An ACCESS DISPUTES PANEL of the ACCESS DISPUTES COMMITTEE

Determination in respect of reference ADP35, 36 and 38

(following a Hearing held at 1 Eversholt Street on 14th September 2009)

The Panel

John Boon: appointed representative of Network Rail
Tony Deighan (Eurostar): elected representative for non-franchised Passenger Class
Lindsay Durham (Freightliner): elected representative for Non-Passenger Class, Band 2
Wallace Weatherill (Southeastern): elected representative for Franchised Passenger Class, Band 2

Panel Chairman: **Sir Anthony Holland**

In attendance:

Suzanne Lloyd Holt (Wragge & Co LLP) - appointed Legal Assessor to the Panel
Tony Skilton – Committee Secretary
Martin Shrubsole – Clerk to the Panel

The Parties

For First ScotRail Ltd, First Greater Western Ltd, First Capital Connect Ltd and First/Keolis TransPennine Ltd: ("the First Group TOCs") (reference ADP38)

Duncan Rimmer	Senior Financial Project Manager (First Rail Holdings Ltd)
Ian Tucker	Burges Salmon LLP
Matt Kyle	Burges Salmon LLP

For New Southern Railway Ltd ("Southern") (reference ADP35) and London & South Eastern Railway Ltd ("Southeastern") (reference ADP36): ("the Govia TOCs")

Dave Walker	Head of Franchise and Access Contracts, Southern
Anne Clark	Head of Franchise and Access, Southeastern
Paul Stewart	Dickinson Dees LLP

For Network Rail Infrastructure Ltd ("Network Rail")

Carew Satchwell	Contract Services Manager
Dan Kayne	Legal Advisor
David Cooke	Financial Controller (HQ Operations & Customer Service)
Andrew Gilbert	Kennedys, Solicitors

Brief Summary of Dispute, and the jurisdiction of the Panel

1. The Panel was asked to determine two points of principle that had emerged from a much larger dispute in which the First Group TOCs and the Govia TOCs were challenging Network Rail to demonstrate that it had complied with the terms of the Railtrack Independent Station Access Conditions 1996 ("RISAC"), in assessing and off-charging Qualifying Expenditure.

2. The dispute had originated with decisions by the TOCs to initiate, in accordance with RISAC 38, an Inspection of *"the books, records and accounts kept by the Station Facility Owner in respect of the Station (including any financial or operational records or data) insofar as they relate to the Common Station Amenities or the Station Services, at any reasonable time upon reasonable notice to the Station Facility Owner."* [RISAC 38.1].

3. In consequence of invoking that process the TOCs had concluded that Network Rail were either withholding access to the documentation that they considered it necessary they inspect, or that the necessary documentation did not exist to substantiate the charges to Qualifying Expenditure that they were being asked to pay in either 2006/7 or 2007/8. The TOCs had therefore initiated proceedings before the Industry Committee as required by the provisions of RISAC 53.1

4. On the basis of the initial submissions by the parties the Disputes Chairman, at a Directions Hearing on 20th May 2009, issued directions, the effect of which was that

    4.1. Network Rail was required to disclose to the TOCs such further documentation as they requested as necessary to permit of proper Inspection;

    4.2. to the extent that that documentation led to agreement amongst the parties as to what QX should be charged, and how any Certificates should be amended and closed, the parties should so agree;

    4.3. to the extent that the documentation revealed differences of assessment or calculation as to the monies payable, such differences should be referred in accordance with the provisions of RISAC 53.2 to Expert Determination;

    4.4. to the extent that the parties still disagreed on matters of principle *"arising out of or in connection with these Station Access Conditions"* they would be required to bring those matters for determination by an AD Panel that would sit on 14th September.

5. In the event, the necessary disclosure was sought and obtained, and several areas declared as being in dispute as at the time of the Directions Hearing were subsequently considered unlikely to raise matters of principle and therefore susceptible to settlement, either directly or as a result of Expert Determination.

