

ACCOUNTABILITY



OFFICE *of the*
RAIL REGULATOR

Accountability of Railtrack

May 2001



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Summary

General

1. Railtrack is a private sector monopoly owner and operator of a national asset of considerable public importance. It is therefore not free to operate, maintain and develop that asset according to purely commercial criteria and is regulated in a number of ways, primarily by the independent Rail Regulator.
2. Railtrack is accountable to the public interest for— (a) operation, maintenance and renewal of the core (*i.e.* existing) network, (b) enhancement of the network (*i.e.* upgrades), (c) disposal of land and other assets, (d) rolling stock approvals and (e) safety.
3. Depending on the subject-matter, Railtrack's accountability is to the Regulator, funders (mainly the Strategic Rail Authority and Passenger Transport Executives), the Health and Safety Executive and customers (train operators).
4. The present Regulator has stated publicly that the regulatory regime as it stood before April 2001 was deficient in a number of important respects. It was weak and over-complex and served the industry and the public interest poorly. He has therefore been improving and strengthening it. In addition, the Transport Act 2000 has streamlined and enhanced the regulatory system with effect from 1 February 2001¹.
5. The existing regulatory regime has considerable scope to improve things. The present Regulator has been—
 - (a) using existing powers to apply pressure on Railtrack (including appropriate enforcement action); and
 - (b) carrying out a programme of reform of the regime, to increase Railtrack's public accountability and put right the weaknesses of the past; he has done this so as markedly to strengthen, simplify and improve it, to introduce better incentives and much greater clarity of what the public gets for its money.
6. The regime has been further enhanced by the Competition Act 1998 (controls on abuse of monopoly power) and the Transport Act 2000 (power to direct Railtrack *re* upgrades, and improvement of enforcement regime).

¹ See *Regulated Railways: Who Does What*, Office of the Rail Regulator and Strategic Rail Authority, London, May 2001

7. The reform programme is almost complete. Some parts of it came into operation in April 2001. It will however take some time for these measures to become fully effective and for passengers and freight customers to get their maximum benefit. That is why the regulatory reform programme has been pursued with the greatest speed.

Existing powers

8. The core obligation on Railtrack is to maintain, renew and develop the network in accordance with best practice and in a timely, efficient and economical manner (Condition 7 of Railtrack's network licence). This obligation is enforceable by the Regulator.

9. The Regulator has used this power in relation to—

- (a) pressure on performance and stewardship on matters such as track quality, broken rails, major projects and possessions strategies; and
- (b) enforcement action on passenger performance (August 1999), the West Coast route modernisation (May 2000) and the national rail recovery plan (January and March 2001).

Increasing Railtrack's accountability - reform programme

10. The Regulator's programme of reform covers —

- (a) **STRONGER LICENCE** - eight new network licence conditions, imposed and enforceable by the Regulator, in relation to—
 - (1) **asset register** - requirement for Railtrack to set up and maintain a reliable and comprehensive register of the condition, capacity and capability of its assets - new licence condition came into force on 18 April 2001;
 - (2) **network quality assessment** - independent reporters assessing and investigating the extent and nature of Railtrack's work, including the sufficiency of its maintenance and renewal of the network - new licence condition came into force on 11 April 2001 and the process of appointing reporters is already under way;
 - (3) **dealings with dependent persons** - binding obligation to deal with third parties fairly, in a timely, efficient and competent manner - new licence condition accepted on 3 May 2001; statutory consultation process ends in June 2001;

- (4) **annual return on performance and condition of network** - report on the performance and condition of Railtrack's network over the previous year, to be verified by reporters - new licence condition came into force on 11 April 2001;
 - (5) **land disposal** - to prevent Railtrack disposing of assets if to do so would be contrary to the public interest (*e.g.* land beside the railway needed for freight terminals, station car park extensions, *etc.*) - new licence condition proposed;
 - (6) **ring-fencing Railtrack's core business** - to preserve, protect and defend its core assets for railway purposes, and ensure that they cannot be pledged for the purpose of non-core activities - new licence condition proposed;
 - (7) **regulatory accounts** - information on how the company is performing against the financial, economic and operational assumptions on which access charges have been based - new licence condition came into force on 11 April 2001;
- (b) **FINANCIAL FRAMEWORK** - rewriting the financial regime for Railtrack, giving it much stronger incentives and pressure to grow the network and do work well, and a clear specification of what Railtrack has to do for the money it gets from train operators and taxpayers, and how extra spending will be treated (*i.e.* the periodic review of Railtrack's access charges which came into force on 1 April 2001);
- (c) **CONTRACTS WITH TRAIN OPERATORS** - stronger, sounder and simpler contracts between Railtrack and train operators, making the relationship a proper joint venture partnership with clear specification of what Railtrack has to do and what happens if things go wrong (*i.e.* new generation of access contracts under section 21, Railways Act 1993); improvements cover—
- (1) binding statements of network quality at train operator level, showing work to be done and what it will produce, both on the core network and for upgrades;
 - (2) better definition of the use of capacity;
 - (3) better remedies for when things go wrong, to encourage compliance and higher standards of delivery and performance;

-
- (d) **ROLLING STOCK APPROVALS** - order to Railtrack to improve relevant procedures, coupled with the Regulator establishing new enforceable standards for efficient, timely and accurate provision of network information and better processes.

Increasing accountability - new statutory powers

11. The Transport Act 2000—
- (a) contains new powers, to be used by the Regulator on the application of the Strategic Rail Authority, to order Railtrack to upgrade parts of its network (including stations) on terms which are fair (*i.e.* new section 16A-I);
- (b) considerably strengthens the regime for enforcement.
12. The Competition Act 1998 contains new prohibitions on abuse of monopoly or dominant power, with strong sanctions including prohibition orders and fines of up to 10% of turnover for serious abuses. The new rules came into force on 1 March 2000.

Conclusion

13. When the Regulator's programme of reform is complete in autumn 2001, the accountability of Railtrack to the public interest will have been enhanced to a very considerable extent.
14. A sound basis for future improved performance and investment in the railway industry is provided by—
- (a) the reform of the regulatory institutions by the Transport Act 2000;
- (b) the policy of tougher and more effective regulation of Railtrack; and
- (c) the changes to the system of licences and contracts which simplify the regime and bring strength and coherence where there was weakness and complexity.
15. The majority of these reforms took effect this year. Others are close to completion. It will take time for the benefits to work through to passengers and freight customers. The next phase is to use the new powers to ensure Railtrack performs, and spends wisely and well, on the right things at the right times.

Accountability of Railtrack

INTRODUCTION

1. This document summarises the accountability of Railtrack to the public interest in relation to its stewardship of the national rail network². Although accountability for safety is mentioned, the regulatory regime for safety is the responsibility of the Health and Safety Executive and is therefore largely outside the scope of this document³.

2. There has been a considerable amount of debate about the sufficiency of Railtrack's accountability to the public interest and to its customers.

3. Railtrack is a monopoly supplier of an essential service - principally the provision of a national rail network and the operation and development of that network. Accordingly, as with other network industries of economic and national importance⁴, it is subject to public interest regulation, established under the authority of Parliament⁵. Railtrack is also accountable under contracts⁶.

4. The present Regulator has stated publicly⁷ that the regulatory regime as it stood before April 2001 was deficient in a number of important respects, and has therefore been pursuing a programme of reform using the mechanisms for change already built into the regime, so as markedly to strengthen and improve it. In addition, the Transport Act 2000 has enhanced the regulatory system with effect from 1 February 2001.

