Consultation on implementing PR13 – Network Rail's response

4 September 2013

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EXECUTIVE SUMMARY

We welcome the opportunity to respond to ORR's PR13 implementation consultation, published on 12 July. Because of the highly contractualised nature of the industry, it is important that ORR's Final Determination is accurately transposed into track and station access contracts and our network licence.

This submission forms part of our response to ORR's PR13 Draft Determination. In the main part, we do not seek to repeat our response to ORR's PR13 Draft Determination. Instead, we have made key policy observations / comments for any aspects that were not addressed in the Draft Determination or where further detail has been provided by ORR as part of this consultation.

In relation to the proposed changes to track access contracts, the majority of our comments are minor relating to detailed drafting points. We request further clarity in a few instances, particularly with regards to ORR's proposals on the indexation of charges. We also have some concerns with the proposed route-level efficiency benefit share (REBS) drafting and its interaction with alliance agreements that we may enter into with train operators.

However, we are very concerned by some of the proposed licence modifications and we wish to discuss these with ORR at a senior level, before conclusions on PR13 are reached. Our primary concerns are focussed on the changes that ORR has proposed to make to Conditions 3 and 4 of our network licence. These concerns are described below and explained in more detail in Chapter 8 of this document.

Licence Condition 3 – financial indebtedness

We are concerned that there should be sufficient headroom allowed by the debt/RAB limit for CP5. As Network Rail will not be provided with an *ex ante* or 'in year' risk buffer, the balance sheet buffer limit set in the debt/RAB limit will become particularly important. As we have set out in our main response to the Draft Determination, we consider that the debt/RAB limit should be set at five per cent above the level described in the CP5 draft delivery plan, which Network Rail will publish in December 2013. In that document we will set out what borrowing in CP5 will be necessary, which will determine the forecast debt/RAB ratio from 2014 to 2019. Given that it is currently envisaged that the debt/RAB limit will be prescribed within Condition 3 of our network licence, it will be important that ORR does not conclude on the CP5 limit until after we have published our draft CP5 delivery plan.

We would emphasise that we have a strong desire to avoid unnecessary increases in debt (and the RAB). However, in the context of the adjusted Weighted Average Cost of Capital (WACC) approach that ORR will apply in CP5, we continue to believe that there is a need for a useable risk buffer. In the absence of such a facility, there would be no real basis for describing the framework as an output-based regime, given the lack of flexibility that would be available.

In addition, where the regulatory framework provides for efficient spend to be added to the RAB (for example to achieve longer term benefits) there **should not** be an additional requirement to avoid breaching the debt-to-RAB limit. We consider that, if such a requirement was in place, the framework arrangements would discourage driving value for users and taxpayers.

In addition, we strongly consider that Network Rail should be regulated as a single entity in line with its corporate structure and our network licence. We have significant concerns with ORR's proposals to include separate debt/RAB limits in the network licence for England & Wales; and Scotland, which we consider are unnecessary and inappropriate.

Licence Condition 4 – financial ring-fence

In order to generate greater value from railway assets we will need a more flexible regulatory regime in CP5. We urge ORR to carry out a more fundamental review of Network Rail's permitted business and licence conditions in 2014 and consider that the current regulatory obligations concerning '*de minimis* activities' are unduly restrictive.

We strongly consider that ORR's proposed reform of our existing obligations regarding dividend payments are unnecessary and inappropriate, and we request further clarity on the risk that these proposals are seeking to address.

As we have discussed in our response to the Draft Determination, we strongly disagree with ORR's proposal to restrict our use of financial outperformance solely to pay down debt or to fund research and development activities. It is not clear to us what problem ORR is seeking to solve with this proposal. We assume that the purpose would *not* be around financial sustainability since the adjusted WACC approach that ORR will apply in CP5 means that Network Rail is likely to want to use funds to reduce debt at least in the first instance, and regardless of this, it also has a strong incentive to avoid unnecessary increases in debt which is reinforced by the specific licence condition (and by our wider network stewardship obligations). In addition, we would only want to invest, rather than use funds to reduce debt, where it is efficient to do so and delivers value for users and taxpayers consistent with our stated purpose to "*generate outstanding value for customers and users*".

The proposal also appears to be inconsistent with incentive-based regulation and we are concerned that it would have unintended consequences. We strongly consider that the potential for outperformance and Network Rail's ability to have discretion in determining how best to use such outperformance is important. We are very concerned that by removing this, there will be less likelihood of such outperformance being created in the first place or indeed a greater chance of underperformance.

We consider, therefore, that Network Rail is best placed to determine best use of any financial outperformance and ORR's proposed restriction on exactly how any outperformance must be used is unnecessary and inappropriate.

Summary

The rationale for many of the proposed changes to our network licence are not fully explained or justified. Given the significant nature of some of the changes, we would expect ORR to have undertaken a Regulatory Impact Assessment before consulting on many of these proposed changes.

As we have highlighted in our response to the Draft Determination, we are concerned that the proposed regulatory regime for CP5 is more intrusive and complex than is regarded as appropriate in other sectors. We consider that it is counter to our proposed principles for regulation in CP5. It is important that the regime provides the right balance between regulatory oversight and the discretion for Network Rail to operate with the necessary flexibility to deliver our purpose.

As stated earlier, it is important that ORR's Final Determination is accurately reflected in track access contracts and our network licence. This response is publicly available and we encourage train operators and other interested parties to review our positions on each area carefully, particularly in relation to track access contracts.

We would welcome further engagement and discussion with ORR on any of the issues raised in this response, and in particular on the significant concerns we have raised in relation to the proposed network licence modifications.

1. INTRODUCTION

1.1 Network Rail welcomes the opportunity to respond to ORR's consultation on the implementation of PR13, in particular on the proposed changes to track and station access contracts and the network licence in order to implement PR13. We do not consider any part of this response to be confidential.

Structure of this response

1.2 There is a considerable amount of documentation relating to ORR's implementation consultation, including the mark-ups of the model track access contracts for Schedules 4; 7; and 8 (for each type of operator) and the Traction Electricity Rules.

1.3 In responding to this consultation, we have focused on key policy areas / concerns in the main body of the response (which are not already addressed in our response to ORR's PR13 Draft Determination). We have set out proposed mark-ups to the network licence, consistent with the comments we make in Chapter 8, below, in **Annex 1** to this document. We have also proposed detailed track access contract drafting suggestions in **Annex 2 (Section A)** to this document, (**Annex 2 (Section B)** reflects suggested changes to Schedule 7 of the freight and passenger track access contracts and Traction Electricity Rules to reflect suggested changes to terminology).

Other implementation activities

1.4 On 12 July 2013 we published updated draft price lists for CP5, consistent with ORR's Draft Determination[1]. In so doing, however, we noted that we did not necessarily agree with all of ORR's policy proposals set out in its Draft Determination.

1.5 We are grateful to operators that have provided comments on the draft price lists for CP5. This feedback is important and Network Rail will consider it carefully, especially since once the price lists have been finalised as part of the PR13 implementation process, there will not be an opportunity to re-open the price lists until the next access charges review.

1.6 ORR also, on 12 July 2013, wrote to each freight and passenger operator and Network Rail, setting out a list of bespoke provisions (if any) in each track access contract and its view on whether or not they should be retained in CP5. We have been working closely with our customers to form a joint position (where possible), and are in the process of responding to ORR's letters.

[1] Available at: http://www.networkrail.co.uk/publications/delivery-plans/control-period-5/periodic-review-2013/

1.7 In addition, we note the recent publication of ORR's letter to all franchised and open access passenger operators[2] on contingency arrangements in the event that the implementation of PR13 is delayed, and the addition of a provision in passenger track access contracts to provide for this. We are in the process of engaging with our customers to make the necessary changes to contracts, and will conclude this process by 15 October 2013 in line with ORR's requirements.

1.8 Following ORR's recent publication of its draft conclusions on the structure of charges and Schedule 8 performance regime for charter operators published on 23 August 2013[3], we note that ORR intends to consult on implementing these changes to the charter access contract in September 2013. We look forward to further engagement with ORR and charter operators in this regard.

Track access billing system

1.9 While not directly related to ORR's consultation, it is important to note that we have started the necessary development work to facilitate the required changes to our track access billing system (TABS), such that we will be able to bill in accordance with the updated provisions set out in freight and passenger operators' track access contracts, with effect from 1 April 2014.

[2] ORR did not write to freight and charter operators because their contracts would not 'time out' at the end of CP4, and would be uplifted by inflation in the event of a delay.

[3] Available at: http://www.rail-reg.gov.uk/pr13/PDF/charter-operators.pdf

2. ACCESS CHARGES

Summary of ORR proposals

2.1 *ORR sets out the proposed changes to Schedule 7 of passenger and freight operator track access contracts that are required to implement the relevant proposals on track access charges in Chapter 16 of ORR's Draft Determination. The key changes that ORR has proposed in its consultation in relation to track access charges are summarised below.*

General

2.2 *ORR refers to the terminology currently used in Schedule 7 noting, in particular, that the current terminology is out-of-date and can be quite confusing. It has sought views on whether and the extent to which changes to particular terminology could have unintended consequences, for example with respect to freight operators' contracts with their customers.*

2.3 *ORR also highlights that in relation to the capacity charge, its Draft Determination sought views on the Rail Freight Operators' Association's (RFOA) proposals for an alternative approach for calculating the capacity charge for freight operators, and whether this approach should also apply to other operators. It notes that if implemented it would require changes to the relevant section of Schedule 7 and it would consult on this in due course.*

Freight operator track access contracts

2.4 *In addition to providing for the decisions on freight charges that ORR sets out in Chapter 16 of its Draft Determination, the consultation refers to the incremental costs provision in paragraph 2.8 of Schedule 7 and requests clarification from Network Rail on how it thinks the process should work in the future. The provision currently provides for train operators to pay Network Rail incremental costs of up to £300,000 if they were to run a service that would exceed the operating constraints of the network as at 1 April 2001.*

Passenger track access contracts

2.5 *Other than the changes that affect all operators' track access contracts (with the exception of the removal of the 'manifest errors' provision which is discussed, below), there are no specific changes proposed to franchised passenger track access contracts.*

2.6 *ORR notes that currently some open access operators have their access charges set out within their contracts rather than on the relevant price lists for CP5. ORR has set out its expectation that the access charges for their services should be included on the CP5 price lists which would be consistent with the provisions for other train operators.*

New or amended charges during the control period

2.7 *ORR clarifies the proposed process for agreeing new or amended charges (for all operators) during the control period and proposes a more consistent approach between the freight and passenger access contracts, where this is appropriate. This includes the contractual provisions for the default rate that will be applied until a supplement is made to the Track Usage Charge Price List. ORR also includes a new provision to require Network Rail to maintain on its website a list of all supplements to the price lists that have been made.*

2.8 *ORR proposes to remove the 'manifest error' provision in passenger access contracts, which currently allows some track access charges to be corrected during the control period.*

Traction electricity charges

2.9 *In relation to changes to the traction electricity provisions, ORR has published revised versions of Schedule 7 for freight and franchised passenger operators reflecting its decisions as set out in the Draft Determination, and the incorporation of the Traction Electricity Rules (TERs) into track access contracts.*

2.10 *ORR has proposed that a number of provisions are moved from the track access contracts to the TERs, including the volume and cost reconciliations and the definitions of geographic areas (ESTAs). ORR has also questioned whether there would be merit in moving the provisions regarding the procurement of traction electricity in freight and passenger contracts to the TERs.*

2.11 *In relation to the volume reconciliation (referred to in this document as the "volume wash-up"), ORR has proposed changes to the contractual drafting so that metered operators do not participate in the volume wash-up and so that a portion of the volume wash-up is allocated to Network Rail to reflect its "ability to manage transmission losses".*

2.12 *ORR has also proposed new values for the Distribution System Loss Factors (DSLF) and proposes levying these on gross metered consumption rather than metered consumption net of regenerated energy.*

2.13 *ORR is proposing that the Schedule 7s for both passenger and freight operators include contractual drafting to accommodate EC4T charges calculated using metered consumption data. Further to this, ORR proposes that freight EC4T charges are calculated consistent with passenger EC4T charges, with freight operators being charged electricity tariffs set by Network Rail's electricity suppliers instead of by an indexed tariff.*

2.14 *In relation to regenerative braking discounts, ORR has proposed streamlining the process, including a requirement on Network Rail to maintain a list of those train operators receiving the discount and the introduction of auditing arrangements. ORR also proposes provisions to allow operators to opt-in or out for the regenerative braking discounts and provisions to audit regenerative braking systems used.*

2.15 *In relation to the cost reconciliation (referred to in this document as the "cost wash-up"), ORR notes that it has not yet consulted on the corresponding contractual wording that it proposes including in the TERs, stating that this will happen in due course through a separate letter, following the publication of a joint ORR/Network Rail note providing more detail on the proposed cost wash-up arrangements for CP5.*

Network Rail response

2.16 We have made detailed drafting comments and observations on this chapter which are set out in **Annex 2 (Section A)** to this document. In the main part, these are minor in nature, however, where we have substantive policy views / concerns, or are responding to a specific question asked by ORR in its consultation, our views are discussed below.

General

2.17 We strongly support reviewing the current terminology used in Schedule 7 of track access contracts so that it reflects how charges are commonly referred to and avoids unnecessary confusion. On this basis we support ORR's proposals to change references to the "Variable *Track Usage Charge*" in passenger track access contracts and "*Variable Rate*" in freight track access contracts to "*Variable Usage Charge*" (VUC), as this is consistent with how it is commonly referred.

2.18 We note that ORR is particularly interested in views on whether and the extent to which changes to particular terminology would have unintended consequences. We consider that our customers are best placed to respond to this, although based on our extensive VUC consultation process during PR13 we are not aware of any issues that could arise as a result of making this change.

2.19 We also consider that there would be merit in reviewing the terminology used for traction electricity charging. We believe that some of the current terms used can be confusing and could be brought into line, more effectively, with the price lists. For example, the use of the defined term "*train category i*" is inconsistent, and we suggest some amendments to the legal drafting in **Annex 2 (Section B)**. The suggested amendments to the terminology are marked-up against the contractual drafting published alongside ORR's implementation consultation document.