6. Although there had been a significant exchange of documents in the build up to the Hearing the Chairman had decided that with the reduction in the number of matters in contention it would be sufficient, for the Panel to reach a determination, that it confine itself to a consideration of the following documents. The documents in question, all of which had been provided to the Panel and exchanged between the parties, were

    6.1. originating with the parties

        6.1.1. Joint document from "Southern" and "Southeastern"

        6.1.2. Additional clarification material (2 paragraphs) from "Southern" and "Southeastern"

        6.1.3. Joint document from the First Group TOCs

6.1.4. Additional material (redaction of a document dated 11 May 2009) from First Group TOCs

6.1.5. Submission from Network Rail

6.1.6. Additional material (redaction of a document dated 30 June 2009) from Network Rail.

6.2. the legal opinion that had been provided by the Assessor at the request of the Chairman and provided in summary to the parties.

7. On the basis of the above, subject only to such verbal comments as might be made by the parties at the Hearing, it was concluded that the issues to be resolved by the Panel were confined to two questions posed by the TOCs as follows:

7.1. Insurance:

7.1.1. ***"should NR reduce the insurance premium charged to QX in 2006/7 by an amount recognising a non-QX aspect of the coverage of the insurance. If so should this be 12% in line with the reduction applied in 2007/8 subject to adjustment by an expert where any relevant changes in scope of the insurance (such as changes to the deductible and any accounting issues which are proven to have an effect) can be shown?"*** **(wording from Opening Statement by Duncan Rimmer on behalf of the First TOCs);**

7.1.2. *"With regard to insurance, Southeastern and Southern have had sight of the arguments made by First Group in its submission made in connection with reference ADP 38 and in its opening remarks today, and agree with and associate themselves with those arguments. Southeastern and Southern have also had sight of the legal opinion provided by Counsel to the Panel and confirm that the summary of the position presented at paragraphs 5.1 to 5.5 accurately reflects the claim put forward in respect of insurance".* **(wording from Opening Statement by Paul Stewart on behalf of the Govia TOCs).**

7.2. **Staff Costs:** ***"Should the split applied by Network Rail of 95% QX/5% non-QX in respect of staff costs for 2006/7 be revised for each of the Relevant Stations (as defined in the Claimants' submission dated 4 September 2009) to reflect the actual split of activities? If so, should Network Rail assess at its own cost the actual split for each Relevant Station, with such splits either being agreed with the Claimants or, in the absence of agreement, determined by an expert?*** "
(Clarification from Govia in e-mail to the AD Committee Secretary on 10/09/2009

8. Network Rail, in its opening address, posed the question ***"Can TOCs claim a re-assessment of QX/non-QX splits which Network Rail believes in good faith to already have been agreed?"*** In other respects Network Rail did not ask the Panel to do other than to determine "No" to the above questions.

9. The Chairman directed the attention of all parties to item (Q) of RISAC Section 1.1 General Interpretation, as potentially having a particular bearing upon the matters in dispute, and asked the parties to bear this provision in mind in addressing their respective actions and answers; item (Q) states *"Good Faith: The Station Facility Owner and all users shall, in exercising their respective rights, and complying with their respective obligations under these Station Access Conditions, (including when conducting any discussions or negotiations arising out of these Station Access Conditions or exercising any discretion under them) at all times act in good faith."*

The relevant contractual provisions

10. At stations where Network Rail is the Station Facility Owner ("SFO") the operation of the station, the obligations and duties of the SFO, and of all Passenger Operators with access rights to the station are governed by the individual Station Access Agreements, each of which incorporate the RISAC. In the general area of these disputes the operative provisions of RISAC are as set out in Part 6 **"Access Charging"** (in particular Conditions 32 to 40), Part 8; **"Litigation and Disputes"** (in particular Condition 53), and Part 16 **"Attribution of Costs"** (in particular Conditions 97 and 98 "apportionment of costs").

