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20 December 2012

Company Secretary
Network Rail Infrastructure Limited
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ORR consent under network licence condition 5

Background

1. On 30 November 2012 Network Rail Infrastructure Limited (Network Rail) wrote to us, identifying three services for which it could not trace a record of consent under the network licence. It described longstanding arrangements in which Network Rail had an interest in the operation of railway vehicles that were not used exclusively in the operation of its network. Network Rail had provided railway vehicles and services for:
 - (a) the recording of track geometry, ultrasonic and overhead line data on the British Airports Authority (BAA)-owned branch line to Heathrow Airport, plus rail grinding services to Heathrow Express (HEX) through the Heathrow tunnels;
 - (b) winter treatment and infrastructure monitoring on two sections of London Underground Limited (LUL) infrastructure: Amersham to Harrow-on-the-Hill and Wimbledon to East Putney; and
 - (c) infrastructure monitoring to the Tyne and Wear Passenger Transport Executive (Nexus) Metro network.
2. A copy of the letter is attached at Annex A.
3. In its subsequent letter of 11 December 2012, Network Rail provided additional and clarifying information in relation to the activities above and requested our consent under condition 5.1 of its network licence so that the arrangements gain regulatory recognition. In that letter Network Rail also requested consent for (d) the planned provision of various railway vehicles in 2013 to assist with the improvement of rail freight capacity on

the existing Thameshaven branch line, in connection with the DP World-owned London Gateway Port Railway (LGPR).

4. The first date for the expected provision of vehicles was given as 29 January 2013. Provision was expected to cease by April 2013, although some extension was possible if the project were not to complete on time. A copy of this letter is at Annex B.

Reasons for our consent

5. The key purpose of condition 5 is to prohibit the network licence holder from entering into arrangements that would constitute vertical integration with passenger train operators.¹ It is clear from Network Rail's correspondence and our discussions with its representatives that there are no vertical integration issues for us to consider from a purposive perspective.

6. All the arrangements are longstanding and in the case of HEX are contractual, pre-date Network Rail taking over the network and may pre-date privatisation. Network Rail cannot be certain as to when the arrangements for LUL and Nexus were put in place but they are at least several years old. However, we note that Network Rail has scheduled the services so that they are not detrimental to core network operations. The company expects to continue providing such railway vehicles and services on an ongoing basis and to put in place charging arrangements based on standard commercial rates where appropriate.

7. We also note that, in respect of the supply of railway vehicles and services to the London Gateway Port project, Network Rail will use spare resource capacity so that there is no detrimental effect on its core business and that charging will be at standard commercial rates. We consider that these arrangements overall are consistent with Network Rail's general duty under condition 1 of its network licence.

8. None of these activities are included in the definition of Permitted Business in part 2 of the network licence but we note that it will conduct each of them as *de minimis* business in accordance with condition 4 (*Financial ring-fence*) of its network licence.

9. On the basis of Network Rail's letters dated 30 November 2012 and 11 December 2012 and supplementary information also provided, and having had regard to our duties under section 4 of the Railways Act 1993, in particular our duty to protect the interests of users of railway services, we consent for the purposes of condition 5.1 of the network licence to the arrangement (a) to (d) as described in the letters and supplementary information.

¹ This separation and our regulation of Network Rail is noted in the European Commission decision of 17 July 2002, which considered that the proposed restructuring of Railtrack plc to the ownership of Network Rail (a company limited by guarantee) would not constitute 'state aid'.

10. We may at any time modify or revoke this consent after consulting you if it appears to us to be requisite or expedient to do so, having regard to the duties imposed on us by section 4 of the Railways Act.

A handwritten signature in black ink, which reads 'Robert M Plaskitt'. The signature is written in a cursive style with a large, looping initial 'R'.

Rob Plaskitt

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30 November 2012

Dear Rob

Licence condition 5 – longstanding service provision of Network Rail owned railway vehicles

As part of our work to understand how to take forward a possible application for a general consent under licence condition 5, we have been reviewing the historic activities that have taken place to date that have necessitated a need to secure such consent. As part of this review we have identified three historic (but ongoing) activities which involve the use of Network Rail owned railway vehicles to provide services to third parties. We are currently unable to trace a record of formal consent being granted to use railway vehicles for these purposes. It would therefore appear that an anomaly exists that may need to be regularised.

