



OFFICE *of*
RAIL REGULATION

Depots Code: Final Conclusions

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Executive Summary

Introduction

1. This document sets out our final conclusions on the Depots Code following considerable input from industry parties, most recently in response to our Depots Code: Draft Conclusions in July 2005 (the July 2005 document) and to consultation on our proposals on the liability framework and abatement regime in December 2005¹.
2. We published a draft of the Code documentation in July 2005 and received many helpful comments. We are continuing to refine the draft to ensure it is as user-friendly as possible and expect to have it finalised and available for use by the industry by the middle of 2006.
3. We have always had a preference for the early adoption of the Code but asked in our July 2005 document for views on implementation options. We have concluded that decisions on accession to the Code are for the industry to make on a depot by depot basis, although we will take every opportunity to promote the Code given the benefits for the industry in terms of reduced costs and increased effectiveness and efficiency of depots.

Liability Framework

4. In December 2005, we asked for industry views on the scope of recoverable losses and the level, nature and definition of caps. We have now reached our conclusions and will welcome the development of an industry consensus to help in finalising the details of our approach.
5. In broad terms, we have concluded that there should be a single incident cap on liabilities, set on a depot by depot basis, with a default cap to act as a benchmark. We have extended the definition of recoverable losses, decided that we should not proceed with a default annual cap on liabilities, and

¹ Depots Code: liability framework and abatement regime letter of 16 December 2005, ORR, London, available at: <http://www.rail-reg.gov.uk/upload/pdf/depcode-abatement-regime-consultlet.pdf>

decided that we would be prepared to review the presumption in favour of symmetrical caps.

Depot change procedures

6. The streamlined change procedures in the Code facilitate change, by supporting investment in new facilities, removing unnecessary bureaucracy and protecting the rights of those with an interest in the depot. In the July 2005 document, we invited view on the treatment of bilateral arrangements and permitted variations, closures and ad hoc users. In the light of consultees' responses, we have reached conclusions that we believe strike the right balance between facilitating changes that have minimal impact within the depot while minimising the administrative burden, and protecting the rights of users of the depot. We also want to make increased use of general approvals or variations that do not require our approval.

Maintenance, repair and renewal responsibilities

7. The Code will provide major and beneficial changes to the allocation of maintenance repair and renewal responsibilities in particular by doing away with split stewardship responsibilities wherever possible and by giving depot facility owners greater operational control. The Code also has a toolkit of new and improved remedies.
8. We consulted on proposals for an abatement regime for depots in December 2005 having appointed MVA as our consultants, to incentivise repairs and renewals in a timely and efficient manner and to provide appropriate compensation to affected parties when there is an asset failure. MVA's report proposed a new list of abatable items, categories of failure and associated daily abatement values. Consultees supported the broad thrust of MVA's work and we propose to incorporate MVA's proposals into the Code subject to various suggestions made by Network Rail and the Association of Train Operating Companies (ATOC). Consultees views have also helped us to finalise our proposals for self-help and performance orders.

Depot charging arrangements

9. While recognising the genuinely commercial nature of depot charges and not wanting to inhibit future negotiations, we made clear in the July 2005 document that we remained keen to bring about greater transparency of

charging. This is a matter we will address outside the Code through the procedures and criteria for dealing with requests for exclusions from the Public Register.

1. Introduction

Background

- 1.1 This document contains the Office of Rail Regulation's (ORR) final conclusions on the Depots Code (the Code). The publication of our final conclusions is the culmination of a reform process that began in 2001 with a series of visits to light maintenance depots, and involved seeking feedback on the current arrangements and identifying issues in those arrangements that needed to be reviewed.
- 1.2 The process has continued with the generous help of industry parties. They have contributed their views, their time on working groups and their resources. They have considered and commented upon our provisional conclusions, published in November 2004; draft conclusions and draft documentation, published in July 2005² (the July 2005 document); and, most recently, on our proposals for the liability framework and abatement regime, published in December 2005. It has been a substantial collaborative effort.
- 1.3 We are grateful to everyone who responded to the July 2005 document. All the consultation responses are published on our website and the respondents are listed here in Annex A.
- 1.4 In the July 2005 document, we said that we would be carrying out further work with the help of the industry on the Code's liability framework and abatement regime. We briefed interested parties on the progress made in these areas in a consultation letter dated 16 December 2005 (the December 2005 consultation)³ and invited comments on a number of proposals. The responses to the December 2005 consultation are also published on our website and the respondents are listed here in Annex B.

² *The Depots Code: Draft Conclusions July 2005*, ORR, available at: <http://www.rail-reg.gov.uk/upload/pdf/243.pdf>.

³ This document is available on our website, at: <http://www.rail-reg.gov.uk/server/show/nav.239>.

Structure of this document

1.5 This document is structured as follows.

- Chapter 2 describes how and when we propose the Code should be implemented and the on-going work of refining the Code documentation.
- Chapter 3 sets out our final conclusions on the liability framework.
- Chapter 4 deals with carve-outs from the depot change procedures and the approval process.
- Chapter 5 summarises our final conclusions on the abatement and performance regimes and self help.
- Chapter 6 deals with the transparency of depot charging arrangements and the approval process.

Next steps

1.6 We are currently refining the draft of the Depots Code, Depot Particulars and Framework Agreement in the light of the consultation responses, including the detailed mark ups of the documents provided by Network Rail and the Association of Train Operating Companies (ATOC).

1.7 We propose to invite Network Rail and ATOC to comment on parts of these documents as refining the draft documentation progresses. We will also provide any consultee requesting them with copies of the parts that we send to Network Rail and ATOC. At the conclusion of this iterative process, we will publish the final draft version of the documents on our website.

1.8 We aim to have the Depots Code documentation finalised and available for use by the industry by the middle of 2006.

1.9 A copy of this document is published on our website and is available in hard copy from our library.

2. Depots Code implementation

Introduction

2.1 In the July 2005 document, we invited consultees to comment on four options for the implementation of the Code, making clear our own view in favour of early implementation. The four options for implementation set out for comment were:

- a 'big bang' approach whereby all the relevant parties would accede to the Code more or less simultaneously;
- when franchises are replaced;
- as depot leases come up for renewal; or
- according to other commercial priorities.