11. RISAC 97 requires that *"...any costs incurred by the SFO or any User which are required under these Station Access Conditions to be reimbursed by, or accounted to, any other of them shall be accounted for in accordance with generally accepted accounting principles applicable in the United Kingdom".*

12. RISAC 98 states that *"Any costs incurred both in relation to (A) Qualifying Expenditure and (B) any other matter or thing, shall be attributed between them on a fair and equitable basis, having regard primarily to the matters as respects which duties are imposed on the Regulator by Section 4 of the Act and taking into account generally accepted accounting principles applicable in the United Kingdom".*

13. *"Total Variable Charge" means in respect of each Passenger Operator, the Passenger Operator's Proportion of the Qualifying Expenditure...*" (Definitions)

14. Part 6 "Access Charging" Conditions 31 to 36 prescribes the disciplines to be respected by both the SFO and the respective Passenger Operators ("PO"s) in order to arrive at

    14.1. "a *best estimate" of the Total Variable Charge* [for each PO] *for that Accounting Year"* (RISAC 32.2(B));

    14.2. *"a detailed breakdown of the estimated Qualifying Expenditure"* (RISAC 32.3 (a)

    14.3. *"details of the specifications and other assumptions applied to the calculation of the Total Variable Charge and any Quoted Fixed Charges"* (RISAC32.3(c);

    14.4. an agreed basis of payments towards the Total Variable Charge for each PO, based upon one or a combination of

        14.4.1. Quoted Fixed Charges that have been accepted by the PO RISAC 33.1)

        14.4.2. negotiated charges agreed between the SFO and the PO (RISAC 33.3(A))

        14.4.3. charges determined by reference to Expert Determination (RISAC 33.3(C)); and/or

        14.4.4. a Residual Variable Charge.

    14.5. provision by the SFO, at the end of the Accounting Year (or half-year), of a Certificate which *"shall contain information in an amount of detail which is at least equal to that required by Condition 32.3 in relation to the charges and costs to which it relates"* (RISAC 34.3) such as to provide confirmation as to whether the payments made by the PO to the SFO (based upon the *"best estimate of the Total Variable Cost"*) have been appropriate to the actual costs and expenditure disbursed by the SFO, with a mechanism for adjustment payments where appropriate (RISAC 35).

15. "*Each User or bona fide prospective User shall be entitled to inspect (or procure that its agents or representatives inspect) the books, records and accounts kept by the Station Facility Owner in respect of the Station (including any financial or operational records or data) insofar*

as they relate to the Common Station Amenities or the Station Services, at any reasonable time upon reasonable notice to the Station Facility Owner." [RISAC 38.1].

16. *"The SFO shall…..(E) use all reasonable endeavours to minimise the costs of the operation of the station:"* RISAC81.1 (E)).

The Panel's findings in respect of facts: general

17. The provisions of RISAC, which have remained largely unaltered since initial publication in 1996, prescribe the processes that Network Rail and the relevant POs should follow to promote and/or protect their respective rights and commercial interests. As such

    17.1. they are processes that are effective only in proportion to the diligence with which each party fulfils its own obligations, and verifies that the other has duly done the same;

    17.2. they are processes requiring annual re-cycling, perhaps in recognition that some initial headline allocations of costs between parties owed more to expediency than to sound accounting and arithmetic, and were thus only estimated approximations;

    17.3. they reasonably contemplate that the level of understanding of station activity, and the accuracy of accounting for that activity would evolve to meet the progressively more sophisticated needs of the privatised railway;

    17.4. whilst they do not preclude "broad brush" agreement at the headline level in relation to the preparation of a "best estimate" of Total Variable Charge, there is no implied provision for such a broad brush approach to specifications of functions, or accounting for actual expenditure, or for such an approach to pre-empt any findings as a result of Inspections;

    17.5. they do not lay down any benchmarks in respect of the proportions of any head of expenditure that should be allocated to either Qualifying Expenditure or non-QX;

    17.6. they do provide mechanisms by which, where parties are not agreed upon the specifics in relation to apportionment between QX and non-QX, they may have recourse to appropriate dispute resolution.

18. The decisions by the First Group TOCs and the Govia TOCs each to invoke the right to inspection accorded by RISAC 38.1 appear to have revealed that the provisions of RISAC have not been observed in detail in significant areas. In particular,

    18.1. where there have been custom and practice allocations between QX and non-QX, no documentation justifying those allocations has been preserved by Network Rail; nor was any evidence brought forward, by any party, as to previous attempts to test their appropriateness;

    18.2. the accounting practices used have not been immune from error, and would appear to have allowed scope for substantial misallocations of expenditure (the Panel was advised of discrepancies thus far totalling £170,000).

