An ACCESS DISPUTES PANEL of the ACCESS DISPUTES COMMITTEE

Determination in respect of reference ADP14

(following a Hearing held at Kings Cross on 22nd February 2006)

The Panel

Tony Crabtree:	elected representative for Franchised Passenger Class, Band 3
Bill Davidson:	appointed representative of Network Rail
Bil McGregor:	elected representative for Franchised Passenger Class, Band 1
Nigel Oatway:	elected representative for Non-Passenger Class, Band 1

Panel Chairman: **George Renwick**

Note that clause 26.8.2 was struck out, on appeal, by the Office of Rail Regulation; and accordingly the text of clause 26.8.1 is incorporated into 26.8.

Brief Summary of Dispute, and the jurisdiction of the Panel

1. First/Keolis Transpennine Limited "TransPennine Express" ("TPE") has procured a fleet of Class 185 Desiro trains to replace the Class 158s and Class 175s that have worked TPE services to date. TPE, working in close cooperation with Network Rail Infrastructure Limited ("Network Rail"), has complied with all the stipulated Group Standards in respect of testing, and vehicle acceptance, and has also obtained Office of Rail Regulation approval of the necessary Supplemental Agreement to its Track Access Contract.

2. A principal feature of the Supplemental Agreement is that it adds a new Variable Track Usage charge ("VTU charge") for the Class 185, that corresponds with the value derived from the industry standard model used to calculate other VTU charges.

3. In addition, the parties have complied with the procedural requirements of Part F of the Network Code (Vehicle Change), including the carrying out of necessary processes of Consultation with other affected Train Operators. The dispute between the parties arises because Network Rail contends that it has a claim for compensation under Part F that TPE is unwilling to concede.

4. Notwithstanding the existence of this dispute, the Parties are in agreement that Class 185 trains may, and will, enter passenger-carrying service with effect from March 20th 2006.

5. The Panel considered that, to the extent that the dispute relates to the interpretation and application of Vehicle Change, it is a matter that properly falls within its jurisdiction under the provisions of Condition F5.

A Summary of the Arguments *(words in italics not otherwise attributed are quotations from the parties' joint submission)*

6. **Network Rail** acknowledged, in a letter of 17th November 2005, that TPE had fulfilled its obligations in respect of the procedural provisions of Part F, including supplying the information necessary to permit adequate consultation with other Train Operators. However, "*Network Rail considers that in relation to the proposed Vehicle Change:….Network Rail should be entitled to compensation from First/Keolis Transpennine Limited for the consequences of the implementation of the change".*

7. In the annexe to the 17th November 2005 letter Network Rail set out seven areas wherein it would seek compensation; six of the seven are not the subject of any dispute between the parties, but the following is not accepted by TPE: **"***First/Keolis Transpennine Limited will meet all costs associated with any increase in track wear and resulting increased maintenance requirements, compared to existing vehicles being operated over approved routes. Network Rail is concerned at the risk of the additional track wear and will be monitoring the track condition following the introduction of the vehicles, as per Line Standard RT/CE/S/103 (Track Inspection Requirements). All costs associated with work required to the network resulting from this monitoring and attributed to this Vehicle Change application will be paid by First/Keolis Transpennine Limited".*

8. Network Rail acknowledges that, before the commencement even of test running, a new VTU charge had been calculated for the Class 185 and included in the Track Usage Price List. This calculation had been made in accordance with the formula for such prices approved by the Office of Rail Regulation.

9. The VTU Charge for the current Class 158s is 11.65 pence per vehicle mile. Because some of the stipulated relevant parameters for the Class 185 differ significantly from those of the Class 158, the VTU charge for the Class 185, in test running, had been calculated to be 19.13 pence per vehicle mile. Network Rail expects that, because this calculation was based upon an under-estimate of the emerging "un-sprung weight" of the Class 185, the VTU charge, once the trains enter passenger carrying service, would be reset to 22.29 pence per vehicle mile. This would result in the total VTU charge for the affected TPE services rising, as a result of the Vehicle Change, by £2.1M to £5.0M.