2.20 In the preparation of our final price lists for CP5, which we will publish on or around 20 December 2013, we will continue to work with ORR on reviewing the terminology in the price lists and making sure that it is consistent with the track access contracts.

2.21 We note ORR's comments in relation to the capacity charge proposals for CP5. Following the publication of ORR's Draft Determination, there has been extensive industry engagement on this, and our response to the Draft Determination sets out the Rail Delivery Group's (RDG) agreed proposal on Schedule 8, the capacity charge and the volume incentive for CP5. As identified by ORR, implementation of wash-up arrangements would require a significant review of the current capacity charge drafting in Schedule 7, on which we would engage accordingly.

Freight operator track access contracts

2.22 In relation to the incremental costs provision which is included in Schedule 7 of freight operators' track access contracts, it is important to note that Network Rail and freight operators have regularly used this provision, which in the main part, covers the 'after hours' operation of signal boxes on the network. It enables us to recover the incremental costs associated with opening parts of the network outside published operational hours. We consider that the workings of the mechanism are well understood by our freight customers.

2.23 We do agree that there would be merit in updating the date that is applied to the operating constraints, to reflect that the baseline capability of the network has changed since 1 April 2001. We therefore consider that this should be changed to "*1 April 2014*". Otherwise we consider that the provision is working as intended and that no further change is required.

2.24 We note that ORR has amended the drafting in relation to the coal spillage reduction investment charge such that we are only required to consult operators in relation to rolling-forward the coal spillage reduction fund at the end of the 2013/14 financial year, rather than annually. Whilst we acknowledge that it may be unlikely, if there continued to be money in the investment fund at the end of the 2014/15 financial year it appears we would no longer be required to consult the industry on whether the investment fund should be rolled-forward, which we do not consider to be quite right. To be prudent we suggest retaining the existing drafting which refers to "*each financial year*" rather than the year ending "*1 April 2014*".

Passenger track access contracts

2.25 We note ORR's comments regarding its proposals for open access operators that currently have their access charges set out in their track access contracts rather than on the relevant price lists. Unless there is a reasonable case to justify the continuation of this approach, we agree that it would be preferable to include these operators' charges on the relevant CP5 price lists. We have been discussing the practicalities of this with the relevant operators, in response to ORR's 12 July 2013 letters on bespoke provisions in track access contracts.

New or amended charges during the control period

2.26 We welcome ORR's proposals to clarify the process for agreeing new or amended charges during the control period and we have some detailed drafting comments regarding the revised provisions for supplementing the price lists. In relation to the appropriate timescale for agreeing a supplement, we consider that 45 days should be an achievable timeframe in which to reach agreement, provided the time period starts to run from the point at which we have all the information we need to calculate the rate.

2.27 We welcome ORR's decision to remove the 'manifest errors' provision in franchised passenger access contracts, particularly since during PR13 Network Rail has carried out an extensive stakeholder engagement process, and the publication of draft price lists for CP5 (both in April and July 2013) has given interested parties ample opportunity to provide input and feedback. We consider that the removal of this provision will help to avoid undue administration costs for all parties during CP5. We also note that this proposal is consistent with our VUC conclusions where we proposed 'locking down' VUC rates in CP5.

2.28 We also welcome ORR's Draft Determination on temporary default rates, and consider that the contractual amendments that ORR has proposed are appropriate. We consider that this will provide a strong incentive to operators to get the 'right' VUC rates agreed, improving cost reflectivity.

2.29 In relation to the indexation of the default charge, it is important that the approach is consistent between freight and passenger track access contracts. We note that as currently drafted, the indexation formulae are different, and that the correct one to apply to the default charge is set out in paragraph 2.7 of Schedule 7 in freight track access contracts.

Traction electricity charges

2.30 We note that ORR proposes to make substantial changes to Schedule 7 and to the newly named TERs to reflect the changes that have been made during CP4, primarily to accommodate on-train metering. Electric train operators can opt to have some of their electricity consumption charged based on modelled consumption rates, and some on metered consumption delivered from on-train meters, this results in a complex set of contractual provisions.

2.31 ORR has proposed that the volume wash-up drafting is changed significantly to reflect the fact that metered operators would no longer participate in it, and that Network Rail would be allocated a share of the volume wash-up to reflect "*its ability to manage transmission losses*". We would, however, like to query the volume wash-up formula set out in the TERs. The formula appears to work so that Network Rail's exposure is set to the percentage of losses (as a mark-up), however, we consider this should be imputed so that the percentage exposure is set to losses as a percentage of the total consumption in that ESTA i.e. DSLF/(1 + DSLF). We suggest that the legal drafting in the TERs is updated to reflect this. We would welcome further discussion with ORR on this point.

2.32 Also in relation to the volume wash-up drafting, ORR proposes that the kWh consumption allocated to Network Rail, to reflect its ability to manage transmission losses, is left 'unallocated' in the wash-up i.e. a separate invoice is not raised against itself. This is likely to require a corresponding adjustment in the cost wash-up provisions so that the costs associated with this 'unallocated' consumption are not passed through to other operators. We are discussing this issue with ORR separately.

2.33 In relation to regenerative braking, we note that ORR has suggested provisions to allow modelled operators to opt-in/out for the regenerative braking discount. We would like to clarify that regenerative braking discounts are applicable to modelled operators only because metered operators have separate billing arrangements to cater for their return of power to the network from regenerative braking. We suggest that this is clearly set out in the drafting. Further to this, we would suggest that freight operators also have similar provisions to opt-in/out for the regenerative braking discount.

2.34 In relation to ESTA definitions, we support ORR's proposal to move these to the TERs. We are committed to communicating and consulting on potential changes to ESTA boundaries in CP5 in an open and transparent way. We would, however, like to point out that there may be changes to the definitions set out in Appendix 5 of the TERS, between now and the start of CP5. We therefore suggest that these are reviewed again before ORR serves the PR13 review notices in December 2013.

2.35 We support ORR's proposal to move the provisions relating to the procurement of traction electricity to the new TERs. We consider that this is a sensible proposal as the arrangements are typically multilateral in nature. We also support ORR's proposal for the industry to lead on any changes it wishes to make to these provisions. We consider that ATOC is best placed to lead on any potential changes, given its role in managing the EC4T Scheme Council meetings.

2.36 We are working with ORR to consult on specific changes to the cost wash-up drafting in the TERs.

3. CONTRACTUAL RE-OPENERS AND OTHER PROVISIONS

Summary of ORR proposals

Interim re-openers

3.1 *In this chapter, ORR sets out its proposed changes to track access contracts that would enable it to re-open the price control during CP5 (re-openers), following its proposal in the Draft Determination to retain the following re-openers:*

i. if there is a material change in the circumstances of Network Rail or in relevant financial markets. This re-opener applies to events in England & Wales and Scotland; and
ii. 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.

3.2 *In relation to (i), above, ORR has proposed a slight change in the contractual drafting so that it can be applied on a forward looking basis as well as applied to events that have already happened.*

3.3 *It also sets out the process that it would follow if it decided to re-open the PR13 determination during CP5.*

Grant dilution

3.4 *ORR also sets out the required changes to the grant dilution provision in part 3A of Schedule 7 of passenger track access contracts. The provision has been updated to reflect ORR's Draft Determination on Network Rail's real vanilla weighted average cost of capital (WACC) of 4.31%.*

Rebates

3.5 *In relation to rebates, ORR has amended the relevant provision in paragraph 7, Part 2 of Schedule 7 so that a rebate in respect of one year would be paid the following year (rather than rebates being paid during the year to which they relate). In addition, ORR has proposed an amendment to reflect its Draft Determination that financial outperformance should be used to pay down debt or fund research and development (R&D) to a value specified in its Final Determination, unless it is satisfied that there are exceptional circumstances.*

Network Rail response

Interim re-openers

3.6 Consistent with our response to ORR's Draft Determination on re-openers, we are content with ORR's proposals in this regard. We support the amendment to the contractual drafting on re-openers to provide for material changes in Network Rail's circumstances or in the relevant financial markets that may be likely in the future, in addition to material changes that have already occurred. The clarity on the process for re-opening the price control, as set out in Annex B of ORR's consultation, is helpful.

Grant dilution

3.7 We agree that the grant compensation formula as set out in part 3A of Schedule 7 of passenger track access contracts needs to be updated to reflect the real vanilla WACC that is to be determined by ORR as part of its Final Determination on CP5, in October 2013. It should be noted that as part of our response to ORR's Draft Determination, we have set out our analysis and views on the appropriate value of the WACC in CP5.

Rebates

3.8 Given the changes in the financial framework for CP5, we would expect to focus outperformance primarily on reducing debt or longer term investment in R&D. However, we do not consider that other uses of outperformance should be excluded as a matter of principle by ORR at this stage. Other areas of outperformance could include, for example, reinvestment of civils outperformance in further civils activity and additional expenditure at level crossings. We discuss this in greater detail in our response to changes to Network Rail's network licence, in paragraphs 8.47 to 8.56 of Chapter 8, later in this response.

3.9 As discussed in our response to ORR's Draft Determination, we propose to publish an update of our policy for use of outperformance. We intend doing this before the beginning of CP5.

3.10 We consider, therefore, that ORR's proposed amendment to Part 2 of Schedule 7 (in paragraph 7.3 (c)) to require Network Rail to "*have regard to whether it would be more appropriate to use any available financial resources to repay and financial indebtedness or fund [R&D] to the value specified in the 2013 Final Determinations*" is neither necessary nor appropriate and should be removed.

4. ROUTE-LEVEL EFFICIENCY BENEFIT SHARING

Summary of ORR proposals

4.1 *ORR proposes amendments to freight and passenger access contracts to give effect to the introduction in CP5 of the route-level efficiency benefit share (REBS) mechanism, which will replace the CP4 efficiency benefit share (EBS) mechanism.*

4.2 *ORR sets out the changes it intends to make to the EBS provision (which needs to be retained to reflect the fact that ORR will determine any EBS payments for 2013/14 (i.e. the last year of CP4) during the first year of CP5), as part of its annual efficiency and finance assessment.*

4.3 *ORR sets out how its proposed policy decisions on REBS will be reflected in the Schedule 7 drafting of track access contracts. It also confirms that the route baseline figures for REBS will be published by Network Rail as part of its CP5 Delivery Plan, consistent with the overall England & Wales; and Scotland baselines in ORR's Final Determination.*

4.4 *While the proposed drafting does not make specific reference to the inclusion of alliance performance within REBS payments, ORR confirms that in its annual efficiency and finance assessment of Network Rail, it will set out the effect on REBS payments from Network Rail's material alliance arrangements i.e. 'alliance before REBS'.*

4.5 *ORR also sets out the conditions under which operators are able to opt-out of REBS. ORR proposes that train operators will be able to opt-out of REBS within 2 months of the start of CP5 (i.e. 1 June 2014). In addition, ORR sets out two further situations when train operators will be able to opt-out of REBS during CP5:*

i. within 2 months of operating services on a route on which the train operator did not previously operate whether as a result of entering into a new franchised passenger track access agreement or open access agreement; or
ii. where Network Rail enters into an alliance agreement with another train operator on a route, and ORR determines that this alliance agreement is likely to have a material direct financial impact on other train operators through the potential impact on any future REBS payments.

4.6 *The proposed drafting stipulates that cash payments between Network Rail and operators must be made within 28 days of the publication of ORR's annual efficiency and finance assessment of Network Rail. It also sets out ORR's understanding of the VAT treatment of EBS and REBS payments, in particular to reflect HMRC's November 2012 ruling that any payments under EBS are effectively a standard rated supply by the operators against Network Rail.*

Network Rail position

4.7 We have made a number of drafting comments which are set out in **Annex 2 (Section A)** to this document. In the main part, these are minor in nature, however, where we have substantive views / concerns on policy (which are not covered by our response to the proposals set out in ORR's Draft Determination) we have discussed these, below.

Schedule 7 definition of Alliance Agreements

4.8 We are very concerned by the proposed definition of an "*Alliance Agreement*" in Schedule 7. As currently drafted the definition is very broad[4]. It would include any type of alliance agreement that we enter into with a train operator, regardless of whether or not it directly financially impacts the elements of costs and income that fall within the scope of REBS.

4.9 The implications of the proposed definition of an *"Alliance Agreement*" would be that where we enter into *any* alliance agreement with one or more train operator(s) on (part of) a route, we would be required to notify other train operators participating in REBS[5] on that route. We strongly consider that this would not be proportionate. We enter into a number of alliance agreements and the proposed drafting means that we would be contractually required to notify train operators, although these agreements may have no direct financial impact on REBS, in particular in cases where they include elements of costs and / or income that are not included in the REBS baselines.

4.10 We are strongly of the view, therefore, that the definition of an "*Alliance Agreement*" needs to be revised for the purposes of the REBS drafting in Schedule 7, so that it only captures the type of arrangement that would be likely to have a material direct financial impact on REBS baselines. We propose that the definition should be changed to:

> *"**Material Alliance Agreement**" means a legally binding agreement between Network Rail and one or more train operators establishing an alliance under which the parties agree to share risk and / or reward in respect of activities on a part of the Network and which is likely to have a material direct financial impact on one or more elements of Network Rail's costs or income included within the Route Baseline."*

Notification requirements of entering into a Material Alliance Agreement

4.11 We also consider that the notification provisions for entering into a "*Material Alliance Agreement*" (as defined, above) need to be clarified. We note that on entering into such an arrangement, ORR's proposals would require us to notify secondary train operators on that route and ORR within 14 days. If ORR were then to confirm, in writing, to secondary train operators participating in REBS on the relevant route that the "*Material Alliance Agreement*" would be likely to have a material direct financial impact on Network Rail's performance on that route, those operators would be able to serve an opt-out notice within 2 months of this written communication.

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[4] The proposed Schedule 7 definition of Alliance Agreement is "*an agreement between Network Rail and one or more train operators establishing an alliance in which those parties work jointly to carry out or otherwise share the risk of activities on a part of the network*."

