



OFFICE OF RAIL REGULATION

# Periodic Review 2013: Consultation on implementing PR13

**July 2013**

**Office of Rail Regulation**

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# 1. Introduction and background

## Purpose

- 1.1 The 2013 Periodic Review (PR13) is the process through which we determine the outputs that Network Rail is expected to deliver, the efficient cost of delivering those outputs, and the access charges the company can levy on train operators for using its network to recover those costs.
- 1.2 It covers the period from 1 April 2014 to 31 March 2019, which is called CP5 (control period 5). PR13 also establishes the wider 'regulatory framework' for CP5. This includes the financial framework within which Network Rail will operate and the incentives that will act on both it and train operators (and through them on suppliers and rolling stock companies) to deliver and outperform our determination.
- 1.3 On 12 June 2013, we published our PR13 draft determination for consultation<sup>1</sup>. In chapter 22 of the draft determination, we gave an overview of the implementation process for PR13. In short, on 20 December 2013, we expect to issue our review notices setting out the amendments to access contracts and Network Rail's network licence required to implement our final determination (which we will issue on 31 October 2013). To prepare for this, we are consulting in this document on the changes to station and track access contracts and the network licence that we propose to make to implement PR13, based on our draft determination.
- 1.4 The detailed proposed changes to access contracts and the network licence are set out on our website. We have included mark-ups against the existing provisions and, where appropriate, 'clean' versions of the proposed CP5 contractual provisions. The purpose of this document is to give an overview of these proposed changes to aid stakeholders' review.

## Structure of this document

- 1.5 Table 1.1 below sets out the structure of the remainder of this document.

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<sup>1</sup> See <http://www.rail-reg.gov.uk/pr13/consultations/draft-determination.php>.

**Table 1.1: Structure of the remainder of this document**

Chapter and title		Purpose
2	Access charges	Gives an overview of our proposed changes to charging provisions in Schedule 7 of track access contracts.
3	Contractual re-openers and other provisions	Give an overview of proposed changes to Schedule 7 of franchised passenger track access contracts relating to: <ul style="list-style-type: none"> <li>provisions enabling us to re-open our determination during CP5;</li> <li>the 'grant dilution' provision providing for increases to track access charges if the governments do not pay network grant; and</li> <li>provisions relating to rebates to train operators.</li> </ul>
4	Route-level efficiency benefit sharing	Gives an overview of our proposed route-level efficiency benefit sharing mechanism (REBS) and changes to the existing efficiency benefit sharing mechanism in Schedule 7 of track access contracts to allow a payment for the last year of CP4 to be made if appropriate.
5	Possessions and performance regimes	Gives an overview of the changes to the Schedule 4 (possessions) and Schedule 8 (performance) regimes in track access contracts.
6	Station access agreements	Sets out the changes to the station access conditions which are incorporated into train operators' station access agreements.
7	Indexation	Sets out proposed changes to the indexation provisions in track access contracts and the station access conditions
8	Changes to Network Rail's network licence	Sets out our proposed changes to Network Rail's network licence, both in respect of changes necessary to implement our PR13 determination and also in respect of other changes to ensure the licence is updated for the start of CP5.
Annex A	Network Rail's share of the volume reconciliation	Explains how we have adjusted the EC4T volume reconciliation formula so that Network Rail has a greater share than that of its own consumption.
Annex B	Process for re-opening the price control	This is an annex to chapter 3 and sets out the process for ORR to initiate an interim review during CP5.

## Responses to this consultation

1.6 We welcome comments on any aspect of the proposed contractual and licence drafting and any other points raised in this document, including on the issues raised in relation to the traction electricity cost reconciliation process in paragraphs 2.48-2.62 onwards which is not yet reflected in contractual drafting.

- 1.7 However, stakeholders are asked to note that substantive comments on ORR policy decisions arising from the draft determination should be dealt with through responses to the consultation on that document. This consultation on implementation is specifically for commenting on the way we are implementing ORR's policy decisions as set out in the draft determination.
- 1.8 Please send your response in **electronic format** by close of business on **Wednesday 4 September 2013** to:
- [alice.jones@orr.gsi.gov.uk](mailto:alice.jones@orr.gsi.gov.uk)
- Alternatively, if it is not possible to email, please send in hard-copy to:
- Alice Jones  
Office of Rail Regulation  
One Kemble Street  
London  
WC2B 4AN  
Tel: 020 7282 2165
- 1.9 Please note, when sending documents to us in electronic format that will be published on our website, we would prefer that you email us your correspondence in Microsoft Word format. This is so that we are able to apply web standards to content on our website. If you do email us a PDF document, where possible please:
- (a) create it from the electronic Microsoft Word file (preferably using Adobe Acrobat), as opposed to sending us a scanned copy of your response; and
  - (b) ensure that the PDF's security method is set to 'no security' in the document properties.
- 1.10 If you send a written response, you should indicate clearly if you wish all or part of your response to remain confidential to ORR and explain why. Otherwise, we would expect to make it available on our website and potentially to quote from it. Where your response is made in confidence please can you provide a statement summarising it, excluding the confidential information, which can be treated as a non-confidential response. We may also publish the names of respondents in future documents or on our website, unless you indicate that you wish your name to be withheld.

## Our proposed changes to access contracts

### Track access contracts

1.11 Our proposed amendments to provisions in our model track access contracts are available on our website. The changes will affect train operators differently depending on whether they run freight, franchised passenger or open access passenger services. There are also operators with different Schedule 7s (e.g. if they are charged on the basis of metered bills for traction electricity rather than modelled consumption rates). Alongside the proposed new schedules/documents (which are ‘clean’ – i.e. unmarked-up), we have provided a range of mark-ups against existing model track access contracts to make it easier for stakeholders to understand the changes that would be made to their contracts. These are accessible from the hyperlinks in Table 1.2.

**Table 1.2: Hyperlinks to mark-ups showing proposed contractual changes**

	Freight customer operator contract <sup>1</sup>	Freight operators	Regular scheduled passenger train operators		
			Franchised (England & Wales)	Franchised (Scotland)	Non-franchised (open access)
Schedule 4	<a href="#">Clean version</a>	<a href="#">Clean version</a>	<a href="#">Clean version</a>		<a href="#">Clean version</a> <sup>2</sup>
	<a href="#">Mark-up</a>	<a href="#">Mark-up</a>	<a href="#">Mark-up</a>		<a href="#">Mark-up</a>
Schedule 7	<a href="#">Clean version</a>	<a href="#">Clean version</a>	<a href="#">Clean version</a>	<a href="#">Clean version</a>	<a href="#">Clean version</a>
	<a href="#">Mark-up</a> (modelled operators)	<a href="#">Mark-up</a> (modelled operators)	<a href="#">Mark-up</a> (modelled operators)	<a href="#">Mark-up</a> <sup>5</sup>	<a href="#">Mark-up</a>
	N/A	<a href="#">Mark-up</a> (metered operators) <sup>3</sup>	<a href="#">Mark-up</a> (metered operators) <sup>4</sup>		
Schedule 8	<a href="#">Clean version</a>	<a href="#">Clean version</a>	<a href="#">Clean version</a>		<a href="#">Clean version</a> <sup>6</sup>
	<a href="#">Mark-up</a>	<a href="#">Mark-up</a>	<a href="#">Mark-up</a>		
Consequential changes	<a href="#">Consequential changes to the contracts</a>				
Traction Electricity Rules	<a href="#">Clean version</a>				N/A <sup>7</sup>
	<a href="#">Marked-up against current EC4T Metering Rules</a>				

## Notes to Table 1.2:

1. We do not currently envisage making material changes as part of PR13 to the model freight customer contract for CP5 (that is, the contract from which access rights are drawn down into a freight customer operator contract).
2. The proposed new open access Schedule 4 is marked-up against the Schedule 4 that was included in open access train operators' contracts when we implemented PR08 (but which takes into account changes to the Access Disputes Resolution Rules (ADRR) made in 2011).
3. Whilst there are currently no metered freight train operators, we have included a mark-up of the proposed Schedule 7 against the template CP4 Schedule 7 that Network Rail developed with on-train metering provisions<sup>2</sup>, as a comparator.
4. Whilst there is no standard model Schedule 7 for passenger operators, we have provided a mark-up against a typical metered train operator's Schedule 7 (in this case London Midland).
5. First ScotRail's contract contains a bespoke Schedule 7 reflecting the role of the Scottish Ministers. We have marked up its current Schedule 7 against the proposed new CP5 Schedule 7 for Scotland to indicate the changes we propose to make.
6. We have not provided a mark-up here because there is no existing model Schedule 8 for open access operators. However, the proposed open access regime will be very similar to that for franchised passengers. Open access operators may therefore wish to note the text in chapter 5 relating to their proposed regime and look at the mark-up for franchised operators to identify the changes associated with PR13.
7. No open access passenger operator currently has traction electricity provisions in its contract. Hence, the Traction Electricity Rules are not relevant to them at present.

1.12 In paragraphs 22.18-22.21 of our draft determination, we said that we would write to Network Rail and each train operator to consult them on whether any existing bespoke elements of Schedules 4, 7 and 8 (or related provisions) of their track access contracts should be retained for CP5. Accordingly, alongside this document, we are issuing a letter in respect of each contract seeking comments from Network Rail and the relevant train operator by 4 September 2013 on our proposals for any bespoke drafting required for CP5 for that contract. It is important that Network Rail and each train operator satisfy themselves that we have correctly identified any tailored elements of their contract that should roll-forward into CP5. Similarly, if any of the new contractual drafting that we describe in this document and publish on our website today would require bespoke amendments not identified in the letter we have issued, please advise us of these.

1.13 We recognise that appropriate amendments to the new CP5 provisions will need to be made to reflect where Transport for London and Merseytravel are concession authorities (in place of the Secretary of State as franchisor). It is not necessary for the purposes of this consultation to set out these changes now, but suitable amendments

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<sup>2</sup> This is available at <http://www.networkrail.co.uk/WorkArea/DownloadAsset.aspx?id=30064780777>.



will be made in the review notices that we issue in December 2013. This should not prevent those affected operators from commenting on the proposed CP5 drafting at this stage.

### **Station access agreements**

- 1.14 There are only a few changes being made to station access conditions and independent station access conditions. These are discussed in chapter 6.

### **Proposed changes to Network Rail's network licence**

- 1.15 Our mark-up of proposed substantive changes to Network Rail's network licence is available on our website<sup>3</sup>.

## **Other implementation-related work**

### **Draft price lists**

- 1.16 In parallel with this consultation, on 12 July 2013 Network Rail published on its website draft price lists for CP5<sup>4</sup>. These reflect the decisions in our draft determination and set out the exact access charges that would be payable if this determination was implemented. Train operators are strongly encouraged to take this opportunity to review the draft price lists and provide comments to Network Rail (copied to ORR<sup>5</sup>) by 4 September 2013<sup>6</sup> before these are locked down and finalised as part of the implementation process for PR13. Once finalised, the price lists can only be revised at the next access charges review.

### **Charter passenger track access contracts**

- 1.17 As set out in our draft determination, amendments to charter passenger track access contracts are being dealt with separately from this document. We met with charter train operators on 24 June 2013 to discuss issues relating to their contracts and our draft determination. Network Rail is also in the process of concluding on its recent consultation on the structure of charges for charter train operators<sup>7</sup>. We will be holding

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<sup>3</sup> See <http://www.rail-reg.gov.uk/pr13/PDF/cp5-licence-conditions-changes.pdf>.

<sup>4</sup> <http://www.networkrail.co.uk/publications/delivery-plans/control-period-5/periodic-review-2013/>

<sup>5</sup> Please copy-in [emma.bentley@orr.gsi.gov.uk](mailto:emma.bentley@orr.gsi.gov.uk) for information to any response send to Network Rail.

<sup>6</sup> <http://www.networkrail.co.uk/publications/delivery-plans/control-period-5/periodic-review-2013/>.

<sup>7</sup> Structure of charges for charter operators in CP5, Network Rail, May 2013, available at: <http://www.networkrail.co.uk/WorkArea/DownloadAsset.aspx?id=30064786015>.

a follow-up meeting with charter train operators in early August, following which we will write to them consulting on proposed changes to their contracts.

## Contingency arrangements for a delay to PR13 implementation

1.18 In April 2013, we consulted on our proposed contingency arrangement in the event that implementation of PR13 was delayed (e.g. if Network Rail objected to our review notices). We concluded on this in paragraph 22.29-22.44 of our draft determination and stated that we would write to train operators separately on the process for putting the contingency plan into place. We will send this letter shortly following this document.

## Other engagement with us on this document

1.19 We will continue to engage with stakeholders at existing industry meetings such as the Variable Track Access Charges working group, Schedules 4 and 8 working groups and the Traction Electricity Steering Group in respect of our proposals for CP5. Alongside these, we would be happy to arrange meetings during the consultation period to discuss particular drafting issues with stakeholders (including their lawyers) if this would be helpful. Please contact Alice Jones (see paragraph 1.8 above) to arrange this.

## Timetable for the implementation process

1.20 Table 1.3 below sets out the key milestones for the implementation process<sup>8</sup>.

**Table 1.3: Timetable for the implementation process**

Formal review phase	
August 2013	After a follow-up meeting with charter train operators, we will develop and circulate proposed changes to the model charter track access contract.
4 September 2013	Deadline for responses to: (1) the consultation on our draft determination; and (2) our consultation on implementing PR13.
4 September 2013	Deadline for train operators to provide comments to Network Rail on the draft price lists published on 12 July 2013.

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<sup>8</sup> As part of implementation for PR13, Network Rail will consult on its draft delivery plan for CP5 in December 2013 and then publish its final delivery plan by 31 March 2014. We have not included this in Table 1.3 as this consultation document is focused on the statutory implementation process relating to access contracts and the network licence.

<b>Formal review phase</b>	
31 October 2013	We publish our final determination, setting out our final decisions on policy issues, expenditure and outputs for CP5. Around this time, we will also circulate, for information, the relevant annexes/appendices of Schedules 4 and 8 to Network Rail and each train operator.
<b>Implementation phase</b>	
20 December 2013	Review notices are served which start the formal implementation of PR13. The review notices set out the proposed changes to track and station access contracts and Network Rail's network licence.
20 December 2013	Final price lists/charge schedules setting out access charges that have been produced by Network Rail are published, following our audit of them.
7 February 2014	Following issue of the review notices in December, Network Rail will have until 7 February 2014 to object to the review notices. If it objects, then we would either issue revised notices or make a reference to the Competition Commission.
February 2014	If Network Rail does not object, we will issue a 'notice of agreement' shortly after 7 February 2014. This will give beneficiaries to track and station access contracts (e.g. train operators) 28 days within which to give notice that they wish to terminate their access contracts, should they wish to do so.
March 2014	Assuming we issue a notice of agreement in February 2014, we would then expect to issue our review implementation notice in March. This confirms that the periodic review will be implemented on 1 April 2014.
1 April 2014	Our PR13 determination is implemented and CP5 begins.

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## 2. Access charges

### Introduction

- 2.1 This chapter sets out the changes to track access contracts we propose to make to implement our decisions on access charges set out in chapter 16 of the draft determination. It covers:
- (a) freight charges;
  - (b) passenger charges, including open access;
  - (c) arrangements relating to changes to charge rates during the control period and supplementing the price lists (this relates to both freight and passenger operators); and
  - (d) arrangements relating to traction electricity.
- 2.2 A general point that applies to Schedule 7 in all contracts is that the definitions of the charges are still based on the current terminology used for Network's Rail published price lists for CP4. We will be liaising with Network Rail over the summer to ensure that the terminology that the contract uses is up-to-date and corresponds to the price lists that Network Rail will publish for CP5. The current terminology is out of date in many instances and can be quite confusing. We particularly welcome views on whether and the extent to which changes to particular terminology (for example the "variable track usage charge" or "variable charges") would have unintended consequences, for example with respect to freight train operators' contracts with their customers.
- 2.3 It should also be noted that, in paragraphs 16.110-16.117 of our draft determination, we discussed the Rail Freight Operators' Association's proposal for an alternative approach for calculating the capacity charge for freight operators<sup>9</sup>. As part of the draft determination, we have sought views on this and whether, if adopted for freight, this approach should also apply to open access passenger services and / or franchised passenger services. If we were to decide to implement this arrangement, it would

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<sup>9</sup> The letter can be found at <http://www.rail-reg.gov.uk/pr13/PDF/freight-capacity-charge-2013-04-24.pdf>.

necessitate changes to the section of Schedule 7 that deals with the capacity charge. We would consult in due course on any proposed contractual drafting for this.