10. Network Rail considers that the VTU charge formula does not cover all possible eventualities; in particular it does not take account of the varying propensity of different vehicles to generate Rolling Contact Fatigue (RCF). Network Rail therefore considers that any compensation to which it is entitled should include *"costs associated with any increase in track wear and resulting increased maintenance requirements, compared to existing vehicles being operated over approved routes"*. Furthermore, Network Rail will introduce revised monitoring procedures, and requires that TPE assume responsibility for *"All costs associated with work required to the network resulting from this monitoring and attributed to this Vehicle Change application".*

11. Furthermore Network Rail states that it *" believes that*

    11.1. *The underlying principle should be applied that a proposer of a change bears the cost of that change;*

11.2. *More work needs to be done in this case to establish what additional costs exist;*

11.3. *The ability to recover additional track wear costs is a reasonable pre-condition of Network Rail's agreeing to the proposed Vehicle Change;*

11.4. *Payment of these costs would not involve additional or duplication of costs already included in the VTU charge set out in Schedule 7".*

12. **TPE** argued that Network Rail was seeking to distort the overall structure of the Track Access Contract, and that

12.1. *"these costs are not a proper precondition of agreeing to establish a Vehicle Change,*

12.2. *the industry framework is designed on the basis that maintenance costs due to the operation of services are paid for by operators under track access charges, principally in this case the fixed track access charge and the VTU charge set out in Schedule 7 of the parties' Track Access Agreement and are not therefore properly dealt with under Part F;*

12.3. *by imposing a pre-condition that additional costs be paid before agreeing to Vehicle Change, Network Rail are in effect attempting to change the basis of charging for access to the Network approved by ORR".*

13. TPE further argued that,

13.1. if compensation is payable in respect of Vehicle Change, in the circumstances Network Rail assert, then the value of that compensation must, in compliance with Condition F3.2, and F3.3, take account of the benefits to Network Rail as much as any detriments;

13.2. a claim for compensation should, by the terms of the concluding paragraph of F3.1, explicitly *"include a statement of the amount of compensation required and the means by which the compensation should be paid"*;

13.3. the form in which Network Rail had expressed its claim to compensation was inappropriately non-specific, contained no predictive assessment of the sums potentially involved, and therefore had more the form of a request for indemnification; and that, therefore

13.4. Network Rail's claim was one that was not admissible under the terms of Part F.

Guidance given to the parties under Access Dispute Resolution Rule ("ADRR") A1.4(c) in respect of "relevant issues of law"

14. The Panel Chairman, in discharge of ADRR A1.4(c) had written to the parties, to remind them "that references to a Panel must, by the terms of the Access Dispute Resolution Rules (15th April 2005), be determined *"on the basis of the legal entitlements of the dispute parties and upon no other basis"* (Rule A1.18)", and to direct their particular attention to the following points

3. *Which is the relevant edition of Part F of the Network Code? Are we all looking at the same (and appropriate) edition?*

4. *Was the version of Schedule 7 to the Track Access Agreement, sent as Annex A, the version in force at the relevant time? I understand that this is the case but wish the parties to confirm as part of their opening statements.*

5. *Have the parties complied with the procedures they are respectively required to follow under Part F? If not, how (if at all) are their contractual rights affected? If they have been unable to comply, does that throw any light on how Part F should be construed?*

6. *Condition F3 does not in terms give Network Rail (NR) a right to compensation, although the existence of such a right is implied. Does the Panel need to see any other documents (e.g. the Track Access Agreement itself)?*

7. *Which party has the onus of proof?*

8. *Is the expression "costs, direct losses and expenses (including loss of revenue)" in F3.2 apt to cover the items of expenditure for which NR claim compensation?*

9. *Is the right to adjust the VTU Charge a "benefit" which must be "taken into account" under F3.3(a)? If so, what is the basis on which it should be taken into account?*

10. *Are the disputed costs mentioned in paragraph 5.2 of the Joint Reference costs of a kind taken into account in arriving at the VTU charge?*

11. *Does paragraph 9 of Part 2 of Schedule 7 throw any light on the matter (having regard to what it doesn't say as well as what it does)?*

12. *It is relevant to consider how NR's claim for compensation fits into the general scheme of things under the Network Code. What did the authors of the Code envisage in relation to -*

    (a) *the need for both NR and the Sponsor to be able to quantify and provide for their respective financial obligations arising out of a Vehicle Change; and*

    (b) *adjusting the new VTU Charge should it prove to be either too high or too low?*

13. *As regards the alternative remedies sought by the Sponsor under paragraph 7 of the Joint Reference -*

    (a) *Does the Panel have the power to make the determination asked for in paragraph 7.2(a)?*

    (b) *Does it have power to provide the remedy requested under 7.2(b) and, if it does, does it have the information and expertise needed in order to exercise that power in the present case?*

The Panel's findings

15. The Panel was satisfied that the documentation submitted by the parties (including some supplementary documents submitted on 23rd January 2006, in response to a letter from the Secretary on 16th January 2006) was sufficient to enable it to make a determination of the issues before it.

16. The Panel found that the parties were in agreement that

    16.1. the version of Network Code Part F applicable to this dispute was that dated 16th October 2005;

16.2. the version of Schedule 7 to the Track Access Agreement, sent as Annex A, is the version in force at the relevant time; and

16.3. both parties have complied with the procedural requirements of Part F, and have not, in respect of compliance with timescales for the exchange of information, acted in any way that may have compromised their respective rights under that Part F.

