

**PHILIP O'DONNELL
DIRECTOR NETWORK GROUP**

DIRECT	020 7654 6357
SECRETARY	020 7654 6316
FACSIMILE	020 7654 6112
EMAIL	philip.o'donnell@sra.gov.uk

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Michael Beswick
Director of Network Regulation
Office of the Rail Regulator
1 Waterhouse Square
138 – 142 Holborn
London
EC1N 2TQ

Fax No. 020 7282 2042

Dear Michael,

Model Clauses for Track Access Agreements

Attached is the response from the sSRA to the Regulator's provisional conclusions on model clauses for track access agreements. I have sent this to you today as I understand you have an internal meeting to consider the responses to the consultation tomorrow.

Following our discussion at the FRSG meeting on 30th August, we have made reference in our response to the comments made that the model clauses were not considered mandatory in relation to agreements dealing with major enhancements.

For this reason, I am sending this letter to you directly without copying more widely at this stage. You may wish to call me to discuss the process for putting this letter into the public domain through the Regulator's web-site.

Yours sincerely,

Philip O'Donnell

Model Clauses for Track Access Agreements: Provisional Conclusions – Response from the sSRA - 11th September 2000

1. General Observations

In previous responses on Model Clauses the sSRA has called for changes to the current contractual and regulatory framework in order to create a presumption in favour of development. The Government's recent Ten Year Plan setting targets for the growth of freight and passenger usage gives added weight to the call. Sustained growth in freight and passenger usage requires investment in enhancing the network. That investment needs the right contractual and regulatory framework and the sSRA's comments on the Regulator's Provisional Conclusions address what is needed.

The sSRA has consistently supported the Regulator in seeking to achieve greater clarity concerning the rights and obligations of parties to track access agreements. Lack of clarity creates risks for the parties and potentially costs which would hinder the development of the network. The sSRA recognises that the content of model clauses can create additional risks for the parties, or change the distribution of existing risks. That can give rise to additional costs which flow back to the sSRA and the taxpayer through higher costs of supporting the railway industry. Given the potential impact the sSRA wishes to ensure that any additional costs are in the public interest and represent value for money.

The sSRA has discussed with the Regulator whether the model clauses should be mandatory. It considers that the model clauses should provide a basis for track access agreements upon which parties may build and which they may wish to customise where significant enhancements are being negotiated. The sSRA has received assurances from the Regulator that he will consider enhancement agreements submitted following franchise replacement on their merits and that he will not seek to impose model clauses on such agreements.

The sSRA notes that the timetable for delivery of the finalised model clauses has been revised and that they will not now be available until October. To the extent that the model clauses are to be incorporated into new access agreements as a result of franchise

replacement it is highly desirable that the October target is met, and that where changes to track access conditions are contemplated (the new part J) there is a very clear understanding of the proposed content and the work for the industry involved (for example local output statements).

The sSRA believes that priorities in implementing model clauses should be determined and that the priority for the industry in developing standardised track access rights and operator based local output statements should be conditioned by franchise replacement. Model clauses facilitating enhancement investment should be the first priority.

2. Specific Comments

The sSRA has already welcomed many of the Regulator's proposals for model clauses and there is no need to repeat endorsements here. Section 2 of this letter therefore focuses on issues where sSRA remains to be convinced on certain points or where further clarification and detail is required. Our comments in our response of 12 May 2000 have been included in italic text as a cross-reference to previous points made by the sSRA.

Chapter 2 - Commercial Purpose

The sSRA notes the industry's interest in a commercial purpose clause, but supports such a clause only where the effect is to clarify rights and obligations embodied in agreements. It is important for bankability reasons, that such clauses reduce rather than increase any ground for contractual uncertainty. A commercial purpose (CP) clause should not be relied upon as a means to fill gaps in a contract which should be filled by detailed and substantive provisions or to cure material legal and commercial flaws. The sSRA, therefore, endorses the Regulator's provisional conclusion that a CP clause should not provide for general obligations that operate even in the absence of ambiguity or omission elsewhere in the contract.

