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Dear Ian and Peter

## **Grand Central Railway Company Limited - track access contract**

1. On 17 January 2007, we directed Network Rail Infrastructure Limited (Network Rail) to enter into a track access contract with Grand Central Railway Company Limited (Grand Central) under section 17 of the Railways Act 1993 (the Act). This letter explains the background of and the reasons for this direction.

### **Background**

2. On 23 March 2006, we issued our decision (the March Decision) in respect of three track access applications for the rights necessary to operate new/additional passenger services on the East Coast Main Line (ECML). These included one from Grand Central, which had submitted an application, including a draft contract, under section 17 of the Act on 24 February 2005.

3. In respect of Grand Central, we said:

(a) We will approve three firm rights each way (Monday to Sunday) for Grand Central to operate services between King's Cross and Sunderland calling at York, Thirsk, Northallerton, Eaglescliffe and Hartlepool. These rights will take effect no earlier than December 2006.

(b) Grand Central's access rights should enable a spread of services through the day, but otherwise contain a degree of flexibility at the discretion of Network Rail, subject to the exercise of the decision criteria in part D of the Network Code. In particular, we do not expect to approve weekday rights which entitle Grand Central to arrivals at King's Cross before 10:10 or to departures from King's Cross between 16:55 and 18:40. In addition,

we expect the access rights to allow for approximately 20 minutes of pathing time between King's Cross and Northallerton, and vice versa.

(c) Grand Central's track access contract will have a minimum term of five years; however, given our current policy in respect of long-term track access contracts, we will be prepared to consider whether this term should be longer if, for example, this is linked to investment in new rolling stock.

(d) We expect Grand Central to use 125 mph rolling stock with performance characteristics as good as that of High Speed Trains (HSTs).

(e) Grand Central's track access contract will contain an access charges review re-opener, which will take effect from 1 April 2009.

(f) We expect Grand Central's track access contract to contain provisions requiring its co-operation with the introduction of a standard hourly timetable on the ECML.

(g) Grand Central's track access contract will be subject to it meeting the usual statutory and safety requirements.

4. This meant that the draft contract originally submitted required significant amendments, and Grand Central and Network Rail (the parties) agreed to work together to produce a revised draft contract taking account of our March Decision. The parties did so and on 3 October 2006 provided a revised draft contract for our consideration. That contract met all the requirements mentioned above except for the commencement and expiry dates, which are discussed further in paragraphs 9 to 11 below.

5. We met the parties on 10 October 2006 to discuss the revised draft contract, issues on which they had been unable to reach agreement, their proposed changes from the model contract and issues we identified during our review. We followed these up in correspondence with the parties.

#### *Modification provisions in other operators' contracts*

6. During the time we were considering Grand Central's application we were also considering track access applications from Great North Eastern Railway Limited, Midland Main Line Limited, Thameslink Rail Limited (now First Capital Connect Limited) and Central Trains Limited relating to the ECML. In order to reach decisions on those applications that would not prejudice our later decision on Grand Central, modification provisions were included in their contracts that would allow their rights to be modified should it prove necessary in order to accommodate any rights that we might subsequently approve for Grand Central.

7. Following the development of the timetable from May 2007 and the finalising of Grand Central's access rights in Schedule 5, Network Rail has confirmed that no modifications are required to any other track access contracts in order to accommodate Grand Central's rights. Consequently, we can confirm that we will not be issuing any modification notices to the train operators concerned.

8. The remainder of this letter explains our position on the significant issues mentioned in paragraph 5. Where necessary, the contract that we have directed Network Rail to enter into with Grand Central (the directed contract) incorporates changes to the draft contract submitted by the parties on 3 October 2006.

### **Term of the contract**

9. Grand Central had planned to start operating on 10 December 2006. Due to a delay in obtaining the necessary rolling stock, Grand Central now proposes to start operating on 20 May 2007 using refurbished HSTs. The commencement date of the contract is therefore 20 May 2007. To ensure that capacity is not sterilised should Grand Central for any reason fail to take up the access rights, we have included a "use it or lose it provision" as new clause 3.7, under which the contract will expire if the services have not started by 9 December 2007. This date is subject to variation by ORR if we consider that such an amendment is appropriate.

10. In our March Decision we said that Grand Central's track access contract should have a minimum term of five years but in accordance with our current policy in respect of long-term track access contracts, we would be prepared to consider a longer term if, for example, this was linked to investment in new rolling stock.

