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Addressee list in Annex C



Dear colleague,

**Decisions on implementation of CP5 capacity charge for new open access operators**

1. On 16 May 2014, we consulted on the approach we proposed to take to implement our PR13 decision on the capacity charge for new entrant open access operators (OAOs)<sup>1</sup>, which we outlined in our final determination<sup>2</sup>. The purpose of this letter is to inform you of our decision on our implementation approach. We will also publish this decision letter on our website.

2. I would like to take the opportunity to thank everyone for their input to the process over a number of months.

3. In this letter we:

- (a) summarise the main changes made to the proposals in our 16 May 2014 consultation letter (“our consultation”);
- (b) recap on our final determination decisions on the capacity charge for new entrant OAOs;
- (c) recap on the issues we consulted on;
- (d) outline the main issues raised in response to our consultation and our response to these issues; and
- (e) summarise and explain our decisions on:
  - (i) the threshold above which higher capacity charge rates are payable;
  - (ii) how the threshold should be allocated across service codes;
  - (iii) how the threshold should be contractualised;
  - (iv) the approach that should be followed when calculating the lower capacity charge rates;

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<sup>1</sup> This is available at: [http://orr.gov.uk/data/assets/pdf\\_file/0017/12167/capacity-charge-open-access-operators-2014-05-16.pdf](http://orr.gov.uk/data/assets/pdf_file/0017/12167/capacity-charge-open-access-operators-2014-05-16.pdf)

<sup>2</sup> This is available at: <http://www.rail-reg.gov.uk/pr13/PDF/pr13-final-determination.pdf>.

(v) how we define a new entrant OAO.

4. This letter contains the following annexes:

- (a) a summary of the issues raised in responses to our consultation;
- (b) a detailed explanation on how to contractualise our decisions;
- (c) a list of addressees; and
- (d) a model Schedule 7 for new entrant OAOs.

#### **Summary of changes we have made to reflect the consultation responses**

5. We have amended the proposals we consulted on in the following respects:

- (a) set a separate threshold for trains operating primarily on the HS1 infrastructure in the UK but with a small amount of mileage on Network Rail Infrastructure Ltd's ("Network Rail's") infrastructure between a high mileage on sections of HS1 infrastructure. We have set this threshold to be the Eurostar International Ltd ("EIL") end-of-CP4 mileage;
- (b) in respect of the rest of the network, defined our decision on the threshold being set at Hull Trains end-of-CP4 mileage as a 'minded to' decision, and said that we will consider representations that a new entrant OAO should have a threshold more similar to that of Grand Central on a case-by-case basis; and
- (c) when more than one service code is introduced at the same time and train diagram mileage exceeds threshold mileage, said that threshold mileage will be allocated across the service codes in proportion to their relative mileages.

#### **Final determination decisions**

6. In our final determination, we recognised that existing OAOs are unlike franchised passenger operators<sup>3</sup>, in that they are fully exposed to changes to the charges and incentives that are established at a periodic review. We therefore concluded that existing OAOs will continue to pay CP4 rates for their existing services (with any anomalies corrected<sup>4</sup>) and will pay CP5 rates for any additional or new services they start to operate during CP5. Contractually, the CP5 rates (as calculated by Arup in Network Rail's PR13 recalibration) are referred to as wash-up rates due to the way the formulae in the track access agreement work.

7. We also concluded in paragraph 16.201, page 592 of our final determination on how the capacity charge should apply to new entrant OAOs. We said:

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<sup>3</sup> Franchised operators pay CP5 rates on all their services but are protected through their franchise agreements against changes to the charges established at a periodic review

<sup>4</sup> Corrected CP4 rates were calculated by Network Rail for existing OAOs operating on the East Coast Main Line because, during the process of recalibrating the capacity charge in PR13, anomalies were discovered in the CP4 rates for these services, which meant that different operators using similar parts of the network with similar services had been subject to significantly different tariffs during CP4. The methodology is explained in the cover note to Network Rail's draft determination consistent price lists

<http://www.networkrail.co.uk/publications/delivery-plans/control-period-5/periodic-review-2013/CP5-Price-Lists-%28consistent-with-ORR-FD%29-Cover-Note.pdf>

“New entrant OAOs will pay CP4 rates on services below a threshold (set to provide broadly equivalent treatment with existing OAOs) and CP5 rates above the threshold. This approach is to ensure that we are treating existing and new entrant OAOs in the same way, as required by European law and our section 4 duties.”

8. In our 30 September 2013 consultation letter<sup>5</sup> on the contractual provisions for implementing options for the capacity charge in CP5, which preceded our final determination, we provided more detail:

“For new entrant OAOs, services below a threshold would pay CP4 rates; any train mileage above the threshold would pay CP5 rates; we would define the threshold as part of PR13 to be equivalent to that of existing services for the smaller of the two main existing OAOs, which at the time of writing is Hull Trains.”

9. We did not receive any objections to our proposal that the threshold be equivalent to that of existing services of the smaller of the two main existing OAOs, Hull Trains.

10. In our 14 May 2014 consultation letter, we noted that our final determination decision and additional detail in our 30 September 2013 consultation letter implied that in CP5 new entrant OAOs will pay:

- (a) for services below a threshold: capacity charge rates that are the equivalent to CP4 rates<sup>6</sup>; and
- (b) for services above a threshold: capacity charge wash-up rates<sup>7</sup>, levied via a year-end wash-up;

where the threshold is set to be equivalent to that for the Hull Trains' services as of the end of CP4.

### **What we consulted on**

11. We consulted on the following areas:

- (a) our proposed threshold at which capacity charge wash-up rates are payable instead of CP4 equivalent capacity charge rates;
- (b) how the threshold should be allocated across service codes;
- (c) how the threshold would be contractualised;
- (d) the approach that should be followed when calculating CP4 equivalent capacity charge rates for a new entrant OAO; and
- (e) how we will define a new entrant OAO.

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<sup>5</sup>This is available at <http://orr.gov.uk/what-and-how-we-regulate/regulation-of-network-rail/how-we-regulate-network-rail/periodic-review-2013/pr13-consultations/implementing-pr13-capacity-charge>

<sup>6</sup> CP4 equivalent capacity charge rates are rates that are equivalent to the capacity charge franchised passenger operators would have paid for running services over a particular part of the network in CP4.

<sup>7</sup> Capacity charge wash-up rates are equivalent to the CP5 capacity charge rates for franchised operators that were calculated by Arup for Network Rail as part of the PR13 recalibration of the capacity charge. The final report is available at <http://www.networkrail.co.uk/WorkArea/DownloadAsset.aspx?id=30064786027>

## Responses to our consultation

12. We received two responses to our consultation, one from Network Rail and one from EIL.

13. EIL raised a specific concern about using the end-of-CP4 Hull Trains mileage as the basis of the threshold for a new entrant OAO operating on the limited part of the Network Rail infrastructure EIL operates on. This is because EIL's baseline is based on its end of CP4 mileage which is considerably less than that of Hull Trains. Network Rail raised a similar concern about any situation where an existing OAO might have a threshold below that of Hull Trains. The only other existing OAO this applies to is Heathrow Connect.

14. In the UK, most of EIL's mileage is on the HS1 infrastructure but it enters Network Rail's infrastructure to call at Ashford International before returning back to the HS1 infrastructure. EIL argued that if the threshold for a new entrant OAO operating on this part of the network were based on the Hull Trains mileage, it could be at an unfair disadvantage.

15. Network Rail commented on our final determination decision arguing that we should revert back to the arrangements that RDG proposed in autumn 2013. It also stated that since our 30 September 2013 consultation letter had a closing date that was after our final determination, there were limited opportunities for objections to be made to setting the threshold at the Hull Trains mileage.

16. In addition to this, Network Rail raised a number of comments on the proposals in our consultation. The most substantive ones were as follows.