² Railtrack is also the owner of virtually all stations in Great Britain. Most stations are leased by Railtrack to the principal passenger train operator using them. Railtrack is the holder of a station licence in respect of its operation of 14 of them (mainly major city stations)

³ This document does not cover matters of the general law such as town and country planning

⁴ Such as gas, electricity, water and telecommunications

⁵ Railways Act 1993 (as amended by the Transport Act 2000) and licences issued under it; Health and Safety at Work *etc.* Act 1974 and regulations made under it; Transport and Works Act 1992; Competition Act 1998

⁶ The terms of certain key contracts - namely contracts for the use or expansion of the capacity of Railtrack's network - are subject to the Regulator's control under sections 16A-22A, Railways Act 1993; see paragraphs 27-40, 84, 117-123, 131-133 and 136-141 of this document

⁷ See, for example, the Regulator's publications on the periodic review of Railtrack's access charges; *Railtrack's Stewardship of the Network*, Office of the Rail Regulator, London, November 1999; House of Commons Committee of Public Accounts, 35th report, *The Office of the Rail Regulator: Ensuring that Railtrack Maintain and Renew the Railway Network*, The Stationery Office Limited, London, July 2000

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5. Railtrack's accountability can be divided into five general areas—
- (a) accountability for the operation, maintenance and renewal of the network, including in matters of the allocation of capacity, timetabling and management of operational disruption;
 - (b) accountability for the enhancement of the network;
 - (c) accountability for the closure or disposal of parts of the network and the company's landholdings;
 - (d) accountability for the approval of rolling stock for use on the network; and
 - (e) accountability for safety.
6. The Regulator's programme of reform of the accountability of Railtrack began in 1999. It covers substantially all of Railtrack's core business, and has three main limbs—
- (a) reform of the financial structure of the industry through the periodic review of Railtrack's access charges⁸;
 - (b) modifications of Railtrack's network licence to strengthen the conditions on which Railtrack is authorised to operate its network⁹; and
 - (c) strengthening and streamlining Railtrack's contracts with train operators (passenger and freight)¹⁰.
7. That programme of reform is nearing completion. Some parts of it came into force in April 2001 and others are expected to be implemented by autumn 2001.

⁸ See paragraphs 74 *et seq* of this document

⁹ See paragraphs 92 *et seq* of this document

¹⁰ See paragraphs 117 *et seq* of this document

RELEVANT PUBLIC AUTHORITIES

General

8. The public authorities to which Railtrack is principally accountable are the Regulator, the providers of public funds (principally the Strategic Rail Authority and Passenger Transport Authorities and Executives) and the Health and Safety Executive.

Rail Regulator¹¹

9. The Regulator is an officer appointed by the Secretary of State and is responsible for the regulation of the monopoly and dominant elements of the railway industry, especially Railtrack. He sets the contractual and financial framework within which Railtrack works to maintain, renew and expand the network. He acts as appeal body in certain types of dispute, and enforces domestic competition law. The Regulator enforces and may modify Railtrack's network licence¹².

10. The Regulator must exercise his powers in accordance with his statutory duties, which include duties to promote the interests of users of railway services and the use and development of the railway network¹³. He is independent of Government¹⁴ but accountable to Parliament.

¹¹ Website: www.rail-reg.gov.uk

¹² Except the consumer protection conditions - see paragraph 12 of this document. The non-consumer protection conditions of Railtrack's network licence concern: safety and standards, network stewardship and independent reporters on network stewardship, a requirement to establish and maintain an asset register, environmental protection, timetabling, non-discrimination, cross-subsidy, ring-fencing and accounting records, economic interests in other railway companies, co-operation with London transport authorities, provision of information to the Regulator and the SRA, fees, misuse of information, change of control, railway computer systems, intra-industry liabilities and regulatory accounts

¹³ The statutory duties are set out in section 4, Railways Act 1993. The Regulator has an additional, overriding statutory duty in section 21 of the Channel Tunnel Rail Link Act 1996 not to impede the performance of a development agreement between the Secretary of State and the undertaker of the CTRL. He must also have regard to the financial position of the CTRL undertaker

¹⁴ He has a new statutory duty to take into account general guidance given to him by the Secretary of State about railway services or other matters relating to railways (section 4(5)(a), Railways Act 1993). As with his other statutory duties, he must balance them in individual cases, giving each appropriate weight as circumstances require

Strategic Rail Authority¹⁵

11. The Strategic Rail Authority, established under the Transport Act 2000, is responsible for the production of a strategic plan for the railway industry. Its jurisdiction is separate from, and does not overlap with, that of the Regulator. The SRA's purposes are to promote the use of the railway for passenger and freight traffic, to secure the development of the network and to contribute to the development of integrated transport¹⁶. It is responsible for consumer protection matters such as fares, quality of service, overcrowding, complaints handling and timetable production. It awards and enforces passenger rail franchises to train operators, and administers the freight grants system in England.

12. In relation to the national network, the SRA is a major customer of Railtrack. The SRA will sponsor and may lead investment projects, such as upgrades of parts of Railtrack's network, and will enter into contracts with Railtrack (and others) for things such as opening up bottlenecks and expanding network capacity. However, it has no powers to compel Railtrack to enter into a contract¹⁷ or to order it to do anything outside a contractual relationship. The only exception to this is the power of the SRA to enforce the consumer protection conditions of Railtrack's network licence¹⁸.

13. The SRA operates under directions and guidance issued by the Government¹⁹. It is therefore not independent.

Passenger Transport Authorities and Executives

14. Passenger Transport Authorities are responsible for drawing up local public transport policies for seven metropolitan areas outside London (six in England and Strathclyde in Scotland). Passenger Transport Executives are statutory bodies subject to PTA control which are responsible for the planning and funding of passenger rail

¹⁵ Website: www.sra.gov.uk

¹⁶ Section 205, Transport Act 2000

¹⁷ As to which, see paragraphs 136-139 of this document

¹⁸ The consumer protection conditions in Railtrack's network licence are those relating to insurance against third party liability, the handling and allocation of claims against railway companies by members of the public, the provision of timetable information to passengers, transport police and dealings with the network of Rail Passengers' Committees - section 7A, Railways Act 1993

¹⁹ Sections 207-209, Transport Act 2000

services in their respective PTA areas, in accordance with policies formulated by their PTAs.

15. PTEs may also enter into agreements for the provision of passenger rail services, including by becoming parties to franchise agreements with the SRA. As funders, PTEs are also entitled to buy railway services direct from Railtrack.

Health and Safety Executive²⁰

16. The Health and Safety Executive, working under the general direction of the Health and Safety Commission, is the regulatory authority for health and safety on the railways²¹. Whilst the principal duty to protect the health and safety of workers and the public in respect of risks arising from railway operation rests with the railway companies, the HSE seeks to ensure that the risks are properly controlled.

17. The HSE enforces health and safety at work law on the railways, both the general requirements that apply to all work activities and specific law relating to railway operations. This includes considering, accepting and monitoring compliance with the safety cases of the railway companies, approval of new works and equipment, inspection, investigation of accidents and complaints, and enforcement of the law.

18. The HSE also gives advice to Government, the SRA and the Regulator on health and safety matters.

TYPES OF INSTRUMENT GIVING EFFECT TO ACCOUNTABILITY

General

19. The principal legal sources and instruments of Railtrack's accountability are—

- (a) the economic regulatory regime, established under the Railways Act 1993, the Competition Act 1998 and the Transport Act 2000 and the licences and other instruments made under those statutes;

²⁰ Website: www.hse.gov.uk

²¹ Section 117, Railways Act 1993

- (b) contracts with its customers and funders, including train operators (passenger and freight) and the SRA;
- (c) the process of the periodic review of Railtrack's access charges, under which the Regulator may adjust the amount of money which Railtrack may charge for use of its network taking into account the company's past performance;
- (d) industry-wide codes which establish operational and technical rules and procedures which need to be common for all industry participants;
- (e) the general rules of administrative law which apply to Railtrack when it is carrying out duties of importance to the public, such as the type approval of new rolling stock; and
- (f) the safety regulatory regime, established under the Health and Safety at Work *etc.* Act 1974 and regulations made under it (principally the Railways (Safety Case) Regulations 2000).

20. Licences and contracts are relevant to all aspects of the accountability of Railtrack, and a general description of them appears below. The remaining sources and instruments of accountability are described in the sections in which they are most relevant.

Licensing regime - overview

Licences - grant and duration

21. The operator of a network - a system which comprises track, signalling and associated installations - must have a licence to run that system. The Railways Act 1993 makes it a criminal offence to do so without one²². The licensing system has been established because the operation of assets of this kind is of significant regional and national importance, and there is a strong public interest in their being well-maintained and competently operated.

22. Certain networks may be exempted from the licensing regime²³. This is to avoid the full force of economic regulation being applied in cases where it is not

²² Section 6, Railways Act 1993

²³ Section 7, Railways Act 1993 and the Railways (Class and Miscellaneous Exemptions) Order 1994 (1994/606)

needed, for example in the case of heritage or preserved railways. Railtrack's network is not exempt.

23. Licences may be granted by the Secretary of State or the Regulator. The first licences (including Railtrack's) - from 1 April 1994 - were granted by the Secretary of State. Since then, all licences have been granted by the Regulator.

24. Railtrack's network licence continues in force unless revoked for fault or on at least ten years' notice (which may not be given before 31 March 2019). Revocation is in the hands of the Secretary of State.

25. The circumstances in which the network licence can be revoked for fault are explained in paragraphs 60 and 62 of this document.