11. Our policy is that we will consider contracts longer than five years for non-franchised passenger services if the beneficiary can demonstrate the existence of contractual commitments, specialised investments or risks<sup>1</sup>. We do not believe that Grand Central has provided sufficient information to be granted a contract term of more than five years. Accordingly, the expiry date of the directed contract is the Passenger Change Date in or around May 2012.

### **Schedule 4 – Restrictions of Use**

12. Grand Central did not want the contract to include a Schedule 4, whilst Network Rail argued that it should.

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<sup>1</sup> Paragraph 3.21 of *Long-term track access contracts: final conclusions*, June 2005, available on the ORR website at: <http://www.rail-reg.gov.uk/upload/pdf/240.pdf>

13. Network Rail said that it was concerned that Part G of the Network Code would in many circumstances effectively give Grand Central the equivalent of Schedule 4 protection without it paying an Access Charge Supplement, which Network Rail believed would be contrary to ORR's policy intent. Network Rail also expressed concerns that, in the absence of Schedule 4 arrangements, it could prove more difficult to secure agreement for a particular possession strategy on the key ECML route where operators were not entitled to compensation for Network Change under Part G.

14. Grand Central said that Schedule 4 had many advantages compared with Part G, but those advantages came at a price – the payment of an Access Charge Supplement – which Grand Central did not wish to pay. Grand Central said that Schedule 4 had not been imposed upon freight operators or other open access operators.

15. Network Rail then suggested a provision that would mean that Grand Central would not be eligible for payments under Part G in circumstances where it would have received payments under the model contract Schedule 4 if it had one.

16. Our policy is not to insist on non-franchised operators having a Schedule 4 if they do not want one and freight operators and other open access operators have opted either not to have one, or to have a highly bespoke one. Neither has Network Rail proposed a Part G carve-out for other operators. We believe that such a provision applied only to Grand Central could be considered unduly discriminatory. Accordingly, the directed contract does not include either a Schedule 4 or Network Rail's proposed Part G carve-out.

17. However, we acknowledge that there may be issues to be addressed and we have asked the Industry Steering Group to undertake a review of the relationship between Schedule 4 and Part G, with a view that all compensation for possessions would be paid through Schedule 4. We would expect to implement any resulting changes through the Periodic Review 2008 (PR 2008).

## **Schedule 5**

### *Grand Central's services*

18. Schedule 5 has been drafted to give Grand Central rights for three return services per day between King's Cross and Sunderland in accordance with our March Decision. Each service has a departure time window of 30 minutes specified in table 8.3. Each service also has a maximum journey time specified in table 6.1. The Specified Equipment is HSTs in a maximum formation of 2+7.

## Schedule 7

### *Payment of Track Charges*

19. Network Rail proposed that Grand Central should pay Track Charges in advance for the first year of the contract. Its reason for this was that it had no proven financial relationship with Grand Central or its parent company and had had previous experience of difficulties in obtaining payment from new small operators. Grand Central wanted the standard model contract payment terms.

20. The model contract Schedule 7 requires payment in arrears. Requiring payment in advance from Grand Central would place an additional financial burden on it that Network Rail has not imposed on other train operators. This could be considered unduly discriminatory. Under Schedule 6 of the model contract, failure to pay access charges is an Event of Default, which can lead to the suspension of the train operator's services. We consider that this is the appropriate remedy for non-payment of Track Charges. Therefore, as Grand Central is not prepared to agree a different payment arrangement with Network Rail, the directed contract contains the standard payment terms in the model contract.

### *Change of Law*

21. Network Rail argued that the contract should include the model contract provisions in Part 3 of Schedule 7 whereby Grand Central would pay a Change of Law charge. Grand Central argued that as a non-franchised operator it should not pay such a charge.

22. We set out in paragraph 5.26 of our *Criteria and procedures for the approval of passenger track access contracts: fourth edition*, May 2006 (Criteria and procedures)<sup>2</sup> what we expect the standard charging regime for non-franchised passenger train operators to contain. This does not include a Change of Law charge, and the directed contract is in accordance with our published policy.

### *Future Access Charges Reviews*

23. Grand Central argued that, because it had elected not to have a Schedule 4, it followed that the access charges review re-opener should exclude Schedule 4. We do not agree that this necessarily follows and are not willing to limit the scope of this provision in this way.

