Track Access Option Policy

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TRACK ACCESS OPTION POLICY

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1. **Introduction**

1.1 A Track Access Option (TAO) is an access contract as defined in section 17(6) of the Railways Act 1993 (the Act), and provides a mechanism by which future access to a railway facility can be secured. In line with our regulatory responsibilities, this policy relates only to the arrangements for granting TAOs between train operators and the facility owner, which in the majority of cases, but not all, will be Network Rail.

1.2 TAOs will only generally be approved where they are supported by focused and dedicated financial investment in a railway facility. This means that the investment should be directly related to a specific location or facility and that the investment would not be used for any other purpose, i.e. the TAO would be granted contingent to the stated investment being made.

1.3 This policy sets out:

(a) the criteria that will need to be satisfied by a potential investor in order for us to approve a contract which will potentially restrict the available capacity of a railway facility for a number of years; and

(b) the way in which we consider that the rights reserved under an access option will be exercised within a Track Access Contract (TAC) once the proposed railway services commence operation.

1.4 The key principles of our policy are:

(a) TAOs should only be approved where sufficient capacity will be available on the network to accommodate the access rights at the time that they are required by the applicant;

(b) TAOs should generally only be approved where they are required to support financial investment (either in enhancements to a railway facility or a wider scheme that is dependent upon securing access to a railway facility);

(c) where there is potential uncertainty about the delivery of the future capacity required, that the ability to adjust other train operators’ access
rights may need to be incorporated into any relevant TACs when they are approved;

(d) in considering whether to approve a TAO, we will consider and assess the overall benefits and costs of doing so;

(e) TAOs should be expressed as a broad envelope of rights, which should, subject to ORR’s approval in the usual way, be converted into more precise contractual rights at an appropriate time within a TAC held by the train operator responsible for exercising them within the timetable; and

(f) where there is an established Route Utilisation Strategy (RUS)\(^1\) for the relevant route over which the proposed TAO will have an impact, then we will take this strategy into account when making our decision. RUSs under development will need to take account of existing contractual arrangements (including TAOs).

1.5 Greater detail on how we reached our policy conclusions can be found on our website.\(^2\)

**Our policy on approving TAOs**

1.6 Under sections 17 and 18 of the Act we may direct a facility owner to enter into a TAO granting access to its facility. Where a party intends to make an application for a TAO, we recommend it contacts ORR at an early stage to discuss its plans and aspirations, and the likely timing of the application. We have found pre-application meetings a useful means of identifying issues that

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\(^1\) A RUS takes a strategic look at the rail network and its usage and capability in relation to current and future demand. It seeks to balance capacity, passenger and freight demand, operational performance, infrastructure maintenance, and costs, to address the requirements of funders and stakeholders. Further information on the RUS programme is available on Network Rail’s website at [http://www.networkrail.co.uk/asp_x/666.aspx](http://www.networkrail.co.uk/asp_x/666.aspx).


can be addressed prior to the formal application being made. They also help to ensure that the party's approach is consistent with our policy.

1.7 In applying for a TAO, we would expect applicants to use, as far as is possible, the most appropriate model contract template and associated application form available as the basis for their application. Until such time as we publish a TAO model contract, this will be restricted to either the passenger or freight model TAC, and we recognise that certain provisions in these and sections of the associated application forms will not apply to TAOs (e.g. possessions arrangements, charging provisions, performance regime). We will, however, consider any bespoke arrangements proposed on their merits where they are in line with this policy and the parties feel that they are more appropriate to their commercial requirements. We expect that the services covered by the TAO will be operated under the terms of a TAC approved by us, which would ensure that the rights are subject to the model clauses that are applied to all such contracts.

1.8 Any applications that are submitted with insufficient detail to address the issues set out within this policy may be rejected.

1.9 As with any TAC with Network Rail, we would expect TAOs relating to Network Rail’s network to incorporate the Network Code as part of the contractual framework.

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3 These can be found on our website at [http://www.rail-reg.gov.uk/server/show/nav.202](http://www.rail-reg.gov.uk/server/show/nav.202) (for passenger services) and [http://www.rail-reg.gov.uk/server/show/nav.204](http://www.rail-reg.gov.uk/server/show/nav.204) (for freight services).
2. Assessment criteria

2.1 We will assess TAOs in the same way that we consider other access contracts, and in particular long-term TACs (LTACs). We will specifically consider two main issues:

(a) the impact of the option on the overall use of enhanced network capacity; and

(b) whether the access option facilitates the investment to be made.