Licences - modification

26. Railtrack's network licence can be amended by the Regulator in one of two ways—

- (a) with the acceptance of Railtrack²⁴; or
- (b) by compulsory means, without Railtrack's agreement, after the matter has been referred by the Regulator to the Competition Commission and the Commission has agreed with the Regulator that the public interest requires the change to be made²⁵.

Capacity consumption - contracts with train operators

Contracts of public importance - requirement for regulatory approval

27. With the increase in the numbers of trains being run, the capacity of some parts of the present network is running out. It is a matter of considerable public importance - as well as commercial significance to the companies concerned - that the capacity of the network is used efficiently and on the right types of services, and that train operators and others are protected from possible abuse of Railtrack's monopoly position.

²⁴ Under section 12, Railways Act 1993

²⁵ See sections 13-15C, Railways Act 1993

28. Accordingly, the Railways Act 1993 provides that the Regulator should oversee and control the consumption of the capacity of railway assets (track, stations and light maintenance depots). That capacity is consumed under contracts - called 'access contracts' - between the facility owner (in the case of track, this is Railtrack) and the beneficiary (the train operator).

29. Because of the importance of these contracts, the legislation requires that, unless exempted or subject to special rules²⁶, each access contract must be approved by the Regulator. In doing so, the Regulator operates according to public interest criteria²⁷.

Access contracts - contents

30. In general terms, track access contracts provide for two basic things. First, they say what Railtrack has to deliver to the train operator by way of capacity provision - called trainpaths - and network quality, and what charges Railtrack is entitled to receive for those things. Second, they provide remedies for each party if the other fails to perform its part of the bargain.

31. The first generation of access contracts, established in 1995-97, contain poor specifications of both these things²⁸. The specification of network capacity and quality which Railtrack has to deliver is, in a number of important respects, imprecise and weak. The regime of liability and remedies has been severely criticised for its opaqueness and uncertainty.

32. Access contracts also contain the arrangements under which Railtrack is paid for the use of capacity and by which Railtrack and train operators are incentivised to use and maintain and renew capacity efficiently. Paragraphs 74-91 of this document explain how these payment arrangements can and have been modified and improved.

²⁶ Exemptions under section 20, Railways Act 1993 and general approvals under section 18 or 22, Railways Act 1993

²⁷ His duties under section 4, Railways Act 1993. The Regulator has also published criteria for the approval of access contracts, and will shortly be revising those criteria after public consultation

²⁸ See *Model Clauses for Track Access Agreements: A Consultation Document*, Office of the Rail Regulator, London, January 2000; *Model Clauses for Track Access Agreements: Emerging Conclusions on Key Issues - A Second Consultation Document*, Office of the Rail Regulator, London, April 2000; *Model Clauses for Track Access Agreements: Provisional Conclusions*, Office of the Rail Regulator, London, July 2000

Compulsory access to railway facilities

33. In the case of its network, if Railtrack demands from a train operator unreasonable terms - for example, too high a price - or unreasonably refuses access altogether, the train operator can obtain access using compulsory means by application to the Regulator under section 17 or 22A of the Railways Act 1993. This means that any abuse of Railtrack's monopoly power in granting access to its network can be checked and, if necessary, overcome.

34. If a section 17 or 22A application is made to him, after following due process the Regulator is empowered to direct Railtrack to enter into an access contract (or an amendment of an existing access contract) with the train operator in question on terms which the Regulator, not Railtrack, decides. These terms will include the price to be paid, the capacity to be provided, a specification of the other services which Railtrack must provide and the standard they must reach, and the remedies available to the train operator if Railtrack fails to honour its obligations under the contract.

Approval of agreed access contracts

35. If Railtrack and the train operator have agreed the terms on which capacity is to be sold to the train operator, that contract still needs to be approved by the Regulator²⁹. The Regulator can require the contract to be changed before he approves it.

36. Amendments of existing access contracts also require the approval of the Regulator³⁰.

37. Once approved by the Regulator, the contract is enforceable only by the parties to it.

Amendment of existing access rights

38. In certain circumstances, a passenger (but not freight) train operator is entitled to secure a change to his existing access contract - whether as to the numbers of trains he runs or some other aspect of his contractual rights - against the will of Railtrack³¹.

²⁹ Section 18, Railways Act 1993

³⁰ Section 22, Railways Act 1993

³¹ Under Part 8 of Schedule 7 of each passenger track access agreement. If the change results in Railtrack having to do more work, it may require an adjustment of charges. The Part 8 power is in addition to the new power under section 22A, Railways Act 1993

39. This procedure requires the assistance of the Regulator in providing criteria for an arbitration of the issue between the train operator and Railtrack, and secondly in approving the outcome of the arbitration. Once made, the change is binding on Railtrack and the train operator.

Strengthening of contracts

40. Paragraphs 117-121 of this document explain how the Regulator intends to strengthen, streamline and simplify the access contracts between Railtrack and train operators.

Timetabling and other disputes

41. Under the industry-wide network code³², the Regulator acts as appeal body for certain disputes in relation to the establishment of the working timetable (which is usually put in place twice a year), network change, changes to rolling stock and certain of the arrangements for dealing with operational disruption.

42. Appeals are made to him after the parties (Railtrack and the train operator) have failed to agree on the relevant matter and after the question has been considered by the relevant industry dispute resolution body. The Regulator's decision is final and binding. Accordingly Railtrack is not free to determine these matters according to commercial criteria - the Regulator's public interest criteria can prevail.

Competition Act 1998 prohibitions

43. The Competition Act 1998 (as extended by the Transport Act 2000) contains prohibitions on anti-competitive agreements and the abuse of a dominant position. Railtrack has a dominant position in the provision of railway infrastructure services in Great Britain.

44. The Regulator has concurrent powers with the Director General of Fair Trading to enforce the Competition Act 1998 in the case of the supply of services relating to railways.

45. The Regulator is able to initiate an investigation if he believes that prohibited behaviour is taking place, or if a complaint about such behaviour has been made to him. The Act gives him considerable powers to obtain relevant information. If the Regulator establishes that behaviour is abusive, he can order the behaviour to be stopped and levy a substantial fine.

³² See paragraphs 46-50 of this document

Industry-wide codes

General

46. There are a number of industry-wide codes to which Railtrack and train operators are parties. The most important of them is the network code³³ which is incorporated in, and takes precedence over, every track access contract. (There are also common codes for access to stations and light maintenance depots.)

47. The network code contain common arrangements for the establishment of the national timetable, environmental matters, changes to the network³⁴, changes to rolling stock using the network, the attribution of responsibility for delays between operators and the handling of operational disruption.

Powers to change industry-wide codes

48. The industry-wide codes also have procedures under which the codes themselves can be changed. This is necessary to ensure that they can be improved over time and can be adapted to meet changing circumstances, including the requirements of the public interest.

49. There are two change procedures—

- (a) a democratic one, in which Railtrack and train operators have voting rights, but where the final approval of the Regulator to the change is still required; and
- (b) a public interest one in the hands of the Regulator, under which he can make changes, if necessary without the agreement of the affected parties, if the public interest would be served by them.

50. The Regulator is in the process of reviewing the network code with a view to its reform, and has published a number of proposals in this respect³⁵.

³³ Presently called the Track Access Conditions

³⁴ See paragraphs 131-133 of this document

³⁵ As part of the use of his powers to establish standard access contracts under section 21, Railways Act 1993. See also paragraphs 117-121 of this document

Administrative law

51. The ordinary rules of administrative law apply to Railtrack insofar as it is exercising public functions. Railtrack exercises public functions when it seeks to achieve some collective benefit for the public or a section of the public and is accepted by the public or that section of the public as having authority to do so. Not everything Railtrack does is within the realm of public law, but its most important functions (such as capacity allocation and the setting of standards) are.

52. To the extent that Railtrack is exercising public functions, Railtrack's actions may be judicially reviewed on the usual grounds of illegality, irrationality and procedural impropriety. However, if a regulatory remedy is also available, it may be better for the aggrieved person to invoke it rather than apply for judicial review.

Other controls on economic behaviour

Prohibition on having interests in train operators etc.

53. Railtrack is not permitted³⁶ to have an economic interest in any train operator or rolling stock leasing company. This is because it is important that Railtrack remains impartial in matters of timetabling, allocation of capacity, rolling stock approval, the expansion of the network and the handing of operational disruption.