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<sup>2</sup> Available on the ORR website at: [http://www.rail-reg.gov.uk/upload/pdf/288-pass\\_candp4ed.pdf](http://www.rail-reg.gov.uk/upload/pdf/288-pass_candp4ed.pdf)

24. Grand Central also argued that changes to the structure of Schedule 8 should not be permitted during the term of its access contract. The access charges review is intended to review all the financial aspects of the contract and we do not consider it appropriate to limit the scope of the re-opener in this manner. We have amended the re-opener in the directed contract to reflect our position.

#### *Capacity Charge Rates*

25. Capacity Charge Rates have been included directly into Part 2 of Schedule 7 as Grand Central does not appear in our published List of Capacity Charge Rates. Network Rail calculated these on a rate per mile for each train, rather than an average. We were content with this approach given the small number of Grand Central services.

#### *Additional Permitted Charges*

26. As submitted, the draft contract did not contain any Additional Permitted Charges. During our review of the contract, we established that Network Rail would have to open some signal boxes for additional hours on a Sunday, specifically to accommodate the final Grand Central service of the day from King's Cross to Sunderland. As Network Rail is not currently funded for this additional cost, this cost should be borne by Grand Central. The directed contract contains suitable provisions.

### **Schedule 8**

#### *Train Operator responsibility incidents*

27. Grand Central argued that the drafting in paragraph 5.3(a)(i) of Schedule 8 of the model contract did not make it clear that any delays resulting from signalling under the control of Network Rail at a light maintenance depot, or physical works undertaken by Network Rail at such a facility, were the responsibility of Network Rail. It had therefore proposed amended drafting.

28. Network Rail said that it believed that the wording proposed by Grand Central should not be included in principle, because the proposed drafting could be interpreted to allocate responsibility for an incident off the Network to Network Rail, i.e. one within a light maintenance depot. This would be contrary to paragraph 5.2(b) under which Network Rail is responsible for incidents "within the control of Network Rail in its capacity as operator of the Network;" which would include signalling at stations, as provided for in paragraph 5.3(a)(iii), but not within light maintenance depots given that such depots are not part of the Network. Delays within depots were the responsibility of the Train Operator as set out in paragraph 5.3(a)(iii).

29. Network Rail confirmed that in the depots that Grand Central was proposing to use there were no signals that were the responsibility of Network Rail, and on that basis Grand Central accepted that the directed contract could use the model contract wording, even though it continued to believe that the model contract drafting was not clear on this point.

#### *Appendix 1*

30. The parties proposed to include draft figures in Appendix 1 of Schedule 8 but agreed that no payments would be made to either party during the first sixteen Periods. A Schedule 11, Relevant Schedule 8 Modifications, was proposed under which the parties would negotiate the appropriate values to be included in Appendix 1 in light of the first year of operation. These would then be applied retrospectively to the start of the contract.

31. We questioned the need to have Appendix 1 populated if no payments were to pass between the parties. Network Rail said that the purpose of having a shadow regime was to get Grand Central into the habit of behaving as if a regime was in place and understanding the impact of day-to-day operations. Grand Central suggested that there was benefit in including draft figures, in that they could be seen as a starting point by any arbitrator, should the Schedule 8 modification process end up in arbitration.

32. We were content with the Schedule 11 process to establish appropriate figures for Appendix 1 but, given that no payments will be made under Schedule 8 during the first 12 to 18 months, we see little value in having draft figures in the contract. Figures do not necessarily have to be in the contract in order to operate a shadow regime, and the negotiation at the end of the first 12 months should use the actual data collected rather than using the draft figures as a starting point. In addition, Network Rail was unable to give Grand Central full access to the detail behind the draft figures because they were based on figures from another train operator that were commercially confidential. We have therefore removed the draft figures from Appendix 1.

#### *Schedule 11 - Relevant Schedule 8 Modifications*

33. The parties had proposed that the definition of 'Relevant Schedule 8 Modifications' should cover the whole of Schedule 8, not just Appendix 1, as they said they may wish to agree something other than the model contract Schedule 8 when negotiating the Appendix 1 figures.

34. These modification provisions are usually applied only to Appendix 1 when the values are not known at the time the contract is entered into. As the parties have already agreed the rest of Schedule 8, we do not consider that the whole of Schedule should be up for renegotiation. Therefore, in the directed contract the modifications are restricted to apply to Appendix 1 only.

### *Procedure for amendments to Appendix 1*

35. The parties advised that the provisions of paragraph 17.2 of the model contract Schedule 8 (the procedure for making amendments to Appendix 1 of Schedule 8) were not consistent with having a Schedule 11, Relevant Schedule 8 Modifications process. We agreed with the parties' suggested revised drafting.