17. In respect of this last consideration the Panel was of the view that the manner in which Network Rail had formulated its claim for compensation was of the essence of the dispute. Therefore, for the avoidance of doubt, the Panel drew the following distinctions;

17.1. Condition F3.1 (c) conceded to Network Rail the right to apply to be compensated *"for the consequences of the implementation of the [Vehicle] change".* However,

17.2. the onus of proof, to demonstrate that the type of compensation sought in this case was admissible under the terms of Part F, was on Network Rail, and that

17.3. the onus of proof has to be discharged through the interpretation of the contractual documents currently in force.

18. The Panel found it helpful, in its deliberations, to view the working provisions of the Track Access Contract (and the Network Code) in the context of the "economic architecture" of the Rail Industry, as overseen and regulated by the Office of Rail Regulation. Thus the Panel concluded that

18.1. the Track Access Contract (incorporating the Network Code) defines the way in which the relevant access parties interact, and the extent to which, at different times, the parties' entitlements are influenced by factors internal or external. The practical financial consequences in respect of most of those influencing factors is a function of top-down derived values or scales of charges; the VTU charge is but one example of such a top-down derived charge;

18.2. all Track Access Contract values or scales of charges are a function of the needs of the industry, as translated, by the Office of Rail Regulation, into its economic architecture. Individual elements within that economic architecture may reflect considerations that have much that is only an approximation to reality, or indeed is arbitrary. For practical purposes however the economic architecture appears generally consistent, and therefore equitable to all Train Operators, and proportionate to Network Rail's assessed needs.

19. Condition F3.1 provides for any claim by Network Rail for compensation to be made by means of a notice, and that any such notice *"shall include a statement of the amount of compensation required".* Condition F3.2 provides that *"Subject to Condition F3.3* [which requires off-setting benefits to be taken into account] *the amount of compensation…shall be an amount equal to the amount of the "costs, direct losses and expenses" (including loss of revenue)…which can reasonably be expected to be incurred by Network Rail…as a consequence of the implementation of the proposed change…".* The Panel considered that Condition F3.1 thus requires a claim for compensation to be presented in terms of a stated amount, based upon a pre-estimate of the costs etc likely to be incurred, whereas Network Rail's claim was, in effect, a claim to be indemnified in respect of an un-stated amount, to be quantified only on the basis of a further (after the event) assessment. In the Panel's view, a claim expressed in these terms was not admissible under Condition F3.1.

20. Network Rail conceded, at the hearing, that, in calculating any compensation to which it was entitled, costs and expenses for which it was compensated in other ways should be excluded, and account should be taken of any off-setting benefits which it enjoyed. The Panel considered that the right to receive an increased VTU charge of 19.13 pence per vehicle mile, as against 11.65 pence for the current Class 158 was a benefit, and that it should be taken into account as compensating fully for all those factors assessed to arrive at a VTU charge.

21. In practice the VTU charge, which is calculated by reference to five specific factors (vehicle weight, un-sprung mass, maximum operating speed, maximum speed, and number of axles) might operate unfairly to either party; some such "unfairnesses" can be addressed directly, and others not. Thus

    21.1. Network Rail considered that there had been an underestimation of the un-sprung mass of the Class 185, and had proposed that this be "re-measured". On this basis, and subject to the approval of the Office of Rail Regulation, the formula for calculating the VTU charge would increase the charge to 22.29 pence per mile. On the other hand, this further uplift might still not exactly recover possible costs deriving from Rolling Contact Fatigue, which is not a factor explicitly incorporated into the calculation;

    21.2. TPE had submitted to the Office of Rail Regulation that, for the purposes of carrying out test running, the VTU charge could reasonably have been calculated on the basis of vehicle tare weight. The Office of Rail Regulation ruling on this had been that

    "The precise definition of the weight characteristic is loaded weight assuming 100% presence in the carriage…."

    "While this uplift will not be correct for all operators services and indeed may not be correct for any services, it provides a constant relative input between vehicle types to ensure that the rate of usage charge paid is on a consistent basis between vehicles."

    "Therefore, while train testing (as with some other types of movements such as ECS moves) will clearly have a lower (or even no) uplift over the tare weight of a vehicle, it would be inappropriate to alter the usage charge rate because of the way the usage charge model allocates between vehicles. Any change would remove constant relative charge between the different vehicles." (quoted in letter from parties of 23rd January 2006)

    21.3. The Panel noted that TPE had accepted this ruling by the Office of Rail Regulation, implying a need, inherent in the formula, to "take the rough with the smooth". Furthermore, the Panel noted that TPE had not raised other potential "unfairness" objections to the proposed VTU charge (such as that, whilst Class 185 was capable of 100mph, TPE would be operating it, except when on the ECML and WCML, on lines restricted to 90mph or less).

