**

16. In our 23 August 2013 letter, we concluded on the following changes to Schedule 8:

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<sup>5</sup> *Structure of charges for charter operators in CP5 – conclusions*, Network Rail, August 2013, available at <http://www.networkrail.co.uk/WorkArea/DownloadAsset.aspx?id=30064787226>.

<sup>6</sup> For an explanation of the 'true-up' approach, please see *Consultation on implementing PR13*, July 2013, available at <http://www.rail-reg.gov.uk/pr13/PDF/pr13-implementation-consultation.pdf>.

- (a) to introduce benchmarks for both Network Rail and charter operators, with compensation being paid for worse than benchmark performance and bonuses paid for better than benchmark performance;
- (b) to introduce an annual adjustment to the charter operator benchmark to reflect changes in traffic levels, which affects the average number of third party trains delayed as a result of a charter operator incident;
- (c) to introduce a menu of incident caps, each available to charter operators in return for an access charge supplement (ACS), to replace the current charter operator and Network Rail caps; and
- (d) to introduce reciprocal annual caps on Schedule 8 liability, consistent with the 'small operator' caps currently in place for the freight Schedule 8 – i.e. an annual cap of approximately £0.5m with all charter operators treated as 'small operators'.

17. We have amended the contractual wording of Schedule 8 to reflect these changes. A large amount of the drafting has been taken from the freight operator Schedule 8, which has worked effectively throughout CP4. Where we have done this, we have amended the contractual definitions and formulae, so they are consistent with those used elsewhere in the charter operator Schedule 8.

18. We have drafted the contract so that the incident caps continue to apply in respect of a planned service, rather than a single incident, to be consistent with the current charter operator and Network Rail caps.

19. We have also included some wording in relation to the newly introduced reciprocal annual cap, so it can be adjusted only if the annual mileage of a particular operator reaches or exceeds 1,000,000 miles.

### **Consequential changes to charter track access contracts**

20. We have made a number of minor changes to charter contracts which are necessary or expedient to give effect to changes elsewhere. These include the incorporation of the Traction Electricity Rules into the contract and the amendment of Schedule 10 (Modifications to the Network Code) to widen the scope to enable any consequential changes to be made to the contract in the event that the Traction Electricity Rules are themselves amended.

21. The incorporation of charter operators in the Traction Electricity Rules would necessitate a number of minor changes to those rules because the current rules (called in CP4 The EC4T Metering Rules) exclude charter operators.

## **Process for making amendments to charter track access contracts**

22. Most charter contracts are due to expire in August 2014 (though First Greater Western's contract expires in 2016). It has been noted that it would be administratively cumbersome for these contracts to be amended through the PR13 review notice process but then only apply for a few months further before expiring in August when new contracts would need to be entered into. An alternative suggestion proposed by DBS was to terminate all contracts early on 31 March 2014, and enter into new contracts applicable for five years from 1 April 2014.

23. We agree that if contracts are not extended by an amendment beyond August 2014, then this would be an administratively inefficient process. We consider that there are two alternative options, as follows.

### *Option 1 – review notice and contract extension*

24. Under this option, ORR would amend the existing contracts through the periodic review process (as per our original plan). However, Network Rail and each charter operator would extend the expiry date of their contracts so that they do not expire in August.

25. Administratively, this would require two supplemental agreements per contract to be agreed: one to extend the contracts, and one to confirm that both parties have given effect to the terms of our review notice. Network Rail would then need to update the consolidated versions of the charter contracts to reflect the amendments.

### *Option 2 – terminate contracts early and enter into new contracts before 1 April 2014*

26. Under this option, Network Rail and each charter train operator would agree an amendment to terminate their contracts early on 31 March 2014 and then enter into a new contract on the CP5 model terms.

27. Administratively, this would require a supplemental agreement to terminate current contracts early on 31 March 2014. Network Rail would then need to update its consolidated versions of each contract within 28 days of the amendment. Then, before 1 April 2014, Network Rail and each operator would need to enter into new track access contracts using the revised model contract with the new CP5 terms.

### *Consideration*

28. Our view is that, broadly, both equate to a similar administrative requirement on the industry. However, we note that, under option 2, if contracts are terminated early and

Network Rail formally objects to the overall periodic review<sup>7</sup>, we would not be able to issue a revised model contract for CP5 until after that objection is resolved. This would be after 1 April 2014.

29. If Network Rail did object, Network Rail and charter operators would quickly need to agree a new track access contract arrangement to ensure their services could continue to operate (and which could by necessity be on the same model terms as the version they would have just terminated), but including a re-opener to ensure that the finalised CP5 access charges can be applied retrospectively back to 1 April 2014 once Network Rail's objection has been resolved. This would be administratively time-consuming. Therefore, our view is that the least risky (and preferable) approach overall is option 1.

30. Therefore, option 1 will be our default approach unless Network Rail and all charter operators collectively prefer option 2. If this is the case, we would be grateful if they would advise us ahead of the end of this consultation. (It is important that there is unanimity on this, as it would be administrative inefficient for Network Rail and ORR to carry out option 1 for some operators and option 2 for others.)

31. It would also be important for us to have certainty that all contracts would expire early, so if option 2 is preferred, we would ask that steps are taken to amend the expiry dates of the contracts by the end of October 2013. This is so that we know whether we need to prepare review notices during November and December.

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<sup>7</sup> Under the Railways Act 1993, Network Rail has the right to object to the changes we propose to make to implement an access charges review. We expect to give Network Rail until 7 February 2014 to lodge an objection.