### *Network Rail Performance Points*

36. Grand Central proposed that the Network Rail Performance Point in Column B of Appendix 1 should ratchet down over the term of the contract, in line with the provisions in franchised operators' contracts. Network Rail argued that it was not obliged to commit to an annual tightening of the ratchet in advance of the review of Schedule 8 as provided for in Schedule 11. It believed that the Access Charges Review 2003 Final Conclusions (ACR2003) applied only to franchised operators, not to open access operators. However, if ORR felt that there should be a ratchet provision, then Network Rail said it should only apply to the end of Control Period 3 (CP3), as it had neither the funding nor knowledge of targets for Control Period 4 (CP4) and beyond. Furthermore, Network Rail thought it would be inappropriate to include the ratchet now, as the figures would change under the Schedule 11 process.

37. We advised the parties that ACR2003 set national targets that were to benefit all users of the network and to deny Grand Central the ratchet would be unduly discriminatory. Network Rail was funded for year on year performance improvements for existing operators to the end of CP3, and therefore a ratchet should apply to all train operators who had the template Schedule 8, irrespective of whether they were franchised or open access.

38. Whilst Network Rail accepted that there were arguments in principle for applying the ratchet it said that, for existing operators, the 2007/08 Network Rail Performance Point was based on applying a performance improvement trajectory in line with ACR2003, to a baseline performance point calculated using performance data from October 2001 – October 2002. For Grand Central, the initial Network Rail baseline Performance Point would be calculated based on actual performance data from May 2007 – May 2008.

39. Network Rail said that, as it was significantly out-performing the performance targets in ACR2003, it was likely that a baseline Performance Point based on actual performance data from May 2007 – May 2008 would reflect a level of Network Rail performance beyond that which would have been represented by a benchmark set in 2001/02 with the appropriate performance improvement trajectory applied. Thus, to apply an improvement trajectory to a baseline Performance Point based on actual performance data from May 2007 – May 2008 would call for an improvement in Network Rail

performance above and beyond that required by ACR2003 (and that represented in the Appendix 1s of existing operators). Therefore, Network Rail believed it would be inappropriate to apply a performance improvement trajectory to the Network Rail Performance Points.

40. We do not accept Network Rail's argument that because it is already performing at or above the projected 2008/09 levels, it should not be incentivised to continue to improve performance on the ECML. The principle of a progressively tightening regime should be maintained. In practice, this will mean only one ratchet in CP3, as the new arrangements to apply in CP4 will be introduced from 1 April 2009. The parties should negotiate the value of the ratchet as part of the Schedule 11 procedure.

*Paragraph 17.2(c)(iii)*

41. A minor area of disagreement between the parties was in respect of paragraph 17.2(c)(iii), where Grand Central had introduced additional drafting to cover the possibility of the introduction of capped values. Network Rail said that as there were no other references to capping in the current drafting of Schedule 8, the words were irrelevant. As this drafting was consistent with the changes made to franchised passenger operators' contracts by our recent Performance Regime Review notice, we did not accept Network Rail's argument.

*Paragraph 17.6*

42. Another matter on which the parties disagreed was in respect of paragraph 17.6, where Grand Central was seeking a self-modification provision that would allow it to unilaterally change monitoring point weightings. It argued that as it was just starting up, it could not guarantee where its business would come from. In addition, including such a provision would allow the weightings to be changed quickly to reflect Grand Central's reaction to changes in its market.

43. Network Rail argued that such a provision would allow Grand Central to make changes on a Period-by-Period basis if it wished, and could potentially allow Grand Central to change the weightings every Period depending on where it believed that delays were likely to occur. Network Rail felt that suitable provisions already existed in Schedule 11 of the draft contract, under which the weightings would be reviewed and agreed or determined after the first full year when actual passenger numbers/revenue was available, and in paragraph 17 of Schedule 8 of the model contract if changes became necessary thereafter.

44. We do not feel that Grand Central has made a strong case for such a radical departure from the model contract. We agree with Network Rail's comments and the directed contract therefore contains the model contract provisions.

### **Copies**

45. Copies of this letter are being sent to Peter Painter and Robin Marie at the Department for Transport, John Czyrko at Central Trains, John Beer at FCC, Adrian Caltieri at GNER, Mark Leving at Hull Trains and Simon Taylor at MML. We will also be placing a copy of this letter on the ORR website, and will then e-mail other interested parties to draw it to their attention.

**Brian Kogan**