Capacity

2.2 The factors we will consider when determining the availability of network capacity are:

(a) safety;

(b) operational integrity;

(c) different passenger and freight operators (and funders) wishing to use the same capacity;

(d) network performance;

(e) maintenance and renewal of the network;

(f) certainty and flexibility; and

(g) efficient use of capacity and competition between operators.

2.3 All proposals for TAOs should be considered by the infrastructure manager and subject to consultation in accordance with the agreed Industry Code of Practice before they are submitted to us. Applications under sections 17 or 22A of the Act may, of course, be submitted to us by the applicant.

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2.4 We will only approve TAOs where sufficient capacity is expected to be made available on the network to accommodate the access rights at the time that they are required to be exercised by, or on behalf of, the applicant. As part of its consideration of the TAO, we would expect the infrastructure manager to assess whether sufficient capacity will be available on its network when the rights are required. We would oversee and review this assessment against the criteria established under this policy. For TAOs associated with large or complex investment we may expect there to be an assessment period with trial running or a ramp-up in services so that the infrastructure manager and the access option holder (AOH) can establish the impact of the proposed services on performance and capacity. The responsibility for ensuring that any required capacity underpinning the TAO is delivered both in respect of off-network enhancements and access to existing off-network facilities lies with the AOH/investor.

2.5 We would expect any assessment of available capacity to take into account established or developed RUSs, existing access contracts and future uses of the network which have been identified during consultation. In reaching a decision we would expect to:

(a) have regard to the firmness of other operators’ plans for the capacity sought, by for example taking account of contractual commitments; and

(b) take account of any major projects, including the firmness of any proposals.

2.6 We do not consider that TAOs should be limited to areas of the network where enhancements are taking place. Often, to take advantage of an investment, an operator will require access to other parts of the network. We consider that, provided there is sufficient available capacity, TAOs should have access to capacity on both the enhanced and unenhanced network. We would not, however, expect to grant TAO rights for parts of the network not required to make use of the investment associated with the TAO. This is an element of a TAO application which we will scrutinise closely to ensure that there is an appropriate balance between the investor being able to benefit from its investment without ossifying use of network capacity.

2.7 Where the capacity required under the TAO is not limited to that provided by the investment we expect the infrastructure manager to satisfy itself that such
capacity either already exists or will be made available as a result of any enhancements funded by an applicant. In the event that the infrastructure manager is unable to do so, perhaps because of anticipated conflicts with other operators’ access rights, the applicant will, of course, be able to submit an application for a TAO under section 17 of the Act. In such cases, sufficient evidence will need to be provided by both parties to the agreement to support their contention that available capacity will or will not be available. In cases where doubt on this matter clearly exists we may wish to seek independent advice in order to inform our decision.

2.8 The rights should also be time-limited from the date that it is expected the first services will operate through to the expiry of the TAO, addressing any specific build up of services that can be identified. This would ensure that capacity is available for other operators before the TAO rights are converted into more precise contractual rights within a TAC.

2.9 When considering a TAO we will have regard to the potential impact of the TAO on the ossification of the network and would seek to ensure that the TAO has sufficient flexibility to deal with changes in demand patterns and allow other more beneficial uses of the network that may appear in the future, for example through the buy-back mechanism discussed in chapter 3.

Capacity choices

2.10 As already stated, we will have regard to the firmness of other operators’ plans for the capacity being sought through a TAO application. In comparing alternatives to the rights sought, as well as having regard to our statutory duties, we will expect to have particular regard to:

(a) the relative benefits to the users of railway services of the alternatives, including the implications for performance and reliability;

(b) the extent to which the allocation of the rights would impact on funds available to the Secretary of State for railways and railway services, and the extent to which rights sought and the plans of other operators reflect a contractual commitment to the Department for Transport (DfT), Transport Scotland (TS) or another funder (e.g. through a franchise or concession agreement);
(c) the balance between the benefits of innovative new services being introduced against the benefits of timetable/planning stability for existing services;

(d) the likelihood of more efficient capacity utilisation resulting (e.g. where there are proposals to run longer trains, or trains with improved rolling stock);

(e) the extent to which an increase in the capacity available is a result of associated funding of network enhancement; and

(f) the specific requirements in competitive markets, such as the availability of paths at short notice for freight.