- (a) New entrant OAOs could be discriminated against in network locations where there is currently an OAO with a mileage above that of Hull Trains. This is because they would be paying 'wash-up' rates on all mileage above that of Hull Trains, whereas the existing OAO would not have to pay 'wash-up' rates on any mileage up to its end of CP4 mileage, which is higher than that of Hull Trains.
- (b) The priority rule proposed for allocating threshold mileage to service codes when more than one service code was introduced at the same time would result in Network Rail under-recovering its additional Schedule 8 liability by the greatest amount. This is because, under our proposal, if several service codes were introduced simultaneously, threshold mileage would be allocated to service codes with the greatest monetary difference between CP4 and CP5 (wash-up) weekday rates first.
- (c) The way in which CP4 equivalent rates would be calculated for new entrant OAOs should be consistent across the network, and follow the same approach that was used to update the CP4 rates for Hull Trains and Grand Central, which involved the definition of an 'anchor' to base the rate on. In terms of defining an 'anchor', Network Rail outlined two options: to select a 'representative' operator or service code(s) to act as the anchor; or to apply a standard discount (based on the difference between East Coast Trains' CP4 and CP5 rates) to the CP5 rate(s) for any new entrant OAO. Network Rail argued that the latter approach is favourable because it is simple and understandable, and would provide certainty to OAOs with regards to their charges. It also considered that this approach would avoid the need

to select a 'representative' operator or service code(s), which would in turn require a set of 'decision' principles to be defined upfront, and introduce a great deal of complexity.

- (d) The way in which a new entrant OAO is defined should minimise undue discrimination by aiming to treat all new entrant OAOs the same, regardless of their group structure. Network Rail said it did not consider that our proposal would achieve this. Network Rail proposed an alternative definition which was as follows:
- (i) "a new Open Access operation is one which is not an existing open access operation"
  - (ii) "an existing Open Access operation is one which is defined in Network Rail's list of capacity charge baselines for CP5, approved or directed by ORR and published on or before 10 February 2014, and one whose services are consistent with the geographical extent of services set out in the consolidated Track Access Contract at 1 April 2014".

### **Our views on consultation responses**

17. Our consultation was specifically about implementing our final determination decision. We are not going to revisit our final determination decision, our reasons for which are already explained in paragraphs 16.194 to 16.205 of our final determination.

18. The closing date of our 30 September 2013 consultation letter was 28 October 2013 initially but was subsequently extended to 4 November 2013. This allowed stakeholders five weeks to respond to us setting the threshold equivalent to the existing services as Hull Trains, which we regard as an adequate amount of time.

19. In relation to the issue raised by EIL, we agree that a discrimination issue could arise if a competitor started running services primarily on the HS1 infrastructure between London and the Channel Tunnel with stops at Ashford International via the Network Rail infrastructure. If a new entrant running similar services were given a threshold based on Hull Trains' end-of-CP4 mileage, it would be able to operate considerably more services on the Network Rail infrastructure at CP4 equivalent rates than EIL.

20. It would be inappropriate to set the threshold for all new entrant OAOs at EIL's mileage on the Network Rail infrastructure since this only represents a very small proportion of the total mileage of the EIL services that run on this part of the network (less than one mile, between Ashford Boundary East and Ashford Boundary West). It would mean that new entrant OAOs operating fully on the Network Rail infrastructure would be entitled to considerably fewer miles at CP4 equivalent rates than the main existing OAOs.

21. We also do not think it would be appropriate to increase the baseline for existing EIL service codes. Given that the mileage that Hull Trains operates on the Network Rail infrastructure is much higher than that of EIL, if we were to do this, in effect it would mean EIL could never reach the threshold through its international services. This would not match our intention in our final determination of protecting existing OAOs from an increase in the capacity charge rates on their existing services, while at the same time exposing them to the full performance regime costs in respect of additional services.



22. The EIL services are atypical of existing OAOs' services in the sense that they run mostly off the Network Rail infrastructure, but run on the Network Rail infrastructure for a very low mileage in the middle of their journey. Most of the track access charges EIL services incur in the UK relate to the HS1 infrastructure. The EIL services are therefore not comparable with the services of OAOs that operate mostly on the Network Rail infrastructure.

23. We will therefore set a different threshold for new entrant OAOs running primarily on the HS1 infrastructure but with a small amount of mileage on the Network Rail infrastructure between a higher mileage on sections of HS1 infrastructure. This threshold will be the EIL end-of-CP4 mileage.

24. Our responses to the other main implementation issues, raised by Network Rail, are as follows. In annex A, we outline briefly each of the issues raised by the two stakeholders that responded and our response.

- (a) The only existing OAO with an end-of-CP4 mileage greater than that of Hull Trains is Grand Central. One way to avoid Network Rail's concern that undue discrimination might result if a new entrant OAO runs services on the same part of the network as Grand Central (as Grand Central would have a higher threshold than the new entrant) would be to set the threshold for all new entrant OAOs at Grand Central's end-of-CP4 mileage. But this in turn would mean that Hull Trains could be unduly discriminated against if a new entrant OAO started operating services on the part of the network on which it operates (leading to Hull Trains' threshold having to be raised accordingly). Also, different thresholds on different parts of the network could result in undue discrimination across different parts of the network.

In order to implement the policy in a way that is simple to administer and avoids undue discrimination, we conclude it best to set the same threshold across the network<sup>8</sup>. Using Hull Trains mileage is preferable to that of Grand Central since it means a lower mileage would be run where Network Rail is unable to recover all its expected Schedule 8 costs through the capacity charge. However, we acknowledge that each individual set of proposals a new entrant OAO brings forward during CP5 needs to be considered on its merits, taking into account its individual circumstances and characteristics. Therefore, while the above is our 'minded-to' position for all new entrant OAOs (operating primarily on the Network Rail infrastructure), we will consider representations that a new entrant OAO should have a threshold comparable to that of Grand Central on a case-by-case basis<sup>9</sup>.

- (b) We agree with Network Rail's comment that the priority rule should not favour service codes with the largest difference between the CP4 equivalent rates and wash-up rates and have been persuaded by its alternative suggestion that we allocate the threshold across service codes based on their proportional contribution towards total planned mileage. We have reflected this in our decision. However, we

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<sup>8</sup> As explained in paragraph 23, there is one exception to this.

<sup>9</sup> This is consistent with our public law duties, to treat each application on its own facts and not be fettered by strictly applying our stated policy where circumstances of the proposed services do not fit that policy or would give a perverse outcome.

do not agree that the whole threshold mileage should be allocated even if the mileage of the approved service codes is lower than the threshold mileage. We provide further explanation of our final decision on the allocation method in paragraphs 39 and 40, below, and in Annex B.

- (c) We agree with Network Rail's suggestion to apply a simple approach to calculating the CP4 equivalent rates for new entrant OAOs. Calculating the CP4 equivalent rates by applying the same discount on the wash-up rates that was applied for existing OAOs operating on the East Coast Mainline would not necessarily result in rates that are very close to what the CP4 capacity charge rates would have been. However, this is a pragmatic approach that is simple and transparent and it also means that new entrant OAOs will be treated in the same way as existing OAOs in the sense that they will have the same percentage discount applied to their wash-up rates up to the mileage threshold. We therefore accept Network Rail's proposal on this.
- (d) Our proposed definition of a new entrant OAO was designed to ensure that new entrant OAOs are treated consistently but at the same time avoid existing OAOs or their owner groups creating affiliates in order to pay CP4 equivalent rates in what amounts to an expansion of existing services or services that are very similar to ones it already runs. Network Rail's proposed definition does not address this issue and is also inconsistent with our final determination decision on existing OAOs as it would allow existing OAOs to run additional mileage at CP4 equivalent rates elsewhere on the network. Also, if an existing OAO were to extend its services geographically, under Network Rail's proposal the additional mileage would be defined as being part of a new open access operation, meaning that the OAO could pay CP4 equivalent rates on some or all of the additional mileage. In total, an existing OAO that expands its services could therefore potentially pay CP4 equivalent rates on double the mileage of Hull Trains' end of CP4 mileage. A new entrant, on the other hand, would only be able to pay CP4 equivalent rates on mileage up to that of Hull Trains' end of CP4 mileage. We regard this as discriminatory. For these reasons we will be implementing the definition of new entrant OAO we proposed in our consultation.

25. We summarise our final decisions on the implementation of the capacity charge for new entrant OAOs in the next sections.

### **Our decision on the threshold above which the higher charge is incurred**

26. The threshold is intended to ensure that a new entrant OAO is treated in an equivalent manner to an existing OAO in terms of when the new entrant would pay the CP4 equivalent rates, and when the new entrant would pay the wash-up rates.

27. As a default, we will be setting the threshold to be the equivalent to the services of Hull Trains at the end of CP4, which reflects what we proposed in our 30 September consultation letter.

28. The one exception to this is in relation to services that run mostly on the HS1 infrastructure when in the UK but enter the Network Rail infrastructure for a short part of their journey, for example, to call at Ashford International. As discussed above, for these services, the threshold will reflect the services of EIL at the end of CP4.