Provision of information to the Regulator and the SRA

54. Railtrack is required to provide to the Regulator or the SRA information which either may reasonably require for the purposes of carrying out certain of its functions³⁷. In the case of the Regulator, the functions are his statutory ones under the Railways Act 1993³⁸. In the case of the SRA, the information must be needed for the purposes of its enforcement of the consumer protection conditions of Railtrack's network licence³⁹.

³⁶ Condition 13 of its network licence

³⁷ Condition 15 of its network licence and section 58, Railways Act 1993

³⁸ The Regulator has separate information powers under the Competition Act 1998

³⁹ On 2 April 2001, Railtrack announced a statement of principles agreed with the Secretary of State and the SRA under which it agreed to provide certain types of information to them; see also paragraph 12 of this document

Miscellaneous

55. Railtrack's network licence contains prohibitions on unfair cross-subsidy, undue discrimination and the misuse of certain classes of information. It also provides for Railtrack to give information to train operators to enable them to publish passenger timetables.

ENFORCEMENT

General

56. The methods of enforcement of these instruments differ. In general terms—

- (a) enforcement of economic regulatory instruments, such as the conditions of Railtrack's licences⁴⁰ and the statutory prohibitions on anti-competitive practices and abuse of a dominant position, is in the hands of the Regulator;
- (b) enforcement of contracts and industry-wide codes is in the hands of the parties to the contracts in question. In the case of access contracts - which allow train operators to use Railtrack's network - it is the passenger and freight train operators themselves which are able to take the necessary action, and public authorities have no *locus* in their enforcement. In the case of contracts between Railtrack and funders (such as the SRA), enforcement is in the hands of the funder;
- (c) the periodic review process - which resets Railtrack's charges for use of its network and other aspects of the railway industry's financial framework every five years - is conducted by the Regulator, with an effective right of appeal to the Competition Commission⁴¹;
- (d) the rules of administrative law permit any person with a sufficient interest in the matter to take action by applying for appropriate public law remedies such as judicial review⁴²; and

⁴⁰ The consumer protection conditions are enforceable by the SRA - see paragraph 12 of this document

⁴¹ Under Schedule 4A, Railways Act 1993, as inserted by the Transport Act 2000

⁴² See paragraphs 51-52 of this document

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- (e) enforcement of safety requirements is in the hands of the Health and Safety Executive, using enforcement and prohibition notices under the Health and Safety at Work *etc.* Act 1974 and regulations made under it; violation of these rules generally carry criminal sanctions.

Enforcement of licence conditions

Statutory basis of enforcement

57. Enforcement of licence conditions by the Regulator⁴³ takes place under section 55, Railways Act 1993, as amended and supplemented by the Transport Act 2000. Those powers of enforcement are considerable.

Scope of enforcement orders

58. The enforcement regime enables the Regulator to take action to require Railtrack to comply with its licence obligations if it is in breach, or where the Regulator is satisfied that a breach is likely.

59. An enforcement order may contain such provisions as the Regulator determines are appropriate to ensure that Railtrack complies with its licence obligations. Therefore, it may specify the result which Railtrack must achieve, leaving it to the company to determine how best to secure that result.

Consequences of breach of enforcement order

60. Breach of an enforcement order has the following consequences—
- (a) it is a breach of statutory duty, and so can be the subject of civil legal proceedings against Railtrack by any person adversely affected; for example, this could involve a freight customer (such as an aggregates company) suing for damages for loss of business;
 - (b) the Regulator may obtain an injunction, ordering performance of the order; breach of an injunction is a contempt of court, and punishable as such;

⁴³ The SRA is the appropriate enforcement authority in the case of the consumer protection provisions of Railtrack's network licence - see paragraph 12 of this document. For brevity, in this document reference will be made only to the Regulator enforcing Railtrack's network licence. However, it should be remembered that the enforcement authority is the SRA in the case of the consumer protection conditions of that licence

- (c) the Regulator may impose monetary penalties⁴⁴;
- (d) the Secretary of State may revoke the network licence on not less than three months' notice if—
 - (i) Railtrack continues to fail to comply with an enforcement order after receiving three months' notice of the Secretary of State's intention to revoke the licence on that ground; and
 - (ii) the revocation of the licence is a proportionate step for the Secretary of State to take; this means that the licence could not be revoked for a trivial breach.

61. In addition, the Transport Act 2000 strengthens the enforcement regime in several respects, including empowering the Regulator to impose a monetary penalty for a past breach of the licence⁴⁵.

Revocation of network licence on other grounds

62. The Secretary of State may also revoke the network licence—
- (a) forthwith, if Railtrack commits a serious breach of the Railways (Safety Case) Regulations 2000; and
 - (b) on three months' notice if:
 - (i) Railtrack ceases to operate a network for a continuous period of at least a year; or
 - (ii) there is an unauthorised change of control of Railtrack.

Enforcement of Competition Act 1998

63. The Competition Act 1998 makes provision for a special regime of enforcement, with rights of appeal to the relevant Competition Commission appeal tribunal.

⁴⁴ In 1999, the Regulator did so, at the rate of £4 million for every one percentage point by which Railtrack fell short of its passenger train performance target; see paragraph 85 of this document

⁴⁵ Before the enactment of the Transport Act 2000, the Regulator could only impose penalties for breach of an enforcement order, and could not do so if the breach had been remedied by the time he took enforcement action

64. There are certain circumstances in which the Regulator may make a direction for interim measures whilst he is investigating a case. This is a temporary cease and desist order to prevent harm to an affected person or to protect the public interest. Once the Regulator has arrived at his conclusions about a matter, he is able to require that any abusive behaviour should stop. He is also able to order that, instead of stopping, the behaviour in question should be changed in a specified way. If the Regulator's direction is not complied with, he can apply to the court for an order requiring compliance.

65. Under the Act, the Regulator has the power to impose financial penalties of up to 10% of an offending company's turnover. Any such penalty would be levied in accordance with guidance issued by the Director General of Fair Trading.

Enforcement of contracts and industry-wide codes

66. Although access contracts and the most important industry-wide codes which are binding on Railtrack require the Regulator's approval, once they have been approved it is for the parties to them to enforce them. They are commercial contracts and the ordinary rules of law about their interpretation apply. The railway industry has established its own tribunals for the rapid resolution of disputes, with rights of appeal either to an arbitrator or, in cases of public importance, the Regulator.

ACCOUNTABILITY FOR NETWORK OPERATION, MAINTENANCE AND RENEWAL

General

67. The operation, maintenance and renewal of the network is Railtrack's core business. In general terms, it involves—

- (a) timetabling and signalling trains over the network in real time, including dealing with operational disruption;
- (b) inspection of the state of its assets, collecting and maintaining data about them, planning and carrying out preventative and unscheduled maintenance, and managing engineering access to the network for the purpose of asset maintenance and renewal;
- (c) renewal of its assets in a timely fashion; and

- (d) the sale to train operators (and others) of the capacity of its network, by means of access contracts which confer rights to use the network to an extent specified in the contract; this will usually specify the numbers of trains which the beneficiary is entitled to run over a given period, their journey times, stopping patterns and other characteristics.

Condition 7 - general requirements

68. The most important of the conditions of Railtrack's network licence is Condition 7 (network stewardship), which requires the company to maintain, renew, replace, improve, enhance and develop the network—

- (a) in accordance with best practice and in a timely, efficient and economical manner;
- (b) so as to meet the reasonable requirements of train operators and funders in respect of the quality and capability of the network;
- (c) to the greatest extent reasonably practicable having regard to all relevant circumstances including matters of finance.

69. This is a wide-ranging and significant condition. It goes to the heart of Railtrack's responsibilities for the maintenance and improvement of the network, including the expansion of its capacity. Under Condition 7, Railtrack may not be required to undertake work without appropriate financial arrangements. The decision on the adequacy of the work and of the associated financial arrangements is a matter for the Regulator, not the company.

70. The circumstances in which the Regulator has so far used Condition 7 include those summarised in paragraphs 85-89 of this document.

Condition 7 - network management statement

71. Condition 7 also requires Railtrack annually to publish a statement - called the network management statement - stating how it expects to comply with its network stewardship obligation under that Condition. The form and period of the statement (normally ten years) must be approved by the Regulator.

72. The network management statement must be provided in sufficient detail to enable providers and potential providers of railway services to plan their businesses and to enable funders of railway services to plan their future financial and service

requirements, in each case with a reasonable degree of assurance. The network management statement must contain—

- (a) projections of future network quality and capability requirements;
- (b) planned modifications to the network;
- (c) the expected effect of such modifications on the quality and capability of the network, the quality of network services and the ability of users to provide improved services to their customers;
- (d) the estimated costs of, and the method proposed for financing, such requirements and improvements within Railtrack's overall financial framework; and
- (e) a progress report on the matters referred to in the last published network management statement.