2.11 To assist our assessment, a TAO application should specify what benefits passengers and/or freight customers are likely to gain and the extent to which capacity and service volume growth is expected to lead to passenger and/or freight volume growth.

2.12 We will also have regard to the benefits and costs of proposals for the TAO compared with alternative uses of the non-enhanced capacity. We may take into account cost-benefit analysis of the proposals and alternatives to facilitate this, and if such evidence is presented, any difference in assumptions compared with the relevant funder appraisal criteria (either DfT’s or TS’s) should be highlighted.

2.13 We recognise that, in some cases, it may be appropriate to give additional weighting to certain factors as described in our passenger criteria and procedures document (C&Ps).

2.14 In line with the current position set out in our C&Ps, we will take into account the strategies described within a RUS, both where it exists and where it is

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6 This is available at http://www.webtag.org.uk/webdocuments/3_Expert/13_Rail/index.htm.

7 This can be found at http://www.transportscotland.gov.uk/defaultpage1221cde0.aspx?pageID=255.


9 See paragraph 4.7 of criteria and procedures for the approval of freight track access contracts: third edition (available on our website at http://www.rail-reg.gov.uk).
being developed, when making our decision. However, where no RUS is in place, nor one in development, we will consider the application in the usual way, and any subsequent RUS would then need to take into account any approved contractual arrangements, exploring the amount of flex that may be associated with such rights in order to obtain optimum capacity utilisation.

2.15 As more RUSs are completed, their role in helping to inform our decisions on applications for busy or congested infrastructure will increase. However, we would not necessarily expect all access contracts (including TAOs) to be wholly consistent with RUSs. When taking a RUS into account there would be a number of relevant considerations, including:

(a) the time since the RUS was published, and the extent to which circumstances had changed over that period; and

(b) the extent and relevance of any analysis supporting the relevant RUS conclusions.

Financial investment

2.16 In accordance with our LTAC criteria we propose that, as well as taking account of our statutory duties, we will specifically consider:

(a) whether the investment could be made without the contractual certainty provided by the TAO; and

(b) the contribution of the investment to the growth and greater efficiency of rail markets.

2.17 A TAO will only be approved when it is required to secure the benefits of an investment or other public interest benefits (for example, reduction in road congestion). The beneficiary must therefore demonstrate why the TAO is required for the investment to take place, and why any alternative arrangements might not be appropriate. An application will therefore need to:

(a) be justified by the length and nature of any relevant commercial contracts (including financing) that are proposed;

(b) justify that the specific investment could not be made without a TAO (for example, because of its size or payback period);

(c) justify that the beneficiary requires the TAO for the period of the application to secure the benefits of investment or other public interest benefits; and

(d) demonstrate that the TAO does not provide the opportunity to eliminate competition from other operators in respect of a substantial part of the services in question.

2.18 We would expect to consider a TAO against each of these criteria. We consider each of them to be important and would not expect to explicitly weight them. Where certain criteria are not satisfied, for example the existence of commercial contracts, we would consider the extent to which this is relevant to the investment.

2.19 Such investment does not necessarily need to take place on the infrastructure manager’s network and can involve investment in ‘off network’ facilities. While we would not limit our consideration to investment in railway facilities we would expect any investment underpinning a TAO application to improve the capacity, capability or utilisation of the network or otherwise provide benefits to the network as a whole. The promoter will, of course, have to satisfy itself, Network Rail and ORR as part of the application/negotiation process that, if the TAO access rights were granted, full use will be made of them. If this turned out not to be the case, the AOH could find itself subject to the TAO UIOLI mechanism and at risk of not realising the expected return on the investment.

2.20 We expect that TAOs would be in place for the minimum period necessary in order to secure the benefits of the investment, which justified the award of the long-term TAO. To reduce the risks of ossification from the award of a long term TAO, a buy-back mechanism must be included in all TAOs of more than 15 years duration. The buy-back mechanism is discussed further in chapter 3.

2.21 The justification could include the implications of a TAO not being granted, for example in terms of the risk that the required capacity would be used by other services or that the investment has a specialised risk profile in terms of
demand and costs and the implications that this has for the viability of the investment.