## Changes to charging provisions in freight track access contracts

- 2.4 We have amended the freight Schedule 7 to reflect our decision in the draft determination that the freight only line charge, which has applied to spent nuclear fuel and ESI coal during CP4, will also apply to iron ore during CP5. We have also added the new freight specific charge into the schedule and applied this to spent nuclear fuel, ESI coal and iron ore (paragraph 2.2.1 of Schedule 7)<sup>10</sup>.
- 2.5 In our draft determination we set out that the freight only line charge, freight specific charge and the variable usage charge for freight would have values that could vary by year, in order to phase-in some larger changes during CP5<sup>11</sup>. We have not had to make any contractual changes to reflect this as the phasing of these charges will be reflected on the Track Usage Price List. However, we have included some drafting in Schedule 7 to ensure that these phased-in charges will be adjusted each year for inflation (paragraph 2.7.3 of Schedule 7).
- 2.6 We have also amended Schedule 7 to reflect the decision in chapter 16 of our draft determination to delete the annual review mechanism for the coal spillage charge. To implement this decision, we are proposing to delete paragraph 2.11 of Schedule 7.
- 2.7 Our draft determination set out that the coal spillage reduction investment charge will not be applied during CP5. However, rather than remove this provision entirely we said it should be disabled during CP5, so that we could switch it back on again in CP6 if we thought appropriate. We have not had to include any contractual wording to do this because the contractual mechanism works by the contract applying the price set out on the Track Usage Price List, which will be set to zero.
- 2.8 Paragraph 2.12 of Schedule 7 currently provides a mechanism by which the income from the coal spillage reduction investment charge is either used to fund capital investment to reduce coal spillage on the network or returned to freight operators. As

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<sup>10</sup> See paragraphs 16.213-16.281 of the draft determination.

<sup>11</sup> See for example Table 16.61 of the draft determination, which shows the charges in the first and last years of CP5.

we are proposing to disable the coal spillage reduction investment charge during CP5 we will only need to retain this mechanism to deal with any money in the fund which is not spent by the end of CP4. We have suggested changes to this paragraph to reflect this but we would be happy to remove the mechanism completely if it is not going to be required.

- 2.9 Paragraphs 2.2.2-2.2.12 of Schedule 7 currently sets out a process by which the parties to the contract can agree a variable usage charge rate for any new vehicle that the operator introduces on to the network. We are proposing amendments to this process to improve it – this is set out below.
- 2.10 We are proposing amendments to the freight Schedule 7 to reflect our policy proposals regarding traction electricity (see paragraphs 2.36-2.79 below).
- 2.11 We have also amended Schedule 7 to set out the route-level efficiency benefit sharing mechanism and have amended the existing efficiency benefit sharing mechanism so that it deals with any payments in relation to the final year of CP4 that may be determined and paid during CP5 (see chapter 4 below).
- 2.12 Finally, we have made changes to Schedule 7 to reflect our proposals on indexation which are discussed in chapter 7 below.

### **Incremental costs provision**

- 2.13 Paragraph 2.8 of Schedule 7 currently provides for the train operator to pay to Network Rail incremental costs up to £300,000 if it would run a service that would “...exceed the Operating Constraints applying as at 1 April 2001”. The intention of this was to avoid the need for the parties to have to seek ORR’s approval to relatively low levels of charges to fund additional capability.
- 2.14 In developing revised terms in Schedule 7 to implement PR13, we have noted that this provision could benefit from updating, not least to ensure its wording recognises that the baseline capability of the network has changed since 2001 to reflect enhancements. Given the passage of time since this provision was developed, we have asked Network Rail to advise us of how it thinks the process should work. We will then produce a revised process and circulate this to Network Rail and freight operators for comment.

## Changes to charging provisions in franchised passenger track access contracts

2.15 The main changes we are proposing to Schedule 7 of the model provisions in franchised passenger track access contracts are:

- (a) amending Schedule 7 to set out the route-level efficiency benefit sharing mechanism. We have also amended the existing efficiency benefit sharing mechanism so that it deals with any payments in relation to the final year of CP4 that may be determined and paid during CP5 (see chapter 4);
- (b) proposing changes to paragraph 9, Part 2 of Schedule 7 to:
  - (i) improve the process for supplementing the price list to include new or amended rates to the List of Capacity Charge Rates, the Traction Electricity Consumption Rates List and the Track Usage Price List;
  - (ii) remove the provision which allows 'manifest errors' in track charges to be corrected; and
  - (iii) provide for a default charge to be applied to any new vehicles introduced to the network that do not have a rate on the Track Usage Price List. This follows the decisions in our draft determination (see paragraphs 16.86-16.94);
- (c) amending provisions relating to traction electricity to implement the policy decisions in our draft determination (see paragraphs 2.36-2.79 below); and
- (d) making changes to Schedule 7 to reflect our proposals on indexation which are discussed in chapter 7.

## Changes to charging provisions in open access passenger track access contracts

2.16 With the exception of the changes to traction electricity provisions, the changes that we are proposing to make to Schedule 7 of open access operators are the same as for franchised passengers. No existing open access passenger operators currently require traction electricity charge provisions in their regulated track access contracts (because either they do not operate electric traction or they have different

arrangements for paying for traction electricity outside of their track access contract<sup>12</sup>). In the interests of simplicity, we are not proposing to include the CP5 model traction electricity provisions into their contracts unless they wish us to do so. Of course, if at any time during CP5 they planned to use electric traction, they could agree an amendment to their contracts with Network Rail to do so.

- 2.17 Currently, some open access operators have their access charges set out within their contracts rather than on the relevant price lists. On the basis that we expect the rates for their services to be included on the CP5 price lists, we are proposing that their contracts refer to the rates on the relevant price lists, consistent with other train operators.

## **New or amended charges during the control period**

- 2.18 Once ORR approves the price lists issued by Network Rail prior to the start of a control period, it is not possible to amend them directly until they are replaced at the next access charges review<sup>13</sup>. This is in part to give train operators assurance that charges will not be re-opened. However, both freight and passenger model track access contracts recognise that it may be necessary to introduce new rates in particular circumstances such as where a new vehicle is introduced to the network, an existing vehicle is modified or to apply a discounted rate where regenerative braking is used by the train operator. (Where existing vehicles are modified, they are reclassified as a new sub-category of that vehicle (e.g. Class 123A) and treated as a new vehicle for pricing purposes.)
- 2.19 The contracts contain provisions for the price lists to be *supplemented* by new charges. However, as the original price list cannot be amended, the supplement can only apply to the track access contract in respect of which it was agreed. This is because each track access contract is a bilateral agreement between Network Rail and the train operator, and there is no direct contractual relationship with other contracts. An amendment under one contract to make a supplement to the price list therefore could not then apply or bind parties in another contract.

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<sup>12</sup> The traction electricity used by Eurostar in respect of its track access contract to use Network Rail's network at Ashford is provided by the adjacent High Speed One network. Heathrow Express pays for its traction electricity for its 'Heathrow Connect' services through its unregulated track access contract with Network Rail (in respect of its non-stopping services between London Paddington and Heathrow).

<sup>13</sup> Though the prices will be adjusted annually for changes in RPI as explained in chapter 7.



2.20 In paragraphs 16.377-16.378 of our draft determination, we noted that we have recently reviewed these provisions in the freight and passenger contracts with the aim of updating them for CP5 and making the processes within them clearer.

## **Overview of how the current supplement provisions work**

### **Passenger track access contracts**

2.21 Paragraph 9, Part 2 of Schedule 7 to the model passenger contract<sup>14</sup> sets out the process for supplementing the price lists to include new or amended rates for the List of Capacity Charge Rates, Traction Electricity Consumption Rates List and Track Usage Price List. This might be necessary where:

- (a) a new vehicle is introduced (or is already operating) on the network and there is no corresponding price for it on the Track Usage Price List;
- (b) an existing vehicle is modified (e.g. fitted with new bogies that are more track friendly) and a new rate needs to be included to reflect the reduced wear and tear that the vehicle imposes on the network). Where this is done, a new sub-category of that rolling stock is added to the price list – e.g. Class 123A;
- (c) a discount for regenerative braking needs to be applied to modelled consumption rates for traction electricity; or
- (d) new modelled consumption rates or capacity charge rates need to be included for new rolling stock or services.

2.22 The process provides for Network Rail or the train operator to propose to the other a supplement to a relevant price list. Where they agree, ORR's consent is required to apply the supplement. Where the parties are unable to agree, the matter is referred to the relevant Access Disputes Resolution Rules (ADRR) Forum. ORR's consent is then required before the supplement can be applied to the price list.

### **Freight track access contracts – existing process**

2.23 The process in the model freight contract<sup>15</sup> applies only to variable usage charge rates. It provides for rates for new vehicles (called “Variable Rates” in the contract) to

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<sup>14</sup> Paragraph 9 of Part 2 to Schedule 7 to the model passenger track access contract, available at [http://www.rail-reg.gov.uk/upload/pdf/model\\_passenger\\_contract.pdf](http://www.rail-reg.gov.uk/upload/pdf/model_passenger_contract.pdf).

<sup>15</sup> Paragraphs 2.2.2-2.2.12 of Schedule 7 to the model freight track access contract, available at <http://www.rail-reg.gov.uk/upload/pdf/model-freight-contract.pdf>.

be deemed to be added to the Track Usage Price List in respect of the train operator's contract. It works as follows:

- (a) the freight operator may serve a notice on Network Rail in respect of the introduction of "New Registered Equipment"<sup>16</sup> where no Variable Rate exists;
- (b) within 14 days of receipt of a notice from the train operator, Network Rail must notify the train operator and ORR of the proposed new Variable Rate. ORR can then determine the rate, taking into account Network Rail's proposal;
- (c) where Network Rail fails to provide a new Variable Rate within the 14 day period, there is provision for ORR to determine the Variable Rate. To do this it must consult Network Rail, the train operator and all other freight operators;
- (d) where ORR determines the new Variable Rate, either Network Rail or the train operator can refer its decision to the relevant ADRR Forum for it to determine the Variable Rate. Then the ADRR Forum's decision is referred back to ORR for consent. ORR can then reject the ADRR Forum's decision, in which case the original ORR determination would stand, or give its consent; and
- (e) provision is included for the finalised Variable Rate to be applied retrospectively to either the commencement of the track access contract or the date when the new vehicle was introduced to the network. Until this happens, a default Variable Rate (which is set out in the contract) is applied.

## Problems with the processes

2.24 In the case of the freight provision:

- (a) as set out in paragraph 2.23(a) above, only the train operator can trigger the process to establish a new charge. Whereas, in the passenger contract, either party can propose a supplement for a new vehicle rate;
- (b) the 14 day timescale referred to in paragraph 2.23(b) is not long enough (it is rarely achieved) and does not reflect that, to be able to calculate the rate, Network Rail needs the train operator to provide it with certain information;
- (c) in respect of paragraph 2.23(c) and (d) above, we think the process is flawed and it pre-dates the present ADRR arrangements in that it provides for ORR's

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<sup>16</sup> That is, a railway vehicle or vehicle commodity combination that is not already on the Track Usage Price List.

decision to be challenged by an ADRR Forum. The process in the model passenger contract is the other way round, with the ADRR Forum determining the matter in the first instance, and then being referred to ORR for consent; and

- (d) we also think the consultation obligation on ORR serves little purpose as the charges are determined by technical input into the charging model. The passenger provision does not have this obligation.

2.25 A more general problem applies to the processes in both the freight and passenger model contracts. Network Rail is sometimes unable to calculate an accurate and cost-reflective charge because the train operator has difficulty obtaining the crucial vehicle parameter information from the train manufacturer. We understand that manufacturers have been reluctant to provide this information ostensibly on the grounds of commercial confidentiality. However, it is important (and in the industry's interest) that train operators pay and Network Rail receives a fair rate for the wear and tear caused to the network.

2.26 One way to address this in future is for train operators to ensure that any procurement contracts with manufacturers include obligations to provide the information necessary for Network Rail to calculate an appropriate track access charge. The relatively high default rates that Network Rail will apply to vehicles without their own rate on the price list will also encourage train operators to do this.

### **The revised provisions for supplementing the price lists**

2.27 We have revised the process in each of the freight and passenger contracts, adopting a more consistent approach between the two model contracts where this is appropriate and seeking to improve their effectiveness.

2.28 The revised provisions provide:

- (a) an obligation for the train operator to inform Network Rail if it intends to introduce new vehicles on to the network, and the date when this is likely to happen. This can then act as a trigger for the parties to agree relevant charge rate(s);
- (b) for the relevant default variable usage charge rate to be applied until a supplement is made to the Track Usage Price List. The default rates will be

included on the price list<sup>17</sup>. As the default rates have been calculated for CP5, the provision provides that the default rate shall apply from the later of 1 April 2014 and the date when the new vehicle is first used;

- (c) in the freight contract, for the train operator to request that Network Rail calculate a rate for a new vehicle (in which case it must provide sufficient information for this purpose). It also provides for Network Rail either to propose a new rate (providing such information necessary to support this) or to request that the train operator furnish it with the information it would need to calculate the new rate. The train operator then has a reasonable endeavours obligation to provide this.
- (d) in the passenger contract, for either Network Rail or the train operator to propose that a price list be supplemented. This includes the, Track Usage Price List, Traction Electricity Consumption Rates List (in respect of a new service code, new service group or new train category) and the List of Capacity Charge Rates (to reflect changes in the pattern and number of services). Any proposal must be accompanied by sufficient information and justification. Also, each party has a 'reasonable endeavours' obligation to provide information requested by the other in relation to any proposal for a supplement;
- (e) where the parties agree on a supplement, to submit this to ORR for its consent. Where the parties are unable to agree on a proposal to supplement the price list within the specified time period (see below), either can refer the matter to the ADRR for determination;
- (f) for ORR to consent to a rate that is either agreed by the parties or determined by a relevant ADRR Forum. Alternatively, where ORR considers it appropriate, it can also determine the supplement after consulting the parties; and
- (g) for the supplement to be applied by Network Rail and for it to issue a credit note or invoice where an adjustment needs to be made to address any financial difference (e.g. where the new rate is applied retrospectively).

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<sup>17</sup> These will be set out in category bands in line with Network Rail's conclusions earlier this year, which we support in this respect. See page 29, *Periodic Review 2013 – Conclusions on the allocation of the Variable Usage Charge*, April 2013, available at: <http://www.networkrail.co.uk/conclusions-on-the-allocation-of-the-variable-usage-charge.pdf>.

- 2.29 We have also included a new provision to require Network Rail to maintain on its website a list of all the supplements to the price lists that have been made. This is to improve transparency but it also makes it easier for others to see if a rate has been agreed elsewhere for a particular type of vehicle. They could then more quickly agree a supplement in respect of their own contract, if it was appropriate to use this rate.
- 2.30 In line with paragraph 2.15 above, we have removed the ‘manifest error’ provision currently found in paragraph 9(d), Part 2 of Schedule 7 of passenger contracts. This will make the model passenger provisions consistent with those of freight in this respect.
- 2.31 We also have removed the provision in the existing model passenger contract for a supplement to be made to the Traction Electricity Consumption Rates Price List to apply a discount for the use of regenerative braking. As set out in paragraphs 2.75-2.76 below, we are proposing that the application of this discount should be carried out through the Traction Electricity Rules.
- 2.32 We welcome comments on the proposed revised provisions, including what would be an appropriate timescale for agreeing a supplement. We think at least 45 days but no more than 90<sup>18</sup>. Overall, we have retained the existing structure of the current provisions, reflecting that the freight contracts currently provide only for supplements to be made to the Track Usage Price List, whereas passenger contracts typically need to be able to supplement the List of Capacity Charge Rates and Traction Electricity Consumption Rates List. However, if freight operators prefer the passenger provision, or if there is a reason why they might need to supplement any of the other price lists, we would be content to develop a version of this for their contracts.

### ***Modified vehicles***

- 2.33 Currently, where vehicles are modified to the extent that a new rate is warranted, the modified vehicle is treated as a new sub-class of that type of rolling stock and a supplement for a new variable usage charge rate is obtained using the relevant process described above. There is no need for a section 22 amendment to be made to the track access contract to do this.

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<sup>18</sup> The draft provisions for freight and passenger contract contain different indicative timescales at the moment. However, after taking into account any views on an appropriate timescale we expect to make this the same in both model contracts.

2.34 Our view is that this approach remains appropriate, but if others disagree we invite suggestions on how else the process should work.

***Guidance on the price list supplement provisions***

2.35 Following the implementation of PR13, we plan to include in our criteria and procedures for track access contracts guidance on the process for obtaining supplements. This will complement the guidance that Network Rail plans to publish.