Issue 1 : the insurance question and whether a provision made in respect of 2007/8 should also apply in respect of 2006/7

19. Network Rail, in relation to making the necessary insurance provisions for its stations had concluded that, as some element of that insurance related to retail areas, some element of the relevant insurance premium should be excluded from QX at the stations involved. In consequence, and for reasons for which Network Rail were unable to provide justification, a proportion of 12% of the relevant premium had been designated as Non-QX in 2007/8.

20. Both the Govia and First Group TOCs advanced the argument that whatever good reasons justified the 12% discount for the year 2007/8, were surely equally valid for the year 2006/7 (the only year that was being contested on the basis of inspections and Certificates not yet closed).

21. Network Rail contested this claim successively on the basis that

    21.1. it was timed out; subsequently accepted as not the case;

    21.2. there was no clear grounds that 12% was actually the right figure, and indeed some evidence suggested that Network Rail had offered a concession based upon a misreading of the extent of cover provided to retail tenants; and in any case

    21.3. the basis of insurance (including the scale of deductibles) had changed between 2006/7 and 2007/8, and that whereas the 12% concession might, subject to further review, be justified for 2007/8, it could not be considered appropriate to 2006/7; subsequently accepted as not the case;

    21.4. the payment amount had already been agreed for 2006/7 and it did not therefore think that it was appropriate or reasonable to re-open the figure for 2006/7.

22. The Panel had the benefit of the extensive critique of the respective arguments that had been prepared by the Legal Assessor which are appended as an annex to this determination. The salient features of the Assessor's findings

    22.1. related to the difficulty in comparing comparable but unlike situations where the issues were not adequately documented to appropriate standards of transparency;

    22.2. brought to the Panel's attention, as an example of good practice, *"the Royal Institution of Chartered Surveyors' Code of Practice for Service Charges in Commercial Property ("the Code"). The Code (at paragraphs 18-20) underlines the need for transparency in service charges and states that "by being transparent both in the accounts and explanatory notes the manager will prevent disputes". It provides that "if the occupiers are paying for an item through the service charge, transparency requires that the manager shares the detail about and information from the contract with all e.g. pedestrian flow data, crime statistics etc".",* and

    22.3. concluded that *"Applying the principles I have set out and doing the best I can, it seems to me that, to the extent that the risks covered are the same for the financial year 2006/7 as they are for 2007/8, I can see no legal or accounting reason why the 12% reduction should not be applied equally to each financial year."*

23. The Panel did not find it necessary to debate in detail either the points raised by the parties or the findings of the Assessor, as Network Rail in its opening statement conceded that it now discovered that the change to the terms of its insurance policy had taken place before the commencement of the 2006/7 Accounting Year, and not between the two years in question. In the mind of the Panel this underscored the need for transparency, and for POs to have access to the precise terms of any insurance policy to which they were asked to contribute, and also undermined Network Rail's most substantive argument.

Issue 2: Apportionment of Staff Costs

24. The Panel noted the arguments of the Govia TOCs and the evaluation of the Assessor (Appended). It considered the most telling points to be:

    24.1. there did not appear to be any documented evidence to support the precise apportionment of staff costs between QX and non-QX that the Govia TOCs were challenging, although this did not imply that the apportionment was therefore intrinsically wrong;

    24.2. the example of the actions of "Virgin", and others, in both reserving positions in respect of the apportionment of staff costs, and in commissioning an appropriate study in order to test and change the apportionment, appeared to highlight that there is scope within the provisions of RISAC for a TOC to protect its interests;

    24.3. at a station with multiple Users it is likely to be the case that all will wish to be party to any consideration of the QX/non-QX split for that station. There is, however, no inevitability that a conclusion at one location that the apportionment should be changed will translate into a similar conclusion for another station;

    24.4. any study of the kind mentioned is likely to be the intellectual property of those who have commissioned and paid for it. It would be improper for Network Rail to make any attempt to generalise any action on the basis of its privileged access to such a study, whether or not to its immediate advantage;

    24.5. the Panel could not identify any station likely to have been covered by the Virgin-led study, where one of the Govia TOCs party to this action was then also a User;

    24.6. there is no impediment on either Network Rail or any TOC to take advantage of any of the change or review provisions incorporated into RISAC, where they can see advantage in so doing. It is for either party, as part of the pursuit of its own interests, to choose when, or not, to undertake such studies;

    24.7. there was no obvious reason why the costs of such a study should fall to any party other than the party initiating it.