2.22 We would also want to ensure that the TAO and resulting investment would provide benefits to users of the network either in terms of facilitating growth and/or improving the efficiency of rail markets. These benefits will form part of our consideration of alternative uses of capacity.

2.23 The use of TAOs is open to both public and private sector investors, and, given the difficulty of separating public and private sector investments, we would expect to apply the same criteria to both types of investments. We consider that these criteria are sufficiently flexible; for example, we would expect to place more weight on public interest benefits when considering whether public sector investments would proceed. We would take into account wider social and economic benefits of both public and private sector investment when considering choices about the use of capacity. One area where we may place different emphasis is on the payback period on the rail investment (or, if inseparable due to inter-dependencies, the total investment) which should be based on the reasonable criteria of the funder. For private sector investors this should be the financial return and for public sector funders this should be the economic return.

2.24 Given their role in the High Level Output Specification (HLOS) process, and the funding of the network as a whole, we would only expect to grant TAOs to DfT and TS in exceptional circumstances, for example if the investment is particularly large and focused and the risks that benefits may not be forthcoming without a TAO are particularly great, and where there is third party finance and risk exposure.

2.25 Where rail investment is part of a wider scheme, for example as part of a port or terminal development project, the beneficiary should where possible separately identify the size, benefits and inter-dependencies of the separate investments so that these are fully understood.

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10 In a periodic review, the modifications to Schedule 4A to the Act made by the Railways Act 2005 require the Secretary of State for Transport (for England and Wales) and Scottish Ministers (for Scotland) to, broadly speaking, provide ORR with a specification (often described as the HLOS) of what outputs they want the railway to deliver, and a statement on the public funds available. ORR must then determine what outputs Network Rail should deliver, the efficient cost of delivering them, and the implications for access charges.
2.26 Some investments may come forward because a promoter is obliged to invest, for example by a Section 106 Agreement. In such cases the promoter would also need to demonstrate that:

(a) the incremental investment in railway facilities supported the requirement for the TAO sought; and/or

(b) the whole investment would be withdrawn if the TAO was not forthcoming, for example if the absence of an option would prevent the achievement of any planning approval obligation such as a rail mode share target.

Consultation

2.27 Generally, where Network Rail is the facility owner, it will be responsible for carrying out the industry consultation for applications to be submitted under section 18. It will do this in line with the Industry Code of Practice. In those rare cases where we conduct the consultation, we will consult the DfT or, where appropriate, TS, on all applications as they will be concerned with the delivery of specified outputs they are funding through the HLOS process. We will also consult and have regard to the views of other operators, Passenger Focus and, depending on where the services are to run, the National Assembly for Wales, the Mayor of London, TfL, London TravelWatch and any Passenger Transport Executives likely to have an interest.

Timescales

2.28 For new agreements such as TAOs, the Industry Code of Practice indicates that our expected time to reach and publish conclusions on an application received for a new contract is 12 weeks (or 18 weeks where we, rather than Network Rail, undertake the industry consultation process). However, for more contentious cases where there is likely to be considerable interest, possible objections and the potential need for an industry hearing to discuss

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11 Section 106 of the Town and Country Planning Act 1990 allows a planning authority to enter into a legally binding agreement (planning obligation), with a land developer over a related issue – commonly termed a ‘Section 106 Agreement’. S106 Agreements can act as a main instrument for placing restrictions on the developers, often requiring them to minimise the impact on the local community and to carry out tasks such as improving railway services, which will provide community benefits.
contentious issues, we would expect the process to take longer and we would recommend allowing up to six months.
3. The structure of a TAO

Term of an access option

3.1 In considering the appropriate length of a TAO proposal, we will have regard to our statutory duties and legislative framework, including the principles set out in this document, regulation 18 (Framework Agreements) of the Railways Infrastructure (Access and Management) Regulations 2005, and our LTAC policy.

3.2 As we propose that a TAO will generally only be justified in relation to investment in a railway facility, our consideration of an option for a period of up to ten years (in line with the criteria set out in paragraph 2.17) would depend on the justification given by the applicant.

3.3 Our LTAC policy states that “we will only consider approving TACs (including track access options) for a term longer than ten years in exceptional circumstances.” Such cases would involve dedicated and focused long-term investment that could be facilitated by the certainty which a long-term contract can provide. For a TAO of more than ten years we will therefore consider:

(a) the beneficiary’s justification for the duration of the access option; and

(b) the benefits, particularly in terms of growth and greater efficiency of rail markets, compared to alternative uses of capacity.