The sSRA supports the Regulator's provisional conclusions on the CP clause but takes issue as to whether the clause as drafted delivers these conclusions. The clause contains general obligations and makes repetition of obligations contained in clause 6 of the agreement. The sSRA believes that if repetition of provisions in clause 6 adds anything, this increases risk. The sSRA is of the view that a CP clause that is to be

relied upon to resolve ambiguities should be concise and capture the essence of the commercial relationship between the parties. It may be that the CP clause cannot be usefully drafted unless tailored to the particular agreement being negotiated. The sSRA notes the Regulator's assurance that in the case of major enhancement agreements, if a standard CP clause as contained in the provisional conclusions is not acceptable to the sSRA, then the CP clause may be customised by the parties. The sSRA also expects to have the flexibility to negotiate and customise such a clause in order to satisfy value for money objectives where the sSRA is funding a project or service. The sSRA will wish to consider this issue further with the Regulator when the model clauses for enhancement projects are available for consultation.

Chapter 3 - Access Rights

Specification of Access Rights - *The sSRA welcomes moves towards templating of access rights as a means of providing clarity in terms of the quality of access rights being granted and encouraging optimum use of the network. However, such templating must also recognise genuine differences between rail markets and the needs of the train operators serving those markets.*

The sSRA supports the Regulator's provisional conclusions in this respect. The sSRA seeks clarification on the future process and timescales for defining the template Schedule 5.

Tiered access rights – The sSRA supports the Regulator's decision to not pursue tiered access rights

Access rights subject to the Rules of the Route and Rules of the Plan – The sSRA supports the Regulator's proposed process for establishing and changing the Rules.

Changes to access rights over time – *The sSRA considers that there is a case for redeemable access rights in respect of new access agreements, provided the circumstances in which rights may be redeemed, compensation provisions and other protections are understood by the parties prior to entering track access agreements. Where there is a provision to redeem access rights under prescribed circumstances, then the sSRA is less convinced that a separate 'use it or lose it' provision is necessary.*

The sSRA queries whether it is the Regulator's intention to provide for both a redemption of rights mechanism and a general 'use it or lose it' provision? It continues to question the merits of this arrangement.

In relation to the proposals for permanent redemption of rights, the sSRA would wish to understand further how a right for Railtrack to apply to remove an operator's access rights is intended to mould with the Franchise Agreement and Passenger Service Requirement obligations.

In order to fulfil its public duties, the sSRA would require the right to make an application to remove an operator's access rights under the criteria to be developed by the Regulator and where there are strong public interest reasons for doing so. The sSRA will comment further when the proposed new Access Condition J governing redemption of access rights is issued for consultation.

Capacity Warranty – The sSRA considers that the absence of a capacity warranty in respect of existing access rights is a shortcoming within existing access agreements, and therefore endorses the Regulator's provisional conclusion that Railtrack should be obliged to provide a capacity warranty in respect of new access agreements.

The sSRA recognises that the transition from the existing situation could lead to Railtrack seeking to minimise its exposure by disclosing (in a way intended to reduce the impact of the proposed warranties) the areas of ambiguity and uncertainty under Railtrack's existing track access agreements. This practice, if it were allowed to develop, would dilute the desirable effects of this change and should be resisted. However, the sSRA also recognises the way in which certain aspects of Train Slots (typically fastest/maximum journey time and optional stopping patterns) may create a difficult position for Railtrack. Therefore, care should be taken when setting up the template for the new Schedule 5 to allow Railtrack sufficient flexibility to deal with these issues in a way which will not lead to Railtrack making wholesale disclosures to avoid the effect of the warranty in Clause 5.5(a). In seeking to provide a capacity warranty it is important to avoid ossification of the network.