The Panel's Determination:

25. The Panel therefore determines the three questions put to it as follows:

26. *"Can TOCs claim a re-assessment of QX/non QX splits which Network Rail believes in good faith to already have been agreed?"*

    26.1. It is not sufficient for either party to believe that a QX/non-QX split has been agreed; it is necessary to be able to demonstrate through a documented audit trail that any such agreement has been reached, including the withdrawal of any reserving of positions, in accordance with the procedures and timescales prescribed within RISAC;

    26.2. where such a proposition can be demonstrated, the scope for re-opening is limited only to such circumstances (if any) as are contemplated within RISAC;

    26.3. the RISAC processes are currently subject to an annual re-cycle; it follows that this places on the parties the obligation positively to re-assert those arrangements that they wish should carry over to a following year.

27. *"Should NR reduce the insurance premium charged to QX in 2006/7 by an amount recognising a non-QX aspect of the coverage of the insurance. If so should this be 12% in line with the reduction applied in 2007/8 subject to adjustment by an expert where any relevant changes in scope of the insurance (such as changes to the deductible and any accounting issues which are proven to have an effect) can be shown?"*

    27.1. Yes.

28. *Should the split applied by Network Rail of 95% QX/5% non-QX in respect of staff costs for 2006/7 be revised for each of the Relevant Stations (as defined in the Claimants' submission dated 4 September 2009) to reflect the actual split of activities? If so, should Network Rail assess at its own cost the actual split for each Relevant Station, with such splits either being agreed with the Claimants or, in the absence of agreement, determined by an expert?*

    28.1. **Subject to 26.1 and 26.2 above, if the Govia TOCs consider that**

        28.1.1. **there are demonstrable grounds as why the QX/non-QX split for 2006/7 was not correct, and**

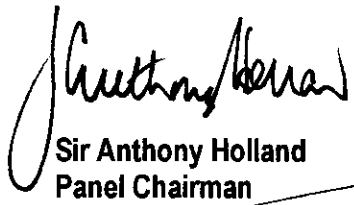
        28.1.2. **there is evident latitude in the RISAC provisions for a fresh evaluation to be undertaken, then**

    the Govia TOCs are entitled to initiate an exercise to gather, at their expense, such evidence as might support a case that the actual duties undertaken by staff in 2006/7 should reasonably be translated into some other split;

    28.2. **to the extent that the carrying out of such an exercise will inevitably involve the collaboration of Network Rail, all possible outcomes (including that where staff costs for 2006/7 should be allocated 100% to QX) should be agreed as admissible from the start;**

    28.3. **the results of analysis are not of themselves conclusive proof either way: they are at best evidence upon which to seek to base a better agreement.**

29. 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.



Sir Anthony Holland
Panel Chairman

25. 09. 09

Extracts from

SUMMARY OF LEGAL OPINION PROVIDED BY SUZANNE LLOYD HOLT, THE ASSESSOR TO THE ACCESS DISPUTES PANEL HEARING REFERENCES ADP 35, 36 AND 38

In relation to the charges made by Network Rail for insurance premiums, what apportionment should be made between Qualifying Expenditure and Non-Qualifying Expenditure?

5.1 This issue is pursued by both Govia and First and I deal with each of their representations in turn. I refer first to Govia's Argument

5.2 In summary, Govia contend that since Network Rail have accepted for the financial year 2007/8 that a proportion (proposed by Network Rail to be 12%) of such insurance expenditure relates to Non-Qualifying Expenditure liabilities and should not therefore be included in Qualifying Expenditure, they should not, in contrast, for the financial year 2006/7 and previous years include in Qualifying Expenditure the whole of the relevant insurance premiums.