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29. It is also the case that the mileage that the open access part of Heathrow Connect runs on the Network Rail network is less than that of Hull Trains (approximately 30,000 miles per annum for Heathrow Connect versus nearly one million miles for Hull Trains).

30. However, we have decided to apply the Hull Trains mileage to any new entrant OAOs operating on this part of the network. We consider that this is appropriate because the Heathrow Connect services are unique in the sense that only part of the service is open access, with the part of the service that operates between Hayes and Harlington and Paddington being franchised. We therefore do not envisage a competitor could compete against these services on an equal basis. But a competitor could, for example, run a service between Heathrow Airport and somewhere other than Hayes and Harlington, with the majority of the service being on the Network Rail infrastructure. In these instances using the Heathrow Connect mileage to inform the threshold of a new entrant OAO could mean it would be discriminated against relative to new entrant OAOs operating elsewhere on the network.

31. We have noted in paragraph 24(a) that our decision is to apply the equivalent of the Hull Trains threshold to all new entrant OAOs operating primarily on the Network Rail infrastructure, but that we will consider representations by a prospective OAO that an equivalent of the Grand Central threshold is more appropriate in order to avoid undue discrimination, depending on the specific facts of the application.

32. In our final determination we did not specify exactly how the threshold, above which a new entrant OAO would pay the wash-up rates in CP5, would be calculated.

33. In our consultation, we considered the following options on where to set the threshold:

- (a) the 2012-13 Hull Trains actual mileage sourced from the Track Access Billing System (TABS);
- (b) the annual mileage value used to calculate the Hull Trains baseline<sup>10</sup> published by Network Rail on 10 February 2014<sup>11</sup>. This mileage figure was derived from train diagram information relating to the end of CP4<sup>12</sup> provided by Hull Trains;
- (c) the £ baseline value for Hull Trains published on 10 February 2014; or
- (d) the number of services operated by Hull Trains over a defined period – e.g. yearly (weekday and weekend).

34. More detail on the options is in Annex A of our consultation.

35. Our decision is to take forward option (b). This is because train diagram mileage is the most transparent to implement, is well understood by operators and Network Rail, and is

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<sup>10</sup> The baseline is a contractual term which has a value in pounds. It is calculated for each service code by subtracting {the revenue that Network Rail would have received at threshold traffic levels if the CP4 equivalent capacity charge was levied} from {the revenue that Network Rail would have received at threshold traffic levels if the capacity charge was levied at the wash-up rates}. Paragraphs 46 to 51 of this letter explain the baseline in more detail.

<sup>11</sup> The list of capacity charge baselines for CP5 can be accessed at: <http://www.networkrail.co.uk/cp5-access-charges/list-of-capacity-charge-baselines.xls>

<sup>12</sup> This mileage accounts for all services which were planned to run, and therefore excludes the impact of cancellations or Network Rail possessions on traffic levels during the year.



based on data that is readily available and that has already been used to set the Hull Trains CP5 capacity charge baseline. It is therefore a measure which would easily be convertible into a baseline for a new operator.

36. This option also allows a new entrant OAO to run the same number of train miles at a CP4 equivalent rate as Hull Trains, while allowing its contractual baseline amount to be informed by the capacity charge rates calculated for that particular OAO's services.

37. In instances where the threshold is based on the services of EIL, the threshold will instead be calculated using the EIL threshold train mileage on the Network Rail infrastructure.

38. The table below shows the thresholds for new entrant OAOs and the end-of-CP4 train diagram mileages that they are based on:

<b>Location of new entrant OAO operation</b>	<b>Threshold mileage</b>	<b>Existing OAO end-of-CP4 mileage that this is based on</b>
Mostly on the Network Rail infrastructure	917,963	Hull Trains
Mostly on the HS1 infrastructure when in the UK but on the Network Rail infrastructure for a short part of their journey	3,760	EILs mileage on the Network Rail infrastructure

### **Our decision on how the threshold should be allocated across service groups**

39. If a new entrant OAO introduces more than one service code, the threshold mileage will be allocated to service codes in the order that the services are introduced.

40. If the new entrant OAO introduces more than one service code at the same time, the threshold mileage will be allocated to the service codes based on each code's proportion of total planned mileage for the new entrant OAO, as suggested by Network Rail in its response to our consultation.

41. However, if the mileage approved for the new entrant OAO were lower than the number of threshold miles, the number of miles allocated to the service codes in order to calculate the baselines would be the total mileage of services approved in respect of the new entrant OAO's service codes, as per their train diagrams.

42. Network Rail proposed in its response to our consultation that all of the total threshold mileage is allocated across the service codes in order to calculate the baseline, which we do not consider is the right approach. Our approach will ensure that if the mileage of the approved services does not cover all the threshold mileage, the remaining threshold mileage will remain available to that operator for future service expansion, which we consider to be the appropriate approach and consistent with the intent of our final determination decision.

43. The numerical example in Network Rail's consultation response suggests that the methodology we proposed for converting the threshold into a baseline would in effect imply separate thresholds for weekday and weekend mileage. This was not the case and would

place undue weight on the split between weekday and weekend mileage of Hull Trains, which may be different from the new entrant OAO's services.

44. The allocation will be done across all mileage, as we previously proposed in our consultation letter (i.e. without taking into account the split between Hull Trains end-of-CP4 weekday and weekend mileage). The percentage split between weekday and weekend miles of the new operator's proposed services will then be used to allocate the total threshold mileage across weekday and weekend, for each service code. This approach is consistent with our final determination decision, which referred to the threshold being set equivalent to the services of existing OAOs overall. An example of how this allocation methodology would work in practice is provided in Annex B.

45. Any remaining threshold mileage could then subsequently be:

- (a) allocated to any service code the OAO might want to introduce in the future; or
- (b) used to increase the baseline of the service code(s) it has already had approved, in case the operator decided to increase service frequency or length,

provided that if included in the OAO's initial track access application, the OAO would still have been treated as a new entrant OAO for capacity charge purposes, as defined paragraph 59.

#### **Our decision on how the threshold should be contractualised**

46. In principle, our PR13 decisions in relation to the capacity charge for existing OAOs could have been implemented through the price list, without using a wash-up. However, this would not have been compatible with TABS, which requires a single charge for a service code. For pragmatic reasons, therefore, we decided to implement our decision through a wash-up.

47. For the same reason, we are implementing our decision for new entrant OAOs through a wash-up. Therefore, the threshold for new entrant OAOs will be converted into a monetary baseline.

48. The baseline amount for each service code will determine any year-end monetary wash-up an operator would have to pay if its actual mileage in a given year exceeds the threshold.

49. The purpose of the wash-up is to ensure that across all its services an operator pays:

- (a) wash-up rates, equivalent to the rates calculated by Arup as part of PR13, on any traffic above the pre-determined threshold; and
- (b) CP4 equivalent rates on any traffic below the pre-determined threshold.

50. For new entrant OAOs with more than one service code and mileage above the threshold, the baseline for an individual service code would be based on an allocation of the threshold mileage, using the prioritisation approach outlined in paragraphs 39 to 45.

51. More detail on the wash-up calculation and how the threshold will be converted into a baseline for each service code of a new entrant OAO is contained in Annex B.

## **Our decision on calculating CP4 equivalent rates for a new entrant OAO**

52. The capacity charge wash-up rates for a new entrant OAO should be calculated using the tool developed by Arup as part of the PR13 capacity charge recalibration, consistent with the approach Network Rail uses for calculating CP5 rates for other types of operator. This is explained further in Network Rail's Capacity Charge Conclusions and Draft Pricelists document published in April 2013<sup>13</sup>.

53. Since no CP4 capacity charge rates exist for services not currently running on the network, CP4 equivalent rates would need to be calculated for any new entrant OAO. In our consultation we proposed that these would be calculated using an approach that is consistent to the one used to calculate the corrected CP4 rates for existing OAOs, making the use of the CP4 and CP5 capacity charge rates for franchised operators<sup>14</sup>.

54. In its consultation response Network Rail suggested methods it could use that meet this principle. As outlined in paragraph 24(d), these were to:

- (a) select a 'representative' operator or service code(s) to act as the anchor; or
- (b) apply a standard discount (based on the difference between East Coast Trains' CP4 and CP5 rates) to the CP5 rate(s) for any new entrant OAO. Network Rail stated that it preferred the latter of the two approaches.

55. Network Rail stated that it preferred the latter approach because it is simple and understandable and would ensure consistent treatment of new entrant OAOs across the network.