## **Changes to provisions relating to traction electricity**

2.36 In paragraphs 16.171-16.195 of our draft determination, we confirmed our decisions relating to traction electricity charges. The decisions relevant to this consultation are as follows:

- (a) to move the volume and cost reconciliation (often referred to as the volume or cost ‘wash-up’) provisions and the definitions of Electricity Supply Tariff Areas (ESTAs) from individual track access contracts to the multilateral EC4T Metering Rules<sup>19</sup>, and rename these rules the ‘Traction Electricity Rules’ (in this chapter, “the rules”);
- (b) to allocate a share of the volume wash-up, over and above that associated with its own consumption, to Network Rail to reflect its ability to manage transmission losses;
- (c) to exempt metered operators from the volume reconciliation (whereas currently those operators with more than a 90% share of the consumption in an ESTA are in the volume reconciliation);
- (d) to set new values for the Distribution System Loss factors (DSLFF) and levy these on metered consumption rather than, as currently, metered consumption net of energy regenerated from braking;
- (e) change the cost reconciliation formula to better reflect tariff structure including EC4T delivery charges;
- (f) to provide for freight operators to be charged on the basis of actual electricity costs rather than an index;

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<sup>19</sup> Further information on the metering rules can be found here <http://www.networkrail.co.uk/using-our-network/on-train-metering/>.

- (g) to support the inclusion of provisions for verifying that regenerative braking for modelled train operators is being used correctly; and
- (h) to remove the Transitional Risk Sharing Mechanism<sup>20</sup> from the EC4T Metering Rules (reflecting that this was a CP4-only arrangement).

## **Changes to Schedule 7 associated with on-train metering**

- 2.37 We have published revised versions of Schedule 7 for freight and franchised passenger operators reflecting our decisions and the incorporation of the Traction Electricity Rules into the track access contracts. As open access passenger operators are not billed for traction electricity we do not propose to include these provisions or incorporate the rules into their contracts.
- 2.38 Whilst currently there are modelled and metered (including partially metered) versions of Schedule 7 in existence at present, our proposed model Schedule 7 for each of freight and passenger operators will provide for all scenarios. Once a train operator opts-in to metering, the details of its fleet/metered vehicles (as now) will be included in an appendix to the schedule. As is the case now, once train operators' fleets/vehicles have become metered, this will be a permanent change and there will be no option to 'opt-out'. This, in part, reflects the benefits that metering brings over using modelled rates.
- 2.39 We have clarified the existing opting-in provisions (paragraph 4.4 of Part 2 of Schedule 7 of the model passenger contract and paragraphs 2.4.5-2.4.10A of Schedule 7 of the model freight contract). This is a relatively minor change to make it clearer how ORR would implement a determination in the event of a dispute between Network Rail and a train operator.
- 2.40 We have changed the basis on which metered operators are charged for transmission losses that occur on Network Rail's infrastructure. In CP4, they were charged as an uplift on metered consumption net of metered electricity regenerated through regenerative braking. We have changed the relevant formula, consistent with our draft determination, so that the uplift is now levied on metered consumption alone.

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<sup>20</sup> This temporary mechanism was introduced in CP4 to offer protection to modelled operators who were concerned about the impact of on-train metering on their modelled bills.

## Strategy for procurement

- 2.41 Both freight and passenger contracts include arrangements for the procurement of traction electricity (paragraphs 4.2- 4.3, Part 2 to Schedule 7 of model passenger contract and paragraph 2.4.11 of the model freight contract)<sup>21</sup>. These are arrangements developed by the industry and we have not sought to make material amendments to them as part of PR13. However, we have made a minor consequential change and also a correction.
- 2.42 We note that these provisions apply generally to all electric train operators. With the establishment of the multilateral Traction Electricity Rules (see below), it may be appropriate to move these provisions into the rules. If the industry wanted to amend the procurement arrangements in future, this would make it easier for the industry to do this as it could use the rules change process (discussed below) rather than, as is the case now, through amendments to individual contracts. We invite comments on whether moving these provisions to the rules would be sensible.

## The Traction Electricity Rules

- 2.43 We have prepared a draft set of the Traction Electricity Rules showing the proposed content marked up as against the current EC4T Metering Rules. These reflect the decisions we set out in the draft determination. The rules will be incorporated into all franchised passenger and freight operators' track access contracts.

## The volume reconciliation

- 2.44 We have moved across the volume reconciliation from Schedule 7 of contracts (paragraph 5 of Part 2 in passenger contracts and paragraph 2.4.2 in freight contracts) to the proposed rules, along with the cost reconciliation. These are set out in paragraph 18 of the proposed rules.
- 2.45 The volume reconciliation provisions:
- (a) reflect our decision that metered services should be excluded from the volume reconciliation (the removal of the '90% rule');

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<sup>21</sup> The model freight contract currently refers to the provisions in the model passenger contract. Network Rail's more recent template Schedule 7 for metered freight operators<sup>21</sup> (issued in February 2012) replaced this with provisions consistent with those for passenger operators. We have made the same change for the draft CP5 Schedule 7.



- (b) explicitly refer to the consumption of traction electricity by Network Rail and third parties such as London Underground Limited (the ' $L_{tmng}$ ' term in the contractual drafting). This has been done for clarity; and
- (c) reflect our decision that Network Rail should be exposed to a portion of the volume reconciliation so that it has an incentive to reduce transmission losses (the ' $\lambda_g \bullet A_{gt}$ ' term in the contractual drafting).

2.46 We have also made some minor changes to the formula, in particular the use of the subscript  $\omega$ , so that it is clear that the volume reconciliation should be calculated separately for each relevant operator. We have needed to make these changes as a consequence of moving the volume reconciliation from bilateral track access contracts to the rules.

### ***Network Rail's share of the volume reconciliation***

2.47 In paragraphs 16.183-16.186 of our draft determination, we said that Network Rail's share of the volume reconciliation should reflect the proportion of costs for which it has control. We have reflected this in paragraph 18 of the proposed rules. For those who wish to see further detail on this, please see annex A which explains the mathematical basis behind the formula.

### **The cost reconciliation**

2.48 As a consequence of freight services being charged on the basis of actual energy prices (rather than a price index) in CP5, the cost reconciliation will apply to freight services as well as passenger services.

2.49 We have moved across the cost reconciliation provisions from Schedule 7, paragraph 5 of Part 2 in passenger contracts to the proposed rules. This is set out in paragraph 18, alongside the volume reconciliation.

2.50 We have not yet produced contractual wording to reflect our decisions on the cost reconciliation. We are conscious of the complexity of this process and because of this both we and Network Rail are particularly keen to ensure there is clarity over what the cost reconciliation is trying to achieve before developing contractual drafting. In line with this, in this section we explain our understanding of the cost reconciliation, how it might be reformed, and the process for finalising the relevant contractual wording.

### ***EC4T cost reconciliation in CP4***

- 2.51 In CP4, in addition to year-end volume reconciliation, a year-end cost reconciliation has applied. This is contractualised, in broad terms, to be the difference between the amount charged to Network Rail from its energy supplier that can be associated with passenger train operators (i.e. excluding Network Rail's own consumption and that of third parties) and that billed to passenger train operators by Network Rail, including the adjustment for volume reconciliation. This discrepancy is then charged or rebated to train operators in proportion to the amount, network-wide, that they have already been billed.
- 2.52 In CP4 Network Rail has not been able to conduct a full cost reconciliation (where the amount charged to operators, third parties and its own consumption is equal to the amount it pays to its electricity supplier) because freight and charter services have paid for electricity according to a price index rather than the actual electricity charge. In CP5, freight services will instead pay actual electricity charges, and Network Rail is proposing that charter services (which are associated with only a very small component of total EC4T consumption) do the same, so that a full cost reconciliation (subject to estimation associated with modelled consumption) would be possible.

### ***PR13 draft determination***

- 2.53 In PR13, Network Rail proposed that there should be changes to the cost reconciliation formula for CP5 to reflect tariff structure more effectively including the EC4T delivery charge. (The delivery charge varies geographically, but in CP4 the cost wash-up has not allowed variation by ESTA or any other geographical disaggregation.) In our draft determination we concluded that we supported Network Rail's proposals.

### ***Source of discrepancies***

- 2.54 After the volume reconciliation, there may still be discrepancies between charges paid by Network Rail to its supplier and those it has levied on train operators (taking account of its own and third party consumption). This may occur for the following reasons:
- (a) at the level of an individual operator, as a consequence of the agreed EC4T procurement strategy for that operator;

- (b) if a charge is set retrospectively by the electricity supplier. This is the case for the National Grid Electricity Transmission Charge (NGET), regulated by Ofgem; or
- (c) if the form of disaggregation of the charge is not reflected in the volume reconciliation (typically due to information constraints); this is the case for delivery charges which vary by supply point (of which there are typically several in each ESTA); and may also be the case for the electricity commodity price which can, for example, vary by time of day.

2.55 The most cost-reflective form of reconciliation may be difficult to contractualise in precise terms. And the level of complexity involved in doing so may be counter-productive, for example it may lack transparency or not be robust to changes in the structure of regulated electricity charges.

### ***Proposals for change***

2.56 Consistent with Network Rail's conclusions and our draft determination, we are proposing to distinguish between two broad categories of electricity charge:

- (a) delivery charges, which include charges for transmission and distribution; and
- (b) energy charges, which consist predominantly of the commodity cost of electricity.

2.57 There would be a separate reconciliation of delivery charge costs for each ESTA. This could take the form of a re-charge or rebate allocated to individual operators in proportion to their (pre-reconciliation) delivery charges for that ESTA.

2.58 For energy costs, the re-charge or rebate would not be disaggregated by ESTA. We are not clear at this stage whether there should be further disaggregation of energy costs, or whether there should be a single reconciliation across all energy consumption in proportion to individual operators' (post-volume reconciliation but pre-cost reconciliation) energy costs.

2.59 As Schedule 7 does not distinguish between delivery costs and energy costs, implementing this change may necessitate changes to Schedule 7 to reflect these two categories.

### ***Next steps***

2.60 We invite comments on this section. In particular:

- (a) whether we appear to have missed or misinterpreted important issues relating to the cost wash-up;

- (b) the merits of distinguishing between delivery and energy costs; and
- (c) other views on how the reconciliation might be contractualised.

- 2.61 We will be working with Network Rail to publish shortly a note providing more details regarding components of the electricity charges, how they might feed into the cost reconciliation, and the amount of revenue associated with each of these charges in total and with respect to reconciliation.
- 2.62 We will consult in due course on specific contractual wording through a separate letter.

## **Updates to values and definitions**

### ***Definitions of geographic areas (or ESTAs)***

- 2.63 We have moved across the definitions of ESTAs from Schedule 7 of the track access contract (currently in Appendix 7B in passenger contracts and Appendix 1 in freight contracts) to the proposed rules. These are set out in Appendix 5.
- 2.64 In Schedule 7 and the proposed rules, each ESTA is referred to as “geographic area g”.
- 2.65 Please note that Network Rail has proposed updates to definition of ESTAs, and these proposed changes are included in the proposed rules. Stakeholders may wish to comment on these.

## **DSLFF**

- 2.66 The DSLFF are the uplifts to metered consumption to reflection transmission losses on Network Rail infrastructure. They are presented in Appendix 3 of the proposed rules.
- 2.67 Appendix 3 has updated values, consistent with table 16.24 of our draft determination. These, as with the vast majority of decisions in our PR13 determination, are to apply from the start of CP5 on 1 April 2014 (not 1 April 2013 as stated in error in the table 16.24).

## **Amendments to the rules change process**

### ***Existing process under the EC4T Metering Rules***

- 2.68 The EC4T Metering Rules currently contain a rules change procedure to allow the industry to make amendments to the rules. In short, this works as follows:
- (a) Network Rail, a metered (or prospective metered) train operator or ORR can propose a change to the rules;

- (b) Network Rail, under its secretariat role, consults all parties that use traction electricity on the proposed rules change;
- (c) the proposing party considers the responses to the consultation and decides whether to continue with its proposal, amend it or drop it;
- (d) where the proposing party wishes to continue with the proposal, Network Rail carries out a vote of all metered (or prospective metered) train operators and itself. Modelled (i.e. non-metered) train operators do not have a vote;
- (e) if there is a majority in favour of a proposal, Network Rail then submits it to ORR for consent. ORR then considers the proposal in line with its statutory duties and takes into account the consultation responses (including from modelled operators who do not have a vote); and
- (f) if ORR gives its consent, the change comes into effect from the relevant date.

2.69 There is also a provision that provides for ORR to make changes to the rules without the consent of other parties (but with a requirement that it consult them)<sup>22</sup>.

### ***Proposed revisions to the change procedure for the Traction Electricity Rules***

2.70 As the scope of the rules will widen to include provisions relating to modelled train operators, it is appropriate that the change procedure be revised to reflect this.

2.71 We are keen not to make this process overly complex (for example, we do not think it necessary to introduce the same voting class structure that is used for the Network Code). We propose that modelled train operators be given the same rights to vote and propose changes as metered operators currently hold. We are also reflecting in the revised change procedure that the DSLF are being set for CP5; neither Network Rail nor train operators will be able to propose a change to them. ORR will retain a right to amend any part of the rules. So, in the very limited circumstances where the DSLF may need to change, such as if the boundaries of ESTAs need to be amended in response to further electrification, ORR can propose a change.

### **Consequential changes to the contract arising from amendments to the Traction Electricity Rules**

2.72 Metered train operators currently have provisions in their track access contracts that provide for any necessary consequential changes to be made to their contracts if the

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<sup>22</sup> This is similar to the arrangements in the Network Code under condition C8.

EC4T Metering Rules are amended. This is based on the provisions in Schedule 10 of track access contracts for consequential changes to be made following modifications to the Network Code.

- 2.73 With the incorporation of the rules into all franchised and freight operators' track access contracts, it is necessary to have a mechanism within these contracts for making any consequential amendments that might be required following changes to the rules.
- 2.74 We are proposing that the scope of Schedule 10 in franchised and freight operators' contracts be extended to provide for consequential modifications arising from changes to the rules. We have set out what these changes would be in our 'Consequential changes to contracts' document available on our website<sup>23</sup>. This also explains other consequential changes we consider are required to the front end of contracts arising from the incorporation of the rules into contracts.

## **Regenerative braking discount for modelled train operators**

### ***Applying the regenerative braking discount***

- 2.75 Modelled passenger train operators are currently able to receive a discount if they use regenerative braking systems that return energy back to the network. To activate the discount, it is currently necessary for Network Rail and the train operator to obtain ORR's consent to a supplement to the price list to apply a revised modelled consumption rate. This is currently done through the process in paragraph 9, Part 2 of Schedule 7 to the track access contract. However, for CP5 we propose to streamline the process for applying the discount and include it within the rules.
- 2.76 A new paragraph 8 in the proposed rules sets out the process for modelled train operators to notify Network Rail that they wish to receive a regenerative braking discount and for Network Rail to apply this. The requirement for ORR's consent would be replaced with contractual protections in the rules to give assurance to third parties, as follows:
- (a) the provision makes clear that the discount is given on the basis that the train operator uses regenerative braking. It also provides an explicit obligation for the train operator to maintain its regenerative braking systems;

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<sup>23</sup> See <http://www.rail-reg.gov.uk/pr13/consultations/pr13-implementation.php>.

- (b) the provision provides for a train operator to cease receiving the discount in specific circumstances, including if the outcome of an audit (see below) is that receipt of the discount is no longer justified; and
- (c) Network Rail will be required to maintain on its website a list of those train operators receiving the discount, with associated relevant information. This should improve transparency and awareness by third parties of those in receipt of the discount.

### ***Auditing the use of regenerative braking***

- 2.77 Whereas no audit arrangements currently exist for verifying that the regenerative braking systems are being used properly in return for the discount, Network Rail concluded in February 2013 that audit provisions should be included in the new proposed Traction Electricity Rules<sup>24</sup>. This reflected concerns raised within the industry that some train operators might be receiving a discount on their bills that was materially greater than the value of the energy that they were regenerating, in particular because the regenerating capability may not be being used on all journeys. If this were the case, the cost of this would ultimately be borne by other train operators in the volume reconciliation. In our draft determination, we supported including provisions for verifying that regenerative braking is being used correctly<sup>25</sup>.
- 2.78 The existing EC4T Metering Rules contain a provision for audits of metered train operators' metering systems. To enable auditing of modelled train operators' regenerative braking systems, we have widened the scope of this provision in the new proposed rules (paragraph 9). This provides for Network Rail to carry out an audit in connection with a modelled train operator's regenerative braking discount. It also provides for third party train operators to request that Network Rail carry out such an audit. The provision provides for referral to the ADRR Forum if there is a dispute arising from an audit.
- 2.79 Ultimately, where an audit concludes that a train operator's discount is not justified, Network Rail could (acting reasonably) cease to apply it. The provisions also include a dispute resolution process.

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<sup>24</sup> See page 10, *Traction Electricity and Electrification Asset Usage Charges in CP5 – Conclusions of Network Rail's consultation*, available at: <http://www.networkrail.co.uk/WorkArea/DownloadAsset.aspx?id=30064784907>.

<sup>25</sup> See Table 16.23 in our draft determination.

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## 3. Contractual re-openers and other provisions

### Introduction

- 3.1 This chapter gives an overview of the amendments to track access contracts to reflect:
- (a) the changes we propose that would enable us to re-open the price control during CP5 (re-openers);
  - (b) the changes we propose to grant dilution; and
  - (c) the treatment of rebates.