Implementation of the Depots Code

2.2 In the July 2005 document, we were clear in expressing our preference for early adoption of the Code by as many depots as possible. Consultees in their responses were clearly opposed to an early big bang approach however, because they considered it impractical for all, or even the majority, of depots to accede to the Code at the same time in the immediate or near future.

2.3 ATOC's and Network Rail's consultation responses referred to the workload implications of accession, which include assessing the condition of assets, checking Depot Particulars, re-negotiating depot lease rentals, managing out existing repair and maintenance contracts and organising new ones. South West Trains (SWT) was particularly concerned about the difficulties of negotiating on a cost-neutral basis the re-allocation of responsibilities for repair, maintenance and renewal.

2.4 Lambert Smith Hampton and Network Rail were also concerned about the effect that an imposed timetable and too early implementation would have on the rollout of the Stations Code. They argued that the Stations Code should have priority and that any lessons learnt from implementing it should be applied later to the rollout of the Depots Code. Implementation of both Codes

at broadly the same time would, in their view, overstretch industry resources with a resulting loss of focus.

- 2.5 Consultees argued in favour of the other options, in particular accession to the Code at the time of franchise renewal. ATOC also argued for staged implementation of parts of the Code, especially for those depot facility owners coming to the end of their franchise periods. However, SWT opposed bolting parts of the Code onto existing arrangements because it considered that this would detract from the potential benefits of the whole package.
- 2.6 We acknowledge that that there is no blank canvas now as there was at the time when the current arrangements were rolled out and that, consequently, implementation of the Code will have to be a managed change. We agree with consultees that for this change to be managed in the most optimal way, the timing will necessarily depend upon depot-specific or, more likely, franchise-specific opportunities and incentives and the availability of resources.
- 2.7 However, while we accept that the rollout of the Code may be over a longer time frame than originally envisaged, we remain committed to the Code and convinced of its benefits. We will therefore consistently work for as wide and as early implementation as circumstances allow.
- 2.8 There is a risk with implementation taking place over a longer period of time, for example, if accession only takes place at franchise renewal. The risk comes from the uncertainty of having a mix of arrangements. However, the reality is that the industry is already characterised by such a mix. There are about 75 depots governed by templated arrangements, 25 governed by customised depot access conditions and about 60 freight depots with their own regulatory framework. All have co-existed for some time without the industry appearing to suffer from the lack of a common set of arrangements and, indeed, whatever happens to the 100 or so regulated depots, the freight depots will retain their own arrangements. Some might argue that varied or bespoke arrangements have been the underlying strength of the industry; proof of its ability to respond flexibly to changing market conditions and needs. In fact, the Code is intended to ensure that this flexibility continues with improved arrangements to accommodate different leasing structures and customised rights and obligations with the minimum of paperwork and legal input. If there is a problem with the mix of arrangements upsetting the level

playing field then the answer is arguably for those depots with less than optimal arrangements to accede to the Code sooner rather than later.

- 2.9 We are not persuaded by the case for a staged rollout of parts of the Code. Our view is that this will undermine the incentive to accede to the whole Code, which would have whole industry benefit. It could also impose non-optimal timescales on a depot or group of depots and probably consume more industry resources over a longer period than straight accession to the Code is likely to do.
- 2.10 In summary, our final conclusions on the implementation of the Code are that:
- decisions on whether and when to accede to the Code are for the industry to take on a depot by depot basis;
 - we will not use our unilateral change power to impose all or parts of the Code;
 - we will not agree to different parts of the Code being implemented at different times; and
 - we will take every opportunity to promote the Code to ensure that the industry can benefit from the new arrangements, particularly given the substantial industry investment made in developing these, which in our view will reduce costs and increase the efficiency and effectiveness of depots.

Improving the draft Depots Code

- 2.11 When we published the July 2005 document, we also published on our website consultation drafts of the Depots Code, Depot Particulars and Framework Agreement. We invited comments on the draft documents, including how they could be simplified or improved.
- 2.12 We are grateful to Network Rail and to ATOC for providing us with marked-up copies of the documents and to these and other consultees for their many detailed, positive and helpful comments. We are currently refining the draft documents in light of these comments. This section of the document highlights the key issues arising out of this work.

- 2.13 We are not intending to make ‘cosmetic’ or stylistic changes other than to correct mistakes. Connected with the intention to avoid re-drafting where not strictly necessary, we will also maintain parity with the Stations Code, unless there were in the depot access conditions, or are now, compelling depot-specific reasons to diverge from it. We think that there is benefit for the industry in retaining parity, as is the case with the templates of the Station Access Conditions and Depot Access Conditions. Depot change and environmental liability are examples of areas of the Code where we accept that there is a continuing need for the provisions of the two Codes to diverge.
- 2.14 Network Rail and ATOC considered that we have made the Depots Code unnecessarily complicated by trying to cater in one document for relatively unusual situations, such as where a depot is connected to another depot or where the Environmental Landlord is not Network Rail. They suggested that such situations be handled in different ways, such as being hived off as optional provisions.
- 2.15 We are considering where the Code can be simplified in the light of consultation comments, but we are not proposing either to carry out a substantial reconstruction of the Code or to hive off the exceptional provisions into alternative Codes. In practice, the majority of depot parties should be able to avoid the complexities by referring with relative ease to those parts of the Code that apply to them. The present structure of the Code also allows it the inbuilt flexibility to cope with most or all situations, including the rare or non-standard situations, without the need for resource-intensive and expensive customisations.
- 2.16 We are committed to making the Code as user-friendly as it is possible for a robust set of contractual rules for the management and operation of depots to be. We are working on further improving signposting and guidance in the Code so that depot parties can quickly find what they need, grasp its meaning (without the need for professional advice) and apply it easily.
- 2.17 Finally, Network Rail argued for amendments to the Framework Agreement, giving it the right of veto on changes to the Code because:
- the absence of the veto increases the likelihood of contentious proposals being escalated for resolution to ORR;
 - the current drafting discourages development of the Code by consensus;

- it is a departure from the position under the existing regime and under the Network Code; and
- there is potential for a change to have strikingly different implications for a network operator and depot owner than for a train operator.