56. If Network Rail were to calculate CP4 equivalent rates by selecting a representative operator or service code as an 'anchor', for any given service code of a new entrant OAO, it is likely there would be more than one way to calculate CP4 equivalent rates, and that one would not necessarily be better than the other. This could result in disputes and as a result could make the process of calculating CP4 equivalent rates unnecessarily cumbersome for both Network Rail and new entrant OAOs.

57. Network Rail's proposed approach to apply a standard discount based on the difference between East Coast Trains' CP4 and CP5 rates is consistent with the approach that was used to calculate the Hull Trains and Grand Central CP4 equivalent rates. We are content that using this method to calculate CP4 rates for new entrant OAOs this achieves the right balance between simplicity, transparency and correctly implementing our final determination decision.

58. However, in the event that a new entrant runs services primarily on the HS1 infrastructure but with a small amount of mileage on the Network Rail infrastructure between higher mileage on sections of HS1 infrastructure, Network Rail should calculate the CP4 equivalent rates in a way that is consistent with those calculated for EIL (the

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<sup>13</sup> This can be accessed at:

<http://www.networkrail.co.uk/WorkArea/DownloadAsset.aspx?id=30064785533&cd=1>.

<sup>14</sup> The CP4 capacity charge rates for franchised operators are available at

<http://www.networkrail.co.uk/browse%20documents/regulatory%20documents/access%20charges%20reviews/cp4%20charges/d%20-%20list%20of%20capacity%20charge%20rates%20for%20cp4.pdf>. The CP5 capacity charge rates are available at <http://www.networkrail.co.uk/using-our-network/cp5-access-charges/> Page 11 of 35

existing OAO operating on this part of the network). As we explained in paragraph 22, we consider services operating on this part of the network as not comparable with services of OAOs that operate mostly on the Network Rail infrastructure.

### **Our decision on how we define new entrant OAO in CP5**

59. We have decided that in order to be treated as a new entrant OAO in relation to the capacity charge rates, an OAO needs to:

- (a) have a company number distinct from any other OAO, with its first ever track access agreement entered into in CP5

and, at the time our initial track access approval takes effect, meet one of the following criteria:

- (b) it is a completely new entrant OAO with no affiliation to an existing OAO at any point in its group company structure<sup>15</sup>; or
- (c) if it is affiliated in any way to an existing OAO, it does not have any service codes<sup>16</sup> with more than one station overlapping with the stations called at by any individual service code of that existing OAO<sup>17</sup>.

60. This is the same as the definition we proposed in our consultation, with additional detail on how the order in which we approve different applications from the same operator might affect the definition (see footnote 16). Through it, we seek to ensure that the implementation of our final determination decision results in a clear and objective definition of new entrant OAO, and balances the following two considerations:

- (a) we do not want a new entrant OAO that is affiliated to an existing OAO to be unfairly discriminated against relative to a completely new entrant OAO with no connection to an existing OAO at any point in its group company structure<sup>18</sup>; and

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<sup>15</sup> For these purposes, “affiliate” means in relation to the existing OAO: a subsidiary or a parent company (or ultimate parent company) of the existing OAO; or a subsidiary of a parent company (or ultimate parent company) of which the existing OAO is itself a subsidiary. The terms “parent company” and “subsidiary” for these purposes are as defined in the Companies Act 2006.

<sup>16</sup> If the OAO subsequently has an additional service code approved, this will not affect whether or not the operator is defined as a new entrant OAO (for the purposes of the capacity charge rates it pays), regardless of the stations that the additional service code calls at. However, any remaining threshold cannot be allocated to any service code subsequently approved that, if included as part of the initial approval, would have meant the OAO would not have been treated as a new entrant OAO for capacity charge purposes.

<sup>17</sup> These criteria regarding overlapping stations can be illustrated by the following examples. If there are two service codes: service code 1 stops at stations A, B and C, and service code 2 stops at B, C and D, then service code 1 would be considered as having more than one station overlapping with service code 2. If there are three service codes: service code 3 stops at stations E, F and G, service code 4 at F, H and I and service code 5 at G, J and K, then service code 3 would not be considered as having more than one station overlapping with the stations in another service code.

<sup>18</sup> For example, if train company A is a completely new entrant OAO with no affiliation to an existing OAO, train company B is owned by the same owner group as an existing OAO and they both start to run open access services to somewhere that currently does not have a service run by an OAO, then we would expect both companies to be treated equally through the charges system

- (b) we do not want an existing OAO or its owner group to create an affiliate in order to pay CP4 equivalent rates on what amounts to an expansion of its existing services or services that are very similar those it already runs<sup>19</sup>.

61. In reaching this decision, we had regard to the reason behind our final determination decision to allow new entrant OAOs to pay CP4 capacity charge rates on services below a threshold, which was to ensure that new entrant OAOs are treated in a way that is equivalent to existing OAOs.

62. We considered a range of definitions of new entrant, ranging between:

- (a) the strict definition that a new entrant OAO is one with its first ever track access agreement entered into in CP5 and no affiliation to an existing OAO anywhere in its group company structure (whether a parent or subsidiary undertaking); and
- (b) the much less strict definition that a new entrant OAO is any company with its first ever track access agreement entered into in CP5 and a company number distinct from any other OAO.

63. More detail on the options we considered is contained in Annex C of our consultation.

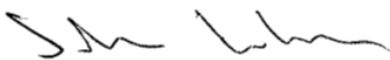
64. In addition to this, we considered the definition Network Rail proposed in its consultation response. As outlined in paragraph 24(d), we rejected it on the grounds that it is not consistent with our final determination decision and could result in new entrant OAOs being unduly discriminated against.

### **Contractual wording**

65. Our implementation decisions for new entrant OAOs will involve the same formulae being used as those in Schedule 7, Section 6 of the template track access agreement for existing OAOs. However, we have needed to make some changes to the definitions of the components of the formulae and the contractual wording.

66. Annex D contains a model Schedule 7 of the track access agreement for new entrant OAOs.

Yours faithfully,



John Larkinson

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<sup>19</sup> For example we would wish to avoid an owner group of an existing OAO, train company C, setting up a new entrant OAO, train company D, to run very similar services to train company C in order to benefit from CP4 equivalent capacity charge rates.



## Annex A – Summary of issues raised in consultation responses

The table below is a summary of the issues raised in the responses we received to our consultation, and our response to these issues.

Issue	Raised by	ORR response
<p>EIL raised a specific concern about using the end- of- CP4 Hull Trains mileage as the basis of the threshold for a new entrant OAO operating on the limited part of the Network Rail network EIL operates on. This is because EIL’s baseline is based on its end of CP4 mileage which is considerably less than that of Hull Trains. Network Rail raised a similar concern about any situation where an existing OAO might have a threshold below that of Hull Trains.</p>	<p>EIL and Network Rail</p>	<p>We will set a different threshold for new entrant OAOs running primarily on the HS1 infrastructure but with a small amount of mileage on the Network Rail infrastructure between larger mileage on sections of HS1 infrastructure. This threshold will be set at the EIL end-of-CP4 mileage. For further explanation, see paragraphs 19-23.</p>
<p>In network locations where there is not currently an OAO (e.g. Wales), any OAO with services at a different network location would be classed as an existing OAO for this location. It would therefore be at a disadvantage compared to an OAO which was completely new to the network.</p>	<p>Network Rail</p>	<p>There are a number of barriers that new entrant OAOs would face compared to existing OAOs when trying to gain access to the network. Our final determination decision protects existing OAOs from an increase in the capacity charge in relation to their current services but requires them to pay CP5 rates on additional services. At the same time it aims to avoid unduly discriminating against new entrants by allowing them to pay CP4 equivalent rates on services equivalent that of existing services of Hull Trains. Our implementation decision is consistent in relation to this.</p>
<p>Under the ORR proposals, franchised passenger operators would pay the CP5 rates on all traffic and would be discriminated against compared to either existing or new entrant OAOs.</p>	<p>Network Rail</p>	<p>Our consultation was specifically about implementing our final determination decision. As we explained in our final determination (paragraph 16.199), we do not consider that our decision would result in undue discrimination between franchised passenger operators and OAOs. We do not plan to</p>