3.4 As part of the beneficiary’s justification for an option of more than ten years, as well as considering the items listed in paragraph 2.17 as appropriate, we will also consider financial information such as the scale of the investment in relation to the turnover of the beneficiary, payback period, any relevant contractual commitments, and the impact of that investment on the growth and greater efficiency of rail markets. Any increment in duration over ten years will also need to be justified, for example by explaining why a TAO should have a term of fifteen years rather than ten.

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12 These regulations can be found at [http://www.opsi.gov.uk/si/si2005/20053049.htm](http://www.opsi.gov.uk/si/si2005/20053049.htm).
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3.5 We would not in general expect to approve a TAO for a duration longer than the associated payback period. However, we would not simply link the duration of the TAO directly to the payback period of the investment as this could distort incentives, and allow relatively poor investments with long payback periods to receive access options of a longer duration than are warranted. In determining the length of an access option, we would expect to place emphasis on both the wider elements of the beneficiary’s justification (see paragraphs 3.3 and 3.4) and our assessment of the benefits of the option (including the investment) compared to alternative uses of non-enhanced capacity.

3.6 As part of our assessment of duration we would consider both rail and non-rail benefits, particularly where non-rail developments are dependent on railway investments, although the relative weight of non-rail benefits will depend on individual circumstances.

3.7 When we consider the duration of any TAO we will have regard to all our statutory duties, and this will assist us in determining the weight that we place on rail and non-rail benefits. While we have a duty to promote the use and development of the railway network in Great Britain to the greatest extent economically practicable we also have railway specific duties such as:

(a) to promote improvements in railway service performance;

(b) to protect the interests of users of railway services; and

(c) to promote efficiency and economy on behalf of those providing railway services.

Use It Or Lose It

3.8 It would not be in the interests of the industry as a whole for TAO rights to be retained if they are not being used as this could ossify network capacity and restrict the access of other operators who could effectively utilise those rights for services for passengers and/or goods. A Use It Or Lose It (UIOLI) mechanism, similar to that for TACs contained in Part J of the Network Code, should therefore be incorporated into all TAOs.

3.9 This mechanism should be based on the following key principles:
(a) there should be a ‘stabilisation period’ at the commencement of the operation of TAO services when the mechanism would not apply to allow the ramp-up or bedding down of services. The length of the stabilisation period will need to be considered on a case-by-case basis depending on the AOH’s service implementation plans. The commencement and expiry of the stabilisation period will need to be formally reflected within the TAO. This is discussed further in paragraph 4.10–4.11);

(b) we would, however, expect the AOH to surrender, either during or after the stabilisation period, any TAO rights that it does not intend to exercise for a defined period in each associated TAC. We would generally expect all TAO rights to be exercised during the term of a TAC to be reflected in an appropriate way (perhaps by time limiting the rights to a specific period within the contract), by the expiry of the stabilisation period. Any TAO rights not drawn down at this point should therefore either be:

(i) supported by clear plans for the AOH to exercise them during the remaining term of the associated TAC;

(ii) surrendered from the TAO for at least the remaining duration of the associated TAC; or

(iii) if there is no reasonable on-going requirement to exercise the TAO rights beyond the expiry of a TAC, surrendered from the TAO for a further period;

c) the infrastructure manager should also be entitled to require the surrender of TAO rights, for a defined period, if they have neither been drawn down nor surrendered by the AOH, and it believes that there is no reasonable prospect of them being exercised. The infrastructure manager may take this course of action at any time from the end of the stabilisation period throughout the term of the TAO. As, in the majority of cases, we would expect all TAO rights that are to be exercised to be drawn down into the first associated TAC and carried forward into subsequent contracts, this process could result in the surrender of any undrawn TAO rights for the full term of the option. The AOH would
have an opportunity to demonstrate that such rights should be retained within the TAO;

(d) the defined period of surrender should be agreed by the parties on a case-by-case basis. It is likely that the characteristics of each TAO will be different. The period therefore for which AOHs will be willing to surrender rights, and which the infrastructure manager will also consider appropriate, will depend upon the service implementation plans and how they develop. In general, surrenders may be required to cover instances such as:

(i) a delay in completing, or the failure to complete all or part of, the enhancement;

(ii) delays in obtaining required rolling stock;

(iii) a delay in identifying a TOC to run the services, and establishing an appropriate TAC through which the services will be exercised;

(iv) delays in anticipated commercial contracts materialising;

(v) anticipated commercial contracts falling through; and/or

(vi) a scaling down of the original planned services.