73. Once the network management statement has been published by Railtrack, the Regulator assesses it. He also consults the railway industry and others in this respect. If he is dissatisfied with the network management statement in any respect, he can reject it or require it to be amended. Enforcement action may follow if the Regulator believes that Railtrack is not complying with the requirements of Condition 7.

Financial structure - periodic review

General

74. The Regulator has the power, every five years, to revise the financial structure and the levels of Railtrack's charges, in a process known as the periodic review of Railtrack's access charges⁴⁶. Each five year period is known as a 'control period'. The Regulator may, if there is an appropriately strong case, carry out one or more interim reviews during a control period⁴⁷. Regulators of the other privatised network industries have the same powers. The Regulator's decision on a periodic review (including an interim one) can effectively be appealed by Railtrack to the Competition Commission, whose decision is final⁴⁸.

⁴⁶ The powers to carry out each periodic review are derived from the access contracts between Railtrack and the passenger train operators

⁴⁷ See paragraphs 90-91 of this document

⁴⁸ Schedule 4A, Railways Act 1993 (as inserted by the Transport Act 2000)

75. The first control period was from 1995-2001. The second began on 1 April 2001 and lasts until 31 March 2006.

76. The financial framework for the first control period, established in 1995, had several material shortcomings. The Regulator has, for the second control period, determined that substantial improvements are required. As in the case of other privatisations, the Regulator tightened the financial framework for the second control period.

77. The recent periodic review has defined, in far greater detail than the one in 1995, what Railtrack has to deliver for the money it receives in the second control period. These things are usually referred to as the relevant 'outputs'. This definition includes—

- (a) specific incremental outputs - extra things which Railtrack has to do - such as annual performance improvements and reductions in the numbers of broken rails;
- (b) investments which the company must make in order to comply with new obligations, such as the installation of the train protection and warning system (TPWS);
- (c) other enhancement schemes which the SRA has stated it wants to buy as part of the periodic review (these are known as 'incremental output statement schemes' or simply 'IOS schemes'); and
- (d) greater specification of the condition and serviceability which specified classes of Railtrack's assets must meet; condition and serviceability measures are required for track, train control systems, structures, electrification equipment, stations and depots; certain measures set specific targets; for example Railtrack is required to achieve annual reductions in the number of broken rails and to achieve a specified level of track geometry; even where specific targets are not quantified, key indicators of network condition will be monitored, including the number and severity of temporary speed restrictions.

78. Railtrack is accountable for the delivery of these outputs in several different ways which are discussed in more detail below. In exercising his functions in these areas, the Regulator must discharge his statutory duties⁴⁹, including the duty not to make it unduly difficult for Railtrack to finance its relevant activities and the duty to

⁴⁹ See paragraph 10 of this document

have regard to the financial position of the SRA. These duties do not, however, require the Regulator to adjust charges to fund inefficiency or remedial action required to compensate for underdelivery of committed outputs. In addition, although any changes in charges are passed through to the SRA under the terms of the franchise agreements⁵⁰, these duties do not require the Regulator to set charges below the efficient cost of the outputs which Railtrack is expected to deliver.

Performance regime

79. The first means of accountability is through the performance regime established in each of the access contracts with passenger and freight train operators. The periodic review has strengthened and simplified the contractual economic incentives on Railtrack to reduce delays. To the extent that delays increase because of a deterioration in the condition of the network, this will have an immediate adverse financial impact on the company. However, improving the performance regime on its own is not enough, since the condition of the network can deteriorate significantly before there is any impact on performance. Accordingly the Regulator has determined that additional measures are necessary, described below.

Adjustments to charges

80. In the recent periodic review, the Regulator set out the approach he would expect to take in the 2006 periodic review if Railtrack fails to deliver the required outputs.

81. This includes the ability of the Regulator to make adjustments to the company's regulatory asset base (or 'RAB')⁵¹, and hence access charges, if Railtrack fails to deliver the required outputs. For example, there is an automatic adjustment mechanism if the actual incidence of broken rails is different to the incidence assumed in the periodic review. This too provides a direct financial incentive for good stewardship of the network, and, the more it secures that the company performs to expectations, or outperforms them, the better the condition of the network.

82. In short, these mechanisms constitute a system of considerable scope and flexibility which allows the Regulator to—

⁵⁰ Clause 18.1

⁵¹ The regulatory asset base is the value of the assets on which the company is entitled to earn a reasonable rate of return (determined by the Regulator). The lower the RAB, the less money the company can make in this way. The Regulator sets the RAB at each periodic review, and can, at any time during a control period, make a statement of an adjustment to the RAB which he will or intends to make if the company falls short in some respect, or exceeds its obligations

- (a) clawback money paid (by adjusting future charges) if the company has failed to deliver in some respect⁵²; and
- (b) ensure that the company is appropriately funded for the efficient and competent delivery of additional outputs, such as the installation of new safety systems.

Enforcement by Regulator

83. If, despite the above measures, the company is still seen to be falling well short of the relevant targets, this may be an incidence of a serious failure of stewardship. As such, immediate enforcement action by the Regulator may be the most appropriate course of action. If so, this could result in monetary penalties. The Regulator has published, in the periodic review, general guidelines on the basis for establishing such penalties⁵³ and he intends to publish further guidelines in relation to the basis for penalties for past breach⁵⁴. In each case, the basic principle is that the penalty should be set at a level which is sufficient to incentivise the company to comply with the relevant obligation without imposing unnecessary risk on the company.

Local output statements

84. Although the periodic review has focussed primarily on aggregate national output measures, the Regulator will also require these national outputs to be translated into local output statements which can be enforced by train operators through their access contracts⁵⁵.

Enforcement action taken under Condition 7

85. The present Regulator has taken enforcement action against Railtrack for breach of Condition 7 on four occasions since July 1999, in relation to—

⁵² In order to reduce uncertainty for investors, the Regulator has published the circumstances in which he would expect to make such adjustments. See Chapter 16, *The Periodic Review of Railtrack's Access Charges: Final Conclusions*, Office of the Rail Regulator, London, October 2000

⁵³ Chapter 17, *The Periodic Review of Railtrack's Access Charges: Final Conclusions*, Office of the Rail Regulator, London, October 2000

⁵⁴ As required by section 57B, Railways Act 1993

⁵⁵ See paragraphs 120-121 of this document

- (a) failure to meet passenger train performance targets in 1998-2000 (August 1999)⁵⁶;
- (b) lack of progress on the West Coast route modernisation (November 1999-May 2000)⁵⁷;
- (c) production of robust TOC-by-TOC and route-by-route rail recovery plans following the Hatfield derailment (January 2001)⁵⁸; and
- (d) the implementation of the rail recovery plans to restore network capability to pre-Hatfield levels (March 2001).

West Coast - special case

86. The West Coast route modernisation is a project of considerable national importance. The Regulator has taken action to compel Railtrack to produce credible and robust plans in relation to the upgrade, and options which the SRA needs to make its decisions on the particular outputs which it wishes to finance in the public interest.

87. In the recent periodic review, the Regulator made allowance for extensive renewal of the route following detailed review of Railtrack's plans. Railtrack's estimates of the cost of the project increased substantially during the periodic review process. However, the Regulator concluded that certain elements of the project were covered by fixed price contracts and that Railtrack should not therefore be provided with any further funding for cost overruns in these areas. Where there was no fixed price contract, he concluded that Railtrack should be provided with additional funding to deliver the outputs which its customers wish to buy, but he adjusted Railtrack's cost projections to take account of further efficiency improvements. The required outputs and associated prices have therefore been defined, and accepted by Railtrack, as part of the periodic review.

⁵⁶ See *Railtrack's performance targets: Statement by the Rail Regulator*, Office of the Rail Regulator, London, August 1999

⁵⁷ See *West Coast Main Line: Statement by the Rail Regulator*, Office of the Rail Regulator, London, November 1999; *West Coast Main Line: Modified Final Order against Railtrack PLC*, Office of the Rail Regulator, London, March 2000; and *West Coast Main Line: Final Order against Railtrack PLC*, Office of the Rail Regulator, London, May 2000

⁵⁸ *Regulator's Statement of Reasons for Provisional Enforcement Order in the Case of the National Rail Recovery Plan*, Office of the Rail Regulator, London, January 2001

88. The Regulator, in conjunction with the SRA, is establishing detailed milestones for the progress of the project, and will use his reporters⁵⁹ to monitor progress. If there is evidence that Railtrack is not delivering the specification without good reason, or other problems occur, the Regulator will require Railtrack to produce and carry out an appropriate remedial plan. He may back up delivery of remedial action with enforcement of Railtrack's network licence.