[5] Under paragraph 4.4b of Part 4 (for freight) and paragraph 1.4(b) of Part 3 (for franchised passenger operators) of Schedule 7.

4.12 We would welcome further clarity and guidance from ORR on the information that it would require to perform this assessment. We also consider that it would be helpful for ORR to set out the timescales in which it would expect to conduct this assessment.

4.13 Given that ORR has proposed to provide written confirmation on whether the "*Material Alliance Agreement*" would be likely to have a material direct financial impact on that route in respect of REBS, we do not agree that the requirement on Network Rail to provide "*such information to the Train Operator as the Train operator may reasonably request in order to determine whether to serve an Opt-out Notice, and such information shall be provided within 14 days of the request*" is necessary or consistent with regulatory best practice of proportionality.

4.14 Furthermore, we have significant concerns regarding the confidentiality implications resulting from this provision. As currently drafted, this could place a contractual requirement on Network Rail to disclose details of a "*Material Alliance Agreement*", parts of which may be confidential or otherwise subject to restrictions on disclosure relating to the timing, content and method of disclosure. If this provision is to be retained, at a minimum, it must not put Network Rail under an obligation to disclose details that are subject to legally binding confidentiality obligations, and must not prevent Network Rail from complying with any other restrictions on disclosure in its alliance agreements.

Opt-out provisions

4.15 We consider that the scope of the proposed provisions under which train operators may opt-out of REBS *during* CP5 need to be widened, to provide for a situation in which a train operator who has entered into a "*Material Alliance Agreement*" with Network Rail during CP5 is contractually able to opt-out of the mechanism. This would be consistent with ORR's statement in paragraph 19.9 of the Draft Determination in which it states "*We see REBS as a stepping stone to the development of more commercial relationships within the industry. As our preference is for more commercial relationships, we would be content to see train operators opting out of REBS to pursue their own commercially negotiated risk and reward sharing agreements with Network Rail, provided such agreements were transparent and non-discriminatory*". It is important that track access contracts allow for this.

REBS payment terms

4.16 We are concerned by the proposed requirement for either party to make payments in respect of REBS within 28 days after the date of publication of ORR's annual efficiency and finance assessment, as we do not consider that this is an achievable timescale.

4.17 There are a number of activities that would need to take place in order to issue payments in respect of REBS, following ORR's annual assessment. These include:

- calculating the proportions payable to / by each operator based on their share of variable usage charge income on the route;
- (where payments are due to operators) seeking board approval to make the payments;
- writing to operators to advise them of payments and agreeing bank account details for making the payments;
- issuing invoices in respect of any payments; and
- where an amount is payable by Network Rail, to make the actual bank transfer, we would normally only make one payment run each month.

4.18 On this basis, we strongly consider that the current drafting (in relation to REBS payments) should be amended to "*within 2 months*" which would allow both parties sufficient time to process the payments. At a minimum, we consider that the REBS drafting should reflect the current EBS payment requirements as set out in track access contracts (which stipulates that the payment must be made within 28 days of the end of the period in which it is determined by ORR that such payment should be made). This would also be consistent with ORR's proposed amendment to the payment terms of any rebates payable to train operators, as set out in paragraph 7.6 of Part 2 of Schedule 7.

5. POSSESSIONS AND PERFORMANCE REGIMES

Summary of ORR proposals

5.1 *ORR is proposing changes to Schedules 4 and 8 of the track access contracts, to give effect to its proposals set out in its Draft Determination on the possessions and performance regimes.*

5.2 *In respect of the model Schedule 4 in freight operators' contracts, ORR is proposing to remove the modification provisions which are no longer required. It is also proposing to make a minor amendment to the definition of actual costs that can be claimed for Category 3 disruption.*

5.3 *In relation to the model Schedule 4 in franchised passenger operators' contracts, ORR is proposing to increase the protection provided to franchised passenger operators by paragraph 2.9.Consistent with ORR's Draft Determination, this would allow franchised operators to recover costs incurred in relation to Type 1 possessions cancelled at short notice by Network Rail, where these costs are £5,000 or more.*

5.4 *ORR is also proposing to make some minor changes to the definition of Sustained Planned Disruption (SPD) and some minor corrections to terms contained within the cost compensation and revenue loss formulae – these changes also apply to the model Schedule 4 for open access operators.*

5.5 *ORR is proposing changes to the freight performance regime set out in Schedule 8, in particular to reflect that the bonus payments in CP5 will be set at the same rate as compensation payment rates and that Network Rail will be required to update the freight operator benchmark every year to reflect changes in traffic levels. In addition ORR is proposing to update 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.*

5.6 *In relation to the model Schedule 8 for franchised passenger operators, the main change that ORR is proposing to make is the removal of passenger charter provisions to give effect to the proposal in its Draft Determination. In addition, it is proposing revisions to clarify the process relating to disagreements between Network Rail and the train operator, and some other minor drafting amendments.*

5.7 *ORR notes that in the case of the model Schedule 8 for open access passenger operators, most of the minor differences (compared with the model Schedule 8 for franchised passenger operators) are unnecessary and it proposes, therefore, that open access operators should have substantively the same contractual performance regime as franchised passenger operators (with the exception of the sustained poor performance provisions, which do not apply).*

5.8 *ORR sets out the next steps relating to Schedules 4 and 8 for PR13, in particular finalising the amounts which will be input into the relevant annexes and appendices of the track access contracts.*

5.9 *Finally, in the Schedule 8 provisions for all operators, ORR has included a reopener relating to the introduction of the European Train Control System (ETCS).*

Network Rail position

5.10 In the event that ORR does determine as part of PR13 to provide for compensation for cancelled Type 1 possessions on a claims basis, we consider that ORR's proposed contractual drafting requires amendment. Currently it provides for train operators being entitled to recover "*the costs to which it is committed or which it has already incurred prior to cancellation*". We consider that the term "*costs*" need to be clarified, on the basis that, at a minimum, such costs must be reasonable and evidenced. We set out our proposed drafting amendments in **Annex 2 (Section A)**.

5.11 In relation to changes proposed to the freight Schedule 8 contract, we are unclear as to why ORR has proposed replacing "*2010*" with "*2014*" (rather than '2015') in paragraph 10.2.1[6]. Under ORR's proposal, we believe that the contractual wording would imply that an update to caps could take place immediately following the start of CP5 i.e. in April 2014. We do not believe that this is as ORR or the industry intends, nor do we believe this would be appropriate. Rather, we consider that adjustments to caps should be possible from the second year of CP5, and as such that "*2010*" should be replaced by "*2015*" in paragraph 10.2.1. We also make a small suggestion around the contractual wording of paragraph 10.2.2, which is set out in **Annex 2 (Section A)**.

5.12 We note the other changes proposed by ORR to Schedules 4 and 8 of the track access contracts and have proposed some further minor drafting amendments in **Annex 2 (Section A)**.

[6] We understand why ORR proposes changing 2009 to 2013 in paragraph 10.2.3 (a), and support the change to the base year.

6. STATION ACCESS AGREEMENTS

Summary of ORR proposals

6.1 *ORR sets out the required changes to the National Station Access Conditions (NSACs) and Independent Station Access Conditions (ISACs) for franchised and managed stations respectively, to give effect to ORR's Draft Determination on station long term charges (LTC).*

6.2 *ORR has proposed to update the indexation formulae relating to the LTC in both sets of station access conditions, consistent with its proposals on indexation in general, which are further discussed in Chapter 7 of this document.*

6.3 *The only other substantive change required is to the equipment inventory in Annex 1 to the ISACs, to reflect ORR's Draft Determination that Stations Information Security Systems (SISS) maintenance; renewals; and repair expenditure will be recovered by the LTC in CP5. To date, the maintenance element of SISS expenditure at managed stations has been recovered through the Qualifying Expenditure (QX) charge which is reflected in the equipment inventory for each managed station.*

Network Rail position

6.4 We agree with ORR's proposed changes to the relevant parts of the equipment inventory and have no further comment to make in this regard.

6.5 We address ORR's indexation proposals for access charges and incentive rates, in Chapter 7, below. While ORR references the parts of the NSACs and ISACs that would require amendment to give effect to ORR's indexation proposals in CP5, it would be helpful for ORR to clarify the exact changes that would be required to both documents to enable this change, consistent with its approach for proposing amendments to track access contracts.

6.6 We have reviewed the indexation provisions relating to other station charges (qualifying expenditure; stations lease and facility charges) and do not consider that ORR's proposals for LTC indexation impact these, although we would welcome confirmation from ORR on this matter.

7. INDEXATION

Summary of ORR proposals

7.1 *In its consultation ORR proposes two key changes to the current approach to uplifting access charges and incentive rates:*

i. Using a consistent approach, based on the change in calendar year annual average RPI (i.e. the methodology currently used to uplift freight access charges), for all operators; and

ii. Introducing a 'true-up' mechanism. A 'true-up' mechanism would adjust for any variance between the RPI uplift applied to charges and incentive rates in a given year (which ORR proposes is based on the change in annual average RPI in the previous year) and outturn RPI in that year. It would do this by making an adjustment to the RPI uplift factor applied to charges in the following year.

7.2 *ORR will also decide, when it publishes its Regulatory Accounting Guidelines in December 2013, whether for consistency it should also use the change in calendar year annual average RPI to adjust values in our Regulatory Accounts.*

Network Rail response

7.3 We welcome the fresh thinking from ORR in relation to the indexation methodology for CP5.

7.4 How we uplift price lists from the price base in the Final Determination (2012/13 prices) to the price base in year one of CP5 (2014/15 prices), and annually in CP5, is important as it will have a material impact on the income that we receive during the control period. Assuming an annual gross revenue requirement of £6.7bn, a 1% 'mismatch' between forecast and outturn inflation would result in a difference of £67m per annum, or £335m over CP5.

7.5 As set out in ORR's consultation, a weakness of the current approach is that inflation in the year preceding the start of the control period is used twice. As ORR will be aware, in PR08 the 2008/09 RPI value that would have been used twice was forecast to be, and turned out to be, very low – outturn RPI was 0.28%. However, as part of PR08, it was agreed that it would unduly penalise Network Rail if this very low RPI value was applied twice when uplifting charges. Therefore, instead of double counting this low RPI value, a forecast of average RPI over CP4 (2.43%) was used when uplifting the price base in the Final Determination. We estimate that this amendment resulted in approximately £650m (cash prices) additional income in CP4 relative to what we would have received under the approach applied historically. However, we also estimate that this is approximately £140m less than we should have received looking back now with 'perfect information'[7].

[7] In the 'perfect information' scenario we have used a forecast of 2013/14 inflation because an outturn figure is not available.

7.6 We respond to ORR's proposals to (i) use a consistent approach to index charges and (ii) introduce a 'true-up' mechanism for CP5 in turn, below.

7.7 The detail of these proposals is important. Therefore, if ORR were to proceed with them we would welcome further discussion on the detail of these methodologies prior to its Final Determination. We consider that this is particularly important given the materiality of the issues.

Using a consistent approach

7.8 We support ORR's proposal to use a consistent approach based on the change in calendar year annual average RPI (i.e. the methodology currently used to uplift freight access charges) for all operators when adjusting charges and incentive rates.

7.9 We agree with ORR that moving to an annual average approach should result in less volatile RPI values, therefore, reducing our exposure to exogenous inflation risk and potential windfall gains / losses. It should also be less volatile for our customers in terms of the charges they pay for use of our infrastructure. It should also be more cost reflective resulting in closer alignment between our nominal costs and nominal revenue. In addition, it would be simpler to understand and administer and eliminate the current inconsistency between how passenger and freight track access charges; station long term charges; and incentive rates are uplifted each year.

7.10 Although it is not clear from ORR's consultation document, we understand that ORR's intention is that its proposal would also apply to the Network Grant income received in lieu of the Fixed Track Access Charges (FTAC). We ask that ORR confirms that this is the case as soon as possible.

7.11 Network Grant income constitutes our largest revenue stream and if the proposed approach were to exclude this we consider that it would seriously undermine ORR's proposals and not appropriately reduce our exposure to exogenous inflation risk.

7.12 We agree with ORR that for the purposes of our Regulatory Accounts, in order to ensure consistency, there would be merit in using an annual average approach instead of using a November to November adjustment.

7.13 If this proposal were to be implemented, we would welcome further discussion with ORR, prior to its Final Determination, to confirm how it intends to 'switch' from using a November to November RPI adjustment to using an annual average one. This is not explicitly set out in ORR's consultation document and we would not want to be unduly penalised in any transition from one methodology to another.

Introducing a 'true-up' mechanism

7.14 We welcome the fresh thinking from ORR in relation to introducing a 'true-up' mechanism for CP5. As noted above, how we uplift charges and incentive rates is important and has a material impact on the income that we receive during the control period.

7.15 Following analysis of various inflation scenarios, we consider that the 'true-up' mechanism proposed by ORR would typically result in closer alignment between our nominal costs and nominal revenue, over a control period. It follows, therefore, that it would also reduce our exposure to exogenous inflation risk and potential windfall gains / losses from the current 'approximate' approach. This improvement in cost reflectivity is intuitive given that under the approach applied historically, if the inflation forecast that ORR uses to uplift prices from the Final Determination, and then each year during the control period, turns out to be materially wrong there would be no retrospective adjustment / 'true-up'.

7.16 On the basis that the proposed 'true-up' methodology would be more cost reflective and better mitigate exogenous inflation risk, we support it being introduced for CP5. We consider introducing a 'true-up' for CP5 would be particularly appropriate given the current uncertainty in relation to future inflation levels, because of the recent turbulence in financial markets and the use of quantitative easing.

7.17 There are, however, some elements of the proposed 'true-up' methodology where we require further clarification from ORR because these are not explicitly addressed in the consultation. In particular, we request clarification, prior to the Final Determination, in relation to the following:

- how the 'true-up' for the last year of the control period will be reflected in the next control period;
- the methodology for uplifting from the price base in the Final Determination to that in the first year of the control period (the example provided in the consultation document does not start with the price base in the PR08 Final Determination); and
- the methodology for forecasting the December 2013 RPI value which will not be available in time for the publication of the CP5 price list.