An infrastructure manager should only be able to challenge any ‘defined period’ proposed by the AOH through issuing its own surrender proposal for any period of non-use following the stabilisation period;

(e) to preclude the need for AOHs to continually justify the retention of rights, the infrastructure manager should not seek the further surrender of a TAO right where surrender has already been sought, and perhaps implemented (albeit for a short period), once during the same TAC period. This situation should be able to change if it were found that the information that had been provided was incorrect in a material respect or there had been a material change to any of the factors or circumstances which had been taken into account;

(f) if the parties agree to any such surrender proposals, and as there would be no detrimental impact on capacity utilisation, TAO rights would be surrendered from the contract upon notification of such an
agreement to ORR, rather than requiring our specific approval. This approach is in line with the process outlined in Part J of the Network Code;

(g) if the parties fail to agree, then either party would be able to refer the matter to ORR, as the dispute body, for determination; and

(h) no compensation would payable to the AOH in relation to any TAO rights surrendered through agreement or ORR determination.

3.10 We would also, of course, expect an AOH to voluntarily surrender any unused rights for which there is no current or likely commercial need from its TAO for the appropriate period.

3.11 It is important to protect the interests of third party operators who may wish to utilise network capacity that is constrained by unused and unsurrendered TAO rights. The UIOLI provisions should provide ORR with the ability to issue a notice to the infrastructure manager and the AOH in the event that an application is made by a third party under either section 17 or section 22A of the Act, where the surrender of unused TAO rights has not been sought elsewhere through the mechanism. We will then determine whether the retention of the unused rights by the AOH is justified. Such a notice could only be served once the relevant stabilisation period had expired.

3.12 The UIOLI provisions need to include criteria upon which the AOH can properly challenge any proposed surrender of its TAO rights. At this time we consider that the grounds for objection should be that:

(a) there is a reasonable on-going requirement for the rights:

   (i) for public interest services we would expect the AOH to demonstrate a socio-economic case for the utilisation of the rights. This may include a cost benefit analysis;

   (ii) for private interest services we would expect the AOH to demonstrate a commercial case for the utilisation of the rights; this should include commitments or the reasonable prospect of a commitment for traffic which cannot be satisfied without the rights;

(b) there is a reasonable ongoing prospect of use of the rights; and
(c) one or more train operators have the necessary committed resources to be able to operate the services on behalf of the AOH.

3.13 Any such arguments would of course need to be supported by evidence provided by the AOH that clearly demonstrates why the rights in question should be retained.

**Buy–back mechanism**

*Principles*

3.14 The purpose of a buy-back mechanism is that it will enable rights to be bought-back for alternative use to help to ensure that, in approving what are long-term access rights, network capacity is not unduly ossified. Such a mechanism would only be triggered when a third party considers that there is demonstrable additional benefit for a proposed alternative use.

3.15 Our key principles underpinning the buy-back mechanism are that:

(a) the AOH is compensated if it is required to surrender rights;

(b) any associated compensation is reasonable and does not prevent more beneficial use of the network; and

(c) the mechanism is simple and transparent which in turn will give predictability to the AOH and the party seeking use of the relevant capacity.

*Application of buy-back to long term TAOs*

3.16 We consider that a TAO of longer than 10 years will create a risk that network capacity is ossified. Applicants for a TAO of greater than 10 years should therefore choose between:

(a) a TAO of up to 15 years, without a buy-back mechanism; or

(b) a TAO of greater than 15 years, which would include a buy-back mechanism from year 10 onwards.

3.17 We consider that the approval or direction of a TAO for a period of longer than 10 years will provide sufficient certainty to support an AOH’s investment. We would therefore expect the associated rights to be reflected in one or more
consecutive TACs rather than a single contract. We do not expect the buy-back provision to be applied to TACs that have reflected rights from a TAO – the only opportunity for rights to be bought out would be when the TAC is being renewed.

3.18 If rights were not subject to buy-back at or around year 10 (i.e. after the expiry of the first TAC) we will then take a view on the term of the next TAC - which could be up to a further 10 years in accordance with our LTAC policy, during which the TAO rights would be protected. Buy-back would then potentially next apply upon the expiry of that TAC.