2.18 We are not persuaded by these arguments. We will consider further suggestions to encourage the development of the Code by consensus, but it is not clear how a veto as such would encourage such a consensus. We are concerned that a power of veto by Network Rail could have the opposite effect by cutting short any developing consensus. We do not believe a veto is consistent with the Network Code. Neither do we believe it is necessary because we will give due and proper consideration to Network Rail's representations before approving any proposed change to the Code.

2.19 As indicated in Chapter 1, we will be working on the drafting over the next few months and expect to finalise the Code documentation and make it available for use by the middle of 2006.

3. Liability framework

Indemnities

3.1 In the July 2005 document, we said we would hold further discussions with industry parties on:

- the scope of recoverable losses;
- the level of the caps and how they are to be defined; and
- whether there should be asymmetrical and/or negotiated caps on a depot-by-depot basis.

December 2005 consultation

3.2 Following discussions with ATOC, we initiated a short consultation inviting consultees to say whether they agreed with us that:

- there should be an annual cap on liabilities and, if so, at what level the template cap should be set and what liabilities should be covered;
- there should be a single incident cap on liabilities and, if so, at what level the template cap should be set and what liabilities should be covered; and
- we should apply the following criteria in handling the approval of, and disputes about, proposed, negotiated, asymmetrical caps as these:
 - should properly reflect the financial position of, and allocation of risk, between the parties;
 - should provide appropriate incentives and remedies for the parties; and
 - are appropriate, taking account of the allocation of risk to the train operator under any franchise arrangements.

Property damage

3.3 The current template depot access agreement and depot access conditions provide for caps on liability. We stated in the December 2005 consultation that they do not apply to property damage. Network Rail pointed out that although

the template depot access agreement does not specify a property liability cap, “the over-arching CAHA [Claims Allocation and Handling Agreement] agreement (to which each DFO [depot facility owner] and beneficiary is a signatory) applies and therefore the property damage liability is not unlimited”. SWT stated that the CAHA cap on property damage of £5 million may be inappropriate and there may be merit in disapplying it. However, it is clear that the CAHA agreement would permit the parties to a Code Depot Agreement to adopt a different level of cap.

Caps and recoverable losses

- 3.4 National Express opposed an annual cap on liabilities and was not persuaded by the case for a single incident cap. It is in favour of the extension of the definition of recoverable losses. Without a default position to fall back on, it is concerned as to how liability negotiations on a depot-by-depot basis will fare. SWT also opposed an annual cap on liabilities but suggested a single incident cap of £155 million. SWT said that the costs of business interruption should be included in the definition of recoverable losses.
- 3.5 Network Rail supported an annual cap because unlimited or excessively high caps would, in its view, incur significant additional insurance costs for both itself and train operators. Network Rail also argued that capping liabilities at £5 million for a single incident and at £20 million annually for all recoverable losses, except for injury claims and abatement regime costs, will provide:
- certainty;
 - simplicity;
 - practicality of calculation;
 - protection for the ability of parties to finance their activities and perform their contractual obligations; and
 - for losses associated with breach of contract to be recovered in full in most cases.
- 3.6 Network Rail considered that the default position of the Code should provide for symmetrical caps. It referred to the potential difficulties involved in negotiating asymmetrical caps and was concerned about the possibility of

double recovery in circumstances where more than one regime may apply to an incident.

3.7 In general, ATOC supported changes to the current arrangements that would:

- increase the scope for recovering losses from a guilty party;
- ensure that parties are fully incentivised to minimise risks;
- reduce total insurance costs;
- remove unnecessary ambiguity and confusion; and
- provide the industry with a methodology that facilitates negotiation.

3.8 ATOC welcomed the proposal to extend indemnity to cover all relevant losses. It believed that in current circumstances a single incident cap of £5 million is too low and would increase rolling stock insurance for train operators. It was concerned about the possibility of manipulation to the detriment of innocent parties and their insurers arising out of an annual cap. It urged ORR not to set a single default level cap for all depots but to provide the industry with a methodology to arrive at a cap on a depot-by-depot basis.

3.9 The methodology proposed by ATOC is:

(a) to add together:

- (i) the value of the depot;
- (ii) the value of the relevant rolling stock that could be in the depot;
- (iii) the value of the other contents of the depot; and
- (iv) the potential value of business interruption costs of an event which lasts “X” number of days; and then

(b) to apply to the sum of those values an agreed industry percentage figure to arrive at the single incident cap.

3.10 ATOC suggested further industry discussions on the number of days of business disruption to be used in the calculations (paragraph 3.9(a)(iv)) and the percentage figure to be applied (paragraph 3.9(b)).

- 3.11 ATOC disagreed with our position on symmetrical caps. In ATOC's view, business interruption cost are more likely to be paid to a train operator than Network Rail and therefore the default position should be one of asymmetrical caps. It argued in favour of a broad brush approach by which a cap on train operator liabilities is set at an industry-agreed percentage of the Network Rail cap.

Conclusions on liability arrangements

- 3.12 Having considered these comments, we have concluded that there should, as now, be a single incident cap on liabilities but that it should be extended to cover business interruption and property damage losses. We are not persuaded that it should, as suggested by Network Rail, exclude injury claims and abatement regime costs. We do not propose to proceed with an annual cap because there is insufficient industry support for the proposal and, on balance and after considering the consultation responses, we are no longer convinced that it would produce whole industry benefits.
- 3.13 We consider that the methodology proposed by ATOC to set a cap on a depot-by-depot basis is helpful but should be amended to include Network Rail losses, principally the performance impact of a breach allowing for the type of route involved. However, we believe that the Code should incorporate a default cap, based on an average case and derived from this methodology, to act as a benchmark and give certainty especially to new entrants.
- 3.14 We are sympathetic to the arguments put forward by ATOC for asymmetrical caps. We are prepared to review the presumption in favour of symmetrical caps if the industry is able to reach agreement, using the methodology for setting an incident cap, on the 'average' relationship between train operator and Network Rail liabilities. Without the certainty of such an arrangement, there are risks that negotiations on asymmetrical caps could be protracted; will divert and consume industry resources; will delay the adoption of the Code; and are likely to stall or result in a series of applications to ORR under section 17 of the Railways Act 1993.
- 3.15 We agree that the Code should prevent double recovery of losses. Further, with divergences opening up between the liability arrangements for track, stations and depots, we have decided that the Code should contain provisions to avoid the cherry-picking of liability arrangements by specifying that where

the breach occurs will determine which regime applies. Accordingly, if the breach occurs within the leased area of the depot then the Depots Code liability regime will apply.