7.18 Recognising the fact that the proposed 'true-up' approach is not perfect (e.g. because our revenue requirement is not constant over time and thus the 'true-up' in the following year would not apply to the same level of charges), we consider that there would be merit in adopting a simple and pragmatic approach, where it is reasonable to do so, in respect of these issues.

7.19 Moreover, although we understand why it is necessary for ORR to forecast December 2013 RPI for the purposes of uplifting values in its Final Determination, we do not consider that it would be necessary, or appropriate, to forecast December RPI values when uplifting charges and incentive rates during the control period. We consider that a better approach would be to uplift rates in CP5 based on the outturn December RPI value, which is published in mid-January, well in advance of the new access charge rates coming into effect in April. This approach is currently adopted in relation to freight charges. From a theoretical perspective, if a forecast December RPI value were to be used during the control period, this would be contrary to the aim of the 'true-up' which is designed to correct for actual outturn values.

7.20 As noted above, although it is not clear from the consultation document, we understand that ORR's intention is that the 'true-up' methodology would also apply to Network Grant income that we receive in lieu of FTAC. We ask that ORR confirms that this is the case as soon as possible. Network Grant income constitutes our largest revenue stream and if the 'true-up' methodology were to exclude this, it would seriously undermine ORR's proposals and not appropriately reduce our exposure to exogenous inflation risk.

7.21 When ORR presented its indexation proposals to industry, at the regular Variable Track Access Charges meeting, we note that operators expressed concern in relation to the complexity of the 'true-up' mechanism and the potential for it to result in more volatile annual indexation factors. Whilst we have sympathy for the concerns expressed by operators, we consider that the benefits of increased cost reflectivity and reduced exposure to inflation risk outweigh any increase in complexity, which we consider to be small. We also note that RPI in CP4 has been particularly volatile, including a period of deflation, and typically one would expect RPI to be more 'steady' and thus annual indexation factors to be less volatile than would be the case if the 'true-up' methodology was applied in CP4.

7.22 We also believe that the illustrative example provided in ORR's consultation document setting out how the indexation factor for 2015/16 would be calculated is incorrect, specifically the indexation factor of 1.34. This is because ORR has used the percentage change in RPI values as inputs, rather than the 'raw numbers' published by the Office of National Statistics (ONS). This is a good example of the potential 'pitfalls' associated with specifying the details of the revised indexation methodology. We reiterate that we would welcome further discussion with ORR, prior to the Final Determination, in relation to the clarification points set out, above, and the detail of these proposed changes more generally. We consider that further discussion is particularly appropriate given the materiality of the issue.

7.23 If ORR is minded not to proceed with its proposal to introduce a 'true-up' mechanism, we strongly consider that it would be appropriate for ORR and Network Rail to have an early discussion in relation to how prices are uplifted from the price base in the Final Determination to the price base in the first year of the control period. We note that this was a material issue in PR08 and we consider that there would be considerable merit in discussing the methodology for uplifting prices at the earliest possible opportunity.

7.24 Finally, we note that paragraph 2.7.2 in Schedule 7 of the freight track access contract specifies that the adjustment factor applied each year should be rounded to three decimals. We consider that clarity in the contract in relation to this detailed point would be very helpful and should avoid charges and incentive rates being uplifted on an inconsistent basis due to different rounding assumptions. We propose, therefore, that ORR clarifies in both the passenger and freight track access contracts that all adjustment factors should be "rounded to three decimal places.

8. CHANGES TO NETWORK RAIL'S LICENCE

Summary of ORR proposals

8.1 *ORR sets out the changes it would need to make to Network Rail's network licence to give effect to its Draft Determination. It also proposes making some other amendments to update and improve the network licence's effectiveness. In both cases, it sets out the ways in which it is able to make the proposed licence changes.*

8.2 *A number of changes are proposed to various licence conditions (LC). These are summarised below:*

- ***LC1 Network management:*** *ORR proposes changes to make this LC more flexible and allow ORR and Network Rail to respond to different conditions over time. This includes the proposal to replace references to "Route Utilisation Strategies" to "long term plans" throughout the licence.*

- ***LC2 Information for passengers:*** *In relation to the obligations on Network Rail to publish or procure publication of the National Rail Timetable (NRT), while noting Network Rail's current consideration of the changes to this process that it wishes to make, ORR states that as matters stand, it does not propose to make any changes to this LC at this time.*

- ***LC3 Financial indebtedness:*** *ORR has proposed changes to this LC to give effect to the relevant aspects of its Draft Determination on the financial framework, in particular separate terms for England & Wales and Scotland; and the level of financial indebtedness and the financial indemnity mechanism (FIM) fee in CP5, that are both specified in LC3.*

- ***LC4 Financial ring-fence:*** *ORR has proposed revising the section on payment of dividends to clarify the circumstances under which we must issue a certificate to ORR and seek its consent. It has also clarified the timescales under which the licence holder must satisfy itself that it will not be in breach of its licence obligations (previously the LC had stated "future" which could imply an indefinite amount of time). Consistent with the changes it has proposed to track access contracts (discussed in paragraph 3.5 of Chapter 3, above), ORR is also proposing to include a specific section in LC4 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 situation.*

- ***LC5 Interests in rolling stock and train operators:*** *ORR has proposed introducing a general consent to allow Network Rail to enter into certain types of arrangements with other parties that would otherwise require specific ORR consent. ORR has also suggested that the LC is renamed to "interests in railway vehicles".*

- ***LC7 Land disposal:*** *ORR is proposing to reduce the current time limits under which we must provide prior notice of an intended disposal of land from "3 months" to "2 months".*

- ***LC8 Stakeholder relationships:*** *ORR is proposing to update references to stakeholder groups so that they are up-to-date.*

- ***LC12 Annual and periodic returns:*** *ORR has proposed clarifying arrangements for Network Rail's preparation and provision of annual and periodic returns to ORR, as well as the publication requirements.*

- ***LC15 Governance:*** *ORR has proposed clarifying what 'good' corporate governance means for Network Rail, consistent with wider developments in this field.*

- ***LC17 Financial Information:*** *On the basis that LC15 is modified in line with ORR's proposals, ORR considers that it should delete LC17 to avoid duplication.*

- ***LC24 Systems code:*** *ORR has proposed deleting this condition.*

- ***Schedule: revocation:*** *ORR proposes to delete this clause after consultation with the Department for Transport and Network Rail.*

Network Rail response

8.3 For clarity we have set out our comments by licence condition. **Annex 1** is also provided which contains a more detailed mark-up of ORR's proposed network licence modifications.

Interpretation

8.4 At paragraphs 8.10 – 8.11 of its consultation, ORR sets out a proposal to simplify the wording around consents making it clearer that any consent may be 'general' or 'specific'. ORR also proposes to amend LC20 to make clear that ORR's general approval for third party liability arrangements is itself a 'consent'.

8.5 We welcome the proposal to clarify that consent can be issued by ORR on a specific case by case basis or by way of a general consent and we support ORR's proposal to amend LC20.

Licence Condition 1 (LC1) Network management

8.6 At paragraphs 8.12 – 8.18 of its consultation, ORR proposes changes to LC1 concerning Network Rail's accountabilities in terms of planning the future of the railway.

8.7 As noted by ORR, RUSs have been the industry's main planning tool for several years and have been one of the key ways in which Network Rail has discharged its obligation to plan the future capability of the national rail network. RUSs have also been successful in showing the value of investment in rail improvement schemes to funders and customers.

8.8 Many of the RUSs that have been produced to date have focused on taking a ten year view on how to make the best use of existing capacity, with some incremental changes and some longer term scenario planning. More recently we have developed the process to take a longer term view (up to 30 years)

about the likely future demand to use Britain's railways. This reflects the long 'gestation period' of some railway projects.

8.9 We recognise that the changes ORR has proposed to LC1 of our network licence are designed to reflect the long-term planning process that Network Rail has now adopted which consists of market studies, route studies and cross-boundary analysis. We welcome ORR's confirmation that it does not intend to 'micromanage' Network Rail's development of a long-term plan or governance of the process.

8.10 We therefore have no objections to the modifications that ORR has proposed to LC1. However, in order to help external stakeholders understand that Network Rail's role is to plan the future capability of the national rail network, we believe that it would be helpful to clarify that references to the "*long term planning process*" include the production of RUSs, which is now a well understood industry term. This would clarify that the changes that ORR is proposing to make to our network licence do not represent a change to our role or the scope of regulation. With this in mind we would suggest that LC1.6(b) is reworded to read *"those associated with or arising from the long term plans (including Route Utilisation Strategies) referred to in condition 1.14*".

Licence Condition 2 (LC2) Information for passengers

8.11 At paragraphs 8.19 – 8.22 of its consultation, ORR sets out our previous discussions regarding publication of the National Rail Timetable (NRT).

8.12 We have been monitoring public demand for the printed NRT over the last few years. It is evident that an overwhelming majority of passengers now use real time journey planning information to plan their journeys as opposed to printed information which can be subject to change. Readership of the printed NRT has, therefore, fallen dramatically in recent years.

8.13 In contrast there has been an increasing demand to make timetable information available in 'raw data' format to train operators and to other parties (including electronic application developers) on a daily basis, to facilitate the development and innovation of electronic journey planning applications. Network Rail is very supportive of providing such 'raw data' to interested parties. These applications provide consumers with free, real time travel information which can be accessed on a number of portable electronic devices including smart phones and tablets.

8.14 In light of the changes to the way in which consumers access and use information, we plan to cease production of the electronic NRT in its current form (which is then used by publishers to produce the hard copy version of the NRT). Instead we propose, subject to stakeholder consultation, to trial the provision of national rail timetable data in a spreadsheet format on our website. We also intend to continue making 'raw data' available to relevant interested parties.

8.15 We agree, therefore, that no changes to LC2 are required at this time.

Licence Condition 3 (LC3) – financial indebtedness

8.16 At paragraphs 8.23 – 8.27 of its consultation ORR sets out its proposal to amend LC3 to include separate permitted levels of financial indebtedness for England & Wales and Scotland. We further note that ORR proposes a debt/RAB limit set between 70 – 75 per cent, with the precise levels of the limits to be concluded in the Final Determination.

8.17 As we have set out in our main response to the Draft Determination, we consider that the debt/RAB limit should be set at five per cent above the level described in the CP5 draft delivery plan, which Network Rail will publish in December 2013. In this document we will set out what borrowing in CP5 will be necessary, which will determine the forecast debt/RAB ratio from 2014 to 2019. Given that it is currently envisaged that the debt/RAB limit will be prescribed within Condition 3 of our network licence, it will be important that ORR does not conclude on the CP5 limit until after we have published our draft CP5 delivery plan.

8.18 We would emphasise that we have a strong desire to avoid unnecessary increases to our total level of debt. However, in the context of the adjusted WACC approach that ORR will apply in CP5, we continue to believe that there is a need for a useable risk buffer. In the absence of such a facility, there would be no real basis for describing the framework as an output-based regime, given the lack of flexibility that would be available.

8.19 In addition, where the regulatory framework provides for efficient spend to be added to the RAB (for example to achieve longer term benefits) there should not be an additional requirement to avoid breaching the debt-to-RAB limit. We consider that, if such a requirement was in place, the framework arrangements would discourage driving value for users and taxpayers.

8.20 Whilst we note ORR's aim to improve the disaggregation of the price control, we believe that Network Rail should be regulated as a single entity in line with its corporate structure and our network licence – which is granted to Network Rail Infrastructure Limited as a single organisation.

8.21 We consider it could be seriously detrimental to Network Rail to have to manage our financial risk profile based on devolved government administrations, the ongoing nature of which is beyond Network Rail's control. This is particularly the case given that a referendum of the Scottish electorate, on the issue of independence from the United Kingdom will be held in September 2014, the outcome of which is unknown.

8.22 Network Rail uses its FIM to raise debt as a single entity. We do not raise debt based on devolved government administrations. The proposed changes to our network licence suggest that ORR's current thinking is that the debt/RAB limits for England & Wales and Scotland will be set at the same level. Therefore, the actual regulatory benefit of ORR's proposed changes is unclear.

8.23 Whilst we note ORR's comment that the proposed change seeks to *"improve the disaggregation of Network Rail's price control"* we do not understand what risk ORR is seeking to remedy through this proposed modification. This is particularly the case given that during CP4 Network Rail has, and will continue to report our debt/RAB ratios based on devolved government administrations. We therefore consider that it is unnecessary and inappropriate to establish separate debt/RAB limits for England & Wales and Scotland and that a single national limit should be maintained in CP5.

8.24 Notwithstanding the above comments, we agree that there is a necessity to amend the existing wording of LC3.1 (and particularly Table 3.1) which currently only applies to CP4 and is silent about what happens after the conclusion of the current control period.

8.25 ORR has proposed to amend LC3.1 such that the upper maximum of Network Rail's debt/RAB limit in the final year of CP5 should apply to 'each subsequent year'.

8.26 We suggest that it would be more appropriate to amend this wording so that the debt/RAB limit will remain at (X) per cent "*in 2018/19 and each subsequent year unless ORR determines a different limit following consultation with the licence holder*". Whilst this represents a small modification we believe that this would give ORR greater flexibility to propose different debt/RAB limits in the future without having to formally agree amendments to our network licence which can take considerable time.

8.27 At paragraph 8.26 of the consultation, ORR refers to the planned changes to the fee that Network Rail pays for the financial indemnity provided by the UK government as set out in its Draft Determination, and proposes to update LC3.5 to reflect this change. Network Rail is content with this modification.

Licence Condition 4 (LC4) – Financial ring-fence

8.28 At paragraphs 8.28 – 8.35, ORR sets out its proposed reforms to LC4 of our network licence including changes to the existing arrangements for payments of dividends and proposed new arrangements regarding outperformance payments to governments. For clarity, we have set out our response to each of these matters under separate headings below. We also comment on the 'permitted business' obligations more generally.

Permitted Business

8.29 At paragraph 8.29 of its consultation, ORR concludes that it does not need to make any changes to the financial ring-fence except where drafting can be improved or simplified.

