IN THE MATTER OF THE RAILWAYS INFRASTRUCTURE (ACCESS AND MANAGEMENT) REGULATIONS 2005 AND CAPACITY CHARGE PROPOSAL MADE BY THE RAIL DELIVERY GROUP

OPINION

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1. I have been asked by ORR to advise on the legality of a proposal put forward by the Rail Delivery Group ("**RDG**") as an alternative to the capacity charge proposals developed by ORR. Those proposals were presented to the industry in ORR's letter dated 19 July 2013.

2. Instructing solicitors have provided me with a copy of the RDG proposal put forward to ORR by RDG at an industry workgroup held on 21 August 2013 ("the RDG proposal").

3. As with ORR's capacity charge options, the RDG proposal is based on the application of a marginal rate capacity charge (i.e. a higher rate applicable only to additional services) to all types of operators: freight, franchise passenger and open access passenger. RDG proposes that franchise and open access operators will be subject to the same arrangement, while freight operators will be subject to what RDG calls a "RFOA-like" arrangement (see "Specific statement 2" of the RDG proposal). I have not been asked to comment on the freight element of the RDG proposal.

Principles of access charging

4. The principles of access charging are specified by the following provisions of Directive 2001/14/EC on the allocation of railway infrastructure capacity and the levying of charges for the use of railway infrastructure and safety certification ("the Directive") and Schedule 3 of the Railways Infrastructure (Access and Management) Regulations 2005 ("the Regulations"), which give effect to the Directive within the United Kingdom.

5. Given that the Regulations implement EU law, they must be interpreted so far as possible in accordance with the Directive and must be applied in accordance with the general principles of EU law, including in particular the principle of equality of treatment.

6. Recitals (11) to (13), and (16) of the Directive state as follows:

> "(11) The charging and capacity allocation schemes should permit equal and non-discriminatory access for all undertakings and attempt as far as possible to meet the needs of all users and traffic types in a fair and non-discriminatory manner."
>
> "(12) Within the framework set out by Member States charging and capacity-allocation schemes should encourage railway infrastructure managers to optimise use of their infrastructure."
>
> "(13) Railway undertakings should receive clear and consistent signals from capacity allocation schemes which lead them to make rational decisions."
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> "(16) Charging and capacity allocation schemes should allow for fair competition in the provision of railway services."

7. Article 7 of the Directive sets out the principles of charging, in particular Article 7(3):

> "Without prejudice to paragraphs 4 or 5 or to Article 8, the charges for the minimum access package and track access to service facilities shall be set at the cost that is directly incurred as a result of operating the train service."

8. Articles 4(4) and (5) provides as follows:

> "Except where specific arrangements are made under Article 8(2), infrastructure managers shall ensure that the charging scheme in use is based on the same principles over the whole of the network."
>
> "Infrastructure managers shall ensure that the application of the charging scheme results in equivalent and non-discriminatory charges for different railway undertakings that perform services of equivalent nature in a similar part of the market and that the charges actually applied comply with the rules laid down in the network statement."

9. Article 8 sets out the exceptions to the charging principles, including Article 8(3):

> "To prevent discrimination, it shall be ensured that any given infrastructure manager's average and marginal charges for equivalent uses of his infrastructure are comparable and that comparable services in the same market segment are subject to the same charges. The infrastructure manager shall show in the network statement that the charging system meets these

requirements in so far as this can be done without disclosing confidential business information."

10. Schedule 3 of the Regulations 2005 gives effect to the Directive and sets out the principles of access charging with which ORR must comply (and therefore with which the RDG proposal must also comply).

11. Paragraph 1(1) of Schedule 3 states:

> "(1) The infrastructure manager must ensure that the application of the charging scheme:
>
> (a) complies with the rules set out in the network statement produced in accordance with regulation 11; and
>
> (b) results in equivalent and non-discriminatory charges for different railway undertakings that perform services of an equivalent nature in a similar part of the market."

12. Paragraph 1(3) states:

> "Except where specific arrangements are made in accordance with paragraph 3,[1] the infrastructure manager must ensure that the charging system in use is based on the same principles over the whole of his network."

The RDG proposal

13. RDG's written proposal states that existing open access ("OA") operators on the east coast main line ("ECML") will be subject to what it terms "special arrangements". I understand that the aim of these arrangements is to protect those OA operators against an immediate transition to new CP5 capacity charge rates on additional services (which I am instructed may, subject to a final conclusion by ORR, be a significant increase on the existing CP4 rates).

14. The "special arrangement" consists of a baseline set reflecting ***all*** ECML passenger traffic during 2011/2012; all ECML traffic operating at levels above that baseline during CP5 would be charged at a single ('blended', in RDG's phrase) CP5 rate; further, the cost of the traffic operating above the baseline would be 'washed up' (that

[1] Paragraph 3 is not relevant here, since it sets out an exception to the charging principles which covers specific investment projects only.

is, shared proportionately) between all passenger traffic on the ECML (so shared between OA operators and the incumbent franchisee).

15. The effect of this arrangement would therefore be to spread any increase in services over all passenger operators within the ECML area – in practice, that would mean that the vast majority of any additional costs would be borne by the franchised operator, whether or not it was responsible for the new service.

16. As written, RDG's proposed application of these arrangements to the ECML services is because "it is these types of service that have significant OA [open access] traffic". The RDG proposal is that new entrants to the open access market on the ECML during CP5 would also be subject to this "special arrangement", so that they would also benefit from the spreading of additional capacity charges between the existing franchised and OA operators.

17. The effect of this proposal is to ensure that there would be no discrimination against new entrants, i.e. between them and existing OA operators running on that particular part of the network ("Any future ECML ex-London Service Codes also covered by same rate and wash-up (meaning no discrimination against similar future Service Codes)").