Other action re stewardship issues

89. In addition, the Regulator has used his powers under Condition 7 to apply pressure on Railtrack, without the necessity of formal enforcement action against the company at this stage, in relation to—

- (a) **Broken rails** The Regulator has taken continual action in this respect since 1999, when it became evident that the number of broken rails was significantly rising⁶⁰. He has required Railtrack to provide him with four-weekly reports of numbers of broken rails and defective rails. He has required Railtrack to explain its analysis of the reasons for the high numbers of breaks in 1998-99 and 1999-2000, to set out its plans for reducing them, and to produce forecasts of the results of its actions and to explain why it failed to meet its own forecasts in 1999 and 2000. In August 2000, the Regulator and the HSE jointly commissioned independent consultants⁶¹ to review both the adequacy of Railtrack's plans and the quality of Railtrack's rail management strategies. The Regulator is now considering Railtrack's response to the report, and together with the HSE will continue to obtain and assess detailed explanations from Railtrack about its plans for implementing the report's recommendations. He will continue to ensure that Railtrack takes action to improve performance in this area;
- (b) **Track quality** The Regulator has identified a significant decline in track quality since the formation of Railtrack, and has required Railtrack to improve the standards of its track maintenance by producing and delivering a track quality improvement programme⁶². This programme - which was

⁵⁹ See paragraphs 101-104 of this document

⁶⁰ Letters from the Regulator to Railtrack dated 12 August 1999, 12 November 1999 and 30 June 2000

⁶¹ Transportation Technology Center, Inc, Pueblo, Colorado; their report is published on the ORR website

⁶² Letters from the Regulator to Railtrack dated 16 July 1998 and 23 December 1998

scheduled for completion in April 2001 - committed Railtrack to eliminating very poor quality track so far as is reasonably practicable, and to restore the extent of good and satisfactory track to at least April 1994 levels. The Regulator is now reviewing the position and considering what further action is required;

- (c) **Possessions strategies** Following concern expressed by train operators and others about planning and management of possessions, the Regulator required Railtrack to produce plans to improve its arrangements. He is now considering the adequacy of Railtrack's proposals for improvement in the light of recent failings at Willesden and Leeds.

Interim reviews

90. The recent periodic review introduced further flexibility for charges to be adjusted before the next periodic review. If the Regulator considers that there has been a material change of circumstances and that in consequence there are compelling reasons for modifying the existing arrangements, he may initiate an interim charges review. For example, the Regulator would generally expect Railtrack to be funded for the efficient cost of meeting additional obligations which are imposed during the next control period. This funding could be provided through the interim review process.

91. Railtrack has also indicated that it expects to apply to the Regulator for an interim review of charges to provide further funding for the longer term implications of the Hatfield derailment. The Regulator set out his proposed approach to such a review on 15 January 2001⁶³.

Reform of network licence

Introduction

92. Railtrack's network licence was granted in March 1994 when the company was in the public sector. Although the then Government stated that, if and when a decision to privatise the company was taken, the licence would be strengthened to

⁶³ *Statement by the Rail Regulator on the Periodic Review and the Implications of the Hatfield Derailment*, Office of the Rail Regulator, London, January 2001

make it fit for a private sector Railtrack, when the company was privatised in May 1996 no appreciable change to the licence was made⁶⁴.

93. Accordingly, the Regulator has embarked on a programme of reform of Railtrack's network licence, to improve Railtrack's accountability in a number of important respects. He has secured six new licence conditions and two remain to be established.

New licence conditions already made

94. In 2000-01 the Regulator has so far secured six modifications of Railtrack's network licence. These are described below.

Safety and Standards Directorate

95. With effect from 1 January 2001, the Regulator introduced a new condition which requires Railtrack to establish a separate subsidiary company, with an independent board of directors, to take on certain key safety-related functions, in particular the setting of safety standards, formerly carried out by Railtrack's Safety and Standards Directorate. The new company is called Railway Safety and its chairman is Sir David Davies, President of the Royal Academy of Engineering.

96. The licence condition requires Railtrack to ensure the independence of Railway Safety.

Asset register

97. Railtrack and its maintenance and renewal contractors need to have comprehensive and reliable information about the condition, capacity and capability of the network. Information of that kind is also needed by others, including train operators, rolling stock manufacturers, developers of new railway facilities (such as freight terminals), local authorities and PTEs.

98. On 18 April 2001 the Regulator amended Railtrack's network licence to include a new condition which requires the company to establish and maintain such a register, to a high standard of accuracy and completeness⁶⁵.

⁶⁴ See *Railtrack's Stewardship of the Network*, Office of the Rail Regulator, London, Nov 1999

⁶⁵ *Consultation on Proposed Modification to Railtrack's Network Licence: Asset Register and Dependent Persons*, Office of the Rail Regulator, London, September 2000; *Notice of Proposed Modification to Railtrack's Network Licence: Asset Register*, Office of the Rail Regulator, London, March 2001

99. The licence condition requires Railtrack to produce for the Regulator's approval, and then to comply with, guidelines setting out the detail of the asset register. The first guidelines are required within 60 days of the licence condition taking effect. Railtrack is required to produce urgent remedial plans to improve its knowledge of its assets.

100. The Regulator's consultation on the terms of the appropriate new licence condition asked how third party access to the data on the register should best be secured. The general consensus was that third parties should have a contractual right to the information, rather than a right enforceable only by the Regulator. Accordingly the Regulator will consult further on the terms on which that access may be secured.

Reporters on Railtrack's stewardship of the network

101. The monitoring of Railtrack's stewardship of the network cannot and should not involve regulatory shadowing of everything Railtrack does. However, it is necessary, on an auditing and sometimes closer basis, to make an assessment of the adequacy of Railtrack's work.

102. On 11 April 2001⁶⁶ the Regulator amended Railtrack's network licence to include a new condition which provides for independent experts to be appointed by Railtrack, with the approval of the Regulator, to carry out assessments and investigations in relation to the extent and nature of Railtrack's work. An example will be the sufficiency of its maintenance and renewal of the network. The experts - called 'reporters' - will be paid for by Railtrack but will report direct to the Regulator, and be accountable to him.

103. The Regulator will be able to determine what depth and level of investigation is carried out by the reporters, and with what frequency. A core task for the reporters will be to verify the information provided by Railtrack in the annual return (see paragraphs 105-107 of this document). At the very least, this will involve audit of the processes used to collect the data and/or the data itself. In some cases, however, specific issues may be examined in more detail and the reporters may be required by the Regulator to provide an independent review of recovery plans where particular stewardship problems have arisen. The reporters will also be expected to provide a report on progress against the milestones established (in conjunction with the SRA) in relation to the West Coast route modernisation⁶⁷.

⁶⁶ *Notice of Proposed Modifications to Railtrack's Network Licence: Reporter, Regulatory Accounts and Annual Return*, Office of the Rail Regulator, London, March 2001

⁶⁷ See paragraph 88 of this document

104. The process of appointing the reporters is under way and the Regulator expects them to begin work in the summer of 2001.

Annual return on performance and condition of network

105. The outputs which Railtrack was expected to deliver in the first control period (1995-2001) were never clearly defined. In other words, the financial framework in that period did not specify sufficiently clearly what Railtrack had to do for the money it received. It is not therefore surprising that the way in which Railtrack reports on these outputs has tended to be rather *ad hoc* and inconsistent. However, the recent periodic review has established the process of defining much more precisely what Railtrack is required to do for the access charges it receives.

106. The new licence condition⁶⁸ requires Railtrack to provide an annual return to the Regulator. That annual return will report on the performance and condition of Railtrack's network over the previous year. It will therefore consolidate the existing and new information in more consistent and useful format and will include an explanation of any significant variances from the April 2001 baseline and the expected levels of performance and condition which are funded in the periodic review. The annual return will operate in addition to the Regulator's existing powers to obtain information from the company, and the verification and monitoring arrangements to be established by means of reporters⁶⁹.

107. The Regulator expects shortly to approve the form of the first annual return. This will be based on the output, asset condition and activity measures underpinning the recent periodic review.