8.30 To date, the financial ring fence has not prevented Network Rail from fulfilling its purpose, role and vision. However, in order to both exploit opportunities that benefit taxpayers and respond effectively to the agenda of our principal funders, we believe that the regulatory regime must be open to evolution as Network Rail demonstrates greater responsibility, transparency and accountability. We believe that a more fundamental review of Network Rail's permitted business and '*de minimis'* licence conditions should be undertaken. As a starting point we consider that certain 'core' Network Rail activities should be reclassified.

8.31 By way of example, in order to achieve the very challenging property income targets that are set out in ORR's Draft Determination (as well as maximising revenues from our existing property portfolio), significant investment will be required in order to grow our long-term single till income. We are also considering how our telecoms and energy business activities might be commercialised so as to grow our revenue streams and in turn reduce our reliance on taxpayer subsidy. We recognise that we will need to ensure that any such activities do not overly distract Network Rail from its core business functions and present an acceptable level of risk and reward to Network Rail and our funders.

8.32 We believe that our current regulatory obligations concerning '*de minimis*' activities are also unduly prescriptive, difficult to understand and give ORR unnecessary powers of 'veto'. We consider that ORR should commit to undertaking a more detailed review of our existing ring-fence obligation early in CP5. We would be very happy to work with ORR on such a review.

LC4 Payment of dividends

8.33 At paragraphs 8.30 – 8.33 of its consultation ORR sets out its proposals to reform our existing obligations regarding dividend payments. The need to obtain ORR's consent is now proposed in addition, rather than (as previously) as an alternative, to the requirement for a compliance certificate.

8.34 We consider many of ORR's proposed changes to this aspect of our network licence to be unnecessary and inappropriate, particularly in light of previous discussions with ORR pertaining to the Network Rail Infrastructure Limited dividend payment to Network Rail (Holdco) Limited earlier this year. We consider the changes proposed by ORR to be disproportionate, particularly as it has not in any way described the risk that the proposed changes are seeking to address.

8.35 As ORR will be aware, Network Rail considered that it was unable to sign the certificate in the form that is currently prescribed in LC4.30 as it contains an open ended statement (which is not time limited) requiring Network Rail to confirm that making the dividend will not impair Network Rail's ability to finance its permitted business. As a result we had to seek ORR's agreement to amend the prescribed form of wording as set out in the certificate, which in turn meant that ORR's consent was required in order to make the dividend payment.

8.36 However, if an acceptable form of wording of any compliance certificate can be agreed (as was the case earlier this year) and implemented into our licence, we do not understand why a further consent requirement (bolstered by the addition of a new element giving ORR discretion to require Network Rail to provide any further information that it may reasonably require) should be imposed on the process. The 'double-lock' requirement of certification and consent implies that even if a certificate were to be compliant, consent might still be withheld. However, neither criteria nor factors have been specified for ORR to consider when assessing whether to grant consent.

8.37 We suggest that the double-lock requirement is deleted as this seems to be unnecessary. However, if it is to be retained, either the basis for withholding consent should be spelt out, or the consent linked directly to the provision of a compliant certificate.

8.38 Within the specific drafting of the revised LC4 obligation, ORR has, at LC4.33(a)(ii), proposed a time limitation that making the dividend will not cause the licence holder to breach its obligations, as set out under LC4 and LC11 for the remainder of the control period or for the next three financial years (whichever is the longer). We do not consider that it is practically possible to confirm satisfaction to these extended timeframes. Thus, the drafting that has been proposed by ORR seems to be practically unworkable.

8.39 The directors of Network Rail are, like all directors of companies, under a duty to act in the best interests of the organisation. They have to act prudently and with due regard to the company's future revenue requirements and to the present and future solvency of Network Rail. This requirement does not have a fixed time horizon. It is not disputed that Network Rail's Board should consider the organisation's future financial position having regard to budget and business plans when deciding whether it is appropriate to propose a dividend. Provided that they act with reasonable care and diligence they should discharge their duties in this regard. However, it would be reasonable and customary for any certification in relation to such financial matters to have a fixed time horizon (and one that is reasonably foreseeable).

8.40 ORR's proposed regime for the approval of distributions goes beyond what a conventional public limited company would have to take into account, in particular the requirement to consider the effect of the distribution on Network Rail's position for the remainder of the relevant control period or for the next three full financial years (whichever is the longer). By way of comparison, in the water industry, it has been acceptable to Ofwat since at least 2003 for distributions to be conditioned on a 12 month forward looking basis.

8.41 The balance of a control period could be up to five years, and three years could straddle two control periods. In these circumstances, it would be impossible for Network Rail's Board to 'second-guess' a future regulatory settlement, and if this remained the relevant criterion, the Network Rail Board would be incapable of compliant certification, and therefore of making a distribution. This is not an acceptable position in that it would impose an obligation on the licence holder with which it would be impossible for it to comply. We consider this to be inappropriate.

8.42 In paragraph 8.33 of the consultation, ORR recognises the need to achieve a viable regime. We consider that twelve months from the date of declaration is more appropriate than ORR's current proposal as this provides a more reasonable indication of market expectation and would be consistent with conventional regulatory best practice. Twelve months is also consistent with the mandatory period for the statement of sufficiency of resources pursuant to LC11.6. It is also the period required for the statement required in prospectuses concerning the sufficiency of the issuer's working capital and for solvency declarations under the Companies Act 2006 for the reduction of capital of private companies without sanction of the court. Furthermore, we believe twelve months should be sufficient for ORR in the context of Network Rail's general obligations under Licence Condition 15.1.

8.43 In addition, as under the existing LC4, ORR proposes to retain the drafting in LC4.33(iii) that "*such payment of dividend or making of distribution, redemption or repurchase will **not** [emphasis added] impair the ability of the licence holder to finance the Permitted Business*". As was highlighted to ORR earlier in the year, the directors of the licence holder are unable to sign a certificate that requires confirmation of satisfaction to such a high and open ended degree.

8.44 As ORR acknowledges "*the future could imply an indefinite period of time*" with respect to the effect of the distribution on the efficiency of Network Rail's Permitted Business. Therefore, there is no obvious logic for retaining this indefinite reference period with respect to the effect of the distribution on Network Rail's financing of such Permitted Business. Accordingly, we suggest the same twelve month reference period as outlined, above, should apply.

8.45 The current wording of LC4 stipulates that provided a recommended distribution is made within 6 months of the date of certification, no fresh certification is required at the point in time the distribution is actually made. The proposed new condition removes this provision without any obvious rationale. Therefore, we suggest the existing wording should be retained.

8.46 In the certificate that was issued to ORR in February 2013 concerning the Network Rail Holdco Limited dividend payment, we included an additional paragraph of text which confirmed that in approving the making of the dividend, the directors of the licence holder had regard to ORR's duties as set out in the Railways Act 1993 and in particular ORR's duty not to render it unduly difficult for persons who are holders of network licences to finance any activities or proposed activities of theirs in relation to which ORR has functions. The certificate also stated that the statement was made on the basis that the outcome of the current access charges review would not render it unduly difficult for the licence holder to carry on the activities authorised by its network licence. We believe that it may be appropriate for ORR to assess whether this form of wording would be more acceptable. However, we recognise that Network Rail cannot, in general terms, condition its compliance with its own obligations, upon compliance by third parties, with their statutory obligations. As such, this matter is likely to require more detailed consideration.

Payment of financial outperformance to the governments

8.47 At paragraphs 8.34 – 8.35 of its consultation, ORR outlines its belief that financial outperformance should be used to pay down debt or fund research and development before payments to governments are considered.

8.48 ORR had previously indicated that it intended to review the regulatory arrangements regarding the payment of financial outperformance to governments. We note that ORR is also proposing similar changes to the track access contract to make discretionary rebates to train operators possible only in exceptional circumstances after we have first considered using any financial outperformance to pay down debt or fund research and development.

8.49 As we have discussed in our response to the Draft Determination, we strongly disagree with ORR's proposal to restrict our use of financial outperformance solely to pay down debt or to fund research and development activities. It is not clear to us what problem ORR is seeking to solve with this proposal. We assume that the purpose would *not* be around financial sustainability since the adjusted WACC approach that ORR will apply in CP5 means that Network Rail is likely to want to use funds to reduce debt at least in the first instance, and regardless of this, it also has a strong incentive to avoid unnecessary increases in debt which is reinforced by the specific licence condition. In addition, we would only want to invest, rather than use funds to reduce debt, where it is efficient to do so and delivers value for users and taxpayers consistent with our stated purpose to "*generate outstanding value for customers and users*".

8.50 The proposal also appears to be inconsistent with incentive-based regulation and we are concerned that it would have unintended consequences. We strongly consider that the potential for outperformance and the ability of the company to have discretion in determining how best to use such outperformance is important. We are very concerned that by removing this, there will be less likelihood of such outperformance being created in the first place or indeed a greater chance of underperformance.

8.51 As highlighted at paragraph 3.9 of this response, we propose to publish an update of our policy for use of outperformance before the beginning of CP5. Given the changes in the financial framework for CP5 we might expect to focus outperformance primarily on reducing debt or longer term investment in R&D. However, we do not believe that other uses of outperformance should be excluded as a matter of principle by ORR at this stage and that it is inappropriate to constrain the use of any financial outperformance in this way.

8.52 By way of example, other areas where it could be appropriate to reinvest any financial outperformance include civils activity, additional expenditure at level crossings or the delivery of additional enhancements that fall outside those defined in the periodic review.

8.53 Consistent with our overall network stewardship obligation in LC1, we believe that it is for Network Rail to determine how best to reinvest any financial outperformance. ORR's proposed restriction on exactly how any outperformance must be used is disproportionate, particularly as ORR has not fully explained the rationale for its proposal.

8.54 Notwithstanding that it appears to be ORR's view that such payments should be limited to exceptional circumstances, the model track access contract currently entitles Network Rail (subject to the approval of ORR) to rebate charges to operators in circumstances where Network Rail has achieved efficiency savings. Given that the track access contract is Network Rail's key customer contract and constitutes ORR's approved instrument for contracting Network Rail's core business, it appears to provide an established and legally sound basis for payment of future efficiency rebates. To this extent, the existing contractual rebate mechanism appears adequate and the proposed new condition regarding payments direct to funders is unnecessary.

8.55 Separately, it is noted that the term *"funders"* in ORR's proposed LC4 drafting is not specified and could be misinterpreted given that "*funder*" is a defined term in Part II of the licence. For the avoidance of doubt and notwithstanding the comments raised above, we believe that the proposed drafting in LC4 should be reworked such that it is made clear that "*funders*", in this context, is referring to the Department for Transport and Transport Scotland.

8.56 In relation to the specific wording of the certificate that ORR has proposed, we would make the same point as raised above regarding dividend payments. We do not consider that it is practically possible to confirm satisfaction to the extended timeframes that the draft licence condition proposes. It is unlikely that Network Rail as licence holder could ever issue a certificate in the form that ORR's drafting requires. We consider, therefore, that a twelve month certification period should be used.

Licence Condition 5 (LC5) Interests in rolling stock and train operators

8.57 At paragraphs 8.36 – 8.41 ORR sets out its proposal to modify LC5 which concerns interests in rolling stock and train operators. ORR specifically outlines its proposal 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. We welcome ORR's proposals in this regard.

8.58 During the course of CP4 Network Rail has sought a number of consents from ORR to enable the hiring out of Network Rail owned railway vehicles in response to requests from third parties, where these vehicles were not required for a period of time, to carry out our Permitted Business activities. We agree that these arrangements do not raise vertical integration issues and do not affect Network Rail's core business and focus.

8.59 Due to the unpredictable nature of third party activities, these requests have often been received at short notice. As a consequence, we have frequently had to turn down such requests given the need to first secure ORR's prior consent even though we might have otherwise been able to satisfy these requests without detriment to our business activities.

8.60 In circumstances where we have sought ORR's specific consent, we agree that the administration relating to each application is burdensome and disproportionate. We have been working with ORR to develop the terms of an appropriate general consent which should enable a positive reduction in the overall burden of regulation.

Licence Condition 7 (LC7) Land disposal

8.61 At paragraphs 8.42 – 8.45 of it consultation, ORR sets out its proposed amendments to LC7, in particular the proposal to reduce the time that ORR is afforded to consider applications to dispose of land from three months to two months. We consider this to be a positive step for the disposal process and welcome ORR's proposal to make this change to our licence. We recognise that this reduction will mean that the onus will be on Network Rail to produce applications of an appropriate quality such that ORR can reach its conclusion in a shorter time period.

8.62 At paragraph 8.45 of its consultation, ORR states that it will 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. The existing provision covers disposals under the 'shadow' of an enactment where Network Rail does not agree the terms of a disposal but accepts the acquiring party would be able to obtain powers and would be prepared to use these if Network Rail did not dispose. Providing that an appropriate mechanism is included within the general consent which would not remove our ability to dispose of land in this instance, then we have no objections to this proposal.

Licence Condition 8 (LC8) Stakeholder relationships

8.63 At paragraph 8.46 of its consultation, ORR outlines some minor drafting changes reflecting updated references to industry stakeholders.

8.64 We agree with the proposal to change "*PRC*" references to "*Passenger Focus*" and "*LTUC*" references to "*London TravelWatch*". We also agree that the definitions in Part II of the licence should be changed accordingly.

Licence Condition 12 (LC12) Annual and periodic returns

8.65 At paragraphs 8.47 – 8.50 of its consultation, ORR proposes a number of amendments to LC12.

8.66 We note ORR's proposed redrafting of LC12.3(b) which would reduce the period in which ORR notifies Network Rail of its annual return requirements. The proposal to notify Network Rail of reporting requirements six months in advance of submission of the annual return is both problematic and impractical, as Network Rail could be asked to report on information six months into a relevant reporting year.

8.67 We note that any such request will always be subject to a test of 'reasonableness' but we believe that it would be more appropriate to retain the current LC12.3 which requires ORR, when it stipulates the inclusion of statistical and other data, to issue a notice on or before 31 December in the year which is two years before that in which the Annual Return is to be published, or such shorter period as may be agreed with Network Rail. This existing obligation gives Network Rail a more appropriate period of time to prepare for future information requirements. This is particularly important in circumstances where we are asked to collect and report on new requirements.