3.16 We are mindful of the need to proceed with caution, particularly in this specialist area of the Code, and to listen carefully to consultees and the views of their insurance and risk advisers. We therefore welcome the early development of an industry consensus to help in finalising the details of our approach. We will do all that we can to facilitate such a consensus on the basis of our conclusions summarised here because we believe that agreement is achievable and consensus is the best way forward. If the industry cannot reach agreement on the details of the liability framework, we will decide how to finalise the work.

3.17 In summary, we have concluded that the Code should:

- not provide for a default annual cap on liabilities;
- provide, on the basis of the methodology proposed by ATOC (as amended above), for a single incident cap to be set on a depot by depot basis, to cap property damage and other losses;
- provide for a default single incident cap where the parties choose not to use this methodology;
- define recoverable losses so as to include loss of profit and loss of revenue (as in the draft consultation version of the Depots Code);
- contain provisions to ensure against double recovery of losses under more than one liability regime, i.e. track and/or stations as well as the Code;
- contain provisions to ensure against cherry-picking of liability frameworks;
- invite industry views on how to address the unknowns in ATOC's methodology for reaching a single incident cap, whether, for example, seven days of business interruption and 50% are appropriate components of the methodology;
- invite industry views on using a formulaic approach to set a single incident default cap; and

- review our position on symmetrical caps if the industry is able to agree a way forward, for example, by adopting ATOC's proposal for a broad brush approach and the use of an agreed percentage because it accepts that Network Rail's liabilities to train operators are more likely to be higher than those of train operators to Network Rail.

4. Depot change procedures

Introduction

4.1 This chapter sets out our final conclusions on:

- changes to bilateral arrangements;
- permitted variations to a Code Depot Agreement;
- the depot facility owner's own services;
- closures; and
- ad hoc users.

4.2 The change procedures in the Code are seen by us as an important component of the reform of existing arrangements by:

- facilitating change, including investment in new facilities and the closure of redundant ones;
- streamlining and clarifying procedures;
- removing or reducing unnecessary administration and bureaucracy; and
- protecting, in an appropriate way, the rights of those with an interest in a Code Depot, including those beneficiaries who, faced with proposed changes, cannot take their business elsewhere as they would be able to do in other market situations.

4.3 In our July 2005 document, we invited consultees to comment on whether:

- proposed changes to a beneficiary's Services and Charges Annex and to its performance regime, so-called "bilateral arrangements", should be carved out of the requirements of the depot change process; and
- changes currently subject to a light maintenance depot access general approval should be capable of being varied by agreement of the parties to a Code Depot Agreement in reliance upon section 22(C)(3) of the Railways 1993, i.e. without the need for the approval of ORR.

- 4.4 Consultees however did not limit their responses to answering these two questions. Instead they, and ATOC in particular, reviewed the depot change package as a whole and, as a result, made a number of suggestions to reduce and refocus the scope of depot change procedures and to improve and clarify the drafting in the Code. Because of the importance that we attach to this area of reform, we have considered all the suggestions very carefully and made changes to the Code drafting, where we consider appropriate.

Bilateral arrangements and permitted variations

- 4.5 In their consultation responses, Network Rail and National Express welcomed the refinements to the depot change procedure whereby bilateral changes that have no impact on other parties at a depot may be carved out of the depot change process. SWT argued in favour of extending the scope of bilateral arrangements to include physical changes to a depot where other parties do not use the facilities being changed.
- 4.6 Network Rail was in favour of changes currently subject to general approval being varied by agreement between the parties providing there is a cost saving to the industry. National Express also supported this proposal but queried how the notification requirement is to be enforced.
- 4.7 SWT argued that depot change procedures should only capture those issues that have a genuine material disbenefit to other users of a depot. It considered the current suite of general approvals to be confusing and difficult to operate, arguing that many changes require two approval processes, one for those changes that are covered by a general approval and another for those requiring the specific approval of ORR. ATOC suggested look-up tables based upon the current suite of general approvals listing the variations that can be agreed between the parties.

Conclusions on depot change and approval processes

- 4.8 We have concluded that the depot change and approval processes should be revised in the light of consultation comments because we believe that, by making them more risk-based, they will be more effective, less costly and provide industry parties with greater assurance and certainty when, for example, they are making the changes associated with the introduction of new rolling stock. In short, unless, for example, changes to bilateral arrangements will impact on third parties, the depot change procedures will

not apply and where there are sufficient safeguards in the arrangements our consent will not be required.

- 4.9 We have concluded that depot change procedures should not cover changes to bilateral arrangements, i.e. changes to a beneficiary's Services and Charges Annex and to the terms of a beneficiary's performance regime, providing the changes:
- are agreed between the depot facility owner and a beneficiary;
 - will have no material and adverse effect on depot services provided to third parties; and
 - are pre-approved by ORR, that is before they are due to take effect, or, if the changes fall within the list of variations which the depot facility and the beneficiary may agree under section 22(C)(3) of the Act, are notified to ORR within the prescribed timescale.
- 4.10 If the proposed changes do not meet this criteria, for example if they are likely to have a material and adverse effect on third parties, then depot change procedures will apply. Any changes to the Code Depot Agreement made or entered into where the above criteria have not been met can be challenged and will be void.
- 4.11 We have further concluded that the Code should incorporate a table of variations that may be agreed between the parties and will not require our approval before they take effect. The table of variations is based upon the contents of the existing suite of general approvals but has been extended to cover other areas of the Depot Particulars.
- 4.12 For the variations to be valid, they must:
- be agreed to by the relevant parties; and
 - not have a material and adverse effect on depot services provided to third parties; or
 - have been subject to depot change procedures, if appropriate; and
 - be notified to ORR within 14 days of being made or entered into.