5.3 Govia say that Network Rail's argument that the introduction of the 12% Non-Qualifying Expenditure allocation for the financial year 2007/8 represents an improvement by the Respondent in the provision of its services, is wrong. They point out that Network Rail acknowledged in June its change in position for 2007/8 was as a result of queries raised by TOCs in relation to the allocation of insurance premiums, and was not the result of a unilateral decision by Network Rail. Govia say further that even if the change had been entirely of Network Rail's own initiative, it would be untenable for Network Rail to argue that such a change should not be considered to be applicable to previous years.

5.4 Govia deal also with Network Rail's argument that no loss has been suffered by the Claimants in relation to the allocation of insurance premiums. Govia contend that unless Network Rail correctly apportions the insurance premiums for 2006/7 to reflect the split between Qualifying Expenditure and Non-Qualifying Expenditure activities, the Claimants will have to pay more than they should be required to pay under RISAC and their Station Access Agreements, thereby causing them to suffer loss and constituting a breach on the part of Network Rail of its obligations under RISAC 33 and 34.

5.5 In summary, Govia say that insurance costs should be included in Qualifying Expenditure only to the extent that they relate to Qualifying Expenditure liabilities: where Network Rail elects to place insurance beyond the scope of Qualifying Expenditure liabilities in order to protect itself from claims, those costs should fall outside Qualifying Expenditure.

5.6 I now turn to First's arguments in relation to this issue which are set out in their submission dated 4 September 2009.

5.7 First's arguments are similar to those put forward by Govia. They say that within the charges for insurance premium, an apportionment must be made between Qualifying Expenditure and Non-Qualifying Expenditure, such that the proportion of the insured risk relating to Non-Qualifying Expenditure liabilities is excluded from Qualifying Expenditure. They say that Network Rail has provided no evidence that the insurance coverage has changed between 2006/7 and 2007/8 in any way which would affect how much is attributable to Qualifying Expenditure and how

much to Non-Qualifying Expenditure. They assert that it is not an efficiency gain simply to make the correct apportionment of costs and, as such, the correction should be applied to 2006/7 as well.

5.8 First also set out their position in relation to breach and loss. They argue that unless Network Rail apportions insurance costs as between Qualifying Expenditure and Non-Qualifying Expenditure, the TOCS will have to pay more than they are required to under RISAC and their Station Access Agreement. They say that would clearly cause them loss and would be a breach of (amongst other things) Network Rail's obligations under RISAC 33 and 34. They also assert that the refusal on the part of Network Rail to apportion insurance costs is in breach of their obligation under RISAC 81 to minimise the cost of operation of the relevant stations.

5.9 I now turn to Network Rail's argument.

5.10 Essentially, Network Rail's position is that in 2006/7, they changed their insurance arrangements for the year 2007/8 "forward", by reducing the excess from £100,000 to £nil per claim for public liability claims. They suggest that was in line with general practice on the property owners' market by landlords arranging insurance on behalf of tenants, but have produced no evidence in support of that assertion. Network Rail acknowledge that the change of insurance arrangements resulted in a higher premium to the TOCs but assert "it reduced uncertainty and administrative costs in dealing with claims, ended the risk of unlimited claims under £100,000 which under the previous insurance the TOCs had to fund themselves where there was no third party negligence e.g. of a contractor". In the absence of detailed investigation, it is not possible to assess the extent to which that assertion may be correct. However, as it seems to me, what Network Rail have not explained is the extent to which the premiums paid may be in respect of insurance placed beyond the scope of Qualifying Expenditure liabilities, and therefore not a cost rechargeable to the TOCs. Paragraph 6.5 of their argument is unclear on this point.

5.11 Network Rail go on to explain that having consulted various TOCs, a 12% discount would be given "for the retail areas within stations including those shared areas which retail customers and passengers both use". However, Network Rail suggest it would be mistaken to argue that a 12% reduction on the earlier assessment of the Qualifying and Non-Qualifying Expenditure split is evidence that the previous arrangements were in breach of Condition 98 or otherwise.