8.68 The new drafting that ORR has proposed for LC12.4 is welcome and addresses an existing anomaly. This year we were in a position to deliver the Annual Return in advance of the stipulated date of 1 July. However, to have published the Annual Return on the planned date of 1 August could have left us in technical breach, had we delivered the Annual Return earlier than 1 July (given the obligation to publish within one calendar month).

8.69 We note that ORR is proposing to retain the current drafting as set out at LC12.5. This requires Network Rail to publish the Annual Return within 'one calendar month of delivery to ORR subject to any modification (including deletions on the grounds of confidentially) approved by ORR.'

8.70 We note that this obligation has never been applied and is unworkable, from a practical point of view. Historically, we have always delivered the Annual Return to ORR on 1 July and published it on 1 August. In the period between sending the Annual Return to ORR and its publication date, ORR has reviewed the submission and provided comments. Network Rail then addresses these comments (to the extent that it is reasonable to do so) and subsequently publishes the document. We then write to ORR to confirm the amendments that were made to the Annual Return in light of ORR's comments.

8.71 ORR's has never 'approved' changes in advance of publication. We, therefore, believe that the words: "*subject to any modification (including deletions on the grounds of confidentially) approved by ORR*" should be deleted from LC12.5. It would be more appropriate to replace this with an obligation which requires Network Rail to publish the Annual Return within one calendar month of the return date having taken into account any comments raised by ORR (to the extent that it is reasonable to do so).

Licence Condition 15 (LC15) Corporate governance

8.72 At paragraphs 8.51 – 8.57 of its consultation ORR sets out some proposed changes to our existing corporate governance obligations. ORR proposes reformulating the condition so that it is clearer on what good corporate governance means for Network Rail, taking account of most recent developments in this field.

8.73 We note ORR's proposal to make explicit reference to compliance with the UK Corporate Governance Code and particularly the drafting that Network Rail must adhere to best practice in corporate governance arrangements so far as is reasonably practicable by "*complying with the relevant provisions and principles of the UK Corporate Governance Code"*. There is, of course, a principles-based approach in the UK which gives companies the option to 'comply or explain' and we believe this should be reflected in our licence. We consider, therefore, that it would be appropriate to include the words "*or explaining in their next annual report why they have not done so*" at the end of the proposed wording of LC15.1(a).

8.74 We would also propose that the wording of LC15.1(c) is amended to read: "*publishing, or procuring the publication of, such relevant information*…", given that some of the rules of the Financial Conduct Authority are less relevant to Network Rail.

8.75 The Board of Directors of Network Rail recognises that there is value in having non-executive directors on its board who have substantial relevant experience of working in the railways. Such experience is extremely important in order to effectively hold the executive to account. However, we believe that it is unnecessary to impose a regulatory requirement which obliges the licence holder to ensure that it retains such experience, as even without such an obligation this is something that our board would want. We consider, therefore, this obligation to be superfluous.

8.76 Notwithstanding this point, in the situation where a relevant person ceases to be a director of Network Rail, we consider that ORR's proposal to remove the one month timescale for Network Rail to satisfy the requirement to have two non-executive directors with railway experience and replace with a 'reasonably practicable' requirement, is helpful.

8.77 We believe the drafting of the revised LC15.2 is extremely broad. The UK Corporate Governance Code is internationally recognised as 'best practice' from a governance perspective. We do not consider it appropriate, therefore, that ORR needs to specify that the licence holder complies with any other arrangements which provide "*at least equivalent standards of best practice corporate governance*". This would appear to suggest that ORR could impose more onerous controls than those required by the UK Corporate Governance Code. In the absence of any evidence as to why this additional regulatory control would be appropriate we propose that LC15.2(a) is deleted.

Licence Condition 17 (LC17) Financial information

8.78 At paragraph 8.58 of its consultation, ORR proposes to delete our existing LC17 obligation due to an overlap with our LC15 obligations and the listing rules of the Financial Conduct Authority.

8.79 We note that the UK Corporate Governance Code requires the publication of financial information and we agree that as there is explicit reference to the Code in LC15, then the requirement to publish the information contained in LC17 is a duplication of Network Rail's LC15 obligation.

Licence Condition 24 (LC24) Systems code

8.80 At paragraph 8.59 of its consultation, ORR proposes to delete LC24 which ceased to have effect on 30 September 2010. We agree with the removal of this condition.

Schedule: revocation

8.81 At paragraph 8.60 of its consultation ORR proposes to remove item 2 of the Schedule pertaining to revocation of the network licence which refers specifically to the Railways (Safety Case) Regulations 2000 which no longer apply.

8.82 We agree that the Railways and Other Guided Transport Systems (Safety) Regulations 2006 now provide an appropriate mechanism to remove Network Rail's safety authorisation in the event of a serious breach of safety and that the existing provision should be deleted.

ANNEX 1: PROPOSED MARK-UP TO NETWORK LICENCE

This annex sets out Network Rail's suggested changes to Network Rail's network licence. Our suggested changes are marked in blue against ORR's changes which are marked in red. These are set out below.

Part II – Interpretation

~~"LTUC"~~ London TravelWatch	means the London Transport Users' Committee and any successor ~~to LTUC body~~ which performs the same functions;
~~"RPC"~~ Passenger Focus	means the ~~Rail~~ Passengers' Council and any successor ~~or delegated~~ ~~body~~ which performs the same functions ~~of the~~ ~~RPC~~; …..
6A	Any consent given by ORR under this licence shall be in writing and may be expressed in general or specific terms.

Part III Conditions

Long term planning

Planning

1.4 The licence holder shall plan the means by which it will comply with the general duty in condition 1.2 over the short, medium and long term to meet reasonably foreseeable future demand for railway services.

1.5 In complying with condition 1.4, the licence holder shall consult, and take into account the views of, persons providing services relating to railways and funders so as to facilitate effective industry-wide planning.

1.6 In complying with condition 1.4, the licence holder shall prepare and provide to ORR plans, strategies or other documents demonstrating its compliance and proposed compliance with the general duty in condition 1.2, including:

(a) the delivery plan referred to in condition 1.10;
(b) those associated with or arising from the ~~route utilisation strategies~~ long term plans (including Route Utilisation Strategies) referred to in condition 1.14;
(c) other plans, strategies or documents that ORR may reasonably require from time to time; and
(d) revisions of the plans, strategies and other documents referred to in condition 1.6 (a) to (c) that ORR may reasonably require from time to time.

1.7 Each of the plans, strategies and other documents referred to in condition 1.6 shall demonstrate the position, as appropriate, on a network-wide basis and at a suitably disaggregated level of detail.

1.8 Each of the plans, strategies and other documents prepared in compliance with condition 1.6 shall be provided to ORR in respect of such period, in

such format and structure, to such standard and level of detail and in accordance with such requirements (including any requirements as to publication) as ORR may, from time to time, specify by notice or in guidelines to the licence holder.

1.9 Any notice or guidelines to the licence holder issued under condition 1.8 may include a procedure under which ORR may object to the contents of a plan, strategy or other document on grounds specified in the notice or guidelines.

Long term planning process ~~*Route Utilisation Strategies*~~

1.14 In complying with condition 1.4, the licence holder shall establish and maintain ~~route utilisation strategies~~ long term plans to promote the ~~route utilisation~~ long term planning objective in accordance with guidelines issued by ORR under condition 1.8.

1.15 The long term planning objective referred to at 1.14 means the effective and efficient use and development of the capacity available on the network, consistent with the funding that is, or may become, available during the period of the long term plans and with the licence.

1.1~~5~~6 The licence holder shall have due regard to the ~~route utilisation strategies~~ long term plans when carrying out its licensed activities.

~~1.16 Each route utilisation strategy shall be established:~~
~~(a) by such dates as are specified in a programme or programmes proposed by the licence holder and approved by ORR or any amendment to such dates which is approved by ORR;~~
~~(b) in accordance with:~~
~~(i) the policies and criteria referred to in condition 1.19(a); and~~
~~(ii) guidelines issued by ORR under condition 1.8.~~

1.17 The licence holder shall from time to time and when so directed by ORR review and, if necessary, amend ~~each route utilisation strategy~~ each long term plan to ensure that it
~~(a)~~ continues to promote the ~~route utilisation~~ long term planning objective.
~~and~~
~~(b) remains in accordance with the policies and criteria referred to in condition 1.19(a).~~
~~The provisions of condition 1.16 in relation to the establishment of a route utilisation strategy shall apply equally to the amendment of a route utilisation~~
~~strategy under this condition 1.17.~~

~~*Interpretation*~~
~~1.24….“route utilisation objective” means the effective and efficient use and development of the capacity available on the network, consistent with the funding that is, or is likely to become, available during the period of the route utilisation strategy and with the licence holder’s performance of the duty in condition 1.2;~~

Proposed changes to the guidelines

ORR also proposes to make the following changes to the current RUS guidelines[1] alongside the licence changes:

1. *Change title to 'ORR guidelines on the Long term planning process'.*
2. *Throughout changes 'Route Utilisation Strategies and RUSs' to 'Long Term Plans and LTPs'. Change Route Utilisation Objective to Long Term Planning Objective.*
3. *At footnote 3 change date to April 2011 and add link http://www.dft.gov.uk/webtag.*
4. *At footnote 6 change 'Stakeholder Management Groups' to 'Working Groups'.*
5. *At footnote 7 update and amend the reference to the directive to European legislation - footnote Directive 2012/34/EU of the European Parliament and of the Council of 21 November 2012 establishing a single European railway area (recast).*
6. *At paragraph 26 delete 'for the purposes of the obligation under condition 1.16 of the network licence.*

3 Financial indebtedness

3.1 Except with the written consent of ORR, the licence holder shall use reasonable endeavours to ensure that at any time the ~~total~~ amount of financial indebtedness of:

(a) the licence holder~~,~~; ~~any subsidiaries of the licence holder,~~

(b) Network Rail Infrastructure Finance; and

(c) any subsidiaries of the licence holder or Network Rail Infrastructure Finance

~~shall~~ does not exceed the limits ~~applicable at that time that are shown~~ set out in table 3.1. ~~which~~ These limits are determined by dividing ~~that~~ the total financial indebtedness of the companies in (a)-(c) above for the relevant area by the Value of the RAB for the relevant area at that time.

[1] http://www.rail-reg.gov.uk/upload/pdf/rus-guidelines-apr09.pdf

Table 3.1: Limits to the level of financial indebtedness expressed as a percentage of the Value of the RAB ~~for England & Wales and for Scotland~~

	~~Limit~~	
Financial year	~~England and Wales~~ **Limit**	~~Scotland~~
20~~09-10~~14-15	~~70.0%~~ *[70-75%]*[2]	*~~[70-75%]~~*
20~~10-11~~15-16	~~70.0%~~ *[70-75%]*	*~~[70-75%]~~*
20~~11-12~~16-17	~~72.5%~~ *[70-75%]*	*~~[70-75%]~~*
20~~12-13~~17-18	~~75.0%~~ *[70-75%]*	*~~[70-75%]~~*
20~~13-14~~ 18-19 and each subsequent year unless ORR determines a different limit following consultation with the licence holder	~~75.0%~~ *[70-75%]*	*~~[70-75%]~~*

3.2 If at any time the total ~~aggregate~~ amount of financial indebtedness of the licence holder, any subsidiaries of the licence holder, Network Rail Infrastructure Finance and any subsidiaries of Network Rail Infrastructure Finance exceeds the limits set out in condition 3.1 applicable to that area in that financial year the licence holder shall, within such time periods as ORR may notify as being appropriate in the circumstances:

(a) provide to ORR details of the steps it intends to take to reduce the amount to those limits or below;

(b) take those steps; and

(c) provide to ORR evidence that it has taken those steps.

3.3 The licence holder shall:

(a) provide, from time to time as requested by ORR and in any event every year in the regulatory financial statements the licence holder prepares pursuant to condition 11, confirmation that, in respect of the financial year to which the statements relate, it has complied, and, in respect of the following financial year, it is not aware of any circumstances which will prevent it complying and it is likely to comply, with condition 3.1 and (where applicable) condition 3.2 and, if so requested by ORR, evidence in support of that confirmation; and

(b) notify ORR immediately in writing if at any time the licence holder becomes aware of any circumstance that means it is no longer complying, or that causes it no longer to have the reasonable expectation that it is likely to comply, with condition 3.1 and (where applicable) condition 3.2.

3.4 The licence holder shall pay to the Secretary of State, at least annually, a fee in respect of the state financial indemnity.

[2] Exact numbers in these tables to be confirmed in the final determination.

3.5 In this condition:

"fee"	means the amount equal to ~~0.8~~ 1.10 per cent (on an annual basis) of the daily outstanding amount of financial indebtedness incurred by Network Rail Infrastructure Finance and which is supported by the state financial indemnity;
	…….
"Network Rail Infrastructure Finance"	has the meaning given to it by condition 4.~~33~~39
	……. …….

(the other definitions in 3.5 are unchanged)

4 Financial ring-fence

…….

Payment of dividends

4.29 The directors of the licence holder shall not~~, without ORR's consent,~~ declare or recommend a dividend unless the conditions in condition 4.31 have been met.

4.30 ~~and t~~The licence holder shall not:

(a) make any other form of distribution, within the meaning of sections 829, 830, 849 or 850 of the Companies Act 2006; or

(b) ~~, or~~ redeem or repurchase any share capital of the licence holder ~~unless prior to the declaration, recommendation or making of the distribution, redemption or repurchase (as the case may be) the licence holder shall have issued to ORR a certificate complying with the following requirements in conditions 4.30 and 4.31~~.

unless the conditions in condition 4.31 have been met.

Conditions for the payment of dividends, distributions, redemptions and repurchases

~~4.30 The certificate shall be in the following form:~~

4.31 The conditions referred to in conditions 4.29 and 4.30 are:

(a) The licence holder has issued to ORR a certificate in the form specified at condition 4.33 concerning the proposed dividend, distribution, redemption or repurchase; and

(b) ORR has consented in writing to the dividend, distribution, redemption or repurchase no more than 6 months prior to it being recommended, declared, or made.

