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Dear Jon and Mark,

Directions in respect of a track access contract between Network Rail Infrastructure Limited and Hull Trains Company Limited

1. The Office of Rail and Road (ORR) has today issued directions under section 17 of the Railways Act 1993 (the Act) to Network Rail Infrastructure Limited (Network Rail) to enter into a track access contract with Hull Trains Company Limited (Hull Trains). The application was submitted to ORR by Hull Trains on 2 September 2015. This letter explains our decision.

The application

2. Hull Trains' application was for a new track access contract for its London King's Cross to Hull and Beverley services for a term of ten years from the expiry of its current track access contract on the Principal Change Date (PCD) in December 2019. Hull Trains' justification for the length of the contract was that it needed to secure the rights for a further ten years in order to enable investment in a fleet of new class 802 bi-mode trains to operate its services.

3. The proposed contract contains the necessary access rights for Hull Trains to continue to operate its existing services, but with the addition of extended services between Hull and Beverley on weekends (see paragraph 16). The contract was also updated to reflect that Hull Trains operates non-franchised passenger services. Whilst the model contract has been used, it contains some bespoke elements such as a break clause concerning investment conditions and an additional Schedule about ERTMS compensation.



4. The application was submitted under section 17 of the Act as the parties were unable to agree all the terms of the contract. In particular Network Rail was unable to agree to the duration of the new contract; the reason given was that “*ORR has yet to make its decision concerning the allocation of capacity on the East Coast Mainline and Network Rail would not wish to agree any rights which might constrain this decision.*”

Industry consultation

5. The consultation process was carried out by Network Rail on behalf of Hull Trains on 31 July 2015. Four responses were received and are summarised below:

Transport Focus

6. Transport Focus fully supported the proposal, highlighting that the new contract and new trains will allow Hull Trains to continue to provide the services that passengers have come to expect.

South Yorkshire Passenger Transport Executive (South Yorkshire PTE)

7. South Yorkshire PTE replied to the consultation on behalf of Doncaster Metropolitan Borough Council, Sheffield City Region Executive and itself. It was supportive of the proposed contract and listed several benefits that would be realised, including newer rolling stock that provides increased flexibility and performance and that will allow a more resilient timetable on the routes served.

Alliance Rail/Grand Central

8. Alliance Rail/Grand Central's response fully supported the proposed contract and welcomed the customer benefits associated with it.

Virgin Trains East Coast (VTEC)

9. As well as welcoming Hull Trains' choice of rolling stock, VTEC raised three points. First, the access rights held by Hull Trains in both its existing and new contracts should in aggregate be for no more than ten years. Second, any changes to the charging regime in CP6 should apply to the new contract in full. Third, it highlighted a drafting point in the contract. On 29 August 2015 Hull Trains responded to VTEC's letter, in its opinion addressing the points raised.

¹ Page 6, Network Rail's representations dated 28 September 2015



ORR review

10. Schedule 4 to the Act requires us to undertake a statutory consultation process for applications made under section 17. In response to our statutory notice, we received notification that there were no Interested Persons within the statutory definition of Paragraph 1 of Schedule 4 to the Act. Formal representations on the application were received from Network Rail on 28 September 2015 and Hull Trains' response to these representations was received on 7 October 2015.

Further discussions

11. Although the application was received under section 17, the parties were keen to continue discussions in order to reach agreement on as many of the outstanding issues as possible; we were content for them to do this. In addition to the statutory consultation responses, we received further representations from Network Rail on 15 October 2015 and from both Network Rail and Hull Trains on 6 November 2015, 11 December 2015 and 22 January 2016. The final version of the contract was submitted for ORR's consideration by Network Rail on 25 February 2016.

12. On 5 and 13 November 2015 we provided comments on the proposed contract and requested that drafting be submitted detailing:

- a) the agreed break clause that curtails the duration of Hull Trains' rights to end after three years at the Principal Change Date in 2022 should the new specified equipment not enter into service; and
- b) the agreed investment condition that makes the rights to use the fleet of Class 802 bi-mode 5-car units conditional on Hull Trains completing a suite of minor station, siding and other investments in the Hull area to enable the full fleet to run on the network.

13. We also requested some additional amendments to the contract including:

- a) amending Table 2.1 in Schedule 5 to include Hatfield and Selby in the "routing" for clarification purposes; and
- b) amending Table 4.1 in Schedule 5 to remove footnotes and additional stations that were no longer required as a consequence of the updated format for template agreements.