Chapter 4 - Output Statements

The sSRA believes that there is merit in the development of operator-based output statements that create contractually enforceable rights for individual train operators in respect of key network outputs. The sSRA favours aligning the obligations under the access agreements more closely with the obligations placed on Railtrack under condition 7 of the Network Licence enabling train operators to enforce these obligations directly. Such operator-based output statements would be a natural development of the provisions of Clause 6.3.3 of existing franchised passenger access agreements, and of the account planning process which Railtrack has already put in place. The content of such train operator output statements may need to be developed subject to multilateral consultation with all interested parties. However, the sSRA is strongly of the view that the access rights to be expressed in operator output statements should be negotiated bilaterally and be capable of bilateral enforcement. The sSRA does not believe that it would be in the public interest for these statements to incorporate multilateral rights or obligations, as would be the case if the statements were route-based. The sSRA sees the operator output statements as an expression and record of the rights contained within the access agreements and so does not provide any duplication of the Part G process. These statements should not be confidential and should be publicly available, as Schedule 5 rights currently are.

The sSRA considers that the purpose of the Local Output Statements is to detail how the obligations of Railtrack under condition 7 of the Network licence break down at an individual operator level in order to empower train operators to enforce these obligations directly. The LOS would also provide information at an operator level on the current capability, quality and performance of the network and the proposed enhancements for the immediate future. Further clarification is required on the actual outputs that are envisaged in relation to these parameters.

The sSRA is concerned that the new Track Access Condition I creates a multilateral consultation process to deliver an obligation that is a Railtrack licence obligation already. Railtrack should be able to (and this ought to be required to) define the existing capability, quality and performance of the network without consultation where a Network Change is not being proposed and it is assumed that this would be the same for all users of a particular route. Railtrack is required to consult all the relevant users of the network and take account of their views but it is not clear how Railtrack will resolve any conflicting views on the content of the LOS.

The sSRA looks for further clarification on how the remedies under the LOS and access agreements relate as there seems some scope for concurrent remedies against Railtrack by multiple users. The remedy for non-delivery of an LOS should be an order to comply rather than damages for non-compliance.

In relation to the delivery of Incremental Output Statements (IOS), the sSRA is of the view that delivery and enforcement of these outputs would be governed through clauses in the bilateral track access agreements and the inclusion of IOS in the LOS is for the purpose of providing information on the network. The proposed timescales for developing the LOS remain to be determined but the sSRA would wish the IOS to be included within access agreements as they are negotiated.

Third Parties – The sSRA considers it appropriate that when funders pay for assets directly or are, otherwise in effect underwriting the train operator’s credit risk, then they should have the opportunity to seek contractual rights. However, the sSRA is not in favour of any more general extension of rights to third parties.

The sSRA’s previous comments on this issue stand. SSRA also supports the Regulator’s view that third party funders should have an enforceable right to be consulted in the LOS process.

Chapter 5 - Network Change

The sSRA supports the proposals as outlined and agree that the periodic review conclusions and model clauses for enhancement need to be in alignment. Provisional conclusions on the framework for enhancement, including model clauses and changes to Part G of the Track Access Conditions are due to be published by the Regulator for consultation in early September and publication of the final model clauses in October 2000. The sSRA sees these clauses as a high priority in light of the franchise replacement process and would be concerned were the timetable to slip any further. The sSRA will comment further when the proposals are issued in early September.

Chapter 6 - Liabilities / Other Issues

The sSRA recognises the widespread concern of operators that additional remedies should be available if operational performance falls below a pre-determined level. However, the sSRA believes that the changes now being made to Schedule 8 of the Track Access Agreement, combined with the changes proposed for Schedule 7 of the Franchise Agreement, should meet the requirements of train operators and render the need for other remedies in respect of operational performance much less compelling. However, the sSRA is also of the view that where the deterioration of performance is such as to amount to denial of access to the network, there is a case for train operators being able to seek additional alternative remedies including perhaps specific performance.

