

To those on the attached list

21 November 2003

## **THE REGULATOR'S LOCAL OUTPUT COMMITMENT CRITERIA: DRAFT FOR CONSULTATION**

1. I am writing to consult you on the Regulator's Local Output Commitment (LOC) criteria, by reference to which any matters referred under Conditions L7.1 or L7.2 of the network code would be determined. Conditions L7.1 and L7.2 deal with appeals to the Industry Committee and the Regulator respectively under the procedure for establishing LOCs in the proposed new Part L of the network code.

### **Background**

2. Following extensive consultation and deliberation with the industry, the Regulator has concluded that he should propose a new provision, Part L, of the network code which would provide for the generation by Network Rail of contractually enforceable local output commitments (LOCs) on a three-year forward-looking basis for each train operator.<sup>1</sup> Each LOC would be supported by a Performance Plan for maintaining, repairing, enhancing etc. the relevant parts of the network, showing how Network Rail intended to achieve the LOC. Whilst a Performance Plan will not in itself be a contractually binding commitment, it will provide important information for a train operator.

3. The Regulator considers that his proposals for LOCs will:

- (a) promote forward planning by Network Rail;
- (b) over time, give train operators reliable, robust three-year projections of performance, with the Performance Plans to support them, so as to provide train operators with a sound basis to plan their businesses;

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<sup>1</sup> Strictly, the LOC would be a commitment to the beneficiary of any Access Agreement with Network Rail which incorporated the network code. This could include a beneficiary which was not a train operator but which contracted with a train operator to run services on its behalf.

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- (c) provide an opportunity for train operators to influence Network Rail's plans, especially as plans for the second and third years of a LOC are being developed; and
  - (d) provide compensation to a train operator for its relevant losses where Network Rail's performance has been exceptionally bad and it has failed to achieve the LOC.<sup>2</sup>
4. LOCs should therefore become a key tool in the delivery of improved performance on the railway.
5. Chris Blackman, on behalf of the Class Representative Committee, is today sending a proposal for change to industry parties under Condition C5.2 of the network code. The proposal for change has been made by the Regulator and would, if implemented, incorporate the new Part L into the network code. Although there is no formal requirement to consult on a draft of the Regulator's LOC criteria, we believe that it is highly desirable to do so and that it will be helpful to respondents if we consult in parallel with the proposal for change consultation.
6. The draft criteria are at Annex 1. It may be helpful to make a few comments on why they are drafted as they are:
- (a) as noted in paragraph 6.33 of the June final conclusions document on the passenger model contract,<sup>3</sup> the Regulator does not believe that the Network Rail-attributable delay minutes LOC is likely to be particularly appropriate or useful for freight operators. Work is going on to establish what should be done for freight operators, but this is at a fairly early stage. As drafted, the criteria circulated with this letter would only apply to passenger operators. The Regulator could, of course, issue revised criteria later which would also cover a freight-specific LOC;
  - (b) the draft criteria are intended to focus on operators having a single type of LOC from April 2004, namely a Class A LOC based on Network Rail-attributable delay minutes per hundred train kilometres. This LOC has been the subject of considerable discussion with the industry. The LOC will not cover 'TOC on TOC' delay minutes;
  - (c) other types of LOC may be developed in due course. But LOCs are a new concept for the industry and it seems preferable to focus on getting the same type of LOC in place for all passenger train operators and getting people used to the procedure before starting to permit new types of LOC or variations of the Network Rail-attributable delay minutes LOC;
  - (d) the draft criteria also include notes explaining what the Regulator would expect a LOC to contain in order to be consistent with a particular criterion (for example, how he would expect *force majeure* events to be treated). We believe that this is likely to be helpful to

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<sup>2</sup> Compensation for all relevant losses for breach of the proposed Class A LOC, after allowing for money already received by the train operator under Schedules 4 and 8, would be payable for breach of a LOC where the operator had a track access agreement based on the Regulator's model passenger track access contract.