Regulatory accounts

108. Railtrack's current regulatory accounts are of very limited use to either the Regulator or investors. In particular, the level of information which they gave was clearly inadequate to inform the recent periodic review, and the accounts provide investors with very little information on how the company is performing against the assumptions which were made at the time of privatisation.

⁶⁸ *Notice of Proposed Modifications to Railtrack's Network Licence: Reporter, Regulatory Accounts and Annual Return*, Office of the Rail Regulator, London, March 2001

⁶⁹ See paragraphs 101-104 of this document

109. The new licence condition⁷⁰ therefore requires Railtrack to provide more detailed and disaggregated information in a way which is consistent with the approach and assumptions adopted in the recent periodic review. Railtrack is also now required to provide an explanation of material variances between the periodic review assumptions and what actually happens in terms of expenditure and revenues in particular areas. This will help to establish whether these variances are due to differences in the company's efficiency, prices or outputs.

Dealings with dependent persons

110. Railtrack's relationships with its customers - mainly (but not exclusively) train operators, rolling stock manufacturers and other railway industry players - have often been criticised as unresponsive, inefficient and in other respects unsatisfactory.

111. The Regulator's new licence condition⁷¹ requires Railtrack to establish and comply with a code of practice which covers its dealings with third parties. The code of practice will be in several parts, with different parts applying to different types of person or dealing. However, the overall principle of the code of practice will be that Railtrack should, in such dealings, behave with due efficiency and economy and in a timely manner, including in all respects with that degree of skill, diligence, prudence and foresight which should be exercised by a skilled and experienced network owner and operator.

112. The licence condition was accepted by Railtrack on 3 May 2001 and the statutory consultation period is now under way. Subject to the results of that consultation, the Regulator expects to make this change to Railtrack's network licence in June 2001.

Licence changes still to be made

113. The two licence modifications which the Regulator has yet to establish concern land disposal and ring-fencing of Railtrack's core business. They are described in the following paragraphs.

⁷⁰ *Notice of Proposed Modifications to Railtrack's Network Licence: Reporter, Regulatory Accounts and Annual Return*, Office of the Rail Regulator, London, March 2001

⁷¹ *Consultation on Proposed Modification to Railtrack's Network Licence: Asset Register and Dependent Persons*, Office of the Rail Regulator, London, September 2000

Land disposal

114. The Regulator intends to modify Railtrack's network licence so as to include a new condition which enables him to prevent Railtrack disposing of land if to do so would be contrary to the public interest⁷².

Ring-fencing

115. It is important that Railtrack's ability to finance its core activities is not prejudiced by other ventures which the company may, in its commercial judgement, decide to undertake. Accordingly, the Regulator has decided that it is necessary for Railtrack to be required to preserve its core assets for railway purposes, and ensure that they cannot be pledged for the purpose of non-core activities. It is also necessary to ensure that Railtrack maintains an appropriate capital structure and that transactions between the core business and other (unregulated) parts of the group are on an arm's length basis.

116. The licences of other regulated network businesses have been modified to introduce stronger controls on financial ring-fencing and the Regulator's proposed modification of Railtrack's network licence is consistent with the approach in other regulated industries. The Regulator considers it appropriate to introduce best practice in this area before rather than after potential problems materialise⁷³.

Contracts with customers - reform*Strengthening of contracts*

117. The Regulator is in the process of exercising his powers to produce standard contracts⁷⁴ for access to railway facilities, starting with access to Railtrack's network⁷⁵. The Regulator's view is that the present generation of access contracts are

⁷² See *Consultation on Proposed Modifications to Railtrack's Network Licence: Disposal of Assets and Ring-fencing*, Office of the Rail Regulator, London, September 2000; see also paragraphs 144-146 of this document

⁷³ See *Consultation on Proposed Modifications to Railtrack's Network Licence: Disposal of Assets and Ring-fencing*, Office of the Rail Regulator, London, September 2000

⁷⁴ Section 21, Railways Act 1993

⁷⁵ *Model Clauses for Track Access Agreements: A Consultation Document*, Office of the Rail Regulator, London, January 2000; *Model Clauses for Track Access Agreements: Emerging Conclusions on Key Issues - A Second Consultation Document*, Office of the Rail Regulator, London, April 2000; *Model Clauses for Track Access Agreements: Provisional Conclusions*, Office of the Rail Regulator, London, July 2000

too weak to ensure that Railtrack is held properly to account inasmuch as they do not have adequate specifications of the outputs Railtrack is required to deliver or adequate remedies if it fails⁷⁶. This matter has been thrown into sharp focus by the aftermath of the Hatfield derailment.

118. Accordingly the Regulator will ensure that the next generation of access contracts - which will run alongside the new franchise agreements which the SRA are devising as part of the franchise replacement programme - will be stronger, using these improved standard terms. He will do this by virtue of the need of Railtrack and the train operators in question to obtain his approval of the new contracts before they may come into force⁷⁷.

119. His policy is also to simplify and streamline the contracts in a number of respects, including in matters of network quality and specification, the provision of information and the remedies available to each party if things go wrong.

Local output statements

120. Part of the process of reform of access contracts involves the introduction of a mechanism under which the train operator is entitled to production by Railtrack of a statement of the outputs in respect of its network which it is required to deliver to that train operator. In other words, the contracts will say what Railtrack must provide by way of network capacity, quality and capability in the case of each individual train operator. This is the general obligation to maintain and improve the network⁷⁸ made specific and local.

121. Once established (whether by agreement with the train operator or after a process to resolve differences), the train operator will be entitled to enforce the local output statement, and will have remedies for non-delivery by Railtrack.

Contracts with funders

122. Funders - the SRA, PTEs, local authorities and others - are free to negotiate with Railtrack in relation to network capacity improvements and other objectives which they want to achieve. The successful result of such negotiations will almost always be a contract. However, funders do not have the power to compel Railtrack

⁷⁶ See also paragraph 31 of this document

⁷⁷ Under section 18, Railways Act 1993

⁷⁸ Condition 7 of Railtrack's network licence; see also paragraphs 68-70 of this document

to enter into a contract. This is because it would be unfair for the buyer of a service to be able itself, and against the will of the seller, to determine the terms on which the seller will provide the service.

123. If funders encounter difficulties in obtaining acceptable terms from Railtrack, the Regulator has powers to ensure that the matter is resolved with fairness to both buyer (funder) and seller (Railtrack). If they wish to buy capacity of the railway for the purpose of train operation, the Regulator's powers under sections 17 and 22A of the Railways Act 1993 (compulsory access to network facilities) are available⁷⁹. In the case of enhancements, section 16A-I of the Railways Act 1993 (provision, improvement and decision of railway facilities) is available⁸⁰.

Railway Group Standards

General

124. Railway Safety - the new Railtrack Group subsidiary company - is obliged to supervise the system of technical and operating standards with which Railtrack, train operators using the national network and certain suppliers must comply. These are known as Railway Group Standards. Since Railway Safety is not itself the holder of a network licence, Condition 6 of Railtrack's network licence requires Railtrack to ensure that Railway Safety meets the public interest requirements of that licence by means of the enforcement of a contract between them. Condition 6 enables the Regulator to require Railtrack to enforce that contract, and so maintains the appropriate degree of regulatory oversight over this important function.

125. In supervising the system of Railway Group Standards, Railway Safety must ensure that they are fit for purpose. This involves a system of continuous review and an obligation, in appropriate cases, to amend or abolish existing Railway Group Standards and to devise new ones. An example is the case of tilting trains for the West Coast main line, where completely new standards are required for new technology.

126. Railway Group Standards could be operated as a barrier to entry to the railway industry. They can also involve significant costs for the persons whose equipment or organisations are obliged to comply with them. Accordingly Railway Safety must be seen to be operating the system of standards-setting and reform in an impartial and

⁷⁹ See paragraphs 33-34 of this document

⁸⁰ See paragraphs 136-139 of this document

open way. If any person is dissatisfied with a decision by Railway Safety in this respect (whether a decision to act or a decision not to take action), that decision can be appealed to the Regulator.

127. A large number of Railway Group Standards are ones which require compliance by Railtrack itself. Accordingly it is a further term of Condition 6 that Railtrack itself abides by those Railway Group Standards. If it fails to do so, the Regulator can take enforcement action for breach of that part of the network licence.

Rolling stock approvals

128. A complaint was made to the Regulator against Railtrack for breach of Railway Group Standards and alleging that the standards themselves were inadequate. It concerned the arrangements for the development and acceptance of new railway vehicles for use on Railtrack's network. The Regulator's decision on the complaint was announced on 30 March 2001. He concluded that Railtrack was in breach of its network licence and that certain Railway Group Standards were not fit for purpose. The Regulator published a proposed direction to Railtrack which would require it to secure that Railway Safety amends the relevant Railway Group Standards to improve the quality and timeliness of information provision as a matter of urgency⁸¹.