14. Following further discussions between Network Rail and Hull Trains, and in reply to ORR's comments, on 11 December 2015 we received a revised draft contract which had



been agreed between the parties. This included an additional clause that required Network Rail and Hull Trains to have agreed a robust service recovery / contingency plan to mitigate the impact on performance of the introduction class 802 bi-mode 5-car units.

Outstanding areas of disagreement

15. Three outstanding areas of disagreement remained between the parties:
- a) Network Rail remained reluctant to agree to enter into the new contract pending ORR's decisions about the allocation of capacity on the East Coast Main Line (ECML);
 - b) The parties disagreed over the inclusion of a bespoke contingency provision which Network Rail wanted in case of delay to implementation of future periodic reviews of access charges; and
 - c) Network Rail wanted to include a 'proving period' provision to provide a mechanism for addressing any deterioration in network performance.

These are discussed in paragraphs 23 to 28 below.

Further industry consultation

16. On 2 December 2015 ORR approved an amendment to Hull Trains' current track access contract (the 20th supplemental agreement) to allow London – Hull services to be extended to and from Beverley on weekends (in addition to weekdays) from the start of the December 2015 timetable. On 23 December 2015 Network Rail issued an industry consultation on a proposal to add these rights to the new contract and remove some unnecessary footnotes from the calling patterns in Table 4.1 of Schedule 5. Four responses were received from Transport Focus, Northern Rail Limited, Alliance Rail Holdings and First Greater Western Limited. None of the consulted parties objected to the proposed amendments to the contract.

17. Following the industry consultation, on 22 January 2016 Network Rail submitted to ORR an amended contract, the industry responses to the consultation and some further representations on behalf of both parties.

Issues considered by ORR

Duration

18. Regulation 18 of The Railways Infrastructure (Access and Management) Regulations 2005 establishes that access contracts (referred to as 'framework



agreements') should in principle be for five years but that the infrastructure manager may agree a shorter or longer duration. The regulation also provides that agreements of longer than five years must be justified by the existence of commercial contracts, specialised investments or risks.

19. Hull Trains explained that it needed the certainty of a long-term track access contract to enable investment in a new fleet of class 802 bi-mode 5-car units and to fund the associated maintenance arrangements. Hull Trains said that the new units would deliver benefits to customers in terms of a higher quality customer environment and an increase in capacity in the form of around 20% more seats per train. The new fleet of bi-mode units would also deliver operational and performance benefits and are expected to improve reliability as well as the ability to switch between electric and diesel modes would also make the ECML timetable more resilient and give flexibility.

20. Hull Trains advised that as well as provision for the costs of operating the new trains on the infrastructure, for example route clearance between Hull and Beverley, it planned to provide a suite of minor station, siding and other investments to enable the new vehicles to run on the network.

21. When considering investment proposals underpinning track access applications, we examine the scale of investment in relation to the turnover of the beneficiary and the payback period for that investment. Hull Trains submitted, confidentially, an investment appraisal setting out its plans and expected return on investment over a ten year period. We assessed this appraisal and considered the costs, benefits and timescales. Based on the information supplied we consider that Hull Trains is making a substantial investment in new rolling-stock to the benefit of passengers and a contract length of ten years is reasonably necessary to support this investment. We are satisfied that without this length of contract underpinning the investment there are risks the investment would not go-ahead in its entirety or on the terms necessary to maximise passenger benefits. Hull Trains demonstrated a significant risk that it would not be able to re-coup and make an appropriate return on its investment in new rolling-stock within a period of less than ten years.

22. As the new trains are not expected to be delivered until December 2019, together with the fact Hull Trains is unable to begin benefiting from its proposed investment until then, it is appropriate that the duration of the access rights proposed should be considered from this date. In addition, the contract contains provisions which lead to termination of the contract if that investment is not made.



ECML Capacity

23. ORR is currently considering applications from VTEC, First Group and Alliance Rail Holdings to run additional services on the ECML. When we consider track access applications, whilst there is no guarantee that other train operators' existing access rights will be extended beyond their expiry date, there is a general presumption that this will be the case unless there is a good reason not to. In looking at what spare capacity may be available for the ECML applicants, Network Rail took existing services as a baseline and this principle has not been challenged by any stakeholder. All potentially affected train operators were consulted on Hull Trains' proposed new contract and none objected to approval of the rights. We set out our view on the duration point raised in VTEC's representations above.

Periodic review contingency

24. Network Rail wanted to include a contingency arrangement in the contract covering a delay in the implementation of a future periodic review. Without such a provision in place, a delay could mean that certain charging provisions within the contract would expire at the end of the current control period.

