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23 April 2008

Network Rail
Franchised passenger train operators

CC Freight Operators
Non-franchised passenger operators
Department for Transport
Transport Scotland
PTE's
Transport for London
Transport Wales

Dear Sir/Madam

Periodic Review 2008 implementation

Overview

This is a consultation letter about a section 22 amendment that we would like you to consider making to your track access contracts to facilitate the implementation of the periodic review 2008 (PR08).

The amendment would allow the contents of any review notice served by us when implementing PR08 and any future access charges review to have effect in franchised passenger train operators' track access contracts regardless of whether the implementation process is then delayed, as a result of Network Rail exercising its statutory right to object to the notice.

These arrangements should continue to facilitate a more efficient implementation process at future periodic reviews. The change would in this case enable the CP4 regime, including not just access charges but required outputs to be implemented as planned from 1 April 2009 replacing the CP3 arrangements, which will have timed out. If as a result of a Network Rail objection, we decide to issue a new review notice straight away or refer the review to the Competition Commission (CC) as provided for under Schedule 4A of the Railways Act 1993 and then issue a new review notice these will have effect as well and so any revised CP4 arrangements would replace the initial CP4 arrangements if applicable.

Background

PR08 will establish Network Rail's regulated outputs, revenue requirement and access charges for CP4, which is due to run from 1 April 2009 – 31 March 2014. We are publishing PR08 draft determinations on 5 June 2008 and final determinations are planned for 30 October 2008. We implement the changes decided in the periodic review final determinations into track and station access contracts (and where applicable to linked licences) following a procedure set out in the Railways Act 1993.¹

We intend to issue the review notice, which is the formal statutory notice that begins the process of implementation of the periodic review, on 18 December 2008. At this point, should it object to the terms of the periodic review, Network Rail has a statutory right to object to the review notice, although such an objection is effective only if it is made within the time specified in the review notice which must be at least 6 weeks from that notice being served. If Network Rail were to object, we must either issue a new review notice or make a reference to the Competition Commission for investigation. It is conceivable, either because any new review notice addressing Network Rail's objections would not be issued in time for the changes to take effect by 1 April 2009, or because any Competition Commission reference is likely to extend beyond March 2009, that the periodic review will not be implemented by 1 April 2009.

In this case, the CP3 arrangements time out and many of them, including certain track access charges payable by franchised train operators to Network Rail in the existing access contracts, do not have stated amounts beyond 31 March 2009. This is also the case for a number of other key figures in the track access contracts, including the schedule 4 payment rates and the schedule 8 performance benchmarks.

The ability of Network Rail and its predecessor Railtrack to object to a periodic review was introduced by the Transport Act 2000 to bring its situation in line with most other companies facing economic regulation in the UK.

Our proposal

We propose that Network Rail and each franchised passenger train operator should enter into a supplemental agreement to amend their existing track access contracts so that they provide for the new PR08 determinations to be implemented. Through this Network Rail will receive the various income payments (which would otherwise be timed out) under those access contracts on and after 1 April 2009, pending possible final implementation of

¹ Schedule 4A, Railways Act 1993.

PR08 through some further review notice. In this way, the review notice would be implemented on 1 April 2009, irrespective of whether Network Rail objects to the notice or a reference is made to the Competition Commission.

This change to track access contracts would not affect either Network Rail's or train operators' ability to make submissions to the Competition Commission in the case of a reference, and we have discussed this approach with the Competition Commission to make sure they are fully aware of the issue.

The proposed approach means that the CP4 arrangements contained in the PR08 final determinations would be introduced, as opposed to the alternative option of rolling forward based on current arrangements. We do not believe that the alternative of simply rolling over the existing access charges beyond 1 April 2009 would be suitable. First, charges in CP3, which runs from 1 April 2004 to 31 March 2009, were profiled, and there is no reason to suppose that the charges payable for the final year relate logically to the appropriate revenue which Network Rail should receive from 1 April 2009 onwards.

Secondly, charges set for CP3 relate to the delivery of outputs specified in the Access Charges Review 2003. Network Rail should be committed to the new outputs for CP4, and we believe that implementation of the review conclusions should, in principle, proceed whilst the Competition Commission conducts its investigation in parallel.

We are aware that some of the CP4 proposals involve changes not just to access contracts but to other elements, e.g. the parallel changes to Schedule 4 and Part G of the Network Code. In this example, the implementation of the changes to Part G would be expected to be dependent on the changes being made to Schedule 4. However, as the changes to Schedule 4 would under this proposal happen despite any objection to the review notice this would not act as an obstacle to the implementation of the changes to Part G. Consultees views on any other examples of this type of dual change are welcome.