ACCOUNTABILITY FOR THE ENHANCEMENT OF THE NETWORK

Condition 7

129. Railtrack's network licence (Condition 7) also requires the company to improve, enhance and develop its network in accordance with best practice, to meet the reasonable requirements of its customers and funders⁸².

130. Condition 7 is an important instrument in ensuring that Railtrack expands the capacity and capability of its network wisely and well, at the right times and at the right prices.

⁸¹ *Vehicle and Route Acceptance: Complaint by Adtranz and Alstom*, Office of the Rail Regulator, London, March 2001

⁸² See paragraphs 57-61 and 68-70 of this document

Network change

131. The network code contains a procedure for changes to the network. A network change is, for example, the installation of new signalling capacity, or turning a two-track line into a four-track one.

132. The network change procedure in the network code contemplates agreed or compulsory network changes. The agreed procedure includes a process of consultation of affected parties - such as other users of the line in question - and possible payment of compensation for any adverse effects on the services of third parties.

133. The compulsory procedure is used in cases where agreement is not reached. It can be used to compel Railtrack to carry out a network change against its wishes⁸³. If it is invoked, it is for the parties to the code to enforce it. However, if there is dispute, an application can be made to the Regulator for a determination and his decision is final and binding.

Project delivery

134. The Regulator's powers to monitor and enforce delivery of specific as well as national outputs in relation to the steady state network apply with equal force to enhancements. Thus, the Regulator is in the process of establishing, in conjunction with the SRA, a programme of works and milestones to ensure efficient and competent delivery of the West Coast route modernisation project⁸⁴.

135. These powers can and will, as necessary, be applied to other enhancements, for example the upgrade of the East Coast main line.

Section 16A-I - compulsory enhancement of network with SRA support

136. If Railtrack demands unreasonable terms for an enhancement, or unreasonably refuses to carry one out, section 16A-I of the Railways Act 1993⁸⁵ establishes a mechanism under which the Regulator can direct Railtrack to carry out a specified enhancement on terms which the Regulator, not Railtrack, determines.

⁸³ This compulsory procedure is in addition to the new section 16A-I, Railways Act 1993 mechanism (see paragraphs 136-139 of this document), and is preserved by virtue of section 16I(2)(b), Railways Act 1993

⁸⁴ See also paragraphs 86-88 of this paper

⁸⁵ As inserted by section 223 of the Transport Act 2000

137. An application for section 16A-I directions may be made either by the SRA or by another person - for example a train operator, another funder or a developer of a new rail freight facility or station - with the consent of the SRA.

138. It is the duty of the Regulator, under this new statutory procedure, to give a determination which ensures that Railtrack is adequately rewarded for carrying out the enhancement. This means that the price and other terms must be fair.

139. Once the Regulator has directed Railtrack to carry out the enhancement, Railtrack has a statutory duty to do so⁸⁶.

Third party enhancement

140. Railtrack is not the only company which is able to carry out enhancements of its network. The company has agreed with the Government and the SRA that it will facilitate enhancement projects planned and carried out by third parties, for example using special purpose vehicles⁸⁷.

141. The Regulator has set out his views in relation to the regulatory framework for enhancement as part of the periodic review. This includes arrangements in relation to third party enhancements⁸⁸. The instruments and mechanisms described in paragraphs 129-139 of this document will assist the sponsors of third party enhancement projects, including the SRA.

ACCOUNTABILITY FOR THE CLOSURE OR DISPOSAL OF PARTS OF THE NETWORK AND THE COMPANY'S LANDHOLDINGS

Statutory closure procedure

142. Closure of railway facilities - including parts of Railtrack's network - is subject to a statutory closure procedure.

143. Closure proposals must be made to the SRA. If it believes the closure should be allowed, it must publish a notice to that effect. After receiving representations,

⁸⁶ Section 144, Railways Act 1993

⁸⁷ See statement of principles agreed between Railtrack, the Secretary of State and the SRA, announced 2 April 2001

⁸⁸ Chapter 11, *The Periodic Review of Railtrack's Access Charges: Provisional Conclusions on the Incentive Framework*, Office of the Rail Regulator, London, April 2000

the Secretary of State decides whether the closure should have effect. Conditions may be attached to a closure consent by the Secretary of State. Failure to comply with this procedure, or with the conditions of a closure consent, may lead to enforcement action.

Disposal of land

144. Railtrack's assets include substantial land assets beside or near the railway which, if disposed of for non-railway purposes, would in most cases be lost to the railway for good.

145. The Regulator intends⁸⁹ to modify Railtrack's network licence so as to include a new condition which enables him to prevent Railtrack disposing of land if to do so would be contrary to the public interest. For example, land beside or near the railway may be needed for a freight terminal or a station car park extensions. The Regulator's proposed new licence condition is substantially the same as the corresponding conditions in the licences held by electricity network businesses.

146. The new condition requires the company to obtain the approval of the Regulator to material disposals of land, whilst allowing the company freedom to deal with its land assets in non-material cases without the need for regulatory intervention. It therefore strikes a balance and ensures that there is no unnecessary interference with the ordinary course of the company's business.

ACCOUNTABILITY FOR THE APPROVAL OF ROLLING STOCK FOR USE ON RAILTRACK'S NETWORK

General

147. Railtrack has an important role in approving new rolling stock for use on its network. Without that approval, new rolling stock may not be brought into service⁹⁰.

148. There are two types of approval—

- (a) vehicle acceptance, which is essentially concerned with the safety of the railway vehicle; and

⁸⁹ *Consultation on Proposed Modifications to Railtrack's Network Licence: Disposal of Assets and Ring-fencing*, Office of the Rail Regulator, London, September 2000

⁹⁰ The Railways and Other Transport Systems (Approval of Works, Plant and Equipment) Regulations 1994 also apply

- (b) route acceptance, which deals with whether a particular vehicle or type of vehicle is safe to be operated on particular parts of the network (for example, in matters of gauge).

Railway Group Standards

149. Railtrack is required by relevant Railway Group Standards⁹¹ to operate a competent and appropriate system of vehicle and route acceptance. Failure to comply with those requirements would be a breach of Condition 6 of its network licence, enforceable by the Regulator.

Vehicle and route acceptance contracts

150. The Regulator is considering publishing standard terms⁹² for contracts between Railtrack and applicants for vehicle and route acceptance⁹³.

151. Such contracts would specify clearly the responsibilities of Railtrack and the applicant in relation to the process, and require Railtrack to provide timely, complete and accurate information which applicants - such as rolling stock manufacturers - need to design, build and commission new rolling stock. They would also require Railtrack to carry out its part in the vehicle and route acceptance process in a timely, efficient and competent manner, with skill, diligence, prudence and foresight. The contracts would also specify appropriate remedies in case of breach⁹⁴.

152. As a track access contract, if Railtrack were to demand unreasonable terms or unreasonably refuse to offer a vehicle and route acceptance contract, the Regulator would be able to direct Railtrack to do so under section 17, Railways Act 1993⁹⁵.

153. The network code also contains a procedure for a train operator to introduce new rolling stock for use on Railtrack's network. The Regulator's present

⁹¹ See paragraph 124 of this document

⁹² Under section 21, Railways Act 1993

⁹³ *Vehicle and Route Acceptance Procedures: A Consultation Document*, Office of the Rail Regulator, London, March 2001

⁹⁴ At present, Railtrack has two such contracts. Each was entered into on 1 May 1998. The first is with West Coast Trains Limited. The second is with CrossCountry Trains Limited. A copy of the second is published in Appendix B to *Vehicle and Route Acceptance Procedures: A Consultation Document*, Office of the Rail Regulator, London, March 2001

⁹⁵ See paragraphs 33-34 of this document

consultation asks whether it would be preferable to amend and expand that procedure, rather than have separate and self-standing vehicle and route acceptance contracts.

154. Enforcement of the contract, once entered into, or the relevant provisions of the network code would be in the hands of the applicant.

155. On 22 March 2001 the Regulator published a consultation document in relation to the reform of Railtrack's procedures for vehicle and route acceptance, including in matters of the availability of network information for the purpose of the design of new trains⁹⁶.

⁹⁶ *Vehicle and route acceptance: a consultation document*, Office of the Rail Regulator, London, March 2001



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