<sup>3</sup> *Model clauses: the template passenger track access contract – Regulator's final conclusions*, Office of the Rail Regulator, London, June 2003, available at [www.rail-reg.gov.uk/filestore/bluedocs/171.pdf](http://www.rail-reg.gov.uk/filestore/bluedocs/171.pdf).

Network Rail and train operators in setting the main parameters within which the first LOCs will be developed;

- (e) Network Rail will be expected to aim to achieve a realistic projection of Network Rail-attributable delay minutes per hundred train kilometres and an operator would be able to appeal if it considered that the projection was insufficiently demanding (see draft criteria (d), (f) and (g)). But the LOC for each operator - the level of performance that Network Rail must achieve before it is in breach of contract - would be set at a level somewhat higher (*i.e.* worse than) this realistic projection of Network Rail-attributable delay minutes per hundred kilometres. Paragraph 6.46 of the June final conclusions document suggested that this margin should be in the region of 25 per cent worse than projected performance, but that the Regulator would do further work to establish whether this was the appropriate level. The 25 per cent figure is therefore in square brackets. Whatever figure is finally determined by the Regulator, he expects that over time it will decrease, as Network Rail improves its understanding of the drivers of good performance, its asset knowledge and business planning processes;
- (f) criterion (d) and note 5 of the draft criteria recognise that, if there is to be, say, a 25 per cent national average figure, the LOCs of some operators will be more than 25 per cent above the realistic projection, just as some will be below 25 per cent;
- (g) the draft criteria deal with differences in the level of LOC for different operators. Some differences will be inevitable, but it is important that Network Rail should be able to justify them. The proposed starting point in considering any LOC would be whether it was realistic in its own right. The draft criterion (f) would also allow the Regulator to consider comparisons with LOCs made in respect of other operators. Such comparisons may provide an additional perspective on whether a LOC was sufficiently demanding;
- (h) draft criterion (j) is intended to apply when a LOC is replaced or superseded in the following year and Network Rail wants to revise the original Year 2 and 3 figures to make them less demanding. This criterion would not be relevant to the process for establishing LOCs for 2004/05. It has been included here for completeness, although it is quite likely that the criteria will be revised and re-issued for LOCs to be set starting in April 2005 (*e.g.* to deal with the inception of a LOC for freight operators or to introduce a new passenger operator LOC or generally to building on lessons from the first year of LOCs).

7. As the proposal for change memorandum for Part L notes, the Regulator will need to decide whether LOCs should go live as contractual commitments by Network Rail to passenger operators for 2004/05. His intention at present is that Part L should indeed go live in this way, subject to transitional arrangements explained in the proposal for change to incorporate Part L into the network code. This letter has been drafted accordingly. But the Regulator intends to take a final decision later, weighing the benefits of introducing LOCs as soon as possible against the practical problems of Network Rail making realistic commitments for 2004/05, particularly given the timing of the conclusion of the access charges review. In the meantime, Network Rail is continuing to work on the basis that Part L will go live for passenger operators to receive LOCs for 2004/05.

8. I would be grateful if you could send us comments on the draft LOC criteria by Tuesday 23 December 2003 please. Responses should be sent to:

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Office of the Rail Regulator  
1 Waterhouse Square  
138 – 142 Holborn  
London EC1N 2TQ

9. Electronic copies should also be e-mailed to: [brian.hatfield@orr.gsi.gov.uk](mailto:brian.hatfield@orr.gsi.gov.uk); (comments on the proposal for change to incorporate Part L into the network code should be kept separate and returned to Chris Blackman).

10. Respondents should indicate clearly if they wish all or part of their response to remain confidential to the ORR. Otherwise it is expected that they will be made available in the ORR library and published on its website and they may be quoted from by the Regulator. Where a response is made in confidence, it should be accompanied by a statement which can be published, placed in the ORR library and on its website and quoted from by the Regulator, summarising the submission but excluding the confidential information. The Regulator may also publish the names of respondents in future documents or on the ORR's website, unless a respondent indicates that he wishes his name to be withheld.

**MICHAEL DAWSON**