18. The proposal then goes on to state that "All other parts of the GB network should have the Arup CP5 OA CC rates introduced at the start of CP5 on current basis". I understand this to mean that any additional services provided anywhere else on Network Rail's network would be charged full CP5 rates on all their traffic. In particular, a new OA operator would face such rates without any blending of the rates currently charged by incumbent operators (all of whom are in practice franchised operators).

19. As written therefore, it appears that the benefits of RDG's proposed "special arrangement" is restricted to those OA operators on the ECML, both existing operators and potential new entrants. However, I understand from instructing solicitors that RDG clarified this point during the working group meeting held on 21 August 2013, indicating that, in principle, the "special arrangement" would be applied to the whole of Network Rail's network.

20. It appears from this explanation that the written version of the proposal was not as clearly drafted as it might be, but reflected the reality that there are currently no OA operators anywhere except on the ECML and it is ***existing*** OA operators that the "special arrangement" is intending to protect. The extension of the benefit to new entrants on the ECML is intended to avoid the risk of discrimination against new entrants on the ECML but RDG's proposal would in principle apply to all areas where there were existing OA operators and to new entrants in such areas.

Legal concerns over the proposal

21. It seems to me that, notwithstanding this helpful clarification, the RDG proposal raises legal concerns under the above legislation and the general principle of equality of treatment, which is clearly a guiding principle under both the Directive and the Regulations.

22. The first concern is that it could be argued that the same principles are ***not*** being applied over the whole of the network, so that the proposal is contrary to paragraph 1(3) of schedule 3. The proposal has the result that new OA operators on different parts of the network would in practice be subject to significantly different charging regimes – whereas a new entrant on the ECML would only face a very small proportion of any increased capacity charge reflecting its additional services, the great bulk of which would be borne by the franchised operator (and a lesser amount by the existing OA operators), a new entrant on any other part of the network would face the full CP5 charge on all its services. As I understand it, that might in practice constitute a substantial barrier to entry for such an operator.

23. The explanation given by RDG during the working group meeting (referred to above) is an attempt to address this concern by arguing that the whole network ***is*** subject to the same principle (the principle being that all routes where there are incumbent OA operators at the start of CP5 will be treated the same, it being merely a contingent fact that in practice there is only one such route, the ECML). However, in practice, the fact of unequal treatment would remain, so that there is a significant risk that the explanation would be viewed as an attempt to "explain away" the resulting

differences rather than demonstrating that the same principles were in reality being applied across the whole network.

24. The obvious alternative would be to remove the condition that there must be existing OA operators for this approach to be adopted and for the proposal thereby to be generalised so that it applied to ***all*** passenger operators, including OA operators entering an area where there were currently no such operators. That would be a much simpler regime that would avoid any discrimination in fact or law.

25. The second concern is that the effect of the proposal is that it would be likely to result in non-equivalent charges being levied on different new OA operators, solely because of where they seek to operate on the network. Although there are parts of the network that are clearly discrete from the ECML, for example services in Wales or Cornwall, there are other parts of the market where that is not the case. For the purposes of paragraph 1(1)(b) of schedule 3 of the Regulations, there seems to me to be a significant risk that, particularly where an area is adjacent or overlapping with services on the ECML, such operators would be found to be "different railway undertakings that perform services of an equivalent nature in a similar part of the market".

26. In such cases, it might well be said that the RDG proposal would result in a charging scheme which did not "result in equivalent and non-discriminatory charges". On the contrary, it could be strongly argued that the RDG proposal in its current form would result in clearly discriminatory charges, where one new OA operator is treated differently to another.

27. Discrimination can in principle be lawful where it is objectively justified, and the explanation given by RDG for the differential treatment of new OA operators on the ECML could be expressed as an argument that it was justifiable to give preferential treatment to new OA operators on the ECML because of there being incumbent OA operators on that part of the network (and thereby to avoid discrimination against new entrants on the ECML). However, although this does explain how the proposal has come about, it does not, in my opinion, justify the discrimination sufficiently to defend a potential challenge.

28. Finally, I note that, as well as this discrimination between new OA operators on different parts of the network, the RDG proposal also appears to result in discrimination between new ***franchise*** passenger operators depending on where they operate on the network. As I understand it, the "special arrangement" on the ECML would apply to new franchised services on that part of the network, whereas new franchised services on the rest of the network would face the capacity charge in full. Depending on the terms of the franchise agreement, whereby such additional charges might be taken into account in the overall terms of the agreement, this may be of a lesser concern than in relation to OA operators, who would face the full additional charge as a cost of their new business.

Conclusion

29. In light of the above, I consider that there is a material risk that, were the RDG proposal adopted in its current form, it would be vulnerable to challenge by new entrants on parts of the network other than the ECML as contrary to the charging principles laid down in the Directive and the Regulations and to the general principle of equality of treatment.

30. Although the circumstances in which such a challenge might be brought is impossible to predict, my current view is that such a challenge would be very likely to obtain permission from the Administrative Court and would have a significantly better than even chance of success.

31. As indicated above, the obvious way to avoid this risk would be to apply it generally to the network, so that each part of the network would be subject to the same "special arrangement", whether or not there was an existing OA operator. Indeed, one possible formulation of a challenge to this proposal would be that the Court should rule that the aspect of the RDG proposal that was unlawful was the additional condition that the "special arrangement" applied only where there was an existing OA operator, so that this (discriminatory and therefore unlawful) condition would have to be disapplied to render the charging principles lawful.

32. Please contact me at Matrix if anything in this Opinion is unclear or if there are other points that require consideration.

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