In his discussion of liability for non-operational performance the Regulator notes that in order to establish a liquidated damages remedy it is necessary to arrive at a genuine pre-estimate of losses, to establish an objective system for measuring compliance and to have calibrated in advance the scale of payments which would become available. The sSRA doubts whether this is practical and hence favours the application of normal contractual remedies

It is suggested that a more appropriate approach may be an indemnity against cost of losses which the injured party might incur. However, the sSRA would wish to approach this proposal with caution. The creation of unquantified risk upon Railtrack and potentially train operators will ultimately flow back to Government in the form of higher costs of supporting the railway industry. The sSRA wishes to be convinced that there would be genuine benefits. It believes that any liabilities should be capped and consequential loss excluded, as the alternative would not provide value for money for taxpayers. Providing operators with the opportunity to seek specific performance may be appropriate for issues such as reinstatement of the network. The merits of an industry arbitration scheme without reliance on the courts warrants further examination.

In reviewing the liabilities and remedies under the access agreements, it is important to ensure that the effect on Railtrack and its ability to fund its obligations is not disproportionate to the benefits that such remedies confer on train operators.

The sSRA supports the Regulator's provisional conclusion that there should be no force majeure provision in access agreements.

It also believes that the current arrangements for the suspension (and termination) of agreements in the event of an operator breaching its safety obligations are appropriate.

Liability for Operational Performance – The sSRA supports the Regulator’s provisional conclusion that in the case of a failure to deliver outputs which dictate operational performance, financial consequences should be under Schedule 8. The issue previously raised of where the deterioration of performance might amount to a denial of access to the network, appears to be dealt with in the Local Output Statements where it is suggested minimum levels of operational performance are included as an output with the opportunity to seek a Performance Order.

Non-Schedule 8 Financial Compensation - The sSRA doubts whether loss of revenue is claimable as a direct loss. Our understanding is that revenue loss might form an element of payments pursuant to Schedule 8 but is otherwise expressly excluded by the statement that there is to be no liability in the case of "loss of revenue or other indirect loss". To include loss of revenue would open up a new area of exposure for both Railtrack and operators which would not in our view serve the public interest.

In relation to the proposal to place caps on liability this proposal appears to have arisen out of the suggestion that loss of revenue, loss of profits and other types of loss are not excluded. Given that sSRA believes that such losses are excluded we would suggest that this obviates the need for a capping mechanism. It might also have the unintended effect of leaving an operator or Railtrack exposed to additional liabilities in situations of claims by third parties under the CAHA arrangements since the amount of the third party claim might not be recoverable by the lead party from the party actually at fault.

Performance Orders – The sSRA is concerned that the performance order process may lead to a more adversarial relationship between the parties to the track access agreement. The sSRA believes that there should be a requirement that where a TOC decides to withhold payment of access charges where there is a dispute, then they should be bound to make payment of these charges into an escrow account.

Implementation of the Regulator’s conclusions and development of a Network Code

Implementation of model clauses – The Regulator has indicated that it may not be appropriate to incorporate all model clauses into track access agreements intended to

deliver enhancement to the network. The sSRA believes making the model clauses mandatory for all agreements would not be in the public interest.

Changes to Track Access Conditions – The sSRA considers the Regulator should propose changes through the Class Representative Committee process rather than the power in Condition C8.

'Big Bang' or Piecemeal Introduction - The sSRA supports the provisional conclusion that model clauses are incorporated in new access agreements. Further clarification on the cut-off dates for inclusion of model clauses in material extensions of existing agreements would be helpful.

Network Code – The sSRA supports the Regulator's proposal for a name change for the Track Access Conditions.

Rights for Third Parties - *The sSRA does not favour contractual rights being extended to third parties not party to access arrangements. However, the consultation process on changes to Access Conditions needs improvement so that funders can contribute to this process where relevant.*

The sSRA supports the Regulator's current views that third party rights should be extended to give consultation rights. The sSRA does not believe that these rights should be extended further.

Star Model or multilateral code – The sSRA would be concerned were there any changes to the star model. We agree there may be advantages for procedural and information requirements but would wish to limit this change to these specific areas.

SSRA 11th September 2000