### Interim re-openers

- 3.2 Interim re-openers are mechanisms in the franchised passenger contracts that can be used during a control period to re-open the price control (i.e. our determination) in certain situations to allow changes to be made to the revenues that Network Rail is allowed to recover. For example, where material events have happened that are beyond reasonable management control or could not have reasonably been foreseen. Hence, through re-openers financial consequences of some elements of the risks that Network Rail faces are transferred to Network Rail's funders and customers.
- 3.3 In paragraph 12.58 of our draft determination, we said that for CP5 we would retain the ability to re-open the price control in the following circumstances:
- (a) if there has been a material change in the circumstances of Network Rail or in relevant financial markets. We are proposing to change this re-opener slightly so that it is prospective as well as retrospective. Our proposed changes are marked up in paragraph 2, Part 7 of Schedule 7 of the model franchised passenger contract. This global re-opener applies to events in England & Wales and Scotland; and
  - (b) for Scotland, if Network Rail's expenditure in Scotland is forecast to be more than 15% higher than our determination for Scotland over a forward looking period of three years. This is the Scotland specific re-opener and we are not proposing any substantive amendments to it.



- 3.4 For PR13, given that it is not likely that Network Rail will issue unsupported debt in CP5 we have decided not to retain the following two re-openers in CP5, as they were specific re-openers that facilitated the issuance of unsupported debt by Network Rail. In particular, the adjusted interest cover ratio (AICR) was a key focus of the credit rating agencies<sup>26</sup>. The risks that these re-openers covered are also covered by the global re-opener. The re-openers that we have decided that we will not retain for CP5 are:
- (a) if Network Rail's AICR is forecast to be equal to, or below, the value of 1.4 on average over a forward looking period of three years; and
  - (b) if Network Rail is forecasting that within the next 18 months it cannot finance itself efficiently.
- 3.5 Franchised passenger track access contracts will reflect the removal of these PR08 re-openers. Open access operators (passenger and freight) do not currently have a re-opener provision within their track access contracts, i.e. their track access charges would not be affected by a re-opening of the price control. We intend to maintain this position for CP5 as the different approaches reflect the different funding and charging arrangements for franchised operators on the one hand and open access passenger and freight operators on the other.
- 3.6 In a situation where Network Rail notifies us that it wants the price control to be re-opened during the control period, we would need to determine whether the terms of the relevant re-opener had been met and, if so, we would then consider whether there is a compelling case for an interim review in light of our statutory duties. In annex B we have set out the process that we would follow if we decided to re-open the PR13 determination during the control period.

## Grant dilution

- 3.7 Current franchised passenger track access contracts include a grant dilution provision in Part 3A of Schedule 7 that provides for increases in track access charges if the governments do not pay network grants according to the agreed schedule of payments.

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<sup>26</sup> These are currently set out in paragraph 2, Part 7 of Schedule 7 of franchised passenger contracts.

- 3.8 In order to ensure that Network Rail recovers its required revenue and can finance its activities in the unlikely situation that the governments did not meet their funding obligations, we decided in December 2012 to retain the grant dilution provision in franchised passenger track access contracts for CP5.
- 3.9 However, we will make one change to the formula in paragraph 3.2, Part 3A of Schedule 7. This is to update the calculation of grant compensation to reflect our assessment of Network Rail's CP5 weighted average cost of capital of 4.31% (on a real vanilla basis) in CP5 rather than the current cost of capital within track access contracts of 5.75%.

## Rebates

- 3.10 In franchised track access contracts, rebates of track access charges from Network Rail to train operators can be made in certain circumstances. Currently, the provisions provide for these [rebates] to be paid during the year to which the rebate relates. For CP5, we are amending the provisions (in paragraph 7, Part 2 of Schedule 7) so that a rebate in respect of one year would be paid in the following year. That is, a rebate relating to 2014-15 would be paid in 2015-16. We have done this as it will allow Network Rail to take a decision on whether a rebate is appropriate after the end of, rather than during, the financial year to which the rebate relates.
- 3.11 We are also proposing to amend paragraph 7.3(c), Part 2 of Schedule 7 of franchised operators contracts to reflect that in our draft determination we said that financial outperformance should be used to pay down debt or fund research and development to a value specified in our final determination, unless we are satisfied that there are exceptional circumstances.

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## 4. Route-level efficiency benefit sharing

### Introduction

- 4.1 This chapter gives an overview of the amendments to track access contracts to reflect the introduction of the CP5 route-level efficiency benefit sharing (REBS) mechanism, which replaces the existing CP4 efficiency benefit sharing mechanism (EBSM).

### Background

- 4.2 In chapter 19 of our draft determination, we set out how REBS in CP5 would work. This mechanism is intended to strengthen the incentive to reduce infrastructure costs. It works by increasing passenger and freight train operators' interest in these costs by exposing them to these costs in each year of the control period.

### Changes for CP5

#### Overview

- 4.3 In CP5, we are improving the existing CP4 efficiency benefit sharing mechanism by replacing it with a route level incentive mechanism. REBS will better encourage Network Rail and the operators to work together and allow both to share in efficiency gains or losses on an annual basis.
- 4.4 We set out below the key changes that we have made to the track access contracts (passenger and freight) to reflect the introduction of REBS in CP5.

#### The existing CP4 EBSM provision

- 4.5 We have retained the provision on the 'Efficiency Benefit Share' within Schedule 7 of passenger and freight track access contracts because we will not have determined whether there is a payment under EBSM for 2013-14 (the final year of CP4) until 2014-15.
- 4.6 However, as EBSM only applies to CP4 (2009-10 to 2013-14), it will not generate payments to train operators that relate to Network Rail's performance in CP5. To reflect this, we have included a paragraph within Schedule 7 that explains that EBSM payments "shall only be payable in respect of Relevant Years ending on or before 31 March 2014."

## The new CP5 REBS provision

4.7 We have included a new provision in Schedule 7 of passenger and freight track access contracts, which explains how the REBS mechanism will work in CP5.

### REBS will operate at a Network Rail operating route level

4.8 EBSM operated at a national level but REBS will operate at a route level in CP5. To reflect the route-based nature of REBS, Schedule 7 explains how route baselines<sup>27</sup> will act as the basis on which Network Rail's performance in CP5 is measured for the purpose of REBS.

4.9 We have not included within the passenger or freight track access contracts:

- (a) the income and expenditure that will be included within the scope of REBS route baselines; or
- (b) the route baseline figures for REBS for CP5.

4.10 Instead, the route baseline figures for REBS will be published by Network Rail, consistent with the overall England & Wales and Scotland baselines in our final determination, in its CP5 Delivery Plan supporting documentation before the start of CP5 (i.e. before 1 April 2014).

### REBS provides operators with capped upside and downside exposure to Network Rail's financial performance

4.11 Under the existing EBSM in CP4, train operators receive a share (in proportion to their variable usage charge payments) of 25% of Network Rail outperformance in each year of the control period but they do not share in the cost of Network Rail's underperformance, i.e. it is an upside-only mechanism.

4.12 In CP5, REBS will allow train operators to share 25% of Network Rail's outperformance against the REBS baseline but also a 10% share of Network Rail's underperformance. However, REBS payments will be capped at 10% of the route baseline for both outperformance and underperformance, for train operators (passenger and freight) as a whole.

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<sup>27</sup> The definition of a route baseline is contained within Part 1 of Schedule 7 of passenger and freight track access contracts.

4.13 In Schedule 7, we set out the formula used to calculate the REBS payment ( $O_t$ ) that each train operator would receive from Network Rail (for each route), where there is outperformance of the REBS baseline:

$$O_t = \frac{V_t}{AV_t} \cdot \left[ \frac{25 \cdot ORB_t}{100} \right]$$

4.14 Table 4.1 presents a worked example of how REBS payments would be calculated for an operator, which accounts for 35% (or £7m) of variable usage charge income on that route, under four different scenarios of outperformance (£15m, £25m, £35m and £50m) of a REBS baseline. Table 4.1 assumes a REBS baseline of £500m in year  $t$ . Therefore, total REBS payments to all operators on that route would be limited at £12.5m<sup>28</sup> in that year.

**Table 4.1: Worked examples of calculating REBS payments with outperformance**

$V_t$	$AV_t$	$ORB_t$	$O_t$
Variable usage Charge (VUC) paid by the Train Operator on the route for relevant year ( $t$ ).	Total VUC paid by all operators on the route for relevant year ( $t$ ).	Lower of: a) outperformance (£m) on the route; or b) an amount equal to 10% of the route baseline.	REBS payment to operator where there is outperformance.
£7m	£20m	£15m	£1.3m
		£25m	£2.2m
		£35m	£3.1m
		£50m <sup>29</sup>	£4.4m

4.15 In the case of underperformance of a REBS baseline, we also set out within Schedule 7 the formula used to calculate the payment ( $U_t$ ) from the train operator to Network Rail:

<sup>28</sup> This is calculated as: 25 (reflecting operators' 25% share of total outperformance) multiplied by £50m (reflecting 10% of the initial £500m REBS baseline - this is the maximum exposure for operators under REBS due to the 10% cap) divided by 100.

<sup>29</sup> If outperformance, in this example, was £60m, then the term  $ORB_t$  would still be capped at £50m and the payment received by the train operator would be capped at £4.4m.

$$U_t = \frac{V_t}{AV_t} \cdot \left[ \frac{10 \cdot URB_t}{100} \right]$$

4.16 Table 4.2 presents a worked example of how REBS payments for an operator would be calculated under four different scenarios of underperformance (£15m, £25m, £35m and £50m) of a REBS baseline, using the same assumptions as in Table 4.1 for the value of the route baseline and the train operator's share of variable usage charge income. In this example, total REBS payments from all operators to Network Rail would be limited at £5.0m<sup>30</sup> in that year.

**Table 4.2: Worked examples of calculating REBS payments with underperformance**

$V_t$	$AV_t$	$URB_t$	$U_t$
Variable usage Charge (VUC) paid by the Train Operator on the route for relevant year (t).	Total VUC paid by all operators on the route for relevant year (t).	Lower of: a) underperformance (£m) on the route; or b) an amount equal to 10% of the route baseline.	REBS payment to Network Rail where there is underperformance.
£7m	£20m	£15m	£0.5m
		£25m	£0.9m
		£35m	£1.2m
		£50m <sup>31</sup>	£1.8m

### REBS pay-outs include the performance of alliances

4.17 In our December 2012 decisions document on REBS<sup>32</sup>, we confirmed that the calculation of REBS performance would include any gains or losses from Network Rail's alliance agreements with other train operators.

4.18 The track access contract does not make specific reference to the inclusion of alliance performance within REBS. However, in each year of CP5, when we confirm Network

<sup>30</sup> This is calculated as: 10 (reflecting operators' 10% share of total underperformance) multiplied by £50m (reflecting 10% of the initial £500m REBS baseline – this is the maximum exposure for operators under REBS due to the 10% cap) divided by 100.

<sup>31</sup> If underperformance, in this example, was £60m, then the term  $URB_t$  would still be capped at £50m and the payment the train operator would make to Network Rail would be capped at £1.8m.

<sup>32</sup> *Aligning incentives: decisions on route-level efficiency benefit sharing (REBS) and train operator exposure to Network Rail's costs at a periodic review*, December 2012, available at: <http://www.rail-reg.gov.uk/pr13/PDF/aligning-incentives-decisions-dec12.pdf>.

Rail's performance in our annual efficiency and finance assessment of Network Rail, we will set out the effect on REBS payments from Network Rail's material alliance arrangements<sup>33</sup>.

### **REBS provides train operators with an opt-out from the mechanism (by route)**

- 4.19 Train operators will have the opportunity (but not the obligation) to opt-out of the REBS mechanism in CP5. Schedule 7 explains how the opt-out will work.
- 4.20 In summary, train operators will be able to opt-out of REBS at the start of the control period by completing and returning the opt-out form (attached in an appendix to Schedule 7) indicating which REBS routes they want to opt-out from, within two months of the start of CP5, i.e. before 1 June 2014. If train operators do not opt-out, then the REBS mechanism will apply to them in respect of each route they operate on.
- 4.21 The provisions within Schedule 7 in track access contracts will also allow an opt-out from REBS during CP5 in the following circumstances:
- (a) where an operator starts operating services on a route on which it did not previously operate, whether as a result of entering into a new franchised passenger track access agreement or an open access agreement. This additional opt-out only applies to the route(s) on which the operator commences operating those services and Network Rail and ORR must be notified that they are opting out within two months of the date on which the operator starts operating the services; or
  - (b) where Network Rail enters into an alliance agreement with another train operator on a route, and we agree that this alliance agreement is likely to have a material direct financial impact on secondary operators on that route via the potential impact on any future REBS payments. This additional opt-out only relates to the route(s) on which the alliance agreement applies and Network Rail and ORR must be notified within two months of the date on which we confirm there is likely to be a material direct financial impact on secondary train operators.

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<sup>33</sup> The effect of all Network Rail alliances will be included within Network Rail's performance.

### **Any REBS payments will be made in cash**

- 4.22 Our draft determination explained that any REBS payments should be made in cash. Schedule 7 sets out how any cash payments between Network Rail and operators will be made, i.e. paid within 28 days of the published annual efficiency and finance assessment of Network Rail.
- 4.23 Schedule 7 also explains the calculation of any REBS payments, where track access contracts start or expire before the end of a year. In summary, REBS payments will be pro-rated based on the number of periods in the year where the contract is applicable.

### **VAT treatment of EBSM and REBS payments**

- 4.24 In November 2012, Network Rail consulted with HM Revenue & Customs (HMRC) on the VAT treatment of EBSM payments in CP4. HMRC ruled that EBSM payments were effectively a standard rated supply by the operators against Network Rail.
- 4.25 To reflect HMRC's ruling, we have revised the provisions in the track access contract for EBSM to reflect that EBSM payments will be made on the basis that they are exclusive of VAT and that, where an EBSM payment is consideration for a supply for VAT purposes, then Network Rail will also need to pay the operator an amount of VAT due in respect of that EBSM payment.
- 4.26 The VAT treatment for REBS payments is substantively the same as for EBSM, with changes to reflect that REBS payments may be paid by either party. The proposed VAT provisions for EBSM and REBS payments are set out in Schedule 7.



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## 5. Possessions and performance regimes

### Introduction

- 5.1 This chapter gives an overview of the changes we propose to make to contractual drafting of Schedules 4 and 8 of track access contracts to reflect the decisions set out in chapter 20 of our draft determination.

### Schedule 4 possessions regime

#### Freight operators

- 5.2 The main change we have made to the drafting of Schedule 4 of the freight operators' and freight customer operator<sup>34</sup> model track access contracts is the removal of the modification provisions from paragraph 8, Part 6 of the Schedule 4.
- 5.3 The provisions were introduced in PR08 when the freight Schedule 4 regime was significantly overhauled. The provisions allowed for freight Schedule 4 payments rates to be reviewed after one year of operation if they were not paying broadly the amount of compensation envisaged at the time of the PR08 final determination. The modification provisions were triggered in 2011 and the rates adjusted. The regime is now operating as intended, therefore the modification provisions are no longer required.
- 5.4 We have also made a minor amendment to the definition of actual costs that can be claimed for Category 3 disruption to make clear that this includes costs associated with a train operator's drivers having to learn new diversionary routes in connection with possessions.

#### Franchised passenger operators

- 5.5 The main change we have made to the drafting of Schedule 4 of the franchised passenger track access contracts is to increase the protection provided by paragraph 2.9 of Schedule 4. This will enable operators to recover costs incurred in relation to a possession cancelled at short notice by Network Rail, where those costs amount to £5,000 or more. These costs might relate to planning for the Type 1

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<sup>34</sup> Where a freight customer has its own freight customer track access contract, the freight customer operator contract is the agreement held by the customer's nominated train operator. The freight operator's contract contains the access rights 'drawn down' from the customer's contract.

possession and then reinstating the timetabled service as a result of the subsequent cancellation by Network Rail at late notice. We have defined late notice as where Network Rail notifies a passenger operator of a cancellation less than 12 weeks before the date the possession is planned to take place. Our reason for making this change is set out in paragraph 20.182 of our draft determination.

- 5.6 We are also making minor changes to the definition of Sustained Planned Disruption (SPD) in paragraph 1.1 of Part 3 to Schedule 4. This is to ensure it is consistent with its purpose as determined in PR08 and that the criteria set out for claiming additional revenue loss and cost compensation is clear and unambiguous to all parties.
- 5.7 Finally, we have made minor corrections to definitions and terms within the revenue loss formula in paragraph 3, Part 3 of Schedule 4 and costs compensation formula in paragraph 4, Part 3 of Schedule 4, to better describe the existing arrangements.

### **Open access passenger operators**

- 5.8 Schedule 4 for open access passenger operators' in CP5 will be amended consistent with the changes we are making for franchised passenger operators (see above), with the exception of the changes to Type 1 possessions (discussed in paragraph 5.5). This is because open access operators only receive compensation for Type 3 Restrictions of Use (though they could receive the same compensation as franchised operators receive, in return for paying an access charge supplement).