- 4.13 We do not believe that changes to depot charges should require our approval because the Code contains safeguards that enable a depot facility owner or a beneficiary to initiate a charging review and for dispute resolution to take place, where the parties cannot agree on changes to depot charges.
- 4.14 We have decided to exclude two key areas of changes to bilateral arrangements from the variations covered by section 22(C)(3) of the Act. These are proposed increases in minimum service levels and proposed changes to a performance regime. If they satisfy the criteria in paragraph 4.9, then such changes will fall outside the scope of depot change procedures as changes to bilateral arrangements. However, we consider that such changes should require our approval before they can be implemented. This will enable us to consult interested parties, if we think it appropriate, and to consider for ourselves any effect of such proposals on capacity allocation at a depot and on the quality and quantity of depot services provided to third parties.

Depot facility owner's own services

- 4.15 We have considered further representations from ATOC and SWT, as well as contrary views from Siemens, on the exclusion of the depot facility owner's own services from the Master Schedule of services and charges in the Depot Particulars. We believe that the administrative tasks involved in submitting to us for approval details of these services and any changes to them have been exaggerated. Further, there is a risk to the continuity of those services, if they were in effect to become unregulated, of becoming subject to the decision criteria.
- 4.16 Changes to a depot facility owner's own services may conceivably have a material and adverse effect on the depot services of a third party beneficiary. We would not expect depot change procedures ordinarily to apply but it is important that the changes are subject to depot change procedures if they will impact on third parties. This safeguard is particularly relevant given that the beneficiaries of a depot often constitute a captive market and that the Code does not include, as set out in the July 2005 document, the provisions of Part S of the template depot access conditions, which require a depot facility owner to consult beneficiaries on proposed changes to the depot work plan.
- 4.17 Proposed increases in the depot facility owner's own minimum level of services will, as now, require the specific approval of ORR. Where there are

no third party beneficiaries, our approval will enable us to be satisfied that the proposed increase in the depot facility owner's minimum level of services is not intended as a blocking device to keep out third parties.

Closures

- 4.18 We accept the case made by ATOC that consultation in the depots context should focus on any material and adverse effect that changes may have on depot services.
- 4.19 The Code will be amended to carve out, from the depot change procedures, the closure of facilities that have not been used for more than a year or where their closure would not impact on depot services because, for example, they are being replaced or relocated without disruption to the users of a depot. This will also ensure that the contractual provisions in the Code in respect of closure are not in danger of becoming more onerous than the statutory ones repealed by the Railways Act 2005, which provided for "Minor Closures". However, in the absence of statutory provisions, we consider it important that a proposal to close the whole of a depot should, as under the current access regime, be subject to objection by relevant consultees.
- 4.20 We do not intend to directly intervene in depot change procedures by making minor closure-type rulings or by making any other rulings as to whether a proposed change should or should not be subject to depot change procedures. Our view is that we should work with the industry to provide the framework and to act as the backstop for when things go wrong. Industry parties should then be able to make their own decisions in a mature and reasonable way on the basis of clear and robust drafting of the rules and procedures.

Ad hoc users

- 4.21 We have considered the arguments to impose further limits on the rights of ad hoc users.
- 4.22 Our overarching intention is to strike a balance between the needs to facilitate change and to put in place appropriate checks and balances to protect the rights of third parties. The current arrangements in the template depot access conditions make the provision of depot services to ad hoc users subject to the

decision criteria and to defeasance in certain circumstances.⁴ On the basis of our review of the depot access regime, and in the light of consultation responses, we have concluded that those with a right to use a depot on an irregular basis, some of which may never exercise that right, should have consultation rights only in respect of depot change. Other beneficiaries, who by specifying and paying for minimum levels of services are the Code Depot's regular customers, should have consultation and objection rights in respect of proposed changes.

Conclusions on ad hoc users

- 4.23 In the light of consultation responses, we will make changes to the definition of ad hoc users to give better effect to our intention, including limiting those consultation rights to ad hoc users who have used the Code Depot in the last twelve months. We do not believe that the Code should also specify a threshold access charge. This would amount to a purchase price for consultation rights, which we believe is unacceptable.
- 4.24 Our view remains that the criteria should be the use of a depot and that if a beneficiary uses a depot then it is entitled to certain rights. An ad hoc user who wishes to play a part in a depot should be able to exercise its right to be consulted. If an ad hoc user contracts with the depot facility owner for a minimum level of services it then changes its status and can play a full part in the depot with consultation and objection rights. Given this view, we do not intend to exempt depots from depot change procedures where beneficiaries are ad hoc users only, subject to the limitations set out above.

⁴ *National Depot Access Conditions (December Standard) Part R Decision Criteria, Unregulated Contracts and Defeasible Rights.*

5. Maintenance, repair and renewal responsibilities

Introduction

- 5.1 The Code envisages major and beneficial changes to the current template allocation of maintenance, repair and renewal responsibilities between Network Rail and depot facility owners. These changes are intended, in particular, to do away with split stewardship responsibilities, wherever possible, and to give depot facility owners greater operational control.
- 5.2 Under the Code, Network Rail retains substantial and significant responsibilities for the care of depot assets and equipment. To ensure that Network Rail and depot facility owners focus on their responsibilities, the Code has a toolkit of new and improved remedies. The abatement and performance order regimes and self-help are key features of this toolkit. This chapter contains:
- a report on the progress of work on the abatement regime since the July 2005 document;
 - a summary of consultation responses; and
 - our final conclusions on the abatement regime, self-help and the performance order regime.

Abatement regime

- 5.3 The development of an abatement regime for depots has been innovative work. As foreshadowed in the July 2005 document, we appointed MVA as our consultants in October 2005, to develop proposals for the specification of an abatement regime and for the amount of compensation payable when abatable items are not fixed or repaired. Working with ATOC and with the help of industry representatives, MVA produced a report in December 2005 that was circulated to consultees for comment as part of the December 2005 consultation.
- 5.4 The purpose of the abatement regime is to:

- reduce the likelihood of asset failure occurring by putting in place mechanisms to optimise the efficient running of a depot;
 - incentivise repairs or renewal in a timely and efficient manner when asset failure occurs; and
 - provide appropriate compensation to affected parties when there is an asset failure.
- 5.5 Under the Code, the abatement regime will replace existing liability arrangements under which Network Rail has to pay the depot facility owner when it is at fault for late and/or cancelled trains. The abatement regime in the Code, however, goes beyond those current arrangements to cover equipment that is crucial to the provision of depot services.
- 5.6 The list of abatable items is broadly of those for which Network Rail has responsibility to maintain, repair and renew. There are a small number of items (carriage washing plant, wheel lathes, cranes and rail vehicle turntables) which, for reasons of operational control, repair and maintenance are allocated to the depot facility owner but, for reasons of cost, the responsibilities to renew are with Network Rail.
- 5.7 The abatement regime is not primarily about compensation. In fact, it will have failed if it leads to Network Rail paying compensation rather than addressing problems. It is not intended to be a successor to the Excess Costs regime, which we have decided not to carry forward from the current arrangements to the Code⁵. Instead, it is about incentives and behaviour. The abatement regime is intended to effectively incentivise Network Rail to maintain, repair and renew those items of equipment for which it has sole responsibility and to effectively incentivise the depot facility owner to maintain and repair those abatable items for which responsibilities are split between it and Network Rail. The incentives extend to ensuring that arrangements are in place to avoid or minimise the consequences of failure on depot services.