5.12 I have considered all the arguments carefully. It seems to me this issue falls within the fair and equitable basis of attribution as required by Condition 98. Network Rail have suggested that evidence of what happens in the landlord and tenant market is of assistance. We do not have any submissions from the Claimants on that suggestion, but it may be helpful to refer to the Royal Institution of Chartered Surveyors' Code of Practice for Service Charges in Commercial Property ("the Code"). The Code (at paragraphs 18-20) underlines the need for transparency in service charges and states that "by being transparent both in the accounts and explanatory notes the manager will prevent disputes". It provides that "if the occupiers are paying for an item through the service charge, transparency requires that the manager shares the detail about and information from the contract with all e.g. pedestrian flow data, crime statistics etc". Although I accept that this is only an example, it seems to me that the principles of the Code can usefully be borne in mind in the present dispute.

5.13 A further landlord and tenant parallel worthy of note is, of course, that in a modern commercial lease, the tenant would normally have access to the policy wording in respect of the insurance taken out by the landlord. I am not clear what has actually been disclosed. The parties have not produced with their submissions the relevant policy wordings or any information suggesting any change in the risks covered. Applying the principles I have set out and doing the best I can, it seems to me that, to the extent that the risks covered are the same for the financial

year 2006/7 as they are for 2007/8, I can see no legal or accounting reason why the 12% reduction should not be applied equally to each financial year.

What is the correct apportionment in respect of staff costs as between Qualifying Expenditure and Non-Qualifying Expenditure ?

6.1 *This issue is pursued by Govia only. Govia complains that Network Rail have applied a split between the allocation of staff costs (including basic pay, National Insurance contributions and pension contributions) of 95% Qualifying Expenditure and 5% Non-Qualifying Expenditure, without any justification being provided to the Govia.*

6.2 Govia also complains that Network Rail has, despite requests, refused to make a time and motion study or the results of that study (into the allocation of staff costs between Qualifying Expenditure and Non-Qualifying Expenditure apparently initiated by a number of other TOCs) available to Govia. Govia asserts that the relevance of that time and motion study is that Network Rail acknowledges that following completion of the study, it reached a "commercial compromise" with the relevant TOCs which included an apportionment of 75% of security costs to Qualifying Expenditure.

6.3 Govia also contends that Network Rail has not complied with its obligation to apportion costs on a fair and equitable basis (RISAC 98), in circumstances where the percentage split it is applying to the staff costs for 2006/7, is not based on any scientific study and, where such a study was carried out on behalf of other TOCs, changes to the apportionment have been made.

6.4 Network Rail said in June that (in contrast to certain other TOCS) Govia did not reserve their rights, that they are not entitled to pursue their claims for adjustment or breach of contract, that the treatment in respect of staff costs was not in breach of contract and that Govia are not therefore entitled to any reimbursement. In light of what I say at paragraph 4.1, my understanding is that Network Rail do not pursue those arguments in respect of 2006/7.

It should be mentioned at this point that Govia are pursuing this issue only in relation to the 2006/7 financial year, but reserve the right to seek a determination in relation to earlier financial years.

6.5 It was not clear if Network Rail assert their time bar argument in relation to this issue but we are now told (8 September 2008) that they do not. We are not told whether the staff costs issue was included in the Kavanagh Knight report supplied on behalf of Govia to Network Rail on 27 March 2008, that report having been prepared following inspection of Network Rail's documents "between August 2007and March 2008 [Govia submission 1.5.1]". For what it is worth, and noting Network Rail's concession, if those staff costs were there so challenged, then the provisions of RISAC 71.1(A) in relation to notice of a claim would be satisfied.

6.6 *I have considered the arguments on both sides. This again is effectively a disclosure issue. As matters stand, Govia are presented with an apportionment which, on its face, looks arbitrary. I suggest that the principles of the RICS Code which I have referred to under paragraph 5 above, are equally helpful in this instance: transparency indicates that some justification of the apportionment should be provided by Network Rail. Given also the clear requirements of RISAC 98, in my view Govia are entitled to justification in relation to the split of staff costs for Qualifying and Non-Qualifying Expenditure. It follows that either they should be given disclosure of the time and motion study or that a mechanism be agreed which enables clarity to be achieved.*