## **Schedule 8 performance regime – freight**

### **Bonus payments**

- 5.9 In our draft determination (paragraphs 20.120 – 20.123), we said that bonus payments in CP5 will be set at the same rate as compensation payment rates. The contractual wording has been adjusted to reflect this, as it no longer needs to distinguish between the different compensation and bonus payment rates.

### **Adjustment to freight operator benchmark**

- 5.10 The wording of paragraph 10 of Schedule 8 has been adjusted to reflect that we will be requiring Network Rail to update the freight operator benchmark every year to reflect changes in traffic levels, rather than only if a 2.5% mileage threshold is crossed. Our reason for making this change is set out in paragraph 20.115(b) in our draft determination.

## Other

- 5.11 We are also updating the dates relating to the baselines to be applied in the calculation of adjustments to the freight operator benchmark and annual caps, so they relate to the appropriate points in time for use during CP5. The adjustment to the baselines relating to annual caps is four rather than five years. This is in order for the baseline to correspond with the year in which the annual caps will be agreed, which will be 2013-14, rather than 2014-15.

## Schedule 8 performance regime – franchised passenger Compensation for passenger charter payments

- 5.12 As set out in paragraphs 20.87 – 20.89 of the draft determination, we are removing passenger charter provisions from Schedule 8. Our proposed new model Schedule 8 reflects this, through the deletion of paragraph 14 and other references, including the reference column relating to this in Appendix 1.

## Other

- 5.13 In line with paragraph 20.91 of the draft determination, we have revised paragraph 17 of Schedule 8 which relates to disagreements between Network Rail and the train operator in respect of proposed amendments to Appendix 1. Our changes are intended to make the process clearer. We have also removed some obsolete text from paragraph 18.1 in the sustained poor performance section, which refers to the period prior to December 2006.
- 5.14 We have simplified the table in appendix 1 to reflect the fact that there is no longer a passenger charter element of the train operator payment rate, or a societal rate element of the Network Rail payment rate<sup>35</sup>(with associated modifications to the payment rate formulae in paragraphs 9 and 10).

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<sup>35</sup> The societal rate element of the Network Rail payment rate was removed at the end of CP2, but two separate columns showing the Network Rail payment rate were retained. We do not regard this duplication as necessary or helpful.

## Schedule 8 performance regime – open access passenger

- 5.15 In PR08, the Schedule 8 in most open access passenger operators' contracts<sup>36</sup> received minor amendments similar to some of the changes made to the franchised Schedule 8 in PR08. The main differences between existing franchised and open access operators' Schedule 8 provisions are that open access operators do not have sustained poor performance (SPP) arrangements (reflecting that open access operators generally still have local output commitment provisions in their contracts) or passenger charter arrangements (which are being removed for CP5). There are a few other minor differences, such as "First year" arrangements used for new operators and out of date definitions (such as for "Restrictions of Use"). We also note that whilst paragraph 17 of Schedule 8 currently refers to the possibility of an introduction of a capped value in respect of a service group, the provision in paragraph 9.1 of Schedule 8 does not include how to incorporate this into the calculation of the Network Rail performance sum.
- 5.16 We consider that most of the minor differences are unnecessary. Therefore, for CP5, unless there are bespoke requirements that need to be accommodated (which will be identified in the process discussed in paragraph 1.12 of this document), we propose that open access operators should receive substantively the same contractual Schedule 8 regime as franchised train operators, with the exception of the paragraphs relating to SPP arrangements (paragraphs 17.5, 18 and 19 of Schedule 8).

## Further work relating to Schedules 4 and 8

- 5.17 Further work before the final determination relating to the implementation of Schedules 4 and 8 includes finalising:
- (a) the amounts which go into the annexes and appendices of Schedules 4 and 8. Draft final annexes and appendices will be circulated to train operators and Network Rail around the time we publish our final determination. This will enable train operators and Network Rail to identify any errors before we publish our review notices; and

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<sup>36</sup> North Yorkshire Moors Railway has an entirely bespoke regime.

(b) the congestion factor which appears in paragraph 10.1.7 of Schedule 8 for freight operators, which we will be reviewing as part of our review of the work that Network Rail commissioned Arup to do to update the capacity charge.

5.18 Our draft determination outlined where drafts values for these amounts have been calculated already and where there is further work to be done. It also set out the next steps between the draft and final determination.

## **European Train Control System re-opener**

5.19 In the Schedule 8 provisions for freight and passenger operators, we have included a re-opener relating to the introduction of the European Train Control System (ETCS). This provision is found in paragraph 12 of Schedule 8 for freight operators and paragraph 17A of Schedule 8 for passenger operators. This is because ETCS will be implemented on some parts of the network before the end of CP5. We have designed the re-opener to be as flexible as possible since further work is needed to determine exactly how the introduction of ETCS should be reflected in the metrics of Schedule 8. We expect the process for deciding when and how Schedule 8 should be amended to reflect the introduction of ETCS to be led by the industry. To ensure maximum flexibility, as a default we intend to include the ETCS re-opener in all track access contracts.

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## 6. Station access agreements

6.1 This chapter sets out the changes we propose to make to station access agreements to reflect our determination relating to the stations long term charge (LTC). Our draft determination set out three main changes (see paragraphs 16.314-16.337 of that document).

### Changes to the stations long term charge price list

6.2 This is a relatively straightforward change to both the Independent Station Access Conditions and the National Station Access Conditions<sup>37</sup> to reflect the revised LTC which will be set out in the price list that Network Rail will issue on or around 20 December 2013. A draft of this price list has or will be published by Network Rail<sup>38</sup> around the same time that this document is published.

### Indexation of the stations long term charge

6.3 The formulae for indexing the LTC in the stations access conditions will be updated to reflect our decision on indexation in general. See chapter 7 for more details.

### Recovery of costs relating to Stations Information and Security Systems (SISS)

- 6.4 In our draft determination, we confirmed that we agreed with Network Rail's conclusion, following consultation, that the cost of maintenance, renewal and repair for Stations Information and Security Systems (SISS) should be recovered through the LTC. At present, these costs are recovered at Network Rail's managed stations (listed in Table 6.1) through a combination of qualifying expenditure (QX) for maintenance costs and through the fixed track access charge for renewals and repair. At franchised stations, the costs are recovered through the fixed track access charge.
- 6.5 For franchised stations, making this change is straightforward, as only the LTC set out in the station access conditions needs to be amended. For Network Rail's 17 managed stations however, certain entries in the equipment inventory in

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<sup>37</sup> The *National Station Access Conditions (England & Wales)*, the *National Station Access Conditions (Scotland)* and *Independent Station Access Conditions* are available at <http://www.rail-reg.gov.uk/server/show/nav.2516>.

<sup>38</sup> See <http://www.networkrail.co.uk/publications/delivery-plans/control-period-5/periodic-review-2013/>.

Appendix 4 to Annex 1 to the independent station access conditions will also need to be amended to reflect that the costs of the maintenance elements of SISS will no longer be recovered through QX.

- 6.6 The proposed amendments to give effect to the change to the recovery of SISS costs are set out in Table 6.2 below as a mark-up against what the station access conditions currently say. For brevity, we have only included the affected rows of the equipment inventory and do not consider that any further drafting amendments are required.

**Table 6.1: List of Network Rail managed stations**

Managed station	Station Specific Annex reference
Birmingham New Street	SSA/26/01/95/01
Edinburgh Waverley	SSA/26/03/95/01
Euston	SSA/26/04/95/01
Glasgow Central	SSA/26/06/95/01
Leeds	SSA/26/08/95/01
Liverpool Lime Street	SSA/26/17/03/01
London Bridge	SSA/26/10/95/01
London Cannon Street	SSA/26/16/02/01
London Charing Cross	SSA/26/02/95/01
London Fenchurch Street	SSA 26/15/02/01
London Kings Cross	SSA/26/07/95/01
London Liverpool Street	SSA/26/09/95/01
London Paddington	SSA/26/12/95/01
London Victoria	SSA/26/13/95/01
London Waterloo	SSA/26/14/95/01
Manchester Piccadilly	SSA/26/11/95/01
St Pancras International	SSA/26/18/07/01

**Table 6.2: Changes to the equipment inventory in Appendix 4 to Annex 1 of the station access conditions at each managed station (with changes showing as red marked-up text)**

ALLOCATION OF COST

	<i>Description</i>	<u>Present at Station</u>	<u>Quantity (where applicable)</u>	<u>Maintenance is Qualifying Expenditure</u>	<u>Repair is Qualifying Expenditure</u>
(10)	Retail Telecoms Systems This means the systems identified in (A) below including (but not limited to) items mentioned in (B) below but excluding items mentioned in (C) below:				
(A)	public address systems	YES		<del>NO</del>	NO
	information display systems (including LED, LCD, or flap-type (Solari boards) and monitoring (monitor based systems)	YES		<del>YES-NO</del>	Network Rail (except that the Station Facility Owner is responsible for this in respect of tubes and (whether due to breakdown or timetable change) flaps on displays)
	station clock systems	YES	(incorporated into CIS displays)	<del>YES-NO</del>	NO
	closed circuit TV for crowd control	YES	147	<del>YES-NO</del>	NO



	<i>Description</i>	<u>Present at Station</u>	<u>Quantity (where applicable)</u>	<u>Maintenance is Qualifying Expenditure</u>	<u>Repair is Qualifying Expenditure</u>
(B)	customer terminal/premises equipment associated with such systems e.g. processors, displays, speakers and amplifiers	YES	N/A	<del>YES</del> -NO	NO
	local cabling and wiring, including any local data/analogue communications devices associated with the Station	YES	N/A	<del>YES</del> -NO	NO

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# 7. Indexation

## Introduction

- 7.1 This chapter gives an overview of our proposed amendments to the indexation methodology used to annually adjust Network Rail's freight and passenger track access charges, regulated station charges and Schedules 4 and 8 payment rates, caps and thresholds in CP5 to account for changes in general inflation.
- 7.2 We are proposing two changes to the way we index charges in CP5:
- (a) use a consistent indexation approach based on an annual average change in the Retail Prices Index (RPI) for all operators (passenger and freight); and
  - (b) introduce a 'true-up' mechanism<sup>39</sup> to more accurately take account of the general inflation risk that Network Rail faces.

## Background

- 7.3 As we set out in our draft determination and financial issues decision document<sup>40</sup>, we do not think that general inflation risk<sup>41</sup> is efficiently controllable by Network Rail, so we have decided not to expose Network Rail to variances in general inflation between the assumptions in our PR13 determination and the actual outturns, by continuing to:
- (a) index allowed revenue (including charges) by general inflation (i.e. RPI), which will provide stability for the industry through CP5; and
  - (b) adjust Network Rail's RAB by the actual movements in general inflation (i.e. RPI) to retain the real value of its asset base (against which it raises finance).
- 7.4 This approach is consistent with conventional regulatory practice and also reflects the views of consultees who responded to our August 2012 consultation on detailed

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<sup>39</sup> A 'true-up' mechanism adjusts forecast financial assumptions for the actual financial effect that has been experienced.

<sup>40</sup> *Financial issues for Network Rail in CP5: decisions*, December 2012, available at <http://www.rail-reg.gov.uk/pr13/PDF/pr13-financial-issues-decisions-dec12.pdf>.

<sup>41</sup> The general level of inflation in the economy is usually measured by reference to the rate of change in the average prices of a basket of goods and services that is representative of typical consumption patterns. The most common measures of inflation are the retail prices index (RPI), and the consumer prices index (CPI).

financial issues<sup>42</sup>. We set out below how we are proposing to implement our indexation of allowed revenue policy.

- 7.5 Network Rail's access charges, regulated station charges and Schedules 4 and 8 payment rates, caps and thresholds are set in real terms in our determination (i.e. 2012-13 prices for PR13) and are indexed each year in the control period to adjust for general inflation. The methodology used to index access charges is outlined in Schedule 7 of the various freight and passenger track access contracts. It is also set out in Part F of the National Station Access Conditions<sup>43</sup> and Part 6 of the Independent Station Access Conditions in relation to the station long term charge. The methodology used to index Schedule 4 & 8 payment rates, caps and thresholds is also included in the various freight and passenger track access contracts.
- 7.6 In PR08, in simple terms, access charges, regulated station charges and Schedules 4 and 8 payment rates, caps and thresholds are indexed by the RPI inflation rate of the previous year. The inflation rate used in the calculation of the indexation rate is the all items RPI CHAW figures published by the Office of National Statistics (RPI CHAW is used as a proxy of the general inflation risk that Network Rail faces).
- 7.7 Freight and passenger track access contracts include slightly different indexation methodologies to adjust charges and Schedules 4 and 8 payment rates, caps and thresholds. At the moment, passenger track access contracts base the indexation rate on a November to November RPI adjustment, whereas freight track access contracts base the indexation rate on the average annual (January to December) RPI<sup>44</sup> indexation rate. The indexation methodology used to adjust regulated station charges, as stated in the Station Access Conditions, is consistent with the approach used in the passenger track access contracts.
- 7.8 The current PR08 indexation methodology is a simple approach, which does not create a significant mismatch between the indexation adjustment and actual general inflation when changes in actual general inflation in the control period are not that

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<sup>42</sup> This document is available at: <http://www.rail-reg.gov.uk/pr13/consultations/financial-issues.php>.

<sup>43</sup> National Station Access Conditions (England & Wales) and National Station Access Conditions (Scotland).

<sup>44</sup> We are required to index charges prior to the beginning of the new charging year. Therefore, it is more accurate to use a January to December annual average instead of an April to March annual average as this involves less forecasting of inflation.

variable. However, when general inflation is not stable, the mismatch between the indexation adjustment and actual general inflation could be more significant. This is because one of the weaknesses in the current PR08 approach is that actual general inflation in 2008-09 is counted twice in the indexation factors for CP4 and actual general inflation in 2013-14 is not included. This could have a significant effect on Network Rail's revenues particularly when general inflation rates are uncertain, as they are at the moment.

7.9 Therefore, we are looking to improve our approach to indexing charges and Schedules 4 and 8 payment rates, caps and thresholds in CP5 and in particular ensure that Network Rail's income better reflects the level of general inflation in CP5. This will also mean that the charges paid by TOCs also better reflect movements in general inflation.

## Annual average indexation

7.10 Different indexation methodologies have historically been used in freight and passenger track access contracts. In certain circumstances, the indexation factor can vary materially depending on how the RPI rate varies between years within the control period. For instance, periods of very low/negative inflation in 2008-09 meant that different indexation factors were applied to freight and passenger track access charges and Schedules 4 and 8 payment rates, caps and thresholds in CP4. The resulting cumulative indexation rates from these two approaches in CP4 are presented in Table 7.1.

**Table 7.1: Cumulative indexation rates in CP4**

Indexation methodology	2009-10	2010-11	2011-12	2012-13	2013-14
November RPI adjustment	1.000	1.003	1.050	1.104	1.137
Average annual adjustment	1.000	0.995	1.041	1.095	1.130

7.11 For consistency and simplicity, we are proposing that both freight and passenger track access contracts use the same approach to index access charges and Schedules 4 and 8 payment rates, caps and thresholds in CP5. We are also proposing that the same approach to indexation for the station long-term charge is adopted in the station access conditions.

- 7.12 We consider that an indexation approach that uses an annual average RPI indexation rate is our preferred approach for CP5, as it reduces the volatility of changes in charges and Schedules 4 and 8 payment rates, caps and thresholds, from changes in RPI in CP5.
- 7.13 In its PR13 SBP, Network Rail has indexed all costs that are used to establish its charges and Schedules 4 and 8 payment rates by the November RPI rate. There will be a slight initial inconsistency in the RPI assumptions used for CP4 and CP5 if we change from a point-to-point adjustment to an annual average adjustment. However, both of these indexation approaches are only an approximation of the actual effect of general inflation on Network Rail and we do not consider that the initial transitional change will have significant implications for Network Rail or TOCs.
- 7.14 In our Regulatory Accounting Guidelines, to be published in December 2013, we will decide whether, for the purposes of Network Rail's regulatory accounts, we should also annually adjust the assumptions in our determination for CP5, using this annual average approach instead of using a November to November adjustment, as this would be more consistent with our proposed approach to the implementation of PR13.

## The 'true-up' mechanism

- 7.15 A lagged measure of general inflation has historically been used to avoid the need to make a forecast of RPI, i.e. instead of forecasting future movements in general inflation we assume the future movement in general inflation is equal to the movement in the previous year. However, this creates a 'lag effect', which can produce a mismatch between the general inflation faced by Network Rail in its cost base and the indexation rate applied to charges and Schedules 4 and 8 payment rates, caps and thresholds.
- 7.16 Table 7.2 sets out the indexation rates that would have been applied and the resulting revenue that would have been received by Network Rail during CP4 given the actual general inflation rates experienced in CP4<sup>45</sup>. For simplicity, we have assumed that Network Rail has constant annual costs of £100m (2008-09 prices), which it recovers through access charges each year.