Interaction with franchise indemnity provisions

We recognise that train operators will want to be clear about how the indemnity provisions in franchise contracts, in some cases contained in Clause 18.1 and in others in Schedule 9 would work with the proposed change to track access contracts. We have had initial discussions with DfT and Transport Scotland to brief them on this issue. They recognise and support the reasoning behind our proposed amendment. They have therefore agreed in principle that consistent with the proposed approach in this letter, that the changes implemented through a review notice that is then objected against should still be dealt with as regulatory changes for the purposes of Clause 18.1 or Schedule 9 as appropriate.

Non-franchised passenger and freight operators

As the vast majority of provisions that time expire are found in franchised passenger operator track access contracts, we are only proposing that these changes be made in these contracts.

Other contracts may have minor issues around the performance regime (Schedule 8) benchmarks but it should be clear what the appropriate benchmark will be going forward.

In principle if other types of operator wanted to include the same provisions in their track access contracts then we would consider this but we are aware of the uncertainty that might be generated through an initial implementation of a review and then potentially a major change to that reviews conclusions following maybe a year later.

Proposed drafting

Annex A provides the proposed legal drafting to implement this proposal. The drafting has been generalised so far as possible so that similar principles would apply to each successive control period in respect of which the access charges review is to be conducted. We note however that the definition of "Current Control Period" in the current draft makes explicit reference to CP3. We are considering more generalised wording in this regard so that the provisions also work at future periodic reviews. Following this consultation, we would expect to issue the finalised drafting (taking into account your comments) as a general approval, and would like this to be entered into as soon as possible.

Responses to this letter should be sent in electronic format (or if not possible, in hard-copy format) by 16 May 2008 to:

Iain Morgan
Senior Economist
Office of Rail Regulation
1 Kemble Street
London WC2B 4AN
Tel: 020 7282 2060

Email: iain.morgan@orr.gsi.gov.uk

Responses will be made available in our library, published on our website and may be quoted from. Respondents should indicate clearly if they wish all or part of their responses to remain confidential to the Office of Rail Regulation (ORR). Where a response is made in confidence, a statement summarising the submission should accompany it, 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.

Copies of this document can be found in the ORR library and on the ORR website (www.rail-reg.gov.uk).

If you have any queries on this please contact Iain Morgan or myself.

Yours sincerely

A handwritten signature in blue ink that reads "Paul McMahon". The signature is written in a cursive style with a large initial 'P'.

Paul McMahon

[] SUPPLEMENTAL AGREEMENT

between

NETWORK RAIL INFRASTRUCTURE LIMITED

and

[The Relevant Train Operator]

**relating to amendments to a Track Access
Contract (Passenger Services) dated [] –
Interim treatment of track access charges review**

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THIS [] SUPPLEMENTAL AGREEMENT is dated [] 2008 and made between:

- (1) **NETWORK RAIL INFRASTRUCTURE LIMITED**, a private company registered in England under company number 02904587, having its registered office at 40 Melton Street, London NW1 2EE ("**Network Rail**"); and
- (2) [], a private company limited by shares registered in England and Wales under company number [], having its registered office at [] (the "**Train Operator**").

Background:

- (A) The parties entered into a Track Access Contract (Passenger Services) dated [] as amended by various supplemental agreements (which track access contract as subsequently amended is hereafter referred to as the "**Contract**").
- (B) The parties wish to amend the Contract to incorporate a mechanism which will provide for the treatment of revised track access charges and certain other matters forming the subject of the Office of Rail Regulation's periodic review pending the final conclusion of the periodic review process. This Supplemental Agreement provides for the insertion of a new Clause [20] in order to incorporate such a mechanism into the Contract.

IT IS HEREBY AGREED as follows:

1. INTERPRETATION

In this Supplemental Agreement words and expressions defined in and rules of interpretation set out in the Contract shall have the same meaning and effect when used in this Supplemental Agreement except where the context requires otherwise.

2. EFFECTIVE DATE AND TERM

The amendments to the Contract made pursuant to this Supplemental Agreement shall have effect from [the date hereof] and shall cease to have effect at [] hours on the Expiry Date or earlier termination of the Contract.

3. AMENDMENTS TO THE CONTRACT

A new Clause [20] shall be inserted into the Contract as follows:

"[20] INTERIM TREATMENT OF ACCESS CHARGES REVIEW

[20].1 Treatment prior to Implementation

If the terms of a Proposed Review Notice are not implemented in accordance with paragraph 7 of Schedule 4A of the Act by the Current Control Period Expiry Date for any reason, then, irrespective of such terms not having been so implemented, each proposed amendment to the Contract set out in the Proposed Review Notice shall, subject to Clause [20].2, have effect from:

- (a) in the case of a Proposed Review Notice which falls within category (a) of the definition of Proposed Review Notice, the day after the Current Control Period Expiry Date or from any later date (or dates) specified in the Proposed Review Notice in respect of any individual amendments; and
- (b) in the case of a Proposed Review Notice which falls within category (b) of the definition of Proposed Review Notice, the date (or dates) specified in the Proposed Review Notice.

