

7 August 2007

All operators with liability insurance obligations

### **Third party liability insurance**

In my letter of 23 February I outlined the Office of Rail Regulation's (ORR's) conclusions following a review of our third party liability insurance (TPLI) requirements'. This letter confirms what we have done so far, and asks for your views on Network Rail's proposal that operators should jointly purchase catastrophe level TPLI.

#### *A simplified approval process*

In February, we said we would introduce a new general approval, to replace the old system of individual approvals. We also said we would streamline our assessment procedures, dropping the requirement for auditors' letters and annual director declarations for established operators. We made those changes in March, and your brokers now confirm to us that your TPLI complies with the general approval. The system is working well. We are considering how best to monitor the new regime.

#### *Network Rail's proposal*

Network Rail suggested that it could buy enhanced catastrophe level cover for all operators with a significant saving in whole-industry costs. Network Rail has subsequently developed that proposal.

The idea is that:

- Operators would buy their own TPLI cover as now, up to £100M per incident.
- A further £100M cover would be bought on behalf of all operators, taking the total cover available per incident to £200M.
- This industry excess layer would be organised by Network Rail, and could (subject to industry agreement) be effective from April 2008.
- The policy would cover all rail industry parties – including ORR licensed TOCs, FOCs, station and LMD operators, as well as some licence exempt operators - that use Network Rail infrastructure.

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<sup>1</sup> <http://www.rail-reg.gov.uk/upload/pdf/insrev-orr-conc-imp.pdf>

- The policy would aim to match or better the scope of all policies currently on the market.
- Cover would be on a 'costs exclusive basis' so costs would not erode the £200M limit.

The benefits of this proposal would be:

- Greater overall catastrophe protection for risks faced by the industry as a whole.
- Total premia paid by the industry would be reduced, reflecting the benefits of centralised purchasing and lower administration costs.
- Operators would still have a strong incentive to manage their own risks properly, since they would buy their own insurance up to the £100M level, where the unit costs of cover are highest.

For such a scheme to work it would likely require:

- Commitment from Network Rail and operators to work together in partnership.
- Agreement on fair funding arrangements.
- Access to data about operations. Confidentiality issues might need to be addressed where data was gathered from each operator individually. The RSSB Safety Risk Model considers risk on a system wide basis and its outputs may also be useful.
- As many participants as possible.

On funding, one option would be to recover the relatively small premium needed through Network Rail's track access charges, to be included as part of the next periodic review. However, this approach would create windfall winners and losers, given franchise agreement mechanisms; some LMD operators who would be covered do not pay track access charges.

A second option would be for Network Rail to invoice the costs of the scheme directly to participants, who would expect to make greater savings in their other arrangements. This would take Network Rail into new areas, require the cooperation of all the other operators and, potentially, some new contractual arrangements. This is our preferred option.

A handful of operators are allowed to buy lower levels of TPLI (less than £100M), as variations from ORR's general approval. Those variations will continue to apply. They

could be explicitly exempted from the scheme and would not be expected to pay additional premia. If we adopted the first option for funding, therefore, we would need to ensure that it catered for this.

We welcome your comments on the Network Rail proposal. We are particularly interested to hear your views on the following issues:

- 1) **Would you be interested in participating in such a scheme?**
- 2) **Do you agree that there would be net benefits to arranging catastrophe level cover collectively up to £200M? If so, what do you think the net benefits will be? If not, why not ?**
- 3) **How should the costs of this scheme be recovered?**
- 4) **Do you agree the proposal is worth further consideration, perhaps via an industry seminar?**
- 5) **Should participation be compulsory?**

Under Condition 12 of its network licence Network Rail would normally need our consent to undertake anything other than Permitted Business (which includes network business and ancillary services). We think this proposed activity would need our consent. This could depend on the way that the scheme is set up. Our main concerns would be to ensure that the scheme was self-funding, that resources would not be diverted from Network Rail's core business and that Network Rail's income would not be used to distort other markets. Alternatively, Network Rail could use the *de minimis* facility in the licence, which allows it to carry on a non-permitted activity up to a specified amount. If the scheme is adopted, we will discuss implementation with Network Rail with this in mind.

We have made no decisions as yet about this proposal. **We would be interested in receiving your comments, if possible by 7 September 2007.** We would prefer to receive responses by email to [Gordon.Herbert@orr.gsi.gov.uk](mailto:Gordon.Herbert@orr.gsi.gov.uk). Alternatively, write to:

Gordon Herbert  
Licensing Team, Office of Rail Regulation  
One Kemble Street  
London WC2B 4AN

As usual, you should indicate clearly if you wish all or part of your response to remain confidential to ORR. Otherwise, we will make it available in our library, publish it on our website and we may quote from it. Where you make a response in confidence, you should

attach a summary, excluding the confidential information, which can be treated as above. We may also publish the names of respondents in future documents or on our website, unless a respondent indicates that they wish their name to be withheld.

Yours sincerely

A handwritten signature in black ink that reads "Rob Plaskitt". The signature is written in a cursive style with a large, sweeping initial 'R' and a distinct 'P'.

**Rob Plaskitt**