The identified services are as follows:

- Since 1998 Railtrack, and subsequently Network Rail, has provided track geometry, ultrasonic and overhead line recording on the BAA owned branchline to Heathrow Airport. We are also providing rail grinding services to Heathrow Express (HEX) through the Heathrow Tunnels.
- Since privatisation some limited winter treatment services and infrastructure monitoring services have also been provided to London Underground Limited (between Amersham and Harrow on the Hill and Wimbledon – East Putney).
- Since at least 2006 we have provided infrastructure monitoring services to NEXUS which have involved the use of Network Rail vehicles.

The most pressing issue is the use of infrastructure monitoring and grinding vehicles on the Heathrow Express Branchline where the next service (a grinding train) is scheduled to operate on the nights of 3 to 6 December. More information about each of these activities is provided below.



Heathrow Express (HEX) branchline

In 1993 British Rail (BR) and Heathrow Airports Ltd (now BAA) entered into a 25 year track access agreement (for commencement from 1997) for HEX to run on the mainline. This agreement also required BR to undertake certain activities on the branchline, including operating the electricity supply, signalling and driver communications system. The branchline was built by BAA and opened in 1998.

In 1998, an Infrastructure Controller agreement was entered into between Railtrack and BAA which established Railtrack's infrastructure manager duties on the branchline. Duties included controlling and monitoring OLE and controlling track, gauge and clearances in accordance with Railway Group Standards. In effect, this necessitated the provision of the associated railway vehicles to carry out these duties. The agreement was subsequently inherited by Network Rail in 2003 and has been amended over the years through side letters. In addition, a maintenance agreement was novated to Network Rail from Amey Rail when the maintenance function was brought in house. Activities under this agreement included the provision of rail grinding services (and therefore the provision of grinding vehicles). In accordance with the terms of these agreements (and subsequent variations to them), Network Rail has continued to carry out infrastructure controller and maintenance activities utilising Network Rail railway vehicles. We also have safety authorisation from ORR under what was The Railways (Safety Case) Regulations 2000 to be infrastructure manager of the branchline.

However, although we understand that ORR was included at some stage in the discussions surrounding these agreements, we have been unable to locate a consent for Railtrack (and subsequently Network Rail) to have a continued interest in rolling stock for use on the branchline. We therefore believe that the need for LC5 consent (or a derogation) may not have been considered by Railtrack and this matter has not, until now, been examined by Network Rail.

We believe that it may be necessary to regularise this historic anomaly. The rail grinding service runs every six months and the new measurement train runs every three months. The next scheduled running of the grinding train is on 3 December and the next scheduled running of the measurement train is in January 2013.

Whilst we recognise that an anomaly may exist in relation to the provision of these services we are intending to proceed with the next rail grinding service as to cancel the service at this late stage could result in operational difficulties on the line including the potential imposition of TSR's. We therefore believe it would be irresponsible for Network Rail not to carry out this planned activity.

London Underground and Nexus

Since privatisation, seasonal treatment and infrastructure monitoring trains have been used on two sections of London Underground's infrastructure; Amersham to Harrow on the Hill

and Wimbledon to East Putney. These are informal arrangements. There are no contracts for these activities and no income is generated. These services are generally carried out every six months. Again, we have been unable to find a record of ORR's formal consideration of these activities.

Similarly, a long standing informal arrangement exists with Nexus to provide an infrastructure monitoring service on the Tyne and Wear Metro network. Again, there is no contractual arrangement and we receive no income. This service has been provided since at least 2006.

Having been unable to trace any correspondence relating to the granting of specific consents to undertake these activities, we are concerned that anomalies may exist that could need to be regularised. However, ORR may have additional information which may help in clarifying the matters outlined in this letter. In the meantime and as previously stated, we intend to proceed with the planned rail grinding service on the HEX branchline next week.

We would be grateful if we could arrange a meeting with ORR as soon as possible in order to discuss this matter in more detail.

Yours sincerely

A handwritten signature in blue ink, appearing to read 'JHaskins', with a stylized flourish extending to the right.