Application to long term TACs

3.19 We consider that the principles of this buy-back mechanism should also apply to all TACs with terms longer than 15 years.

Contractual framework for the buy-back mechanism

3.20 The buy-back mechanism will be included as part of the model clauses for long-term access contracts (including TAOs). This will allow the mechanism to be tailored to the individual circumstances, which may require bespoke provisions due to the nature of the associated investment.

Criteria for implementation of buy-back

3.21 Third parties will be eligible to buy-back rights already granted through a TAO or LTAC provided that:

(a) the third party must first seek to secure available capacity before applying to activate the buy-back mechanism; and

(b) consideration must be given as to whether the network can be further enhanced at a lower cost than employing the buy-back mechanism.

3.22 Where the third party is unable to obtain access rights without the buy-back mechanism then it must demonstrate that the alternative use offers better value. This should include a cost benefit analysis of alternative uses of capacity and also highlight where there are differential impacts against our section 4 duties.
Mechanism for buy-back of rights within a TAO

3.23 The following mechanism will apply to the buy-back of TAO rights:

(a) a stakeholder (be it a train operator, prospective train operator, or funder) would apply, through Network Rail, and within a reasonable period before the expiry of the existing TAC, to use the TAO rights from the point of renewal of the associated TAC. Through this the new applicant would need to demonstrate that it could bear the cost of the buy-back and that the proposed use for the capacity is of greater benefit than the existing or proposed use under the TAO;

(b) we would then review and consult on this application;

(c) following consultation there are two possible outcomes:

(i) if the AOH agrees to the buy-back, and provided no issues were identified with the use of the rights by the new applicant, with regard to our statutory duties we would consider approving the buy-out of rights from the TAO and their inclusion in the relevant TAC; or

(ii) if the AOH does not agree to the buy-back, then we would expect the AOH to demonstrate the impact of the loss of the rights. We would then carry out an independent assessment of the use of the rights by the AOH and the new applicant, taking into account our statutory duties, and in accordance with the approach set out in our criteria and procedures (particularly paragraphs 4.30 to 4.38 inclusive). In particular we will have regard to the costs and benefits of alternative uses of capacity and may take into account cost-benefit analysis of the proposals and alternatives in order to facilitate this assessment;

(d) if we identified the new use had greater merit then we would notify the AOH that we had reviewed an application for rights that they hold and were minded to approve that Network Rail could buy-back those rights;

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(e) the AOH would then have a right to make further representations which could lead to a hearing;

(f) if the rights are bought-out from the AOH, then Network Rail would pay compensation to the AOH in line with the compensation calculations described below; and

(g) within the TAC or TAO for the new applicant (if applicable) there would be an additional charge, the “buy-back charge” to compensate Network Rail for the cost of the buy-back.

Calculation of compensation

3.24 The following paragraphs describe the default approach for calculating buy-back compensation, to be included in the TAO. If desired the AOH, Network Rail and the new applicant could agree to lower compensation.

3.25 The buy-back compensation should be the total (undepreciated) investment cost per right for the remaining duration of the option.

3.26 For lump sum compensation, buy-back compensation for right \( w \) in year \( t \) would be:

\[
\text{Buy-back}_{w} = \text{Weighted right cost}_{w} + \text{financing cost}_{w}
\]

where:

\[
\text{Weighted total right cost}_{w} = \text{Total right cost}_{w} \times \text{Right weight}_{w}
\]

Right weight_{w} is a value between 0 and the total number of rights and the total value of right weights across all rights is equal to the number of rights. We would expect rights to have no more than six different weightings. AOHs should provide supporting evidence for the weightings chosen, for example the relative level of demand or economic or financial benefits.

3.27 The financing cost is calculated as:

\[
\text{Financing Cost} = \frac{r \times n \times AF}{1 - \frac{1}{(1 + r)^n}}
\]
Where: 
Financing Cost = Total Interest cost on amount financed 
AF = Amount financed 
N = number of years of repayment of amount finance (in equal instalments) 
r = interest rate used

3.28 The total right cost in year t is calculated as:

\[
\text{Total Right Cost}_t = \sum_{i=t}^{\text{Option Length}} \frac{\text{Right Cost}_i}{(1 + \text{Annual Cost of Capital})^{(i-t)}}
\]

where the annual cost of capital is the pre-tax cost of capital for the investor, in nominal terms, in the year in which the enhancement is financed. Option length is the duration of the option in years. Compensation would therefore be paid for the remainder of the TAO, irrespective of the duration of the new use.  