⁵ Condition D11 of the template depot access conditions, *Excess Maintenance and Repair Costs*, provides for the excess costs of maintaining certain critical assets over an agreed annual threshold and subject to an agreed level of usage to be divided between Network Rail and a depot facility owner so as to incentivise each to carry out its responsibilities to maintain, repair and renew in a timely and effective way.

5.8 If compensation does become payable, Network Rail will be liable to pay the depot facility owner. The only exception is where Network Rail has to renew an asset because of poor maintenance and repair by the depot facility owner. In that case, Network Rail would be able to claim back some of the cost of premature renewal from the depot facility owner.

5.9 In summary, MVA proposed in its report:

- a new list of abatable items different from those in the July 2005 document (other than those for which responsibility is split: carriage washing plant, wheel lathes, cranes and rail vehicle turntables). This list included: permanent way; traction current (third rail or overhead); utilities; lighting (including towers); signalling; and fuel (storage, pumping and dispensing);
- minimal scope for customisation/negotiation;
- three categories of failure, defined as Critical, Important and Other;
- the daily abatement value for a Critical failure to be 25% of annual plant lease cost;
- the daily abatement amount of an Important failure to be 35% and of an Other failure 5% respectively of the Critical figure;
- two different levels of abatement depending on when the failures occurs – night or day; and
- grace periods before which the abatement becomes payable.

In respect of those assets for which responsibilities are split, MVA proposed:

- defining the expected life time of the asset or type of asset;
- agreeing a period in the expected life of an asset after which failure becomes the responsibility of Network Rail; and
- categorising each type of asset by importance on the likely disruption if it should fail.

Customisation and conflict

- 5.10 In the December 2005 consultation, we asked consultees whether MVA's report provided a satisfactory basis for the Code abatement regime and, if not, why and what changes they would suggest.
- 5.11 Consultees supported the broad thrust of MVA's work, although they had some concerns. SWT, for example, thought that the Code should contain MVA's abatement regime as the default position but allow for customisations where, for example, the depot facility owner has a full repairing lease and where there are landlords other than Network Rail or with different responsibilities. We agree that the Code should provide for customisation, including the disapplication of the regime in certain circumstances.
- 5.12 SWT was also concerned about the potential of the regime to cause conflict. Network Rail lent support to this argument in its statement that an abatement regime is not the only way to improve efficiency and outputs. It said that it is currently undertaking a fundamental review of roles and responsibilities within and outside its business that it believed would help.
- 5.13 Our support for an abatement regime is not intended to increase conflict and confrontation between depot facility owners and Network Rail. In fact, we welcome the review referred to by Network Rail if it leads to better and more co-operative ways of working. The abatement regime is one of a number of measures in the Code designed to encourage a change in behaviour towards their obligations by the parties joining a Code Depot Agreement and to provide depot facility owners with an alternative to resigned acceptance when things go wrong.

Involvement of beneficiaries

- 5.14 ATOC had general concerns, some of which, we believe, arise out of MVA's description in its draft final report of the abatement regime as a tripartite relationship. As stated in MVA's final report, which was sent to consultees, the abatement regime will operate between the depot landlord and the depot facility owner (*paragraph 1.2: Contractual Framework*). A beneficiary will not be entitled to claim compensation from the depot landlord or the depot facility owner under the terms of the abatement regime. Some of the compensation paid by the depot landlord to the depot facility owner may flow to a beneficiary

but any compensation paid to a beneficiary will arise out of that beneficiary's performance regime.

Assets where only renewal responsibility lies with the depot landlord

- 5.15 National Express was concerned that it will incur excess maintenance costs on new or renewed equipment. ATOC argued for the return of the excess costs regime and its use of base utilisation levels and relevant threshold sums. We concede the need for a mechanism to ensure that depot facility owners are compensated for excess maintenance costs arising, for example, in the early life of an asset or following a defective overhaul for which they are not at fault. The excess costs regime, where it was understood and applied, may have compensated depot facility owners for the cost of any excess maintenance they were forced to carry in these circumstances. However, we have decided against restoring that regime because its overall effect has been to make the best of a bad job, i.e. to perpetuate problems rather than cause them to be effectively addressed.
- 5.16 Network Rail argued that the potential shortening of asset life by effectively suggesting that an asset's life expires at 90% of the agreed period risks an increase in industry costs. It also stated that if the depot landlord becomes liable for all failure costs in the last 10% of an asset's life, there is no incentive on the depot facility owner to maintain that asset to the required standard.
- 5.17 We believe that the depot facility owner is likely to be incentivised to maintain and repair an asset in the first 90% of its life because of operational imperatives. If the depot facility owner fails to meet its obligations, the depot landlord will be able to recover costs associated with that failure if it has to renew an asset earlier than expected. The incentives to minimise repair and maintenance costs in the last 10% of the asset's life or to renew the asset will however lie most appropriately with the depot landlord.
- 5.18 Network Rail stated that there could be protracted negotiation to agree the expected life of the assets involved. Although we wish to reduce the scope and the need for negotiation, it is important for the implementation, and success, of the Code arrangements that the depot facility owner and the depot landlord engage in a robust process to assess and record the condition of all the assets of a depot before entering into a Code Depot Agreement. For

those few assets for which responsibility is split, we cannot believe, or accept, that it is beyond the industry to reach an agreement on, or understanding of, in reasonable time, how long an asset, like a wheel lathe, is likely to last before it has to be scrapped or overhauled. The depot stewardship plan should provide the context for on-going discussions between depot landlord and depot facility owner on issues arising from the condition of assets.