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<sup>45</sup> We have included a forecast for general inflation in 2013-14.

**Table 7.2: Indexation of charges in CP4 using the current methodology**

	2008-09	2009-10	2010-11	2011-12	2012-13	2013-14	CP4
Inflation rate (RPI <sub>t</sub> )	3.75%	-0.51%	4.63%	5.19%	3.19%	2.75%	
Costs (2008-09 prices)		100.00	100.00	100.00	100.00	100.00	
Nominal costs (£m)		99.49	104.10	109.50	112.99	116.10	542.17
Adjustment factor (RPI <sub>t-1</sub> )		3.75%	-0.51%	4.63%	5.19%	3.19%	
Charging revenue (2008-09 prices)		100.00	100.00	100.00	100.00	100.00	
Nominal revenue (£m)		103.75	103.22	108.00	113.60	117.23	545.80
<b>Nominal costs - nominal revenue (£m)</b>		<b>-4.26</b>	<b>0.88</b>	<b>1.50</b>	<b>-0.61</b>	<b>-1.13</b>	<b>-3.63</b>

Note: This is a simple example showing movements in income and costs over time under the PR08 approach to indexation.

7.17 Under the current PR08 approach, RPI in 2008-09 is counted twice in the indexation factors for CP4. After 2008-09, the indexation adjustment factor uses the previous year's RPI inflation rate to adjust the charges as a forecast for general inflation in those years. As a result, general inflation in 2013-14 is not reflected in charges in CP4. The resulting effect, as illustrated in the example above, is a mismatch between the actual RPI inflation faced by Network Rail and the indexation rate applied to charges, Schedules 4 and 8 rates, caps and thresholds. In our example, the difference is £3.63m.

7.18 For CP5, we are proposing a new approach to indexation that uses an annual 'true-up' mechanism to reduce the implications of the 'lag effect'. The true-up approach makes an annual adjustment to charges and Schedules 4 and 8 payment rates to account for the differences between forecast RPI and actual RPI in the previous year, i.e. to correct for errors in the prior year general inflation forecast.

7.19 This approach continues to use the previous year's RPI figures as a forecast for the current year's general inflation rate to avoid forecasting general inflation<sup>46</sup> but it also

<sup>46</sup> There is a lot of uncertainty about future general inflation rates, so forecasting general inflation for the next five years as part of our PR13 determination is difficult and doing it yearly would create a more bureaucratic process.

applies an annual ‘true-up’ adjustment to reflect the difference between the general inflation forecast used for the previous year and the actual general inflation rate in the previous year. The formula for the proposed indexation approach, for year t, is presented below:

$$\text{Indexation Factor}_t = \left(1 + \frac{RPI_{t-1} - RPI_{t-2}}{RPI_{t-2}}\right) * (1 + TRUEUP_{t-1})$$

$$\text{Where: True-up}_{t-1} = \frac{RPI_{t-1} - RPI_{t-2}}{RPI_{t-2}} - \frac{RPI_{t-2} - RPI_{t-3}}{RPI_{t-3}}$$

7.20 For example, to calculate the charge for 2015-16, we would use the following calculation:

$$\text{Indexation Factor}_{2015-16} = \left(1 + \frac{RPI_{2014-15} - RPI_{2013-14}}{RPI_{2013-14}}\right) * (1 + TRUEUP_{2014-15})$$

Using the inflation assumptions for 2012-13 (3.19%), 2013-14 (2.75%) and 2014-15 (3.00%), the indexation factor for 2015-16 would be calculated as follows:

$$\text{Indexation Factor}_{2015-16} = \left(1 + \frac{3.00\% - 2.75\%}{2.75\%}\right) * \left[1 + \left(\frac{3.00\% - 2.75\%}{2.75\%} - \frac{2.75\% - 3.19\%}{3.19\%}\right)\right]$$

$$\text{Indexation Factor}_{2015-16} = (1 + 9.09\%) * [1 + (9.09\% + 13.79\%)]$$

$$\text{Indexation Factor}_{2015-16} = 1.341$$

7.21 By addressing the ‘lag effect’, this approach should better reflect general inflation in CP5 and reduce the risk of Network Rail under or over recovering costs due to the ‘lag effect’. Whilst the ‘lag effect’ cannot be completely eliminated in this way, the proposed indexation approach results in a more accurate reflection of the effect of general inflation in the control period than using the PR08 approach.

7.22 Using the same example as set out in Table 7.2, Table 7.3 outlines how our proposed CP5 indexation methodology would have adjusted charges in CP4. In this example, the indexation adjustment factor continues to use the previous year’s general inflation rate as a forecast to predict the following year’s general inflation rate, but an annual ‘true up’ adjustment is also applied, to reflect the difference between the general inflation forecast and the actual general inflation rate in the previous year. The new indexation approach results in a more accurate reflection of actual inflation throughout the control period. In this case, the difference between Network Rail’s costs and revenue in CP5 is only £0.40m.

**Table 7.3: Example of the indexation of charges in CP4 using the true-up methodology**

	2008-09	2009-10	2010-11	2011-12	2012-13	2013-14	CP4
Inflation rate (RPI <sub>t</sub> )	3.75%	-0.51%	4.63%	5.19%	3.19%	2.75%	
Costs (2008-09 prices)		100.00	100.00	100.00	100.00	100.00	
Nominal costs (£m)		99.49	104.10	109.50	112.99	116.10	542.17
Forecast inflation rate (RPI <sub>t-1</sub> )		3.75%	-0.51%	4.63%	5.19%	3.19%	
True-up (RPI <sub>t-1</sub> - RPI <sub>t-2</sub> )		-	-4.26%	5.14%	0.56%	-2.00%	
Adjustment factor ((1+Forecast inflation rate) * (1+True-up))		3.75%	-4.75%	10.02%	5.77%	1.13%	
Charging revenue (2008-09 prices)		100.00	100.00	100.00	100.00	100.00	
Nominal revenue (£m)		103.75	98.82	108.72	114.99	116.29	542.56
<b>Nominal costs - nominal revenue (£m)</b>		<b>-4.26</b>	<b>5.28</b>	<b>0.78</b>	<b>-2.00</b>	<b>-0.19</b>	<b>-0.40</b>

7.23 Furthermore, the difference between general inflation in the last year of CP5 and forecast general inflation will be accounted for in CP6. In the above example, this will reduce the difference of £0.40m by £0.30m. Therefore, the overall difference for CP5 is £0.1m.

## Implementation of the indexation approach in CP5

7.24 Network Rail's final price list for CP5 is scheduled for publication on or around 20 December 2013. The prices will be presented in 2014-15 prices, which involves:

- (a) adjusting the figures included in our PR13 determination to a 2013-14 price base using a 2013-14 January to December annual average RPI uplift<sup>47</sup>; and

<sup>47</sup> The December RPI figure will not have been published in time to include it in the January to December average annual figure that will be used to adjust the figures to 2013-14 prices. Therefore, we will forecast the RPI figure for December 2013 and use that forecast in the January to December annual average. The same methodology will also be used for the calculation of the indexation adjustment for each year of CP5 but the effect of using the forecast is unwound in the following year as in any case the January to December annual average is just a forecast of the general inflation risk that Network Rail faces in a year and the 'true-up' adjusts for any error in the inflation forecast.



(b) then adjusting the figures that are in a 2013-14 price base to 2014-15 prices, using the 2013-14 January to December annual average RPI as a forecast for the change in RPI for 2014-15.

- 7.25 Once the initial price list has been set, the freight and passenger track access contracts and station access contracts will annually adjust freight and passenger access charges and Schedules 4 and 8 payment rates, caps and thresholds in CP5 using the indexation factor shown above.
- 7.26 The true-up mechanism would continue until the final year of CP5 and an adjustment between the forecast RPI change for 2018-19 and the actual annual average RPI change for 2018-19, will be made for the opening year of CP6.
- 7.27 We do not consider that these amendments will have significant financial implications on franchisees. This is because franchised operators have significant protection against the financial impact of the changes to access charges we make at a periodic review. Under the financial adjustment mechanism in franchise agreements (which is either set out in schedule 9 or clause 18.1), franchise payments to operators are adjusted to take account of the net financial impact of the changes to charges determined at the periodic review for the services specified in their franchise.
- 7.28 Freight and open access operators do not have this protection but having a more accurate adjustment for the effects of general inflation on Network Rail on the charges they pay should reduce the effect of general inflation risk on them.
- 7.29 We have had initial discussions of these issues with Network Rail, TOCs and FOCs. TOCs and FOCs have some concerns about the potential volatility of the proposed mechanism on charges during a control period. This is because the adjustment for the error in the inflation forecast occurs immediately in the following year. However, smoothing the changes in charges using our proposed 'true-up' mechanism would be unduly complicated. We will discuss these issues further with Network Rail, TOCs and FOCs in the summer.
- 7.30 We are proposing changes to the following parts of the freight and passenger track access contracts and station contracts to reflect the above proposed changes:
- (a) Schedule 7 of the freight, franchised and open access track access contracts;

- (b) paragraphs 9, 13 and 19 of Schedule 8 of the franchised passenger track access contract;
- (c) paragraph 14, Part 3 and paragraph 2, Part 5 of Schedule 4 of the franchised passenger track access contract;
- (d) paragraphs 9 and 13 of Schedule 8 of the open access passenger track access contract;
- (e) paragraph 14, Part 3 of Schedule 4 of the open access passenger track access contract;
- (f) paragraph 42, Part 6 of the Independent Station Access Conditions; and
- (g) condition F11 of both the National Station Access Conditions (England & Wales) and the National Station Access Conditions (Scotland).

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## 8. Changes to Network Rail's network licence

### Introduction

8.1 The network licence is part of the framework for our economic regulation of Network Rail. We need to make some changes to Network Rail's network licence to help give effect to our PR13 determination for CP5<sup>48</sup>. We also want to make some other changes to update and improve the network licence, for example by making obligations clearer. This chapter sets out our proposed changes to Network Rail's network licence<sup>49</sup> to take effect on or by 1 April 2014.

8.2 There are two ways we can make licence changes: through a 'linked licence' process as part of the periodic review, or by using the procedure set out in section 12 of the Railways Act 1993 (the Act). These processes are explained below. We propose to make changes directly related and integral to our determination using the linked licence route, and to use section 12 for the rest.

8.3 The network licence conditions (LCs) discussed in this chapter are:

- (a) Part II Interpretation;
- (b) LC1 Route utilisation strategies;
- (c) LC2 Information for passengers;
- (d) LC3 Financial indebtedness;
- (e) LC4 Financial ring fence;
- (f) LC5 Interests in rolling stock and train operators;
- (g) LC7 Land disposal;
- (h) LC8 Stakeholder relationships;
- (i) LC12 Annual returns;
- (j) LC15 Governance;

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<sup>48</sup> The draft determination is at: <http://www.rail-reg.gov.uk/pr13/PDF/pr13-draft-determination.pdf>.

<sup>49</sup> In this chapter references to Network Rail are references to Network Rail Infrastructure Ltd. References to its licence refer to its network licence. See: [http://www.rail-reg.gov.uk/upload/pdf/network\\_licence.pdf](http://www.rail-reg.gov.uk/upload/pdf/network_licence.pdf).

- (k) LC17 Financial information;
- (l) LC20 Insurance;
- (m) LC24 Systems code; and
- (n) Schedule: Revocation.

8.4 We outline the changes and our thinking in paragraphs 8.10 to 8.60 but the draft text for the revised licence wording is in a separate document on our website<sup>50</sup>.

## Licence change procedures

### The linked licence process

8.5 The periodic review includes both a review of access agreements and any linked licences. Network Rail is a party to all the agreements that are being reviewed in this document and in most cases will be the facility or installation owner. Network Rail's licence therefore meets the definition of a linked licence under paragraph 1A of schedule 4A of the Railways Act 1993. We can make changes to the conditions of a linked licence as part of the periodic review process. To do so, we must set out the changes to be made in a review notice issued under schedule 4A to the Act.

8.6 Network Rail can object to a review notice, following which we can either issue a new review notice or make a reference to the Competition Commission for a determination on whether the changes are adverse to the public interest.

8.7 We intend to use the linked licence provisions to make changes to LC3 covering financial indebtedness and the part of LC4 relating to payments to funders.

### The section 12 process

8.8 Under this process the licence holder must consent to the changes for them to come into effect. If it objects then we can consider making a reference to the Competition Commission under section 13 of the Act.

8.9 We will use section 12 to effect all the other changes we propose to the network licence beyond those changed using the linked licence process. In autumn 2013 we will publish a formal, shorter, consultation on the final changes to be made using the

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<sup>50</sup> <http://www.rail-reg.gov.uk/pr13/PDF/cp5-licence-conditions-changes.pdf>.

section 12 process and the exact wording to be used. This statutory consultation will include any changes made as a result of your comments.

## Proposed licence changes

### Part II Interpretation

#### General consents

- 8.10 The network licence contains a set of conditions under which Network Rail must operate. Some provisions specifically allow Network Rail to apply to us for a consent to engage in a particular activity. Whilst we can give consent on a case by case basis we can also issue general consents applicable to certain situations. General consents cover common situations we have already thought about. We have already issued general consents for land disposals under LC7 and for insurance under LC20. These work well, freeing up Network Rail and ORR from devoting resources to applications for routine and straightforward cases.
- 8.11 We propose to simplify the wording around consents and to make it clearer through the interpretation part of the licence that any consent we may give can be a specific or a general consent. We also propose amending LC20 to make it clear that ORR's general approval for third party liability arrangements is itself a 'consent'.

### LC1 Network management

#### Route utilisation strategies

- 8.12 One of Network Rail's key roles is planning the future capability of the national rail network. Route utilisation strategies (RUSs) have been the industry's main planning tool for several years. RUSs also show the value of investment in rail improvement schemes to funders and customers<sup>51</sup>. Since 2006, Network Rail has led the production of RUSs on behalf of the industry. Network Rail's role is underpinned by LC1 and in particular LC1.14-1.17, where it is required to "...establish and maintain route utilisation strategies".
- 8.13 RUSs have focused on taking a ten year view of making the best use of existing capacity, with some incremental changes and some longer term scenario planning. However, rail projects tend to have long gestation periods. After the first tranche of 19 geographic RUSs had been completed for CP4 and CP5, and following some

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<sup>51</sup> See the ORR webpage for more information <http://www.rail-reg.gov.uk/server/show/nav.1480>.

recent updates, it was found necessary to develop the process to take a longer term view for up to 30 years. This requires consideration of step changes in economic growth, passenger demand, freight commodities, and other such opportunities.

- 8.14 In 2011, Network Rail proposed and consulted on a new long term planning process to replace the RUS process. The new long term planning process consists of three phases: market studies, route studies, and cross-boundary analysis. Network Rail gave us its proposals in February 2012 and in April 2012 we endorsed these as discharging its obligations under LC1.14<sup>52</sup>.
- 8.15 Network Rail has convened working groups and regional groups for the four identified markets: long distance, regional urban, London & South East and freight. Market studies have been published in draft form<sup>53</sup>.
- 8.16 The proposed revisions to the licence condition would make it more flexible and allow both ORR and Network Rail to adapt to different conditions over time.
- 8.17 We propose to:
- (a) replace references to RUS with “long term plans” throughout the licence;
  - (b) remove much of the specific requirements in the licence condition and replace them with updated, more flexible ORR guidelines, under existing LC1.8; and
  - (c) update the relevant guidelines.
- 8.18 The changes to LC1.14 to 1.17 should provide a more flexible and appropriate framework for long term planning. It is not our intention to micromanage Network Rail’s development of a long term plan or governance of the process. However, we can intervene if necessary.

## **LC2 Information for passengers**

### **National timetable**

- 8.19 Under LC2.6 Network Rail is obliged to publish or procure publication of a National Rail Timetable (NRT). This is done twice a year and the full NRT is uploaded on to

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<sup>52</sup> See <http://www.rail-reg.gov.uk/upload/pdf/ltp-endorsement-letter-230412.pdf> for details.

<sup>53</sup> <http://www.networkrail.co.uk/improvements/planning-policies-and-plans/long-term-planning-process/market-studies/>.

Network Rail's website<sup>54</sup>. Network Rail puts considerable effort into formatting the NRT. It is used by two publishers who produce hard copies for general sale.

