

NOTE OF ORR'S TRACK ACCESS OPTION WORKSHOP - 28 SEPTEMBER 2007

1. The aim of the workshop was to provide an opportunity to discuss the proposals for Use It or Lose It (UIOLI) and option rights buy-back mechanisms outlined in chapter 2 of the consultation document published by ORR on 23 August 2007.¹ We hoped that such an approach would help inform the responses to this consultation that are due to be submitted by 31 October 2007. A list of the attendees at the workshop is attached to this note, along with copies of the speaker's slides.

2. In addition to the issues outlined in the presentations workshop attendees made the following key comments.

Use it or Lose it (UIOLI) – Andrew Eyles

3. This presentation set out the reasons for ORR's proposal to incorporate a UIOLI mechanism in all access options, and explained the way in which the mechanism was developed and how it was expected that the surrender processes would work.

4. There was a perception at the workshop that when option rights were 'drawn down' into a corresponding track access contract (TAC) so that services could be operated, such access rights would be granted to a train operator by the access option holder (AOH). ORR was clear that any such rights granted to a train operator would require the standard approval or direction of ORR through the section 17, 18 or 22 processes set out in the Railways Act.

5. Concern was expressed about ORR's proposal that Network Rail would be able to seek the surrender of option rights for the whole option period. There was a preference that such surrender should only last for the period of the TAC in which such rights had been exercised, or that there should be a mechanism whereby rights would have to be lost from two consecutive TACs before such a long term surrender might apply. ORR explained that, whilst the length of an option might involve the use of several consecutive TACs, in the majority of cases it would expect the access rights to be drawn down and utilised in the initial TAC. If, therefore, there was no intended use of the rights once the services had been established then it would be appropriate for Network Rail to seek their permanent surrender from the option. The AOH would, however, have certain grounds for objection within the UIOLI mechanism under which it could argue that any rights should be retained or should be surrendered for a shorter period. The AOH would also have the protection of being able to refer any dispute to ORR for determination if agreement could not be reached with Network Rail.

¹ *Access option emerging conclusions*, ORR, August 2007 (<http://www.rail-reg.gov.uk/upload/pdf/334-accopt.pdf>).

6. In response to a question about the frequency of the voluntary surrender process that would be initiated by the AOH, ORR confirmed that the option holder would only have to voluntarily surrender rights at the commencement of any TAC underpinning an access option. Surrender at any other time would be proposed by either Network Rail or a Third Party Operator.

7. ORR confirmed that once option rights had been 'drawn down' into a TAC, the normal Part J mechanisms would apply to the rights being exercised in that TAC. ORR's proposal to include a UIOLI mechanism within a model clause access option template was questioned, however, particularly as ORR had expressed the view that due to the nature, size and specific characteristics of an option, a 'one size fits all' mechanism might not be appropriate. ORR expressed the view that it hoped to develop a template UIOLI mechanism that could be adapted by the parties through negotiation in order to fit their specific needs. This is why, initially at least, it was not considered appropriate to include a standard mechanism within the Network Code. A preference for a Network Code approach was expressed, however, by certain attendees to ensure that there was a clear understanding of the mechanisms that applied to all access options.

8. More guidance was requested within ORR's policy conclusions on what a defined period of surrender might be. It was considered that any surrender for a period of less than two years would provide little benefit to other operators who would probably not be able to make use of the available capacity over what would be a relatively short period of time.

9. It was also questioned whether, if rights were lost from a TAC through the Part J mechanisms, they would also be lost from the access option. ORR expressed the view that in such a case the loss from the option would not be automatic, but that the rights could still be subject to the option UIOLI mechanism being subsequently triggered.

Buy-back mechanism for access options – Tim Griffiths

10. This presentation outlined ORR's proposals for a mechanism under which option rights could be bought by a third party with a greater economic use for the capacity in question, and how any compensation payable to the affected AOH under such circumstances might be calculated.

11. It was questioned whether ORR's compensation arrangements, which propose applying an equal value per path, adequately addressed arrangements in London where there is a clear peak and off peak differential in such values. ORR's view was that whilst it would consider applications taking into account the higher economic value of peak paths, it was felt that it would be too complicated to relate compensate payments to economic values. ORR's intention was to keep the buy-back mechanism as simple as possible to facilitate transparency for potential investors from the outset.