25. In the last two previous periodic reviews, we wrote to train operators ahead of implementation to ask them to include a contingency provision in their contracts with Network Rail. Whilst we are aware that Network Rail is keen to include such a provision in each relevant contract as early as possible ahead of the next periodic review (PR18), we are not willing to approve the inclusion of a similar provision unless:

- (a) the train operator in question agrees to its inclusion. (That is, we will not direct that the provision be included during CP5 where the parties do not agree);
- (b) we are satisfied that the drafting is fit for purpose and addresses the issues we raised with Network Rail following our previous bilateral exchanges about the provision; and
- (c) Network Rail has consulted train operators on the proposed provision.

26. As these conditions have not been met, we have not directed the provision be included in the contract. This does not stop the parties agreeing to include such a provision subsequently after Network Rail has produced a suitable provision and consulted.



Proving period

27. Network Rail also wished to include a proving period provision within the contract to provide a mechanism for addressing any deterioration of network performance caused by the introduction of the services contained within the application. Hull Train's felt there were no grounds for the inclusion of this clause as the potential issue is adequately dealt with in the Network Code and the contract performance regime.

28. We agree with Hull Trains that it is not necessary to include this clause. Schedule 8 of the contract deals with compensation due to unplanned service disruption (lateness and cancellations) attributable to poor performance. The Network Code specifies at Condition B5.1 that "*TAC Parties shall, not less than once every six months, meet, review performance and discuss alterations to their operations which will improve train performance and reduce train delays and cancellations.*"²

Service recovery / contingency plan

29. We also note that the parties have agreed to include within the contract a provision for "Network Rail and Hull Trains to have agreed a robust service recovery/ contingency plan to mitigate the impact on performance of the introduction of Class 802 Bi-Mode 5-car units". We are content for this clause to be included within the contract.

Liability Cap in Schedule 9

30. The existing Hull Trains contract contains a Liability Cap of £10m, set at the minimum level for passenger operators, and the draft contract submitted to us proposed £10m. It is important that the monetary amounts are in the correct price base. Therefore the figure (taken from our criteria and procedures published in March 2015) has been updated to £12m.

Other variations from the model passenger track access contract

31. The existing model contract is designed for franchised passenger operators and, as such, some amendments are appropriate for open access operators. The draft contract has been checked against the model contract and against the existing Hull Trains contract, and we consider that the variations from the model contract are justified.

² The Network Code - Part B - Performance Monitoring



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32. The parties have included an ERTMS clause under which an appointed Expert would have the ability to insert a compensation/apportionment of costs schedule, essentially as a fall-back position in case industry commercial negotiations about ERTMS costs do not come to fruition. The inclusion of this schedule is reasonable as, unlike franchised passenger operators, open access operators do not have franchise obligations which include ERTMS commitments.

Contract effective date

33. Hull Trains applied for the new contract to commence from the expiry of its current track access contract on the Principal Change Date in December 2019 (which was the only option with a section 17 application). However, this would mean that there would be two track access contracts, the existing one until December 2019 and the new one from December 2019 onwards. This would cause administrative burden as any amendments made to the current contract would also have to be made to the new contract under a separate process so that any changes made to the current contract are not undone come December 2019. It could also potentially complicate the process for the next periodic review which will take effect on 1 April 2019.

34. ORR therefore requested that Hull Trains and Network Rail agree to bring forward the start date of the new contract and simultaneously enter into a supplemental agreement under section 22 of the Act, that would amend the definition of the expiry date in order to bring forward the expiry of the existing contract. Both parties agreed to this.

35. The new contract will therefore have an effective date of:

“The provisions of this contract, other than Clause 5, shall take effect from the later of the expiry of the existing Track Access Contract between Network Rail Infrastructure Limited and Hull Trains Company Limited and the date of signing of this agreement.”

ORR's conclusions

36. In considering the contract and in reaching our decision, we have had to weigh and strike the appropriate balance in discharging our statutory duties under section 4 of the Act. We concluded that issuing directions in respect of this contract is consistent with our section 4 duties, in particular those relating to:

- a) promoting improvements in railway service performance;



- b) protecting the interests of users of railway services;
- c) promoting the use of the railway network for the carriage of passengers and goods;
- d) promoting competition in the provision of railway services for the benefit of users of railway services; and
- e) enabling persons providing railway services to plan their businesses with a reasonable degree of assurance.

Administration

37. A copy of the Directions and the signed contract will be placed on our public register, copies of this letter and the contract will also be placed on the ORR website. I am also copying this letter to Peter Craig at Network Rail, Keith Merritt at DfT and Andy Wylie at First Group.

38. Once the agreement is signed, in accordance with section 72(5) of the Act, you must send a copy to ORR within 14 days.

Yours sincerely,



Michael Scarff