- 8.20 Network Rail tells us the effort that it takes to produce the NRT in its current format is now disproportionate to its usage. Network Rail has told us that the number of downloads of the full NRT from its website has declined dramatically to less than 1000 an edition, down from 30,000 in June 2010, and the number of page views is less than ten a month. It says that most users have switched to other sources of more up to date 'live' information such as the National Rail Enquiries website or pocket timetables produced by the train operators.
- 8.21 Network Rail has suggested that it scales down the resources devoted to formatting the NRT and preparing it for publication. It proposes instead to provide simpler spreadsheets on its website which can be accessed by industry parties and the few passengers who cannot find the information they want elsewhere. The core information in the NRT would still be available but in a different format. Network Rail would also continue to make the working timetable available through its website and would provide timetable information suitable for 'App' developers.
- 8.22 We are sympathetic to Network Rail's position. Network Rail is considering what changes it wants to make and their timing. We expect it will discuss these plans with affected stakeholders over the next few months. However, as matters stand, we do not propose to make any changes to the licence condition at this time.

### **LC3 Financial indebtedness**

- 8.23 Under LC3 we restrict the level of Network Rail's financial indebtedness. As set out in chapter 12 of our draft determination and consistent with our aim of improving the disaggregation of Network Rail's price control, we are proposing to amend LC3 to include separate terms for England & Wales and Scotland<sup>55</sup>. We implement this policy through LC3.
- 8.24 We will finalise the specific levels of Network Rail's maximum level of financial indebtedness in each year of CP5, in our final determination, as the levels need to reflect the entire PR13 package. Our current thinking based on our financial modelling

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<sup>54</sup> <http://www.networkrail.co.uk/asp/3828.aspx>.

<sup>55</sup> In network licence condition 3, the restriction on its level of debt is presented as a percentage (i.e. debt/regulatory asset base).

is that the level of financial indebtedness (expressed as debt/RAB) in each year of CP5, should at no point exceed a limit set between 70-75% for England & Wales and Scotland. We will conclude on the level of the limits in the final determination and we will amend the licence to include these new limits as part of PR13 implementation.

- 8.25 Under the current wording of LC3, the restrictions on financial indebtedness for the current control period would expire on 1 April 2014 unless amended. Therefore, if for any reason, implementation of PR13 were delayed, the restrictions on financial indebtedness would cease. To avoid this risk in CP6, we are proposing to change the wording of LC3 so that the restriction on financial indebtedness in the final year of CP5 should apply to all subsequent years, until revised (e.g. at a future periodic review) or we have removed the licence condition.
- 8.26 In our draft determination we have also set out that the fee that Network Rail pays for the financial indemnity provided by the UK government will be 1.10% on the outstanding financial indemnity mechanism (FIM) backed debt. We propose to update LC3.5 to reflect this change.
- 8.27 We propose to make these changes to LC3 using the linked licence procedure.

#### **LC4 Financial ring-fence**

- 8.28 LC4 protects Network Rail's funders and customers from the company being exposed to risks that are not part of its role as the rail infrastructure operator for Great Britain. Thus Network Rail is restricted from carrying out activities that are not part of its core business.
- 8.29 We have reviewed the financial ring-fence for Network Rail and the financial ring-fences used by other regulators. As a result of this, we do not, at present, think that we need to make any changes to the financial ring-fence except where the drafting of the financial ring-fence can be improved or simplified as discussed below.

#### **Payment of dividends**

- 8.30 Network Rail's ultimate parent company, Network Rail Limited (NRL), is a not-for-dividend company limited by guarantee and is directly accountable to its members rather than shareholders. Whereas shareholders provide equity and expect to receive dividends in return for the risk on their capital, Network Rail's members have virtually no capital at risk. Therefore the company does not pay its members dividends.



- 8.31 However, there may be occasions when Network Rail (that is, Network Rail Infrastructure Limited – ‘NRIL’)<sup>56</sup> wishes to make a dividend payment to another company in the Network Rail group to improve the efficiency of its financial structure and LC4 prohibits the payment of dividends without our consent.
- 8.32 We propose to revise the section on the payment of dividends to make it clear that the licence holder shall not declare or recommend a dividend or make any other distribution<sup>57</sup> or redeem or repurchase any share capital of the licence holder unless it has both issued a certificate to us and we have consented.
- 8.33 The provision requiring the licence holder to satisfy itself that it will not be in breach of its licence obligations in the future is in practice very difficult to meet, since ‘the future’ could imply an indefinite period of time. We propose to replace ‘in the future’, with ‘for the rest of the current control period or for the next three financial years (whichever is the longer)’. These proposed changes are set out in revised LC4.29 to 4.33. We intend to use the section 12 process to make these changes.

### **Payment of financial outperformance to the governments**

- 8.34 We set out in the draft determination that financial outperformance should not be used to make payments to the governments in CP5, unless we are satisfied that there are exceptional circumstances. Instead, financial outperformance should be used to pay down debt or fund research and development<sup>58</sup>.
- 8.35 In order to be clearer that a payment to the governments in relation to financial outperformance requires our consent, we are proposing to include a specific section in the network licence restricting Network Rail from making payments to the governments that are not made in the ordinary course of business or in order to comply with a legal obligation. These proposed changes are set out in revised LC4.34 to 4.38. We intend to use the linked licence process to make these changes to the licence condition.

### **LC5 Interests in rolling stock and train operators**

- 8.36 LC5 restricts Network Rail’s interests in the ownership or operation of rolling stock. Its purpose is to prevent the network operator from becoming vertically integrated. LC5

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<sup>56</sup> NRIL is the member of the Network Rail group of companies that holds a network licence.

<sup>57</sup> Within the meaning of sections 829, 830, 849 or 850 of the Companies Act 2006.

<sup>58</sup> See chapter 12, paragraphs 12.155 to 12.163 of our draft determination for further details.

says that Network Rail must not, without our consent, be interested in the ownership or operation of any railway vehicle in Great Britain, except where it is used for network operations or forms the Royal Train.

- 8.37 Over time Network Rail has entered several limited, usually short-term arrangements that have involved an interest in train operation; often the lease of temporarily surplus equipment to other networks. Individual consents issued under this condition are listed on our website<sup>59</sup>.
- 8.38 Arrangements such as these do not raise vertical integration issues and are unlikely to affect Network Rail's core business and focus. However, each consent requires our scrutiny, often at very short notice. The administration around each case can be burdensome and disproportionate to the issues and outcomes for both Network Rail and ORR. The requirement for consent where Network Rail believes cases to be uncontroversial can also lead to uncertainty for the company in planning its business and for dealing with issues that arise unexpectedly.
- 8.39 We propose to introduce a general consent to allow Network Rail to enter into certain types of arrangements with other parties that would otherwise require specific ORR consent. (See paragraphs 8.10-8.11 above on general consents.) In cases not covered by the general consent, Network Rail would need to obtain our specific consent. The general consent would be flexible and could be changed when needed.
- 8.40 We also intend to retitle the condition "interests in railway vehicles". This is to reflect more properly what the condition actually covers.
- 8.41 We will consult with Network Rail on the terms of a new general consent before the start of CP5. There are some recurrent themes to the individual consents we have given Network Rail. For example, the temporary loan of plant (such as stone blowers) to other infrastructure operators when not needed by Network Rail. A general consent could cover these sort of situations.

## **LC7 Land disposal**

- 8.42 LC7 protects land that may be required for future development of the railway network and prohibits the disposal of that land if it is against the public interest. Accordingly, Network Rail is obliged to give us three months' prior notice of an intended disposal

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<sup>59</sup> <http://www.rail-reg.gov.uk/server/show/nav.2105>.

and must seek our specific consent for any disposal not covered by an ORR general consent. The regulatory arrangements are available on our website<sup>60</sup>.

- 8.43 Since the introduction of the land disposal condition in 2001 we have from time to time revised the procedures around casework handling. Originally, ORR was responsible for consulting the industry on Network Rail's proposed land disposals. The existing requirement for three months' prior written notice reflected the time to do that. However, in 2008 we gave Network Rail the responsibility for consulting the industry on land disposals before submitting its proposals to us. Network Rail has suggested the current time limits should therefore be reduced.
- 8.44 We already aim to conclude casework referred to us within one month where the issues are straightforward. If we were to reduce the notice period to two months the onus would be on Network Rail to ensure its submissions are sufficiently robust, clear and accurate to allow us to consider them properly within that timescale. Such a change should not therefore weaken the protection for stakeholders.
- 8.45 We therefore propose to replace "3 months" with "2 months" in condition 7.2. We also propose to simplify the rest of LC7.2 so that its purpose, procedures and potential outcomes are clearer for everyone. We will also discuss with Network Rail whether land potentially subject to a compulsory purchase order should be included within the general consent, rather than on the face of the licence, at the same time we modify the licence.

## **LC8 Stakeholder relationships**

### **References to Passenger Focus and London TravelWatch**

- 8.46 The Rail Passengers' Council has been renamed as the Passengers' Council<sup>61</sup> and is also more popularly known as Passenger Focus. The London Transport Users' Committee (LTUC) is also better known as London TravelWatch. In LC8 we propose changing RPC references to Passenger Focus and LTUC to London TravelWatch. The definitions in Part II of the licence would also be changed accordingly.

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<sup>60</sup> <http://www.rail-reg.gov.uk/upload/pdf/land-disposal-regulatory-arrangements.pdf>.

<sup>61</sup> <http://www.legislation.gov.uk/ukxi/2010/439/contents/made>.

## LC12 Annual and periodic returns

### Annual returns

- 8.47 LC12 sets out Network Rail's obligation to prepare and provide annual and periodic returns to ORR. Annual returns report on Network Rail's achievements, developments and challenges. LC12.1 and 12.2 specify when annual returns and related notices must be published. These periods are intended to ensure that Network Rail is given fair notice of the information it has to collect and report on. Our original intention behind the current LC12.3 was to ensure that Network Rail had more notice (at least two years) where *new* sets of statistical and other data are to be collected. However, the condition could be interpreted to mean that changes to *any* statistical data should have such a notification period.
- 8.48 LC12 could be more flexible and reflective of what is now realistic. We propose to improve the condition by making the arrangements clearer and simply stating that we must give Network Rail at least six months' notice of information to be supplied in its annual returns. The notice period could be shorter but only if Network Rail and ORR both agree. Any information requests must of course be achievable and practical.
- 8.49 We also propose to change LC12.5 so that Network Rail should publish the annual return within one month of the date it is due rather than the date it is actually delivered to ORR.
- 8.50 We do not propose to change LC12.6 which relates only to periodic returns.

### LC15 Governance

- 8.51 The purpose of LC15 is to ensure Network Rail applies good corporate governance standards similar to those of a listed public limited company (PLC). Good corporate governance standards support the overall direction, effectiveness, supervision and accountability of an organisation.
- 8.52 We think LC15 could be improved and made clearer. We propose to reformulate the condition so it is clearer on what good corporate governance means for Network Rail, taking account of the most recent developments in this field.

- 8.53 We propose to update the condition to make explicit reference to compliance with the UK Corporate Governance Code<sup>62</sup>, which applies to all listed companies, and sets out standards of good practice in relation to board leadership and effectiveness, remuneration, accountability and relations with shareholders. If Network Rail did not comply with an individual element of the code, it would have to explain why.
- 8.54 The condition would continue to require Network Rail to comply with the publication rules for companies admitted to the Official List of the Listing Authority<sup>63</sup> and ensure that its board of directors contains a majority of non-executive directors, two of which must have substantial railway experience.
- 8.55 However, we recognise that given the nature of Network Rail, not all the rules will be necessarily relevant or practical to apply. The revised condition would allow us to consent to, or specify, that other equivalent arrangements be put in place by Network Rail. ORR would retain the ability to intervene at any stage, where necessary.
- 8.56 Our view is that the requirement to have two non-executive directors with substantial railway experience should be retained, while acknowledging Network Rail's concerns. However, we do agree with Network Rail that the current requirement to fill vacancies for this post within one month is impractical. We propose to delete this requirement and the process described above would apply instead.
- 8.57 For the avoidance of doubt, our view is that where the code refers to responsibilities towards shareholders, 'shareholders' should be interpreted as the Network Rail members<sup>64</sup> who perform a similar role for Network Rail as the shareholders in public limited companies.

## LC17 Financial information

- 8.58 Network Rail is not on the Official List of the UK listing authority and it is not listed on any stock market. However our general intention is for Network Rail to behave as if it were a listed company in the way it publishes information. LC17 does this. However, there is some overlap between the listing rules of the Financial Conduct Authority<sup>65</sup>,

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<sup>62</sup> <http://www.frc.org.uk/Our-Work/Codes-Standards/Corporate-governance/UK-Corporate-Governance-Code.aspx>.

<sup>63</sup> <http://www.fca.org.uk/firms/markets/ukla>.

<sup>64</sup> <http://www.networkrail.co.uk/aspx/721.aspx> "Network Rail does not have shareholders, ....."

<sup>65</sup> <http://www.fca.org.uk/firms/markets/ukla>.

LC15 and the corporate governance code. Therefore we think we should delete LC17 if LC15 is modified as discussed above because this would then require the publication of such financial information.

## **LC24 Systems code**

8.59 This licence condition ceased to have effect on 30 September 2010. We propose to delete it. Today an industry forum, the Systems Code Industry Review Group, handles systems code issues.

## **Schedule: revocation**

8.60 Item 2 of the revocation schedule says the Secretary of State, on consultation with ORR, may revoke the licence if the licence holder commits a serious breach of the Railways (Safety Case) Regulations 2000. These Regulations no longer apply and other legislation<sup>66</sup> has been introduced. There is now a mechanism for the safety authorisation to be removed, which did not exist before. The need to revoke, on safety grounds, the ability to operate through revocation of the licence is no longer needed. We propose to delete this clause after consultation with the Department for Transport (given that it was the then Secretary of State that granted the network licence) and Network Rail (as the licence holder).

## **General note on cross references**

8.61 The changes we propose to make to the licence will require consequential changes, including to licence condition numbering and changes to other references. These changes will be set out in more detail when we prepare our shorter, statutory, consultation on the final changes to the licence that we propose to make using the section 12 process in the autumn.

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<sup>66</sup> The Railways and Other Guided Transport Systems (Safety) Regulations 2006.

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# Annex A: Network Rail's share of the volume reconciliation

## Introduction

A.1. Further to the discussion on traction electricity charges in chapter 2, we have included this annex to explain a particular aspect of paragraph 18 of the proposed Traction Electricity Rules which set out the traction electricity volume reconciliation process. These rules provide that Network Rail will share a proportion of the volume reconciliation over and above that associated with its own consumption of EC4T<sup>67</sup>. The calculation for this is set out (with a mathematical explanation) below. This should be read in conjunction with paragraph 18 of the rules, and the algebraic terms used in this annex are defined in paragraph 18<sup>68</sup>.

## Network Rail's share of the volume reconciliation

- A.2. In our draft determination, we said that Network Rail's share of the volume reconciliation would reflect the proportion of costs for which it has control, and we took this to mean the total estimated level of losses in each ESTA. This means that its share is equivalent to having  $(\lambda_g) / (1 + \lambda_g)$  of consumption in the ESTA, where  $\lambda_g$  is the DSLF for ESTA g.
- A.3. As three ESTAs operate both AC and DC services, for simplicity we have taken the AC estimate of the DSLF for such cases (this is given in the definition of  $\lambda_g$ ).
- A.4. The formula allocates the discrepancy between the volume billed to Network Rail by its electricity supplier and that billed by Network Rail to train operators and other parties (the amount  $\{A_{gt} - L_{tmog} - L_{tmeg} - L_{tmug} - L_{tmng}\}$  in the formula).
- A.5. We have inserted the  $\lambda_g \bullet A_{gt}$  term to that formula in the denominator. This means that, once the reconciliation is calculated and allocated to modelled services<sup>69</sup>, and for third

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<sup>67</sup> Throughout this annex, we are focusing on Network Rail's share of the volume reconciliation over and above that associated with its own consumption. The latter is incorporated in the  $L_{tmng}$  term.

<sup>68</sup> See <http://www.rail-reg.gov.uk/pr13/PDF/ec4t-rules-clean.pdf>.

<sup>69</sup>  $L_{tmog} / \{L_{tmog} + L_{tmng} + \lambda_g \bullet A_{gt}\}$ , expressed in monetary terms as  $\sum E_{tmog\omega} / \{L_{tmog} + L_{tmng} + \lambda_g \bullet A_{gt}\}$ , summed ( $\Sigma$ ) over all operators  $\omega$ .

parties and for Network Rail's own consumption<sup>70</sup>, there is a residual percentage of the volume discrepancy remaining of  $(\lambda_g \bullet A_{gt}) / (L_{tmog} + L_{tmng} + \lambda_g \bullet A_{gt})$ , which is the share that Network Rail bears to reflect its own consumption.