~~4.32 The licence holder shall provide to ORR any information it reasonably requires in order to decide whether to consent to the payment of a dividend or making of a distribution, redemption or repurchase for the purposes of condition 4.31(b).~~

4.32 A certificate issued under condition 4.31(a) shall:

(a) be in the following form:

"After making enquiries, the directors of the licence holder ~~are satisfied~~ have a reasonable expectation:

(i) that the licence holder is ~~in compliance~~ complying in all material respects with all obligations imposed on it by this condition 4 and condition 11 of its network licence;

(ii) that the payment of a dividend or making of a distribution, redemption or repurchase of [ ] on [ ] will not, either alone or when taken together with other circumstances reasonably foreseeable at the date of this certificate, cause the licence holder to be in breach to a material extent of any of these obligations ~~in the future for the remainder of the current control period or for the next three full financial years (whichever is the longer)~~ during the next 12 months; and

(iii) that such payment of dividend or making of distribution, redemption or repurchase will not either alone or when taken together with other circumstances reasonably foreseeable at the end date of this certificate impair the ability of the licence holder to finance the Permitted Business and to the intent that in making such statement the directors of the licence holder have made specific enquiries regarding, and taken into account the following:

(1) the requirements of the Companies Act 2006 relating to distributions

(2) the existence of distributable profits, as determined by reference to the licence holder's most recent financial statements delivered in accordance with condition 11 of the licence holder's licence

(3) the availability and sufficiency of funds required for the relevant dividend, distribution, redemption or repurchase."

(b) ~~4.31The certificate shall~~ be signed by a director of the licence holder and approved by a resolution of the board of directors of the licence holder passed not more than 14 days ~~before~~ of declaration of the relevant dividend or the date on which the ~~consent of ORR to the declaration, recommendation or payment will be made under condition 4.31 is requested in writing~~ relevant repurchase of Shares is made.

4.33 Where the certificate required by condition 4.29 has been issued in respect of the declaration or recommendation of a dividend or the making of a distribution, redemption or repurchase, the licence holder shall be under no obligation to issue a further certificate prior to payment of that dividend or the making of that distribution, redemption or repurchase provided such payment, distribution, redemption or repurchase is made within six months of the issuing of that certificate.

~~*Relevant payments to funders*~~

~~4.34 For the purposes of this condition a payment to a funder is a relevant payment unless it is a payment made in the ordinary course of business or in order to comply with a legal obligation.~~

Outperformance payments to the Secretary of State for Transport and Transport Scotland

4.34 The licence holder shall not make ~~a relevant~~ an outperformance payment to the Secretary of State for Transport or Transport Scotland unless the ~~conditions in~~ condition ~~4.36 have~~ 4.34 has been met.

~~Conditions~~ Condition for ~~relevant~~ outperformance payments

4.35 The ~~conditions~~ condition referred to in condition ~~4.35 are:(a) The~~4.33 is that the licence holder has issued to ORR a certificate in the form specified at condition ~~4.38~~ 4.35 concerning the ~~relevant~~ outperformance payment~~; and~~.

~~(b) ORR has consented in writing to the relevant payment no more than 6 months prior to it being made.~~

~~4.37 The licence holder shall provide to ORR any information it reasonably requires in order to decide whether to consent to a payment for the purposes of condition 4.36(b).~~

4.36 A certificate issued under condition ~~4.36~~ 4.34(a) shall:

(a) be in the following form:

"Having had regard to:

(i) the licence holder's obligations under condition 4 and condition 11 of this licence ~~and any contracts to which it is a party~~;

(ii) the extent to which its efficiency and economy in discharging the obligations referred to in condition ~~4.38~~ 4.35(a)(i) exceeds any assumptions which ORR made in its most recent access charges review;

(iii) the licence holder's current and foreseeable ~~future~~ financial position for the next 12 months including whether it would be more appropriate to ~~use any available financial resources~~ retain some or all of any funds that would otherwise have become available to make an outperformance payment for use in any part of the licence holder's Permitted Business (in such proportions as the licence holder sees fit), including without limitation, to repay any financial indebtedness of the licence holder and/or fund research and development expenditure ~~up to the value specified in the final determinations of the 2013 access charges review~~ rather than to make ~~a relevant~~ an outperformance payment; and

(iv) [the need for long term investment in the network;] [as identified in the most recent access charges review];

the directors of the licence holder ~~are satisfied~~ have a reasonable expectation that the making of ~~a relevant~~ an outperformance payment will not impair the ability of the licence holder to finance the Permitted Business for the ~~remainder of the current control period or the next three financial years (whichever is the longer)~~ next 12 months.

(b) be signed by a director of the licence holder and approved by a resolution of the board of directors of the licence holder passed not

~~the~~ relevant outperformance payment ~~under condition 4.36(b) is requested in writing~~ will be made.

4.37 ……..

" an outperformance payment" means [ ]

"current control period" means the period in respect of which the conclusions of ORR's most recent access charges review have been implemented.

……..

"access charges review" has the meaning ascribed to it under schedule 4A of the Act.

5 Interests in ~~rolling stock and train operators~~ railway vehicles

5.1 ~~Subject to condition 5.2, t~~The licence holder shall not~~, except in so far as ORR may otherwise consent,~~ be directly or indirectly interested in the ownership or operation of any railway vehicle in Great Britain.

5.2 For the purposes of condition 5.1 the licence holder is "directly interested" in the ownership or operation of railway vehicles where the licence holder:

(a) has any legal or beneficial interest in any railway vehicle (in whole or in part); or

(b) has the right to manage the affairs of another person who has any such interest in, or operates, any railway vehicle.

5.3 For the purposes of condition 5.1 the licence holder is "indirectly interested" in the ownership or operation of any railway vehicle which is operated by any of its affiliates or in which the licence holder or any of its affiliates has any legal or beneficial interest (in whole or in part).

5.~~2~~4 Condition 5.1 shall not apply in respect of a~~ny~~ railway vehicle where:

(a) it is used wholly or mainly for ~~any such~~ the purposes as ~~is mentioned in sub-paragraph 1(b) or (c)~~ set out in paragraph 1 of Part 1 ~~of the~~ (S~~s~~cope) of this licence; or

(b) it forms~~ing~~ part of the Royal Train~~.~~; or

(c) ORR has consented to the licence holder having an interest in the ownership or operation of that railway vehicle.

~~5.3 The licence holder shall, without limitation to the generality of condition 5.1, be regarded as directly interested in the ownership or operation of railway vehicles where the licence holder:~~

~~(a) has any legal or beneficial interest in any railway vehicle (in whole or in part); or~~

~~(b) has the right to manage the affairs of another person who has any such interest in, or operates, any railway vehicle.~~

~~5.4 The licence holder shall, without prejudice to the generality of condition 5.1, be regarded as indirectly interested in the ownership or operation of any railway vehicle which is operated by any of its affiliates or in which the licence holder or any of its affiliates has any legal or beneficial interest (in whole or in part).~~

7 Land disposal

7.1 The licence holder shall not dispose of any land otherwise than in accordance with ~~the following paragraphs of~~ this condition ~~7~~.

7.2 The licence holder may dispose of any land where:
(a) ORR consents to such disposal; or
(b) the disposal is required by or under any enactment.

7.3 Where the licence holder seeks ORR's consent it must give a minimum of 2 months' prior written notice specifying the land disposal it intends to make (the notice). A notice under this condition shall be in such form and contain such particulars as ORR specifies.

7.4 Having given such notice, the licence holder shall provide further information as ORR may require.

7.5 Unless otherwise agreed between ORR and the licence holder, if ORR does not inform the licence holder of a consent or refusal of consent within the time specified in the notice, the licence holder will be deemed to have consent and may dispose of land in accordance with the notice.

7.6 If ORR refuses consent to the disposal of land specified in the notice, the licence holder will be informed of any entitlement to appropriate compensation for the loss of value (if any) as a result of not being able to make such disposal.

~~7.2 Save as provided in condition 7.3, the licence holder shall give to ORR not less than 3 months' prior written notice of its intention to dispose of any land. Having given such notice, the licence holder shall supply such further information as ORR may require relating to such land or the circumstances of such intended disposal or where such a disposal to a specific person is in contemplation the known relevant intentions of the person proposing to acquire such land. The licence holder shall supply the required information within seven days of the requirement being made, or such further time as allowed by ORR.~~

~~7.3 Notwithstanding conditions 7.1 and 7.2, the licence holder may dispose of any land:~~
~~(a) where:~~

~~(i) ORR has issued directions for the purposes of this condition containing a general consent (whether or not subject to conditions) to:~~

~~(aa) transactions of a specified description; and/or~~

~~(bb) the disposal of land specified in the directions as excluded land;~~

~~and~~

~~which specifies the intervals at which the general consent can be reviewed; and~~

~~(ii) the disposal of the land in question is effected pursuant to a transaction of a description specified in any directions given under condition 7.3(a)(i) or the land in question is specified in those directions as excluded land and the disposal is in accordance with any conditions to which the general consent under condition 7.3(a)(i) is subject; or~~

~~(b) where the disposal in question is required by or under any enactment and for these purposes a disposal shall be treated as being under an enactment if:~~

~~(i) the licence holder agrees to the terms of a disposal which would otherwise be required under an enactment; or~~

~~(ii) the disposal would have been under an enactment had the acquiring party taken all the steps which were open for it to take providing that the acquiring party has acted with reasonable expedition and diligence.~~

~~7.4 Notwithstanding condition 7.1, the licence holder may dispose of any land specified in a notice given under condition 7.2 in circumstances where:~~

~~(a) ORR confirms in writing that it consents to such disposal (which consent may be made subject to the acceptance by the licence holder of such conditions relating to railway use, network business or the carrying out of licensed activities as ORR may specify and the licence holder shall ensure that any such disposal shall be subject to those conditions); or~~

~~(b) ORR has not, within the notice period referred to in condition 7.2, issued a direction for the purpose of this condition 7 requiring the licence holder not to proceed with such disposal and notifying the licence holder that it is entitled to be compensated appropriately for the loss of value (if any) as a result of ORR issuing a direction under this condition 7.4(b).~~

7.~~5~~7 In this condition:

"disposal" includes any sale, assignment, gift, lease, licence, the grant of any right of possession, loan, security, mortgage, charge or the grant of any other encumbrance or knowingly permitting any

encumbrance to subsist (other than an encumbrance subsisting on the date when the land was acquired by the licence holder or on 15 November 2001) or any other disposition to a third party, and "dispose" shall be construed accordingly;

~~"excluded land" means any land which is specified as such in directions issued under condition 7.3;~~

"land" includes buildings and other structures, land covered by water, and any estate, interest, easements, servitudes or rights in or over land.

8 Stakeholder relationships

Cooperation with passenger representatives

Whenever reasonably requested to do so by Passenger Focus ~~the RPC~~ ~~and~~ ~~LTUC~~ or London TravelWatch (as relevant) in connection with its licensed activities, the licence holder shall cooperate with Passenger Focus ~~the RPC~~ and ~~LTUC~~ London TravelWatch (as relevant) in respect of the proper performance of their respective statutory functions, including the provision of relevant information held by the licence holder.

Interpretation

8.1 In this condition:

…….

(f) ~~RPC~~ Passenger Focus and ~~LTUC~~ London TravelWatch in respect of their respective statutory functions.

12 Annual and periodic returns

Annual returns

12.1 The licence holder shall prepare and provide to ORR an annual return by ~~1 July each year (or a later date approved by ORR)~~ a specified return date each year. ~~The annual return shall be prepared in such format and structure, to such standard and level of detail and in accordance with such requirements as ORR shall specify by notice to the licence holder.~~

12.2 ~~No notice of ORR under condition 12.1 shall be effective unless:~~

~~(a) it is given on or before 31 December in the year before that in which the annual return is to be published; and~~

~~(b) ORR has consulted the licence holder before 31 October in the year before that in which the annual return is to be published and has taken into consideration any representations duly made.~~

The annual return must comply with the requirements set out by ORR following consultation with the licence holder, including:

(a) as to its form and content; and

(b) the dates to which the annual return relates.

12.3 The specified return date must be a date:

(a) not less than 3 months after the last day to which the annual return relates; and

(b) at least 6 months after the date on which ORR notifies the licence holder of the annual return requirements unless the licence holder otherwise agrees.

12.4 To the extent that a notice of ORR under condition 12.1 requires the inclusion of statistical and other data, the notice shall not be effective unless it is given on or before 31 December in the year which is two years before that in which the annual return is to be provided, or such shorter period as may be agreed with the licence holder.

~~12.4 If ORR has not given an effective notice under condition 12.1 in respect of any year, the notice last given under that condition shall apply to that year.~~

12.5 If, in any year, ORR has not consulted upon the annual return requirements or specified a return date in accordance with conditions 12.2 and 12.3, the licence holder shall prepare and provide an annual return for that particular year by the day and month previously specified in accordance with condition 12.3 and on the basis of the annual return requirements relevant to that specified return date.

12.6 Within one calendar month of ~~delivery to ORR~~ the return date, ~~subject to any modification (including deletions on the grounds of confidentiality) approved by ORR,~~ having taken into account any comments raised by ORR (to the extent that it is reasonable to do so) the licence holder shall publish the annual return, except to the extent that ORR is satisfied that the information would or might seriously and prejudicially affect the interests of the licence holder or any other person and has so notified the licence holder.

…….

15 Governance

15.1 The licence holder must adhere to best practice corporate governance arrangements, so far as is reasonably practicable, by:

(a) complying with the relevant provisions and principles of the UK Corporate Governance Code or explaining in their next annual report why they have not done so;

(b) maintaining a board of directors with an appropriate balance of skills, experience, independence and knowledge, where at least two non-executive directors have substantial experience of working in the rail industry; and

(c) publishing, or procuring the publication of, such relevant information as is required by the rules of the Financial Conduct Authority of a company whose ordinary shares are for the time being admitted to the Official List of the UK Listing Authority.

15.2 ORR may ~~consent to, or specify that the licence holder complies with, any other arrangements which:~~

~~(a) provide at least equivalent standards of best practice corporate governance; or(b)~~ relieve the licence holder of its obligations under any part of condition 15.1 to such extent, for such period of time, and subject to such conditions as may be specified in the consent or specification.