		revisit this decision.
In network locations where there is currently an OAO (e.g. ECML), if the incumbent OAO's threshold mileage is above that of Hull Trains (i.e. Grand Central), any new entrant OAO would be disadvantaged through the ORR's proposals.	Network Rail	Using Hull Trains mileage is preferable to that of Grand Central since it means a lower mileage would be run where Network Rail is unable to recover all its expected incremental Schedule 8 costs through the capacity charge. This is explained in more detail in paragraph 24(a). We acknowledge that depending on what proposals a new entrant OAO brings forward during CP5, there may still be potential for discrimination, and therefore, while the above is our 'minded-to' position for new entrant OAOs, we will consider representations that a new entrant OAO should have a threshold more similar to that of Grand Central on a case-by-case basis.
With regards to ORR's statement that it " <i>did not receive any objections to our proposal that the threshold is equivalent to that of existing services of the smaller of the two main existing OAOs, Hull Trains</i> ", Network Rail argued that the ORR first raised this issue in a consultation letter which closed after the publication of the final determination in which it committed to this approach without allowing the industry sufficient opportunity to comment.	Network Rail	The closing date of our 30 September 2013 consultation letter was 28 October 2013 initially and subsequently extended to 4 November 2013. This allowed stakeholders five weeks to comment on our proposal to set the threshold equivalent to the existing services of Hull Trains, which we regard as an adequate amount of time.
The selection of Hull Trains mileage for setting the baseline is completely arbitrary.	Network Rail	We have set a threshold in order to give prospective operators certainty. Setting the level to any threshold would involve some degree of judgement but we explain our reason why we consider Hull Trains' end of CP4 mileage as the most appropriate choice in paragraph 24(a).
The proposal to use Hull Trains' mileage to calculate baselines for new entrant OAOs means that for much of	Network Rail	In our consultation, we outlined an alternative approach to setting the baseline based on train paths which sought to

<p>the network, the capacity charge baseline for new entrant OAOs would be unrepresentative of their actual services. For example, for a new entrant OAO operating an infrequent, short service (in terms of mileage), it is unlikely that the threshold mileage would ever be reached.</p>		<p>avoid this issue. Having considered this approach against the train diagram mileage approach, we concluded that there were significant disadvantages with this alternative approach (see annex C of our consultation).</p>
<p>The use of Hull Trains' mileage to calculate baselines for new entrant OAOs sends incorrect price signals to OAOs. For example, under the proposal, it would appear reasonable for OAOs to plan mileage only up to the threshold level, potentially by concentrating mileage on the most profitable sections of the network. The most profitable sections of the network are likely to be the most congested, and therefore this proposal could discourage OAOs from making best use of capacity.</p>	<p>Network Rail</p>	<p>We do not agree with Network Rail that new entrant OAOs should avoid concentrating mileage on the most profitable parts of the network. This is a commercial decision for the OAO. However, as part of our process for deciding whether to approve access applications from OAOs, we consider whether or not the proposed new services are primarily abstractive of incumbents' revenue.</p>
<p>ORR's proposed approach for allocating threshold mileage, which prioritises service codes with the greatest difference between CP4 and CP5 (wash-up) weekday rates would mean that Network Rail under-recovers its additional Schedule 8 liability by the greatest amount.</p>	<p>Network Rail</p>	<p>We have revised this aspect of our implementation decision. If the new entrant OAO introduces more than one service code at the same time, the threshold mileage should be allocated to the service codes based on each code's proportion of total planned mileage for the new entrant OAO. More detail on this is contained in Annex B.</p>
<p>ORR's proposal only allocates threshold mileage up to the OAO's planned mileage for that service code. If the OAO plans to operate fewer miles than the Hull Trains threshold, there would be some 'leftover' threshold mileage not allocated to any service code. The implication is that, for any new entrant OAO planning to operate fewer miles than Hull Trains, its baseline would not be equivalent to that of Hull Trains. It would instead</p>	<p>Network Rail</p>	<p>Our approach ensures that if the planned mileage of an OAO does not cover all the threshold mileage, the remaining threshold mileage will be available for future service expansion, which we consider is consistent with our final determination decision – i.e. to allow a new entrant to run mileage equivalent to that of existing operators at CP4 equivalent rates.</p>

be equivalent to the mileage that it plans to operate.		
<p>Network Rail considered that the approach that should be followed when calculating CP4 equivalent capacity charge rates for a new entrant OAO should be consistent across the network, and follow the same approach as was used to update the CP4 rates for Hull Trains and Grand Central. In terms of defining an 'anchor' for new entrant OAOs, Network Rail argued that there appear to be two options: to select a 'representative' operator or service code(s) to act as the anchor, or; to apply a standard discount (based on East Coast Trains rates) to the CP5 rate(s) for any new entrant OAO. Network Rail considered that the latter approach is favourable.</p>	Network Rail	<p>We are content with Network Rail's preferred approach to calculate CP4 equivalent rates for a new entrant OAO by applying a standard network wide percentage discount to the wash-up rates of its service codes. This discount is the same as that applied to the Hull Trains and Grand Central wash-up rates to get their CP4 equivalent rates. Our reasons for this decision are explained in paragraphs 52-58.</p>

## Annex B – converting the threshold into a baseline for each service code

1. As discussed in the main section, in principle, our PR13 decisions in relation to the capacity charge for new entrant OAOs could be implemented through the price list. However, this is not compatible with TABS, which requires a single charge for a service code. For pragmatic reasons, therefore, we are implementing our decision through a wash-up, consistent with our approach for implementing our decision for existing OAOs.
2. The wash-up represents the monetary amount an OAO pays Network Rail at the end of the year if its actual mileage in a given year exceeds the threshold. The formula for the wash-up for existing OAOs as outlined in Schedule 7 is:

$$\text{Wash-up} = (M_{te} - B_{te} - A_{te})$$

3. As per Schedule 7 of the track access agreement, this formula only results in a payment if the wash-up has a positive value.
4. In this formula,  $A_{te}$  is Network Rail's estimate of the revenue it is owed in relation to the particular service code for the year  $t$  in accordance with the main capacity charge formula (i.e. not the wash-up) in Schedule 7 of the open access TAA<sup>20</sup>. This is in effect the amount obtained by applying the CP4 equivalent weekday and weekend rates, as set out in the List of Capacity Charge Rates, to actual traffic within the year.
5.  $M_{te}$  is Network Rail's reasonable estimate of the aggregate revenue it would have been entitled to receive during year  $t$  for a specific service code if, in the main capacity charge formula, the weekday and weekend capacity charge wash-up rates were used instead of CP4 equivalent rates.
6.  $B_{te}$  is the baseline value in pounds (defined below).
7. The purpose of the wash-up is to ensure an operator is paying wash-up rates, equivalent to the rates calculated by Arup as part of PR13, on any traffic above the pre-determined threshold. Consistent with our final determination, each baseline is defined such that its respective wash-up is equal to zero if traffic is at threshold levels.
8. We have concluded that the same formula for wash-up will be used and, with the threshold defined as the annual mileage value used to calculate the Hull Trains baseline, the baseline for each service code of a new entrant OAO will be equal to:
  - (a) the revenue that Network Rail would have received at the threshold traffic levels if the capacity charge was levied at the wash-up rates (i.e. the new full CP5 rates as calculated by Network Rail using the tool developed by Arup as part of the PR13 recalibration exercise);  
minus:

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<sup>20</sup> This is the formula at the beginning of section 6 of Schedule 7 (pages 121 to 122) of the document: 'Review Notice: Open Access Passenger Operator Track Access Agreements' ([http://orr.gov.uk/data/assets/pdf\\_file/0006/5874/pr13-review-notice-open-access.pdf](http://orr.gov.uk/data/assets/pdf_file/0006/5874/pr13-review-notice-open-access.pdf)).  $A_{te}$  is equivalent to  $K_t$  in this formula.  
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(b) the revenue that Network Rail would have received at the threshold traffic levels if the CP4 equivalent capacity charge was levied.

9. The baseline value of each service code will determine any year-end monetary wash-up an operator would have to pay if its actual mileage in a given year exceeds the threshold.

10. The baseline for a service code would be calculated through the following formula:

$$\text{Baseline} = \text{allocation of threshold weekday train miles} * (\text{weekday wash-up rate} - \text{CP4 equivalent weekday rate}) + \text{allocation of threshold weekend train miles} * (\text{weekend wash-up rate} - \text{CP4 equivalent weekend rate})$$

11. If a new entrant OAO introduces more than one service code, we propose that the threshold mileage is allocated to service codes in the order that the services are introduced.

12. If the new entrant OAO introduces more than one service code at the same time, the threshold mileage should be allocated to the service codes based on each code's proportion of total planned mileage for the new entrant OAO.