- 5.19 We have decided to adopt MVA's proposals for those assets where only renewal responsibility lies with the depot landlord. There will be provisions in the Code to deal with disputes about any excess maintenance costs or disruption costs arising in the first 90% of an asset's life.

Detailed changes to the abatement regime

- 5.20 Network Rail and ATOC made many helpful suggestions in their consultation responses as to how to improve the detail of the abatement regime. We do not propose to act upon all the suggestions because, as the consultation letter of 16 December 2005 pointed out, there is a paucity of data in this area. In the absence of that data, MVA had to rely upon its own professional judgment and the help of industry volunteers to design a regime which we intend to be simple, fair and effective. Where possible, MVA has provided reasoned arguments for its proposals or suggested reasonable provisions. We do not therefore intend to unpick the provisions of MVA's regime unless the alternatives proposed are clearly better. We shall however monitor the regime and make any changes as necessary.

Conclusions on the abatement regime

- 5.21 For the reasons we have given, we therefore propose to incorporate MVA's proposals into the Code, reflecting:

- (a) Network Rail's suggestions in respect of:
 - (i) uncontrollable failures;
 - (ii) the extent of depot usage;
 - (iii) temporary repairs; and
 - (iv) delayed fault reporting; and

- (b) ATOC's suggestions in respect of:
- (i) a value for maintenance roads; and
 - (ii) the measurement of the proportion of the depot affected by utility, signalling and lighting failure.

Self-help

5.22 In the July 2005 document, we set out our views on the way that the self-help remedies should operate:

- as a form of rapid relief in respect of critical items of equipment or elements of the depot;
- with appropriate safeguards against the possibility of an unsatisfactory 'quick fix';
- with strong cost recovery mechanisms; and
- as an effective incentive upon Network Rail and the depot facility owner.

5.23 We invited consultees to comment on the list of critical items of equipment and elements of the depot that should be subject to the Code's self-help provisions.

5.24 In its consultation response, ATOC expressed a number of concerns. Perhaps its most fundamental concern was over the policy decision that we have taken to extend self-help rights to beneficiaries. ATOC is concerned because:

- it could have material, adverse consequences on the depot facility owner's safety responsibilities;
- it is inappropriate where the original failing lies with Network Rail; and
- the depot facility owner's and beneficiaries' interests are usually aligned (although it agrees that the remedy is more justified where the interests are not aligned).

5.25 ATOC also argued that depot facility owners should have the right to set-off payments against depot rents because of the difficulties of recovering monies due from Network Rail. The list of items to which the self-help remedies

should apply should be extended to elements of the depot. Finally, it cautioned against self-help leading to gold-plating of depot assets, which will increase depot costs inappropriately.

- 5.26 Network Rail believed that too many items are subject to the self-help provisions. It argued that the output or capability specification of an item on the list needs to be better defined to avoid disputes between itself and the depot facility owner over whether and what action needs to be taken.
- 5.27 National Express argued that there should be an order of priority as to who actually exercises the self-help remedy. It agreed with ATOC that the list should include elements of the depot. It was worried however that 20 business days is simply too long to wait for action, especially for traction, supply and signalling equipment.

Conclusions on self-help remedies

- 5.28 We are grateful for the suggestions made to improve the self-help provisions of the Code, many of which are being taken forward. On the main consultation issue, we have decided to align the Depots Code with the Stations Code and to make all the assets of a Code Depot subject to self-help provisions. This change highlights the importance we attach to the self-help provisions of the Code. It will enable the parties to a Code Depot Agreement to enforce contractual compliance in respect any faulty piece of equipment or any element of the depot that is having an adverse and material effect on depot services. It should also bring greater clarity and certainty to the operation of the self-help provisions.
- 5.29 We have concluded that the self-help remedy should be directly available to beneficiaries to use, with suitable safeguards, if other remedies have been tried first but have failed to secure the desired effect. The remedy may be particularly useful in situations where the depot facility owner has a full repairing lease and Network Rail's responsibilities are few.

Performance orders and other remedies

- 5.30 In their responses to the July 2005 document, consultees made a number of comments on the performance order regime.

- 5.31 ATOC argued the need for “urgent resolution” (the factor which determines whether an anticipatory application can be made) to have an objective basis. Network Rail did not see the need for a performance order remedy for anticipatory breaches because:
- the industry is currently working towards a replacement of the Local Output Commitments (LOC) regime, on which this is based, by joint performance improvements plans (JPIPs) together with revised compensation arrangements under Schedule 8 of track access agreements; and
 - such a remedy runs counter to developing co-operation between industry parties and the focus of the Government's Rail Review⁶, which was about delivering partnership rather than counter-productive wrangling.
- 5.32 We do not see a conflict between the availability of a full toolkit of remedies and co-operation between industry parties. In addition, although industry discussions on JPIPs may, in due course, render anticipatory performance orders unnecessary, they have yet to reach a conclusion. We do not, therefore, intend to remove from the Code a performance order remedy for anticipatory breaches at this time but will review this issue once the position on JPIPs is clear.
- 5.33 Siemens asked how the depot facility owner's renewal obligations will be enforced. We have decided, for the time being, not to extend the abatement regime to enable beneficiaries to claim compensation directly from the depot facility owner for problems arising from the failure to renew equipment for which it is responsible. Instead, we believe that the depot facility owners' renewal obligations should be sufficiently incentivised through the franchise agreement or the depot lease and/or the depot performance regime. We also believe that work on the Statement of Condition, the negotiation of depot rent on the basis of the new allocation of repair, maintenance and renewal responsibilities and Depot Stewardship Plans will all play an important part in ensuring that depot facility owners fulfil their renewal responsibilities. We will review the position if these incentives and other arrangements prove to be inadequate.

⁶ *The Future of Rail* White Paper, published July 2004 and available in summary on the ORR website at: <http://www.rail-reg.gov.uk/server/show/nav.115>.