15.3 In this condition:

"the UK Corporate Governance Code" means the code published by the Financial Reporting Council in September 2012, or any successor document having a similar purpose and content;

and

"rules of the Financial Conduct Authority" means the rules made by or under Part VI of Financial Services and Markets Act 2000 and contained in the Financial Conduct Authority Handbook, or equivalent rules of any successor body.

20 Insurance

20.1 The licence holder shall, in respect of licensed activities, maintain insurance against third party liabilities in accordance with any relevant ORR ~~general or specific approval~~ consent~~, as amended from time to time~~.

ANNEX 2: SECTION A - DRAFTING COMMENTS ON ORR'S PROPOSED AMENDMENTS TO THE TRACK ACCESS CONTRACTS

Section A of this annex sets out Network Rail's detailed comments and suggested changes to ORR's proposed drafting for Schedules 4, 7 and 8 of the track access contracts and the Traction Electricity Rules. Where we have proposed amendments to a section of text, proposed deletions are shown struck-out and proposed additions are shown double underlined. Section B sets out our suggested mark-ups to specific aspects of terminology relating to the traction electricity charge provisions in Schedule 7 of the freight and passenger track access contracts.

Schedule 4

Changes to Restrictions of Use

- Paragraph 2.6(c) (franchised passenger contracts): We do not think it is correct that the cross-reference to paragraph 3 should be changed to a cross-reference to paragraph 4. In the circumstances described in this clause, calculation of payments under paragraph 3 remains relevant.

- Paragraph 2.9 of Part 3 (franchised passenger contracts): As explained in paragraph 5.10 of this response, we consider that further clarification is required as to the costs which a train operator may recover in the event of the cancellation of a Type 1 possession. Our proposed drafting amendments are set out, below:

  "(d) Where:

  (i) the notice served by the Train Operator under paragraph 2.9(c) is in respect of a cancellation of a Type 1 Restriction of Use that was notified to the Train Operator less than 12 weeks before the date on which that Type 1 Restriction of Use was scheduled to occur; and

  (ii) the costs to which the Train Operator is committed or which it has already incurred prior to the cancellation of the Type 1 Restriction of Use and any costs associated with responding to that cancellation, amount to £5000 or more,

  the Train Operator shall be entitled to recover those costs.- provided that such costs are reasonable and were properly committed or incurred in the circumstances. For the purposes of this paragraph 2.9(d), references to "costs" shall mean those categories of costs described in the definition of "RoU Direct Costs" (save that references in that definition to "Type 2 Restriction of Use" shall be deemed to refer to "Type 1 Restriction of Use".)"

Dispute Resolution

- Paragraph 10 of Part 3 (Open Access contracts): The cross-reference to paragraph 2.7(c) should be deleted as there is no such paragraph.

Schedule 7

New or amended charges (supplements)

- Paragraph 2.2.3 (freight contracts) / paragraph 9.1 of Part 2 (passenger contracts): The drafting should be amended to clarify that the Train Operator shall inform Network Rail "*in writing*" of the date or likely date from which it intends to use the new equipment.

- Paragraphs 2.2.5 - 2.2.7 (freight contracts): Network Rail's obligation to calculate the Supplement Rate (in paragraph 2.2.6) and the time period for the parties to agree the Supplement Rate (in paragraph 2.2.7) should only trigger once the Train Operator has provided the relevant information to enable Network Rail to calculate and propose the Supplement Rate. Under the proposed drafting, these obligations are triggered by the giving of a notice under paragraphs 2.2.5(a) or (b), which can happen before Network Rail has all the information it needs to calculate the rate. We suggest that the drafting in paragraph 2.2 is amended accordingly.

- Paragraph 2.2.5(b)(i) (freight contracts): Network Rail's obligation to provide "*all information*" on which it based the calculation of the Supplement Rate should be subject to a materiality threshold. We suggest this is amended to say "*all material information*".

- Timescale for agreeing a supplement: As explained in paragraph 2.26 of the main body of this response, we consider that, in the case of both passenger and freight contracts, 45 days is an adequate time period for the parties to agree a supplement, provided that this period runs from the date on which Network Rail has been provided with all the information it needs to calculate and propose a supplement. We propose that appropriate amendments are made to both the passenger and freight contracts to reflect this.

Traction Electricity Charge

- Paragraph 2.1.1 (freight contracts): The references to "$S1_{t\omega}$"and "$S2_{t\omega}$" are incorrect here as these supplementary amounts are calculated at the end of each year and in respect of the whole year rather than in respect of each Charging Period. We suggest that the payment and invoicing provisions for these supplementary amounts are dealt with separately, as they are in the passenger contracts.

- Definition of "*tariff band*": We suggest that the defined term is changed to "*tariff band j*", because "*j*" is used to denote the tariff band in the formulae for the calculation of the traction electricity charge.

- Paragraph 2.4.1.2 (freight contracts): Regenerative braking discounts are not stated to be taken into account in the calculation of "C_i" in the freight contracts. Although no freight operators currently receive this discount, we suggest this is referred to in the definition of "C_i" in the freight contracts, to

- Paragraph 2.4.1.2 (freight contracts): The term "*Vehicle Miles*" has been used in place of "*Train Miles*" in the definition of *"UE_{igjt}"* in the modelled consumption formula, but there is no definition of Vehicle Miles. The drafting should be amended to include an appropriate definition.

- Reference to "*train category i*": the term "*train category i*" is used in various sections of the legal drafting relating to EC4T, however, it is not clearly defined. We suggest that a new term "*metered train m*" is included to reflect that metered consumption should be provided for each metered train , and that this new term is used in the metered EC4T charges drafting. Modelled EC4T consumption rates are set out for each vehicle type operating on a particular service code (or a particular service group for freight operators), therefore we have clarified the definition for "*train category i*", to reflect this. We have marked-up ORR's proposed versions of Schedule 7 of the passenger and freight track access contracts, and the Traction Electricity Rules, to reflect these suggested changes. These mark-ups are set out in **Annex 2 (Section B)**.

Incremental Costs (freight contracts)

- Paragraph 2.8: As explained in paragraph 2.23 of this response, we propose that the references to operating constraints as at "*1 April 2001*" are updated to "*1 April 2014*."

Capacity Charge (passenger contracts)

- Paragraph 6 of Part 2: in respect of the formula for the calculation of the Capacity Charge:

    a) The definition of "*Service Coded Group*" should be re-instated (franchised operator and Scotrail contracts) or included (open access contracts), because the term is used in defining the term Pg_{twd}.

    b) The term "*i*" has been introduced to denote "*Service Coded Group*", in place of "*g*". We assume this is to prevent any confusion between the use of "*g*" here and elsewhere in Schedule 7, where it means "*geographic area*". However, we do not think that "*i*" is appropriate here, because "*i*" is used in other places in Schedule 7 (e.g. in the formula for the calculation of Traction Electricity Charges), where it has a different meaning. We suggest a different term such as "*sc*" or "*scg*" would be more appropriate.

Route-Level Efficiency Benefit Share

- Definition of "*Alliance Agreement*": As explained in paragraph 4.10 of the main body of this response, we propose that this definition should be replaced with the following and that all references to "*Alliance Agreement*" be replaced by references to "*Material Alliance Agreement*":

  > *"**Material Alliance Agreement**" means a legally binding agreement between Network Rail and one or more train operators establishing an alliance under which the parties agree to share risk and / or reward in respect of activities on a part of the Network and which is likely to have a material direct financial impact on one or more elements of Network Rail's costs or income included within a Route Baseline."*

- Definition of "*Route-Level Efficiency Benefit Share*": The definition is not always hyphenated when used in the drafting (see e.g. definition of "*Route Level Efficiency Benefit Share Mechanism*" and paragraph 4.1 of the freight contracts). We suggest this is updated throughout for consistency.

- Definition of "*Route-Level Efficiency Benefit Share Mechanism*" (passenger contracts): The cross-reference should be to paragraph 1 of Part 3, rather than paragraph 1.3 of Part 3.

Calculation of the Route-Level Efficiency Benefit Share

- Paragraph 4.1 (freight contracts) / paragraph 1 of Part 3 (passenger contracts): We propose the following drafting amendments:

  a) We suggest that "O_t" and "U_t" are defined as payments in respect of REBS Outperformance and REBS Underperformance respectively, as this more accurately describes the nature of the payment, which is made in respect of outperformance or underperformance on a route. Please see suggested amendments marked-up below (the mark-up of the defined term "U_t" also corrects a minor typographical error:

  "O_t means the amount that is payable by Network Rail to the Train Operator in respect of ~~the~~ REBS Outperformance ~~Route~~ in Relevant Year t;"

  "U_t means the amount that is payable ~~or~~ by the Train Operator to Network Rail in respect of ~~the~~ REBS Underperformance ~~Route~~ in Relevant Year t; and"

  b) The calculations of "V_{ct}" and "AV_{ct}" should be based on amounts payable rather than amounts paid. We suggest deleting the word "paid" from both these definitions.

- Paragraph 4.2 (freight contracts) / paragraph 1.2 of Part 3 (passenger contracts): We suggest that the drafting is amended to clarify that, where a Train Operator has opted-out, the Route-Level Efficiency Benefit Share shall not be payable by or to the Train Operator in respect of that REBS Route, as other operators may receive a REBS payment in respect of that REBS Route. We propose the following marked-up drafting amendment:

"The Route-Level Efficiency Benefit Share (if any) calculated under paragraph 1.1 shall be payable for each REBS Route for Relevant Year t, unless the Train Operator has exercised a right to opt out in respect of a particular REBS Route in accordance with paragraph 1.3 or 1.4. Where the Train Operator has exercised such a right, no Route-Level Efficiency Benefit Share shall be payable by or to the Train Operator~~,~~ in respect of that REBS Route for the Relevant Year in the course of which the notice referred to in paragraph 1.3 was served and all subsequent Relevant Years up to 31 March 2019."

- Paragraph 4.6 (freight contracts) / paragraph 1.6 of Part 3 (passenger contracts): The reference to "*Train operator*" should be to "*Train Operator*".

Obligation to pay the Route-Level Efficiency Benefit Share

- Paragraph 4.7 (freight contracts) / paragraph 1.7 of Part 3 (passenger contracts): As explained in paragraph 4.16 of the main body of this response, we consider that the obligation to make payment within 28 days after the publication of ORR's annual efficiency and finance assessment of Network Rail should be amended to "*within 2 months*" or, (at the very minimum) "*within 28 days after the end of the [Charging] Period in which it is determined by the ORR that such payment should be made*".

Schedule 8

- Paragraph 10.1.5(a) (freight customer specific contracts): Sub-clause (v) should be re-numbered as (iv).

- Paragraph 10.1.9 (freight customer specific contract): Reference to "*expert relevant ADRR Forum*" should be to "*a relevant ADRR Forum*".

- Paragraph 10.2.2 (c) (freight customer specific contract): We suggest the phrase "*in respect of year t+1*" is inserted following Network Rail Cap and/or Train Operator Cap.

- Paragraph 17.2(h) (passenger contracts): We suggest that the word "*agreed*" is deleted from this sub-paragraph as this provision can also apply where the amendments are determined in accordance with the ADRR, rather than agreed. The amendments can also be determined by ORR (as referred to in paragraph 17.2(i)), so we suggest that this sub-paragraph is amended as follows:

  "*(h) Subject to paragraph 17.2(i), ~~Any~~ any ~~agreed~~ amendment to Appendix 1 in connection with the proposal referred to in paragraph 17.1 which is approved by ORR under section 22 of the Act shall apply with effect from either:*

  (i) the relevant Principal Change Date or Subsidiary Change Date (where paragraph 17.2(a)(i) applies); or

  (ii) the date proposed ~~agreed~~ by the ~~parties~~ party requesting the change (where ~~in accordance with~~ paragraph 17.2(a)(ii) applies), ~~(~~unless otherwise agreed by the parties or determined by the relevant ADRR Forum in accordance with paragraph 17.2(f)~~)~~."

Traction Electricity Rules

- Paragraph 1.1 (Definition of "*Regenerative Braking Audit*"): This should also refer to an audit of another train operator's regenerative braking system, which the Train Operator can request Network Rail to carry out under paragraph 9.20. Currently the definition only refers to an audit of the Train Operator's own system.

- Paragraph 8.1 - Regenerative braking discount: As explained in the main body of the response, this should be amended so that it is limited to Modelled Train Operators.

- Paragraph 18.2 – Volume reconciliation: as explained in paragraph 2.31 of the main body of this response ORR has proposed that the volume wash-up drafting is changed so that Network Rail would be allocated a share of the volume wash-up to reflect "*its ability to manage transmission losses*". The (λ_g x A_{gt}) portion of the volume wash-up formula reflects the 'share' of the wash-up discrepancy that is to be retained by Network Rail. The value associated with the 'λ_g' term, is set out in Appendix 3 to the TERs. Appendix 3 sets out the DSLFs which are expressed as a mark-up i.e. these values are used to uplift metered consumption to recover the estimated transmission losses associated with that consumption. It is our understanding that ORR's intention was to expose Network Rail to the proportion of the total consumption, in each ESTA, that is associated with transmission losses (this is discussed in paragraph 16.185 of ORR's Draft Determination), with the corresponding values set out in Table 16.25 of ORR's Draft Determination. We would suggest that instead of the term 'λ_g' the formula could refer to a new term which uses values from a new table which is consistent with Table 16.25 (of the Draft Determination).

- On a related point, and as explained in paragraph 2.32 of the main body of the response, this change to the volume wash-up is likely to require a corresponding adjustment in the cost wash-up provisions so that the costs associated with this 'unallocated' consumption are not passed through to other operators. We are discussing this issue with ORR separately.

Consequential changes proposed to the contracts

We are content with ORR's proposed consequential changes.

ANNEX 2: SECTION B - IMPLEMENTING PR13: NETWORK RAIL MARK-UPS TO SCHEDULE 7 (FRANCHISED PASSENGER AND FREIGHT) AND THE TRACTION ELECTRICITY RULES