13. However we do not agree with Network Rail's suggestion to allocate all the threshold mileage to the service codes first introduced. The number of threshold miles that will be allocated to the new entrant OAO will be equal to the total mileage planned in respect of the OAO's service codes, if this value is less than the total number of threshold miles, or equal to the total number of threshold miles available if it is higher. This will ensure that if the planned mileage does not cover all the threshold mileage, the remaining threshold mileage will be available for future service expansion.

14. Furthermore, as we previously proposed in our consultation letter, the allocation will be done across total mileage (i.e. without taking into account the split between weekday and weekend mileage).

15. For the purpose of calculating a baseline, the total threshold mileage allocated to each service code will be split between weekday and weekend mileage based on the percentage split between weekday and weekend miles of the new operator's proposed service codes. This will ensure that mileage is not exhausted in relation to either the weekday or weekend thresholds individually, which we understand could happen under Network Rail's proposal in its response to our consultation.

16. Any remaining threshold mileage can subsequently be allocated to further service codes the OAO might introduce in the future, or, if the operator decided to increase service frequency or mileage, used to increase the baseline for its existing service codes.

17. An example of how this allocation methodology will work in practice is shown below. All the values shown are indicative, and for illustration purposes only. It is assumed that the threshold is 1,000,000 miles.

18. In the scenario below, SG1 and SG2 are introduced at the same time, with SG3 being introduced subsequently.

	<b>Weekday miles</b>	<b>Weekend miles</b>	<b>Total miles</b>	<b>% weekday mileage</b>	<b>% of total proposed mileage (for SG1+SG2)</b>
SG1 (introduced with SG2)	350,000	125,000	475,000	74%	56%
SG2 (introduced with SG1)	270,000	100,000	370,000	73%	44%
SG3 (introduced after SG1 and SG2)	300,000	75,000	375,000	80%	N/A

19. This results in the following allocation of threshold mileage:

	<b>Remaining threshold (before SG introduction)</b>	<b>Total mileage</b>	<b>Threshold miles allocated (total)</b>	<b>% weekday mileage</b>	<b>Threshold weekday miles allocated</b>	<b>Threshold weekend miles allocated</b>
SG1	1,000,000	475,000	<b>475,000</b>	74%	74% * 475,000 = <b>350,000</b>	475,000 – 350,000 = <b>125,000</b>
SG2		370,000	<b>370,000</b>	73%	73% * 370,000 = <b>270,000</b>	370,000 – 270,000 = <b>100,000</b>
SG3 (introduced subsequently)	1,000,000 – 475,000 – 370,000 = 155,000	375,000	<b>155,000</b>	80%	80% * 155,000 = <b>124,000</b>	155,000 – 124,000 = <b>31,000</b>

20. Once the threshold miles have been allocated to the new entrant OAO's service codes, a baseline is calculated for each service code using the following formula outlined in paragraph 10. For example, for SG1 above, the baseline would be:

$$SG1 \text{ baseline} = 350,000 * (\text{weekday wash-up rate} - CP4 \text{ equivalent weekday rate}) + 125,000 * (\text{weekend wash-up rate} - CP4 \text{ equivalent weekend rate})$$

## **Annex C – Addressee list**

Abellio, Alliance Rail Holdings, Arriva Trains Wales, ATOC, Centro, Chiltern railways, Cross Country Trains, DfT, East Coast, Eurostar, First Capital Connect, First Scot Rail, First Hull Trains, First Greater Western, First Transpennine Express, First Group, Go ahead, Go-op, Grand Central, Greater Anglia, Heathrow Express, London Midland, LOROL, Mersey Rail, National Express, Network Rail, Northern Rail, North Yorkshire Moors Railway, Nexus, PTEG, Rail Delivery Group, Southeastern Railway, Southern Railway, Stagecoach, Stagecoach East Midlands Trains, Stagecoach South Western Trains, Swanage Railway, Transport Scotland, Virgin Trains

## Annex D – Schedule 7 for new entrant OAOs

The mark-up below shows the changes we have made to Schedule 7 of the track access agreement for existing OAOs in order to implement our decisions in relation to new entrant open access operators.

The version of the track access agreement which we have marked-up is the one we published on 20 December 2013 accompanying our PR13 Review Notices. This can be accessed [here](#)<sup>21</sup>.

### SCHEDULE 7: TRACK CHARGES AND OTHER PAYMENTS

#### PART 1: INTERPRETATION

##### 1 Definitions

In Parts 1-7 inclusive, unless the context otherwise requires:

<b>“2008 Final Determinations”</b>	means the document entitled “Periodic Review 2008: Determination of Network Rail’s outputs and funding for 2009-14” published by ORR on 30 October 2008;
<b>“2013 Final Determination”</b>	means the document entitled “Periodic Review 2013: Final determination of Network Rail’s outputs and funding for 2014-19” published by ORR on 31 October 2013;
<b>“access charges review”</b>	has the meaning ascribed to it by Schedule 4A to the Act;
<b>“Capacity Charge”</b>	means a variable charge, calculated in accordance with paragraph 6 of Part 2;
<b>“Capacity Charge Wash-up”</b>	means the charge calculated in accordance with paragraph 6.2;
<b>“Capacity Charge Wash-up Weekday Rate”</b>	has the meaning as ascribed to it in paragraph 6.4;
<b>“Capacity Charge Wash-up Weekend Rate”</b>	has the meaning as ascribed to it in paragraph 6.4;

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<sup>21</sup> The relevant document is titled “*Review Notice: Open Access Passenger Operator Track Access Agreements*”. Schedule 7 begins on page 111 of that document – Appendix 4 to Annex 2.

<b>“Default Charge”</b>	means a variable charge calculated in accordance with paragraph 3.3 of Part 2;
<b>“Default Period”</b>	means the period from the later of: <ul style="list-style-type: none"> <li>(a) the date on which the New Specified Equipment is first used on the Network by the Train Operator; or</li> <li>(b) 1 April 2014,</li> </ul> until the date on which ORR consents to or determines a supplement to the Track Usage Price List under paragraph 9.10 of Part 2 in respect of that New Specified Equipment;
<b>“Default Rate”</b>	means, in respect of any New Specified Equipment used on the Network by the Train Operator, the corresponding passenger default rate for that type of vehicle set out in the section of the Track Usage Price List entitled “Passenger Variable Usage Charge default rates”;
<b>“Default Train Consist Data”</b>	means the data listed in Appendix 7C as amended from time to time in accordance with paragraph 10.4 of Part 2;
<b>“Delivery Plan”</b>	means the document, including its supporting documentation, published by Network Rail on or about 31 March 2014 setting out its delivery plan for the period 1 April 2014 – 31 March 2019;
<b>“Efficiency Benefit Share”</b>	means the amount determined in accordance with paragraph 5.1 of Part 2;
<b><u>“Eligible Service Codes”</u></b>	means each of the following Service Coded Groups:



**“Initial Indexation Factor”**

is derived from the following formula:

$$\text{IIF} = \left( 1 + \frac{(\text{RPI}_{2013} - \text{RPI}_{2012})}{\text{RPI}_{2012}} \right)^2$$

where:

IIF means Initial Indexation Factor;

RPI<sub>2012</sub> means the RPI published or determined with respect to the month of November 2012; and

RPI<sub>2013</sub> means the RPI published or determined with respect to the month of November 2013;

**“List of Capacity Charge Rates”**

means the document entitled “List of Capacity Charge Rates” published by Network Rail on or about 20 December 2013 which, for the purposes of this contract, shall be deemed to incorporate any supplements to that document consented to or determined pursuant to paragraph 9.10 of Part 2 of Schedule 7 to this contract;

**“Material Alliance Agreement”**

means a legally binding agreement between:

(a) Network Rail and the Train Operator; or

(b) Network Rail, the Train Operator and one or more other train operators; or

(c) Network Rail and one or more other train operators,

establishing an alliance under which the parties to such legally binding agreement agree to share risk or reward or both on a REBS Route or part thereof on which the Train Operator operates Services and which is likely to have a material direct financial impact on one or more elements of Network Rail’s costs or income included within the Route Baseline;

**“New Specified Equipment”**

means a type of railway vehicle not included in the section of the Track Usage Price List entitled “Passenger Variable Usage Charge rates”;