12. Clarification was asked as to whether the 10 year period where buy-back would not be allowed applied from the commencement of the option or from the end of the stabilisation period. ORR confirmed that the 10 year period would commence once the access rights were first exercised under a TAC. It was also suggested that a period of 10 years could restrict the efficient use of the network. ORR explained that the proposed timing was a

trade off between providing an AOH with the certainty it requires to make the initial investment and giving flexibility to allow other users access to the network. ORR believes that 10 years, which is consistent with its Long Term Access Contract policy² is a sufficient period to provide certainty to encourage investment in the railway.

13. In terms of the duration that compensation should be paid for in the event that the whole option period is not bought back, the workshop felt that account needed to be taken of the period of use by the new/interim operator plus any subsequent period that the original AOH requires to restart its services.

14. It was suggested that the key driver for a freight investor was to make a profit rather than the asset value, and ORR's proposed approach appeared to be somewhat simplistic as it did not reflect returns from the investment and the level of compensation should therefore be considered on a case-by-case basis. ORR stated that it was willing to consider alternative approaches that consultees may feel would be more appropriate, although to aid transparency it would prefer to retain a formula based approach to calculating compensation.

15. It was also suggested that it may be better to consider compensation on a case-by-case basis rather than by a standard formulaic approach. ORR considered that it would be more transparent to have a standardised approach so that all parties are aware of the position from the outset of an option. It was, however, willing to consider alternative approaches suggested by consultees

16. One approach to calculating compensation outlined in the consultation document would be to assume that the value of the investment declined over the asset life. ORR confirmed that it would use standard Network Rail asset life assumptions as a basis for its assessment, ensuring consistency across the network. ORR acknowledged that, when assessing unusual assets, that the asset life would need to be decided based on reference to the treatment of similar assets elsewhere and agreement with the applicant. Parties should express any concerns they have about this in their consultation response.

17. ORR confirmed that the same approach was proposed for both private and public sector investment.

18. ORR confirmed that when considering the size of the investment for inclusion in the compensation calculations it intends to consider the size and degree to which the investment would be dependent upon the access option. This would be considered on a case-by-case basis.

19. It was suggested that the value of the asset after the expiry of the access option would be zero. ORR considered that this was not necessarily the case, as rights will not necessarily be lost on the expiry of an option with an AOH holder being able to apply for rights using the normal contractual and timetable process.

² *Long-term track access contracts: final conclusions*, ORR, June 2005
(<http://www.rail-reg.gov.uk/upload/pdf/240.pdf>)

20. ORR was asked how it would decide whether the new applicant's proposals would provide better economic value than the AOH. ORR explained that it would take account of the economic value of both proposals in line with its section 4 duties. ORR said it would consider further whether it would be beneficial to develop specific criteria to underpin its approach.

21. ORR was asked, in a scenario where an investor draws down all rights into a 30 year TAC to bypass the 10 year trigger point, if it has already approved an option for 30 years on the basis of the proposed investment, what grounds would there be for refusing a co-terminus long term TAC. ORR considered that limiting option related TACS to 10 years would provide adequate protection for both the investor and the industry, and allow sufficient flexibility in terms of the managing the network and accounting for changes to the access regime.

22. ORR considered that an investor might be able to negotiate a lower compensation 'cap' if, for example, the expected level of financial return at the outset of the project was not being achieved.

23. A concern was raised that an applicant might want to buy-back option rights from more than one AOH where the options did not have co-terminus expiry dates. Whilst ORR considered such a scenario unlikely, it was an issue that ORR would need to think about further.

General Discussion on wider issues

24. Freight representatives commented that they were not entirely persuaded by ORR's argument against a 'Rights Co' arrangement and may respond accordingly. It was also suggested that, as there are different markets in the freight industry, ORR might receive competing option applications. ORR was asked how it would deal with these. ORR explained that it already has criteria in place setting out how competing access contracts are considered.

25. In response to a question as to whether responses on the wider emerging conclusions (i.e. those outside chapter 2) could be included within a consultation response, ORR acknowledged that there was nothing to stop comments being made on any of its conclusions and indeed it welcomed these as this would help to inform further development of the policy going forward.

26. In closing the workshop, Colin Greenslade reminded attendees that responses to the consultation document should be submitted by 31 October 2007.