- A.6. This share is equivalent to a modelled operator having  $(\lambda_g) / (1 + \lambda_g)$  of the ESTA's consumption, as per our conclusions.
- A.7. This can be seen, for example, by considering the case where all services in ESTA g are modelled. In such a case,  $L_{tmog} + L_{tmng} \approx A_{gt}$ . Under such a scenario, from paragraph A.5, Network Rail's residual share of the volume discrepancy is  $(\lambda_g \bullet A_{gt}) / (L_{tmog} + L_{tmng} + \lambda_g \bullet A_{gt})$ . This is approximately equal to  $(\lambda_g \bullet A_{gt}) / (A_{gt} + \lambda_g \bullet A_{gt}) = (\lambda_g) / (1 + \lambda_g)$ .
- A.8. In the case were all services are metered (and there is no consumption by Network Rail and third parties, i.e.  $L_{tmog} + L_{tmng} = 0$ ), from paragraph A.5, Network Rail's residual share of the volume discrepancy is  $(\lambda_g \bullet A_{gt}) / (L_{tmog} + L_{tmng} + \lambda_g \bullet A_{gt}) = (\lambda_g \bullet A_{gt}) / (\lambda_g \bullet A_{gt}) = 100\%$ , i.e. all volume risk is allocated to Network Rail.

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<sup>70</sup>  $\{L_{tmng} / \{L_{tmog} + L_{tmng} + \lambda_g \bullet A_{gt}\}$



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# Annex B: Process for re-opening the price control

## Introduction

- B.1. Chapter 3 explains the circumstances in which the regulatory settlement for Network Rail in CP5 may be re-opened during a control period.
- B.2. This annex sets out the procedure that we expect to follow in the circumstances that one or more of the criteria for initiating an access charges review prior to 1 April 2019 (interim review) may have been triggered. We have developed this procedure on the assumption that any such interim review would need to be conducted as quickly as possible.

## Background

- B.3. Our determination provides Network Rail with a revenue stream that, in our view, is sufficient for it to deliver all its regulatory outputs provided that it operates efficiently. In addition, the regulatory framework provides a number of protections to Network Rail in the event of unforeseen circumstances. These protections are described in our determination. It is not the intention, however, that the allowed revenues are sufficient to absorb all significant external cost shocks. In such circumstances, the determination may need to be re-opened during a control period, by means of an interim review.
- B.4. As described in our determination and as set out in Schedule 7 of franchise operators' track access contracts, there are circumstances in which an interim review may be triggered:
  - (a) **material change in circumstances re-opener:** Where there has been or is likely to be a material change in the circumstances:
    - (i) of Network Rail; and/or
    - (ii) in relevant financial markets or any part of such markets.
  - (b) **Scotland re-opener:** Where Network Rail projects its forward three-year average total net expenditure in Scotland to be more than 15% greater than that

assumed in the regulatory determination. This would trigger the interim review process for Scotland only. When there is less than three years remaining in CP5, the calculation will be solely for the remaining part of CP5.

- B.5. We would need to determine whether the terms of the relevant re-opener provision have been met and, if so, we would then consider whether there is a compelling case for an interim review in the light of our section 4 duties (Railways Act 1993).
- B.6. The process under Schedule 4A of the Railways Act 1993 would require the Secretary of State and/or Scottish Ministers (as applicable) to provide a new high-level output statement (HLOS) and statement of funds available (SoFA). The outcome of an interim review may be a change in Network Rail's regulatory requirements and/or allowed revenues. However, it may also be a reaffirmation of the existing regulatory requirements and allowed revenues.

## Triggering an interim review

### Stage 1: Process commencement

- B.7. Should Network Rail think that it has satisfied the conditions of one or more of the re-opener provisions, it will be able to apply to us to request a triggering of the interim review process. It will need to apply to us in writing to do this, setting out:
  - (a) the re-opener provision(s) under which it is requesting the interim review;
  - (b) a detailed explanation of the reasons why it thinks it has satisfied the terms of the re-opener, including evidence on the extent to which its efficient costs have been or are expected to be impacted. Network Rail should set out the cost and revenue requirement implications for delivering the HLOSs and also options for reducing outputs to continue to operate within the latest determination. We would expect Network Rail's submission to include relevant financial projections that have been externally verified; and
  - (c) the actions (if any) it has taken to mitigate any change in efficient costs.
- B.8. At this stage we would also consider whether we should, having regard to Network Rail's financial circumstances, be conducting the interim review on an expedited basis. We could do this, in accordance with paragraph 1C of Schedule 4A of the Railways Act 1993, by giving notice of an access charges review on a conditional basis, which would enable DfT and/or Transport Scotland to prepare their HLOSs and

SoFAs at the same time as we conducted our assessment to determine whether the terms of the re-openers have been met (see below). We are able to include conditions in any such notice which need to be satisfied if we are to proceed with an access charges review. We would propose to make the notice conditional on us concluding at the end of our stage 2 assessment process, that the trigger for an interim review had been satisfied.

- B.9. If we decide to assess whether an interim review should be carried out, we will notify Network Rail, setting out:
- (a) the re-opener provision(s) that we consider may have been satisfied; and
  - (b) a detailed explanation of our reasons.

## Stage 2: Assessment

- B.10. Stage 2 will involve an assessment by us of whether the terms of the re-opener(s) concerned have been met and hence whether we should conduct an interim review. We will complete this assessment within two calendar months of notifying Network Rail that we are triggering the process to assess whether an interim review should be carried out.
- B.11. We expect that this will involve considerable engagement with Network Rail and may require Network Rail to provide us with specified information to tight timescales to enable us to complete our assessment within the timescale. We, therefore, expect Network Rail to make the necessary people and information available.
- B.12. The precise details of what the assessment will involve depends on the re-opener(s) concerned.
- (a) **Material change in circumstance re-opener:** The regulatory framework, including the re-opener process, is intended to provide a number of protections to Network Rail in the event of unforeseen circumstances. Before initiating a re-opener as a result of a material change of circumstances, we would have regard to Network Rail's view as to whether it felt it needed an interim review of charges and outputs. We would then examine the evidence for whether there has been a material change in circumstances. There are clearly a number of events that might constitute a material change in circumstance, which for example could include a substantial, sustained and unanticipated rise in input prices or interest costs that an efficient Network Rail would face.

- (b) **Scotland re-opener:** We will assess the robustness of Network Rail's net expenditure projections for Scotland. Network Rail will need to ensure, in any case, that the projections it provides to us are externally verified. We would want to understand from Network Rail the assumptions underlying the projections.
- B.13. Where we think that the terms of one or more of the re-opener provisions have been met, we will then consider whether there is a compelling case for an interim review against our section 4 duties. We would expect to have particular regard to the following duties:
- (a) to act in a manner which we consider will not render it unduly difficult for Network Rail to finance its activities;
  - (b) to promote efficiency and economy on the part of persons providing railway services; and
  - (c) to protect the interests of users of railway services.
- B.14. It will be necessary for us to take into account the views of interested persons, such as the affected funders, during stage 2. In view of the need to conclude stage 2 within two calendar months, consultees would only have relatively short timescales in which to set out their views. Where appropriate, we would therefore consider whether the best way to understand the views of interested persons might be a hearing.
- B.15. Where we are satisfied that the terms have been met, we will initiate an interim review. If the issue is confined to a single geographic area (i.e. to England & Wales only or to Scotland only), then we will ensure that the outcome of the review impacts only on the appropriate train operators and funders.
- B.16. Where we are not satisfied that the terms of the re-opener have been met, there will be no interim review and Network Rail will need to deliver the required regulatory outputs for CP5 in accordance with our PR13 determination.
- B.17. Importantly, should there be further changes in Network Rail's financial position, it would be able to ask us to re-open the price control. We would also keep the situation under review as part of our on-going monitoring of Network Rail's financial position.
- B.18. It is important to note that our regular monitoring of Network Rail should provide early warning of impending difficulties. For instance, we assess Network Rail's performance against the regulatory assumptions on an annual basis. The expenditure analysis

included in our annual assessment currently provides our assessment of Network Rail's performance for support, operations, maintenance, renewals, enhancement expenditure and financing costs.

### **Stage 3: Undertaking an interim review**

- B.19. If the terms of a re-opener are satisfied, we will undertake an interim review of Network Rail's allowed revenues and regulatory outputs.
- B.20. Immediately following the conclusion of stage 2 of the initiation process, we will issue a review initiation notice, commencing the formal phase of the review. Alternatively we will, if we have already served a conditional review initiation notice, confirm that the relevant condition has been satisfied. This will require DfT and/or Transport Scotland, as necessary, to restate their HLOS(s) and SoFA(s). The notice would also state the period to be covered by the new regulatory settlement.
- B.21. Generally, we would expect that the new settlement would run until the end of the current control period (i.e. end March 2019). However, we may specify an alternative period, for example a new five-year period, where we believe that this would be more appropriate. DfT and Transport Scotland can also set out their opinion on this issue when they provide their restated HLOS(s) and SoFA(s).
- B.22. Governments may choose to leave their HLOSs and SoFAs unchanged or to update one or both of them.
- B.23. Even if we are not conducting the interim review on an expedited basis (see paragraph B.8) we would consider whether we should rely on paragraph 1C (5)(a) of Schedule 4A to the Railways Act 1993, in which case the governments would need to provide us with their updated HLOS(s) and SoFA(s) within four weeks of receipt of the review initiation notice.
- B.24. Immediately following the receipt of the HLOS(s) and SoFA(s), we would begin a thorough review of the efficient cost of delivering the HLOS(s). If one or both of the HLOS(s) have been restated, we would ask Network Rail to provide a further submission with its forecast of the cost of delivering the restated HLOS(s). If the HLOS(s) cannot be delivered within the SoFA(s), we would inform DfT and/or Transport Scotland that this is the case following the process set out in Schedule 4A of the Railways Act 1993.

- B.25. We would not generally expect to reassess the regulatory framework unless the particular circumstances of the re-opener suggested that this was appropriate.
- B.26. We would aim to publish the new draft settlement for consultation within six calendar months of receiving the updated HLOS(s) and SoFA(s). The consultation period would be limited to six weeks to ensure that we provide Network Rail with a revised settlement as quickly as possible but also enabling proper consultation. During the period when we considered the revised HLOS(s) and SoFA(s) we would consider the most appropriate way to take into account the views of interested persons which might include:
- (a) focussed consultations on issues for which we would expect response times to be not more than one month;
  - (b) workshops;
  - (c) bilateral meetings; and
  - (d) industry hearings.
- B.27. We would then aim to publish our new final settlement within one month of the end of the consultation period. Following this, we would then aim to publish the review notice, in accordance with Schedule 4A of the Railways Act 1993, within one calendar month of the publication of the new final settlement.
- B.28. The review notice commences the formal implementation phase of the review and includes a number of mandatory timescales. Network Rail would have a period of at least six weeks to object to the review notice. If we did not receive such an objection or any objection that was made was subsequently withdrawn, we would then publish a notice of agreement. Access beneficiaries then have a 28 day period during which they can serve a termination notice. After the expiry of this period the review can be formally implemented by service of a review implementation notice.
- B.29. Provided that there is no mismatch between the updated HLOS(s) and SoFA(s) and the timescales set out above are achieved, we should be able to determine the new regulatory settlement within ten months of concluding stage 2 of the initiation process and issuing the review initiation notice. Should the iterative process be required because of a mismatch between the HLOS and SoFA for England & Wales and Scotland, this would affect these timescales. We do not think that we can set out an

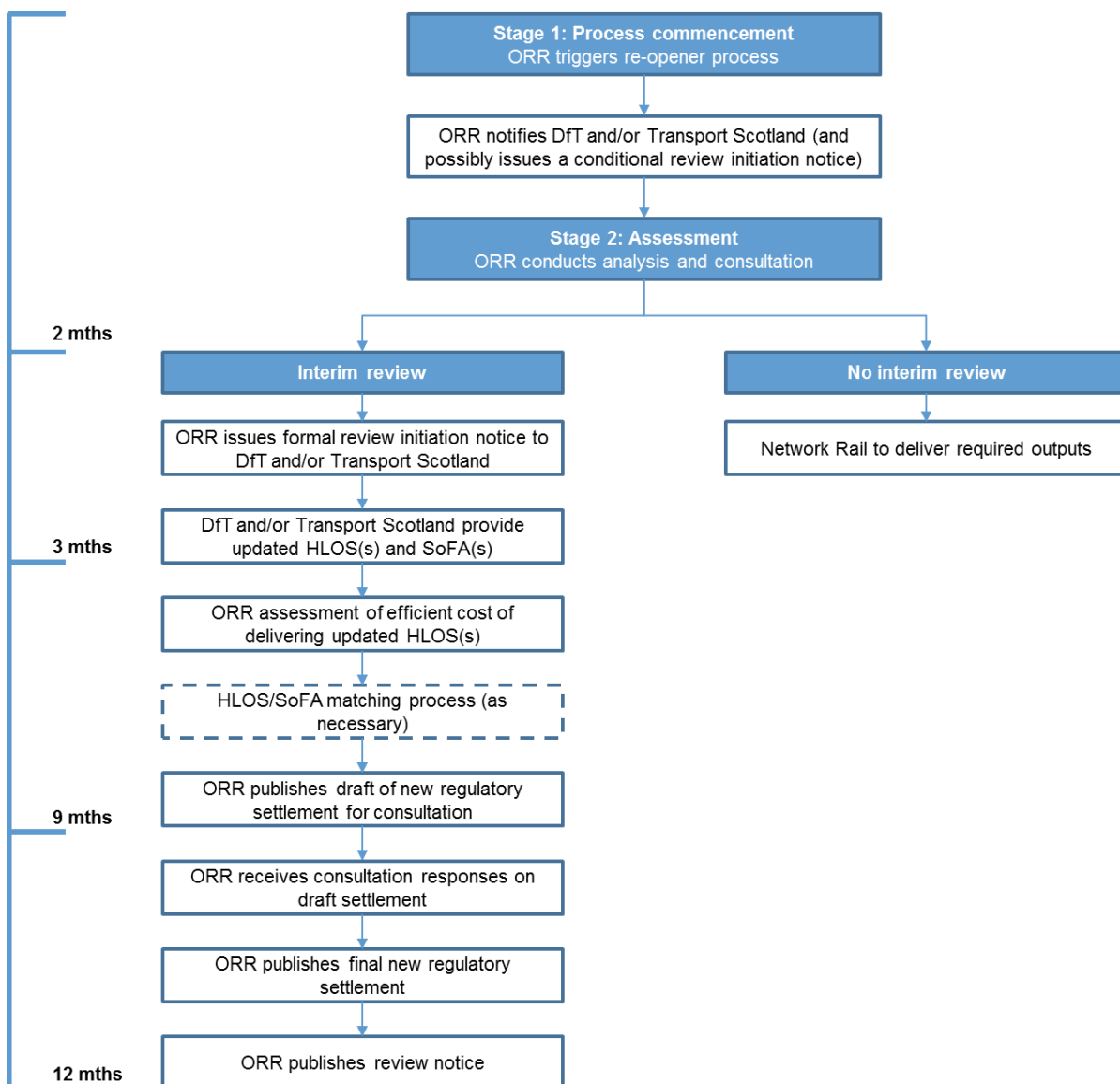
overall timescale for the iterative process but would expect to set tight timescales for responses by DfT and/or Transport Scotland of not more than one month.

B.30. We have to work within the statutory process and allow for the possibility that there could be a significant amount of analysis and consultation to undertake as part of an interim review. However, wherever possible, we will strive to conduct an interim review in the shortest time practicable in order to minimise the period of uncertainty.

### Sequence of events

B.31. The sequence of events for the interim review process is set out in the figure B.1 below. It assumes that there is no iterative process required as a result of a mismatch between the HLOS(s) and SoFA(s).

**Figure B.1: Interim review process – sequence of events with target timescale**



# Abbreviations and acronyms

ADRR	Access Disputes Resolution Rules
AICR	Adjusted Interest Cover Ratio
CP4	Control period 4 (1 April 2009 to 31 March 2014)
CP5	Control period 5 (1 April 2014 to 31 March 2019)
CP6	Control period 6 (1 April 2019 to 31 March 2024)
DfT	Department for Transport
DSLFL	Distribution Systems Loss Factors
EBSM	Efficiency Benefit Sharing Mechanism
EC4T	Electric Current for Traction
ESI	Electricity Supply Industry
ESTA	Electricity Supply Tariff Area
ETCS	European Train Control System
FIM	Financial Indemnity Mechanism
FOC	Freight Operating Company
HLOS	High-level Output Specification
LCs	Network Rail's network licence conditions
LTC	Station Long Term Charge
NGET	National Grid Electricity Transmission
NRIL	Network Rail Infrastructure Limited
NRL	Network Rail Limited
NRT	National Rail Timetable
ORR	Office of Rail Regulation
PR08	The 2008 periodic review (relating to CP4)
PR13	The 2013 periodic review (relating to CP5)
QX	Qualifying expenditure (for stations)
RAB	Regulatory Asset Base
REBS	Route-level Efficiency Benefit Sharing mechanism
RPI	Retail Prices Index
RUSs	Route Utilisation Strategies
SBP	Network Rail's Strategic Business Plan



SISS	Stations Information and Security Systems
SoFA	Statement of Funds Available
SPP	Sustained Poor Performance
The Act	The Railways Act 1993
TOC	Train Operating Company
VUC	Variable Usage Charge

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