<b>“Outperformance Cap”</b>	means the maximum possible amount in pounds sterling that can be attributed to a REBS Outperformance as published by Network Rail in its Delivery Plan;
<b>“Outperformance Sum”</b>	means the lower of: <ul style="list-style-type: none"> <li>(a) the Outperformance Cap as indexed in accordance with paragraph 1.11 of Part 3; and</li> <li>(b) 25% of the amount in pounds sterling which ORR, in its annual efficiency and finance assessment of Network Rail, determines in respect of the REBS Outperformance;</li> </ul>
<b>“Period”</b>	has the meaning ascribed to it in Schedule 8;
<b>“REBS Outperformance”</b>	means the situation where ORR’s annual efficiency and finance assessment of Network Rail in respect of the REBS Route in Relevant Year t has identified, in accordance with the methodology and principles set out in Chapter 19 of the 2013 Final Determination, that Network Rail’s performance has exceeded the performance set in the Route Baseline as indexed in accordance with paragraph 1.10 of Part 3;
<b>“REBS Route”</b>	means a route specified in the table in Appendix 7A for the purposes of the Route-Level Efficiency Benefit Share Mechanism;
<b>“REBS Underperformance”</b>	means the situation where ORR’s annual efficiency and finance assessment of Network Rail in respect of the REBS Route in Relevant Year t has identified, in accordance with the methodology and principles set out in Chapter 19 of the 2013 Final Determination, that Network Rail’s performance has not achieved the performance set in the Route Baseline as indexed in accordance with paragraph 1.10 of Part 3;

<b>“Relevant Year”</b>	means a year commencing at 0000 hours on 1 April and ending at 2359 hours on the following 31 March; “Relevant Year t” means the Relevant Year for the purposes of which any calculation falls to be made; “Relevant Year t-1” means the Relevant Year preceding Relevant Year t; and similar expressions shall be construed accordingly;
<b>“Route Baseline”</b>	means the baseline value in respect of a REBS Route in Relevant Year t that is published by Network Rail in its Delivery Plan;
<b>“Route-Level Efficiency Benefit Share”</b>	has the meaning ascribed to it in paragraph 1.1 of Part 3;
<b>“Route-Level Efficiency Benefit Share Mechanism”</b>	means the provisions for the calculation and payment of the Route-Level Efficiency Benefit Share in respect of one or more REBS Routes as described in paragraph 1 of Part 3;
<b>“RPI”</b>	means the General Index of Retail Prices All Items measured by CHAW and published each month, or: <ul style="list-style-type: none"> <li>(a) if the index for any month in any year shall not have been published on or before the last day of the third month after such month, such index for such month or months as ORR may (after consultation with the parties and such other persons as it considers appropriate) determine to be appropriate in the circumstances; or</li> <li>(b) if there is a material change in the basis of the index, such other index as ORR may (after consultation with the parties and such other persons as it considers appropriate) determine to be appropriate in the circumstances;</li> </ul>
<b>“Service Coded Group”</b>	means any Service or collection of Services or Ancillary Movements operating under a service code specified in the List of Capacity Charge Rates, and any Ancillary Movements relating to such Services;

<b>“Track Usage Price List”</b>	means the document entitled “Track Usage Price List” published by Network Rail on or about 20 December 2013 which, for the purposes of this contract, shall be deemed to incorporate any supplements to that document consented to or determined pursuant to paragraph 9.10 of Part 2 of Schedule 7 to this contract;
<b>“Train Consist Data”</b>	means the information relating to the number(s) and type(s) of railway vehicle comprised in a train movement;
<b>“Train Mile”</b>	in relation to a train, means a mile travelled by that train on the Network;
<b>“Underperformance Cap”</b>	means the maximum possible amount in pounds sterling that can be attributed to a REBS Underperformance as published by Network Rail in its Delivery Plan;
<b>“Underperformance Sum”</b>	means the lower of: <ul style="list-style-type: none"> <li>(a) the Underperformance Cap as indexed in accordance with paragraph 1.11 of Part 3; and</li> <li>(b) 10% of the amount in pounds sterling which ORR, in its annual efficiency and finance assessment of Network Rail, determines in respect of the REBS Underperformance;</li> </ul>
<b>“Variable Charges”</b>	means the Capacity Charge, the Default Charge and the Variable Usage Charge;
<b>“Variable Usage Charge”</b>	means a variable charge, calculated in accordance with paragraph 3.1 of Part 2;
<b>“Vehicle Mile”</b>	in relation to a railway vehicle, means a mile travelled by that vehicle on the Network; and
<b>“Weekday”</b>	has the meaning ascribed to it in paragraph 1.1 of Schedule 5.

## **PART 2: TRACK CHARGES**

### **1 Principal formula**

During each Relevant Year, Network Rail shall levy and the Train Operator shall pay Track Charges in accordance with the following formula:

$$T_t = V_t + K_t + KW_t + D_t - BS_t$$

where:

$T_t$  means Track Charges in Relevant Year t;

$V_t$  means an amount in respect of the Variable Usage Charge in Relevant Year t which is derived from the formula in paragraph 3.1;

$K_t$  means an amount in respect of the Capacity Charge in Relevant Year t which is derived from the formula in paragraph 6;

$KW_t$  means an amount, if any, in respect of the Capacity Charge Wash-up in Relevant Year t which shall be calculated in accordance with paragraph 6.3;

$D_t$  means an amount (if any) in respect of the Default Charge in Relevant Year t which is calculated in accordance with paragraph 3.3; and

$BS_t$  means an amount (which shall not be a negative value) in respect of the Efficiency Benefit Share in Relevant Year t which is determined in accordance with paragraph 5.1.

**2** Not used.

### **3 Variable-Usage Charge**

#### **3.1 Variable Usage Charge**

For the purposes of paragraph 1, the term  $V_t$  means an amount in respect of the Variable Usage Charge in Relevant Year t which is derived from the following formula:

$$V_t = \sum V_{it} \cdot UV_{it}$$

where:

$V_{it}$  means an amount-for a type of vehicle i for Relevant Year t which is derived from the following formula:

$$V_{it} = V_{it-1} \cdot \left( 1 + \frac{(RPI_{t-1} - RPI_{t-2})}{RPI_{t-2}} \right)$$

where:

$RPI_{t-1}$  means the RPI published or determined with respect to the month of November in Relevant Year t-1;

$RPI_{t-2}$  means the RPI published or determined with respect to the month of November in Relevant Year t-2,

but so that in relation to the Relevant Year commencing on 1 April 2014,  $V_{it}$  shall have, in respect of vehicle type i, the corresponding variable usage charge rate per Vehicle Mile for that vehicle type i set out in the Track Usage Price List; multiplied by the Initial Indexation Factor; and in relation to the next following Relevant Year  $V_{it-1}$  shall have the same value;

$UV_{it}$  means the actual volume of usage (in Vehicle Miles) in Relevant Year t of vehicle type i (referred to in the Track Usage Price List) operated by or on behalf of the Train Operator; and

$\Sigma$  means the summation across all relevant categories of vehicle types i.

3.2 Not used

3.3 *Default Charge*

For the purposes of paragraph 1, the term  $D_t$  means the amount of Default Charge payable in respect of New Specified Equipment in Relevant Year t which is derived from the following formula:

$$D_t = \sum D_{nt} \cdot UD_{nt}$$

where:



$D_{nt}$  means the Default Rate for that New Specified Equipment for Relevant Year t which is derived from the following formula:

$$D_{nt} = D_{nt-1} \cdot \left( 1 + \frac{(RPI_{t-1} - RPI_{t-2})}{RPI_{t-2}} \right)$$

where:

$RPI_{t-1}$  has the meaning set out in paragraph 3.1 above;

$RPI_{t-2}$  has the meaning set out in paragraph 3.1 above,

but so that in relation to the Relevant Year commencing on 1 April 2014,  $D_{nt}$  shall have, in respect of New Specified Equipment, the corresponding Default Rate for that New Specified Equipment, multiplied by the Initial Indexation Factor; and in relation to the next following Relevant Year  $D_{nt-1}$  shall have the same value;

$UD_{nt}$  means the actual volume of usage of New Specified Equipment in Vehicle Miles during the Default Period in Relevant Year t operated by or on behalf of the Train Operator; and

$\Sigma$  means the summation across all relevant New Specified Equipment.

#### **4 Not used.**

#### **5. Efficiency benefit share**

##### **5.1 The Efficiency Benefit Share:**

(a) is an amount (which shall not be a negative value) representing a return of Track Charges which shall be identified in the ORR's annual assessment of Network Rail as the "Efficiency Benefit Share", if any, to be rebated to the Train Operator, such amount to be determined in accordance with the methodology and principles set out in paragraphs 27.34 to 27.53 (inclusive) of the 2008 Final Determinations; and

(b) shall only be payable in respect of Relevant Years ending on or before 31 March 2014.