22. The Panel was clear in its understanding that, if either party considered that the application of the laid down process for calculating the VTU charge created a degree of unfairness considered intolerable, then the proper (and only) remedy was to apply to the Office of Rail Regulation for some form of special relief, recognising that to amend the basis of calculating the VTU charge would affect the charges payable in respect of all classes of rolling stock. Condition F3.1, in its present form, does not entitle Network Rail to impose, through a claim for compensation, what would be in effect a variation of the VTU charge (away from the formula), without the need for Office of Rail Regulation approval.

23. The Panel noted that, as part of progressing the Vehicle Change procedures, TPE had met various development costs, including direct payment for the calculation of bespoke Sectional Running Times for the Class 185. It was noted that charges/compensation claims of such a nature are properly one-off payments, relating to the process of change or transition, that can be assessed in advance; they are not on-going, and/or open-ended commitments to reimburse, or indemnify, Network Rail against un-quantified contingencies.

24. In relation to the future monitoring of the performance of Class 185, in respect of track wear, the Panel considered that this was a duty that Network Rail was expected to perform, in relation to all classes of rolling stock, as a function of its basic role as infrastructure controller. Such general monitoring duties, in the view of the Panel, could not, therefore, be the subject of a claim for compensation under Condition F3.1.

25. The Panel was of the view therefore that

    25.1. it was beyond its remit to make any comment on the merits of the determination, by Office of Rail Regulation, of either the content of the Track Usage Price computation formula, or of the place of the VTU charge in the overall structure of Network Rail's income, because these are a function of the economic architecture; any entitlements under the Track Access Contract to these set charges are to such values of such charges as the Office of Rail Regulation has determined, and not to any otherwise "fair" assessment;

    25.2. what Network Rail was attempting to argue was that the provisions for claiming compensation in Part F could be used to provide the conduit for on-going costs not otherwise explicitly catered for within the economic architecture, to be raised as an additional supplementary, and un-regulated, charge; this would imply that Part F could be used as a mechanism to modify, or even circumvent, the economic architecture;

    25.3. in practical terms, any attempt to argue, or worse, determine, that operation of the Track Access Contract could, or should undermine the economic architecture of the industry, as determined by the Office of Rail Regulation, would be perverse, and well beyond the competence of the Panel.

The Panel's determination

26. The Panel therefore determined that

    26.1. the reference can properly be determined by the Panel, and relates to the interpretation of Network Code Part F in the 16th October 2005 version;

    26.2. the nature of the dispute, which relates essentially to the quantum of compensation (that is the subject envisaged in Condition F3.1(c)) rather than to grounds for objecting absolutely to the introduction of Class 185s (that is the grounds in Condition F3.1(a), as reinforced by Condition F3.4), has been duly referred to the Access Dispute process, and therefore is one that, even if not immediately resolved, does not prevent the implementation of the Vehicle Change, and the introduction of the Class 185s into passenger carrying service;

26.3. it accepts the argument presented by TPE, that the claims for compensation envisaged by the drafters of Part F (and in particular Condition F3.2), are for specific amounts, assessed in prospect; and that therefore

26.4. Network Rail's claim under Condition F3.1, which is expressed, not in prospective terms, but as if seeking indemnification against as yet un-quantified or un-realised, dis-benefits, is not admissible;

26.5. the opportunity, in this case, to add a new charge to the Track Usage Price list is potentially a direct compensatory benefit to Network Rail, even where it can be argued that the change in revenues does not exactly track a change in costs; however

26.6. a claim for compensation cannot be used to create a supplementary, and unregulated, stream of Track Access charging, over and beyond the categories of charge envisaged in Schedule 7 of the Track Access Contract, and in the Office of Rail Regulation's Access Charges Review of 2003;

26.7. for the avoidance of doubt, any monitoring of the interaction between stock and track is considered by the Panel to fall within the basic accountability of Network Rail to manage the Network, and as such, therefore, did not justify separate supplementary funding through Part F;

26.8. TPE is required to pay the VTU charge for the Class 185, but otherwise, on the basis of the arguments presented to the Panel, Network Rail is not entitled to claim, and TPE is not under any obligation to pay, compensation in respect of "*costs associated with any increase in track wear and resulting increased maintenance requirements, compared to existing vehicles being operated over approved routes"*.

27. The Panel has complied with the requirements of Rule A1.72, and is satisfied that the determination, in all the circumstances set out above, is legally sound, and appropriate in form.

George Renwick

Panel Chairman