Jon Haskins
Head of Regulatory Compliance & Reporting

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11 December 2012

Dear Les

Licence condition 5 – service provision of Network Rail owned railway vehicles consent application

As agreed in our meeting with you on 6 December, we are writing to further clarify the details outlined in our letter of 30 November concerning the longstanding service provision of Network Rail owned railway vehicles to third parties. We are additionally seeking to regularise the historic anomalies outlined in that letter by requesting consent under licence condition 5 formalise the regulatory arrangements associated with Network Rail's involvement in the provision of services on the Heathrow Express branchline, LUL and NEXUS networks which involve the use of Network Rail railway vehicles.

Also discussed in our meeting was the future planned provision of railway vehicles for involvement in the London Gateway Port development. We informed you that the first service involving the use of Network Rail owned railway vehicles has been scheduled for January. It was agreed that we would seek consent for this activity alongside those stated above.

Heathrow Express, LUL and NEXUS services

As discussed, we can confirm that the allocation of Network Rail owned railway vehicles for the provision of infrastructure monitoring and seasonal treatment on the above third party networks is carried out with no detrimental impact on Network Rail's ability to carry out its permitted business. The following points should be specifically noted:

- In relation to rail grinding services Network Rail contracts 270 shifts per rail grinder per year (Network Rail owns 6 rail grinders). These shifts are allocated in blocks to each route. The Western route will have a block of around 6 weeks per annum and can utilise their allocated shifts as they require them, which includes service provision to HEX. Thus the HEX services are provided as part of normal operational activities on the route.



- Infrastructure Monitoring: Network Rail must ensure that its infrastructure is fit for purpose and compliant with railway standards. This is achieved by looking at all the routes, the periodicity of when we have to record (this is more frequent for the heavier used track for instance) and working up an integrated plan that then utilises the different infrastructure monitoring trains to cover the network against the recording periodicities. This plan does have spare capacity in it to allow for recovery runs and contingency requirements. The integrated plan is put together so that each train on a certain patch is utilised in the most economical and efficient way. HEX, NEXUS and LUL are included in the planned shifts of the trains when they are on the relevant route and undertaking Network Rail activities in reasonable proximity to these additional service areas.
- The seasonal treatment services on the LUL network were historically carried out by Chiltern's treatment train, which serviced both the national network lines and LUL. In 2009, Network Rail's treatment trains replaced Chiltern's (at Chiltern's request) to provide a circuit treatment. LUL therefore approached Network Rail to provide this service and we subsequently added on the LUL sections into the overall circuit. This circuit covers approximately 22 hours of treatment on LNWS south, with a small portion of this (approximately 2 hours) on LUL's network.

We can also confirm that whilst the Wimbledon to East Putney section of the District Line is owned by LUL Network Rail has rights to operate Stagecoach South West Trains services along the route. Network Rail also has rights to operate Chiltern services over the Amersham to Harrow on the Hill section of LUL's network. We are therefore providing infrastructure monitoring and seasonal treatment services for the benefit of our customers.

In relation to charging arrangements (as we discussed when we met) we do not currently charge LUL or NEXUS for the provision of infrastructure monitoring and seasonal treatment services. However, we intend to review whether these informal arrangements should continue. We of course note our obligations in relation to non discrimination and therefore any future charging structures would be based on standard commercial rates. Any future income generated as a result of formal charges will be allocated as *de minimis* activity and reflected in the regulatory accounts.

As we have already stated, charging arrangements for service provision on the HEX branchline are based on standard commercial rates. Income from this activity is reflected as *de minimis* turnover in the regulatory accounts.

We have undertaken a detailed review of activities with colleagues in the National Delivery Service (NDS) team. Following this review, Martin Elwood (Director, NDS) has confirmed that there are no other activities involving the use of Network Rail owned railway vehicles for the provision of services to third parties. As discussed, we are now seeking consent under

licence condition 5 for Network Rail to provide the following services which utilise Network Rail owned railway vehicles:

- General infrastructure monitoring and maintenance services, including, but not limited to; track geometry, ultrasonic and overhead line recording together with rail grinding, on the HEX branchline.
- General infrastructure monitoring and seasonal treatment services on the Amersham to Harrow on the Hill and Wimbledon to East Putney sections of the LUL network.
- General infrastructure monitoring services on the NEXUS owned network.

The services are scheduled in such a way (as described above) that they do not have a detrimental impact on Network Rail's ability to deliver its core business and we would request that any consent allows for ongoing service provision until such a time that all parties involved agree otherwise.