[Note: Clause 20.1 is to cover the situation where a Review Notice (or any subsequent Revised Review Notice) is not implemented by 31 March 2009 "for any reason", which, as well as covering delays due to a Competition Commission reference, would also cover any other delays in implementing a Review Notice issued prior to 31 March 2009 (or in implementing any Revised Review Notice issued after 31 March 2009).

It is proposed that the terms of the most recent Review Notice (whether the initial Review Notice or a subsequent Revised Review Notice) would always take effect. Therefore, as well as covering the basic position of a single Review Notice issued prior to 31 March 2009, Clause 20.1 is also intended to cover the situation where a Revised Review Notice is prepared to accommodate any objections to the first Review Notice and (in the case of Clause 20.1(a)) that Revised Review Notice is also issued prior to 31 March 2009 or (in the case of Clause 20.1(b)) the Revised Review Notice is issued after 31 March 2009.]

[20].2 Treatment after Implementation

From the Implementation Date, the Contract (as amended pursuant to Clause [20].1) shall be further amended to incorporate any changes made pursuant to paragraphs 12 and 14 of Schedule 4A of the Act, provided that if no changes are made pursuant to paragraphs 12 and 14 of Schedule 4A of the Act then there shall be no Implementation Date and the Contract shall continue as amended pursuant to Clause [20].1.

[Note: It is proposed that once a Review Notice (or a Revised Review Notice) takes effect pursuant to Clause 20.1, it will remain in effect subject to any further changes requested by the Competition Commission or otherwise made by the ORR as part of the reference process. Any such further changes are to take effect on the date they are made in accordance with the Act.

This recognises that the Competition Commission may ultimately not require any changes to be made to the Review Notice or may require changes to be made to only certain parts of it, in which case those parts of the Review Notice not requiring any change would simply continue in effect (having already been brought into effect pursuant to Clause 20.1).]

[20].3 Definitions

In this Clause [20]:

"Current Control Period" means the period of five Relevant Years commencing on 1 April [2004] and ending on 31 March [2009];

"Current Control Period Expiry Date" means the last day of the Current Control Period;

"Implementation Date" means the date on which any changes pursuant to paragraphs 12 and 14 of Schedule 4A of the Act are made in accordance with Schedule 4A of the Act

"Proposed Review Notice" means either:

- (a) the most recent Review Notice (including any Revised Review Notice) given by the Office of Rail Regulation during the Current Control Period; or
- (b) any Revised Review Notice given after the Current Control Period in respect of a Review Notice given during the Current Control Period,

in each case the terms of which are proposed to take effect after the Current Control Period Expiry Date;

“**Relevant Year**” has the meaning given to that term in Part 1 of Schedule 7 of the Contract;

"**Review Notice**" has the meaning given to “review notice” in paragraph 4 of Schedule 4A of the Act;"

"**Revised Review Notice**" means any new Review Notice given by the Office of Rail Regulation pursuant to paragraph 8(2) of Schedule 4A of the Act;

4. **EFFECT OF THIS SUPPLEMENTAL AGREEMENT ON THE CONTRACT**

The parties agree that the Contract, as amended by this Supplemental Agreement, shall remain in full force and effect in accordance with its terms, and with effect from and including the date hereof and during the period in which the amendments made by this Supplemental Agreement are to have effect, all references in the Contract to the "Contract", "herein", "hereof", "hereunder" and other similar expressions shall, unless the context requires otherwise, be read and construed as a reference to the Contract as amended by this Supplemental Agreement.

5. **LAW**

This Supplemental Agreement shall be governed by, construed and given effect to in all respects in accordance with the law of [England and Wales] [Scotland].

6. **THIRD PARTY RIGHTS**

No person who is not a party to this Supplemental Agreement shall have any right under the Contracts (Rights of Third Parties) Act 1999 to enforce any term of this Supplemental Agreement.

7. **COUNTERPARTS**

This Supplemental Agreement may be executed in any number of counterparts, each of which when executed and delivered shall constitute an original, but all the counterparts shall together constitute one and the same instrument.

IN WITNESS of which Network Rail and the Train Operator have, by their duly authorised representatives, respectively entered into this Supplemental Agreement on the date first above written.

SIGNED BY)
for and on behalf of)
NETWORK RAIL)
INFRASTRUCTURE LIMITED)

SIGNED BY)
for and on behalf of)
[*Relevant Train Operator*])
)