5.2 If, pursuant to paragraph 5.1, the Train Operator is entitled to payment of an Efficiency Benefit Share in respect of Relevant Year t, then, subject to

paragraph 5.3, such payment shall be made by Network Rail to the Train Operator as a lump sum payment within 28 days after the end of the Period in which it is determined by the ORR that such payment should be made.

- 5.3 If, in respect of any Relevant Year  $t$ , an Efficiency Benefit Share is payable in accordance with paragraph 5.2 and this contract has either commenced or expired or otherwise been terminated during the course of that Relevant Year  $t$ , the Train Operator shall be entitled to a pro rata payment of the Efficiency Benefit Share payable in respect of that Relevant Year  $t$ . Such pro rata payment (which shall be payable in accordance with paragraph 5.2) shall be calculated as follows:

$$\text{Pro rata BS}_t = \left( \frac{\text{EBS}}{13} \right) \times \text{CP}$$

where:

EBS means the total amount of the Efficiency Benefit Share that would have been payable to the Train Operator in respect of the whole of the Relevant Year  $t$  in question had this contract been in force for the entire Relevant Year  $t$ ; and

CP means the number of Periods during that Relevant Year  $t$  either:

- (a) where this contract commences during the course of that Relevant Year  $t$ , following commencement of this contract; or
- (b) where this contract expires or is otherwise terminated during the course of that Relevant Year  $t$ , prior to the expiry or other termination of this contract,

provided that, in each case:

- (i) if this contract expires or is otherwise terminated on or before the fourteenth day of a Period, such Period shall not be included in the calculation of 'CP';
- (ii) if this contract expires or is otherwise terminated on or after the fifteenth day of a Period, such Period shall be included in the calculation of 'CP';
- (iii) if this contract commences on or before the fourteenth day of a Period, such Period shall be included in the calculation of 'CP'; and

- (iv) if this contract commences on or after the fifteenth day of a Period, such Period shall not be included in the calculation of 'CP'.

5.4 Without prejudice to the generality of Clause 16.3.1, any payment of an Efficiency Benefit Share (an “**EBS payment**”) shall be made on the basis that it is to be treated as exclusive of VAT, so that where and to the extent that the EBS payment is consideration for a supply for VAT purposes Network Rail shall in addition pay to the Train Operator an amount equal to the amount of VAT due in respect of that EBS payment and either:

- (a) the Train Operator shall issue a VAT invoice to Network Rail in respect of the relevant amount; or
- (b) if the parties so agree and have entered into an applicable self-billing agreement (within the meaning of regulation 13(3A) of the Value Added Tax Regulations 1995 (the “**VAT Regulations**”)) that continues in force then Network Rail shall produce for itself a self-billed invoice (within the meaning of regulation 13(3) of the VAT Regulations) in respect of the relevant amount.

## 6 Capacity Charge and Capacity Charge Wash-up

6.1 For the purposes of paragraph 1, the term  $K_t$  means an amount in respect of the Capacity Charge in Relevant Year  $t$  which shall be derived from the following formula:

$$K_t = \left[ \sum (P_{g_{twdi}} \cdot T_{g_{twdi}}) + (P_{g_{twei}} \cdot T_{g_{twei}}) \right]$$

where:

$\sum$  means the sum across all Service Coded Groups  $i$ ;

$P_{g_{twdi}}$  means the Weekday rate per Service Coded Group  $i$  in respect of Relevant Year  $t$  shown in the List of Capacity Charge Rates and indexed in accordance with the following formula:

$$P_{g_{twdi}} = P_{g_{t-1wdi}} \cdot \left( 1 + \frac{(RPI_{t-1} - RPI_{t-2})}{RPI_{t-2}} \right)$$

where:

$RPI_{t-1}$  has the meaning set out in paragraph 3.1 above; and

$RPI_{t-2}$  has the meaning set out in paragraph 3.1 above.

but so that in relation to the Relevant Year t commencing on 1 April 2014,  $Pg_{twdi}$  shall have the value for the Weekday rate per Service Coded Group i shown for the Train Operator in the List of Capacity Charge Rates, multiplied by the Initial Indexation Factor; and in relation to the next following Relevant Year,  $Pg_{t-1wdi}$  shall have the same value;

$Pg_{twei}$  means the weekend rate per Service Coded Group i in respect of Relevant Year t shown in the List of Capacity Charge Rates and indexed in accordance with the following formula:

$$Pg_{twei} = Pg_{t-1wei} \cdot \left( 1 + \frac{(RPI_{t-1} - RPI_{t-2})}{RPI_{t-2}} \right)$$

where:

$RPI_{t-1}$  has the meaning set out in paragraph 3.1 above; and

$RPI_{t-2}$  has the meaning set out in paragraph 3.1 above,

but so that in relation to the Relevant Year t commencing on 1 April 2014,  $Pg_{twei}$  shall have the value for the weekend rate per Service Coded Group i shown for the Train Operator in the List of Capacity Charge Rates, multiplied by the Initial Indexation Factor; and in relation to the next following Relevant Year,  $Pg_{t-1wei}$  shall have the same value;

$Tg_{twdi}$  means the actual Train Miles run on Weekdays by Services or Ancillary Movements in Service Coded Group i in the Relevant Year t; and

$T_{g_{twei}}$  means the actual Train Miles run on weekends by Services or Ancillary Movements in Service Coded Group i in the Relevant Year t.

6.2 Within 90 days after the end of Relevant Year t, Network Rail shall calculate any Capacity Charge Wash-up for the Train Operator ( $KW_t$ ) in accordance with paragraph 6.3 and provide the Train Operator such background data and workings as may reasonably be required for a proper understanding of Network Rail's calculations. If  $KW_t$  is a positive sum then it shall be payable by the Train Operator. If  $KW_t$  is a negative sum or equal to zero then no sum shall be payable by the Train Operator or by Network Rail.

6.3  $KW_t$  is derived from the following formula:

$$KW_t = \sum KW_{te}$$

Where  $\sum$  means the summation across all the Eligible Service Codes e.

6.4 For each Eligible Service Code e,  $KW_{te}$  is derived from the following formula:

$$KW_{te} = (M_{te} - B_{te} - A_{te})$$

where:

$M_{te}$  means Network Rail's reasonable estimate of the aggregate revenue it would have been entitled to receive during Relevant Year t from the Capacity Charge for Services or Ancillary Movements operating under Eligible Service Code e under this track access agreement if, in the calculation of the Capacity Charge under paragraph 6.1 above, the weekday rate and weekend rate for any Eligible Service Code e were interpreted to mean the Capacity Charge Wash-up Weekday Rate and Capacity Charge Wash-up Weekend Rate respectively, as set out in the corresponding columns in the List of Capacity Charge Rates, and had been applied as such for all Services or Ancillary Movements relating to the Eligible Service Code e that had operated on the Network during Relevant Year t;

$B_{te}$  means a baseline value in pounds for Eligible Service Code e for the Train Operator ( $BV_t$ ) in Relevant Year t which shall be derived from the following formula:

$$BV_t = BV_{t-1} \cdot \left( 1 + \frac{(RPI_{t-1} - RPI_{t-2})}{RPI_{t-2}} \right)$$

where:

$RPI_{t-1}$  has the meaning set out in paragraph 3.1 above; and

$RPI_{t-2}$  has the meaning set out in paragraph 3.1 above.

but so that in relation to the Relevant Year  $t$  commencing on 1 April 2014,  $BV_t$ , shall be the baseline value in pounds for Eligible Service Code  $e$  for the Train Operator as set out in Network Rail's List of Capacity Charge Baselines for CP5, approved or directed by ORR and published on or before 10 February 2014, and as supplemented (with ORR's approval) from time to time, multiplied by the Initial Indexation Factor and in relation to the next following Relevant Year  $BV_{t-1}$  shall have the same value.

$A_{te}$  means the aggregate income which Network Rail, acting reasonably, estimates is owed to it under paragraph 6.1 of Schedule 7 of this track access agreement in respect of the Capacity Charge for all Services or Ancillary Movements relating to Eligible Service Code  $e$  that have been operated on the Network during Relevant Year  $t$ ;

If  $KW_{te}$  is a negative sum, then for the purposes of paragraph 6.3 above, it shall be zero.

***\*\*The rest of Schedule 7 is not included in this document as we are only proposing changes relating to the capacity charge.\*\****