London Gateway Port – application for consent under licence condition 5

London Gateway Port Ltd (LGP) is currently developing a deep-sea intermodal port and business park at Thameshaven on the north bank of the Thames Estuary. Key to the success of the proposed port and business park will be its connection to the national rail network. In light of this LGP is currently undertaking an infrastructure project to improve capacity on the existing Thameshaven branch line. This essentially involves doubling of the existing single-track, partially on a new alignment. The branchline is situated on land owned by Network Rail and LGP, but the client has, with the agreement of Network Rail, let the construction as one contract. Network Rail's ownership ends at a boundary point of 28 miles and 12 chains whereby LGP's ownership begins.

Network Rail has been approached by LGP's contractors to supply specialist railway vehicles and materials to the enhancement project. The specialist railway vehicles will deliver these materials beyond Network Rail's ownership boundary point. The types of vehicles that have been requested include, but are not limited to:

- Rail delivery trains – Network Rail is the only potential supplier of this type of vehicle in the country.
- Auto hopper wagons - Network Rail is the only potential supplier of 60 ton auto hopper wagons in the country.
- Side tippers.
- 60 ton open box wagons (Falcons).
- Tampers.
- Infrastructure monitoring trains.

It may be necessary to supply additional types of vehicles as the project requires but the above list will currently meet LGP's requirements. The first scheduled date for vehicle supply to the project is 29 January 2013. It is likely that the final commissioning stages will be completed by April 2013. However, it may be necessary to extend the contract at the request of LGP's contractors if the project is not completed by April.

In terms of supplying the vehicles to the project, Network Rail has adopted a resource plan approach that will utilise midweek or spare resources. Therefore providing these services to LGP will not impact Network Rail's ability to deliver its core business.

Network Rail will charge LGP's contractors for the supply of its vehicles at standard commercial rates and it is intended that income from these activities will be captured within Network Rail's de minimis arrangements.

Licence Condition 5 implications

We recognise that the above proposal will mean Network Rail will have an interest in the ownership of railway vehicles not being used in the operation of the network. We are therefore seeking a consent which will enable us to fulfil the service requirements of LGP (and its contractors). We would request that any consent allows flexibility for NDS to respond to service requests for the duration of the LGP enhancement project.

Network Rail shall be responsible for the insurance of its vehicles and shall keep in full force insurance of not less than £2m covering against the physical loss or damage to the rail vehicles on an all risks basis. This will include keeping in full force and effect for the duration of the hiring agreement, insurance of not less than:

- a) £10 million or any higher amount required to comply with applicable local regulatory insurance requirements against liabilities for death or personal injury to any persons arising out of the use or operation of the rail vehicles and against liabilities for loss of or damage to any property arising out of the use or operation of the rail vehicles ; and
- b) £5 million in respect of Employers' Liability insurance; and such other insurance cover as shall be necessary to cover any other risks under the terms of the proposed agreement.

Accordingly, and on the basis as outlined above, Network Rail believes that it has taken all such steps as are appropriate to protect its legal interest in the vehicle.

Licence Condition 4 implications

As you will be aware LC4 prohibits Network Rail (except with the written consent of ORR) from conducting any business other than the Permitted Business (effectively operating and maintaining the network).

ORR has previously determined in relation to the hiring of wagons for use by a third party when they are not required by Network Rail, that this activity is not included in the definition of Permitted Business although such an activity would be permissible if carried on with consent or within our *de minimis* facility under licence condition 4.

As stated above it is therefore our intention that the proposed vehicle and material supply arrangement will be carried out under the *de minimis* facility, and tracked as a 'turnover' activity. For the avoidance of doubt, Network Rail's actual 'investment' costs under the *de minimis* facility will be negligible - the costs to Network Rail being the staff costs of working up this transaction with LGP's contractors plus the costs of the individual shifts being undertaken. These will be tracked accordingly.

In conclusion, we are requesting consent/s under licence condition 5 in relation to our activities involving the use of Network Rail owned railway vehicles for services on the HEX branchline, LUL and NEXUS networks; and the supply of railway vehicles to the LGP project.

Should you require any further information with regard to any of these ongoing or planned activities, please do not hesitate to contact me.

Yours sincerely

A handwritten signature in black ink, appearing to read 'Sarah Mountford', written in a cursive style.

Sarah Mountford
Senior Regulatory Specialist