6. Depot charging arrangements

Introduction

6.1 In the July 2005 document, we said that we recognised the genuinely commercial nature of most, if not all, negotiations over depot charges and the variability of factors underlying them. We added that we did not seek to inhibit future depot charging negotiations but remained keen to bring about greater transparency. To further review how to achieve this, we asked consultees how we:

- could bring greater transparency to the prices charged for depot services; and
- further develop our approval criteria.

Transparency of depot charging arrangements

6.2 In its consultation response, ATOC argued that, as there is no evidence of current problems regarding the transparency of depot charges, the requirement for greater transparency is being driven by ideology rather than by need. It is concerned that publishing depot charges may have an inflationary effect, which we assume would be because depot facility owners will react by adjusting their prices upwards, rather than downwards, as they become aware of different charging levels at other depots.

6.3 Instead of charging transparency, ATOC preferred greater transparency of the costs underlying depot charges by strengthening the beneficiary's access at the negotiation stage to the calculation method used to arrive at the proposed depot charges. It believed that a right to information on the cost break-down of depot charges and other supporting information would be useful and foster good industry working relationships.

6.4 Lambert Smith Hampton said that the commercial elements of depot charging should not be made more transparent because a decision was taken at privatisation by all parties, including us, that as far as possible depots should operate on a commercial basis and be subject to market forces. In its views, no case has been made to support disclosure.

- 6.5 SWT said that it opposed the proposal for transparency of depot overheads because they vary tremendously by depot and company structure. It argued that there would be less clarity rather than more if we were to pursue our proposals because of the range of variables involved.
- 6.6 Siemens and National Express took a different view from those described above. Siemens supported greater transparency of depot charges unless the depot facility owner believes that charges at particular locations should remain commercially sensitive. National Express simply stated that depot facility owners should be required to publish a tariff of their prices and the terms associated with them.
- 6.7 Siemens did not support our proposal that the depot facility owner should be obliged to confirm with an application under section 18 of the Act that the beneficiary is content with information provided on the overheads underlying the depot charges. Siemens believed that such a declaration should be voluntary unless the parties are unable to agree on this or other issues and the beneficiary, as a result, submits an application to ORR under section 17 of the Act. In such circumstances, Siemens supported obligatory transparency in respect of depot overheads.

Conclusions on the transparency of charges and the approval criteria

- 6.8 We have decided that both of these issues are matters of policy and process to be addressed outside of the Code.
- 6.9 Contrary to the views expressed above, we are aware that there have been problems arising out of the lack of transparency of depot charges. Depot beneficiaries and potential beneficiaries have regularly complained to us over the last four or five years about the charges they are paying or are being asked to pay. They have also sought information on indicative charges or the charges made to other beneficiaries. In cases where we have concluded that it is appropriate to exclude this information from the Public Register, in accordance with section 72(3) of the Act, we have then been unable to disclose this information without the consent of the party which provided the information to us because of the prohibition in section 145(1).
- 6.10 It undermines any party's application under section 18 of the Act if they feel they are effectively agreeing to commercial terms which in reality they do not

understand or feel comfortable with. There are remedies available under section 17 of the Act and in the price review provisions of the template depot access conditions (Condition F4 – Review of Access Charge), both of which will also continue to be available under the Code. However, in every case known to us, parties unhappy with depot charges have decided against tying up their resources in these ways when the outcome is uncertain and the risks to the continuity of services and future good working relationships are perceived as real.

- 6.11 We consider that our arrangements should be consistent with one of the objectives of the First Package of EU Rail Directives, which is to increase transparency in charging regimes. We also consider that they should be consistent with the imperatives on the industry to reduce costs and increase efficiency.
- 6.12 In entering any provision on the Public Register, we are required to have regard to the need to exclude, so far as is practicable, the matters specified in sections 71(2)(a) and (b) of the Act. These sections refer to:
- (a) any matter which relates to the affairs of an individual, where publication of that matter would or might, in the opinion of ORR, seriously and prejudicially affect the interests of that individual; and
 - (b) any matter which relates specifically to the affairs of a particular body of persons, whether corporate or incorporate, where publication of that matter would or might, in the opinion of ORR, seriously and prejudicially affect the interests of the body.
- 6.13 We must use our judgement in interpreting these provisions, in a manner consistent with our duties under the Act. Currently, we consider excluding:
- details of financial arrangements, including those relating to performance incentives, compensation costs or other payments made under change proposals, and access charges which are or may in future be subject to negotiation; and
 - matters which may have a material impact on commercial negotiations with third parties.

6.14 In particular, we currently exclude the following information from depot access agreements before publication:

- the limit of authority figures in paragraph 4 of Appendix 1 to Schedule 5; paragraph 3 of Appendix 1 to Schedule 7; paragraph 1 of Appendix 2 to Schedule 9; and paragraph 3 of Appendix 1 to Schedule 10;
- the charges and unit costs in Appendix 2 to Schedules 5, 6, 7 and 8; in Appendix 1 to Schedule 9; and in Appendix 2 to Schedules 10, 11 and 12;
- the numbers of minutes and rates of payment in Schedules 13 and 14;
- the rate of liquidated damages and incentive payments in Part 1 and Part 2 of Schedules 15 and 16; and
- the amounts in Schedule 17.

6.15 We have decided that in future the parties will need to make a case on each individual application as to why this information should be excluded under section 71(2) of the Act. We will take a more stringent view in applying the test in section 71(2) of the Act, given the importance we attach to greater transparency.

6.16 We will in due course issue process guidance on our approval criteria, which takes account of consultation responses to our provisional and draft conclusions documents. In a change to our current policy, we will seek to bring about greater transparency of depot overheads by asking a proposed beneficiary whether, in negotiating a depot access contract with the depot facility owner, it has had access to sufficient information on the costs underlying the depot charges to consent to the application under section 18 of the Act.

Annex A: List of respondents to the July 2005 document

Association of Train Operating Companies (ATOC)
FirstGroup Plc
Jarvis Fastline Limited
Lambert Smith Hampton
National Express
Network Rail Infrastructure Limited
Siemens Plc
South West Trains Limited (SWT)
Strathclyde Passenger Transport Executive (SPTE)
Transport for London (TfL)

Annex B: List of respondents to the December 2005 consultation

Association of Train Operating Companies (ATOC)
Go-Ahead
National Express Group
Network Rail Infrastructure Limited
South West Trains Limited (SWT)