3.29 The investment cost per right in year t should be calculated as:

\[
\text{Path Cost}_t = \left( \frac{\text{Investment Cost}_t}{\text{Capacity Measure}} \right)
\]

where the investment cost in year t is calculated as:

\[
\text{Investment Cost}_t = \text{Annual Depreciation Charge}_t + (\text{NBV of Investment}_t \times \text{Annual Cost of Capital})
\]

and where the:

(a) net book value is the initial investment cost minus accumulated depreciation. As the TAO will only provide surety to the holder for the duration of the TAO we consider that compensation should be related to the depreciation of the investment that would have occurred over the life of the TAO;

(b) initial investment cost is the cost to the investor of the enhancement (excluding financing costs and after allowing for depreciation) relevant to the TAO. Incremental unavoidable operating, maintenance and renewals costs may also be included;

\[14\] Changes to the repayment profile may be needed if the new operator’s access agreement is not is not co-terminus with the original option.
(c) depreciation charge is that determined by depreciating the enhancement on a straight-line basis over the life of the option; and

(d) capacity measure is the number of the rights in the TAO. Where the capacity generated by the initial investment is greater than that included in the TAO we would expect to proportionately adjust the relevant investment included in the compensation calculations.

3.30 The size of the investment will be considered on a case-by-case basis, taking into account:

(a) the extent to which the option is necessary to justify the investment and is needed by the beneficiary to secure the benefits of the investment or other public interest benefits; and

(b) the degree to which all or part of the investment is committed.

3.31 Both on and off Network Rail network could be considered to be relevant to the option and the calculation of compensation. Such a situation would be considered on a case-by-case basis.

3.32 It should be emphasised that compensation is calculated on the basis of the actual cost of the investment and does not reflect a number of other costs such as lost revenues and financing costs.

3.33 We consider that the default mechanism for compensation payments should be through a lump sum payment from Network Rail funded by annual payments from the new operator, although we would allow alternative arrangements if agreed between the incumbent and new applicant, providing these align with our statutory duties. We are content to take any losses that Network Rail would incur from an operator going out of business into account in subsequent access charges reviews.

**Termination of an access option**

3.34 There may be instances where a TAO will be approved but, for whatever reason (lack of finance, planning issues, change of mind), it becomes clear that the new facility/enhancement will not be built.

3.35 To address this possibility it will be necessary to include within a TAO provisions which allow the termination of the TAO in the event that the
investment is not, or will not be, taken forward or completed by a certain date, and therefore the capacity reserved by the TAO is not utilised.

3.36 The infrastructure manager’s role in delivering any associated enhancements may define the application of termination or adjustment mechanisms. This is in addition to the UIOLI and buy-back mechanisms discussed previously.

Other key provisions

3.37 We believe that the TAO should also include specific provisions which:

(a) place a clear obligation on the infrastructure manager to enter into a TAC under which the TAO rights can be exercised, allowing the AOH access to the section 17 process if the terms offered by the infrastructure manager are considered to be inappropriate. Any TAC submitted to us for approval/direction (under either section 17 or section 18) will, of course, be subject to consideration under any policy principles that are in place at the time. For example, it is expected that the contractual terms of the relevant TAC will be based on the current edition of model clauses unless a departure can be justified, or where bespoke provisions are required to take account of the impact of enhancements (e.g. in the performance regime);

(b) set out the process by which TAO rights will be exercised within a TAC, including detailing the way in which a TAO has been exercised, thus ensuring that rights are only contained within one approved access contract at any one time. This will be of particular importance where rights within a TAO are exercised on behalf of more than one operator or only exercised for a limited period; and

(c) enable the surrender and utilisation of rights, and availability of capacity, to be clearly recorded and available to other train operators.

Reserving capacity under the TAO

3.38 Existing operators’ rights will remain separate from any granted to AOHs and should be used for the purpose for which they were approved in the first place. No AOH can expect to ‘sit on’ its rights. Therefore, the increased traffic resulting from the investment should be drawn down first from the rights
ensuing from the TAO. We will only agree to approve the reservation of capacity, in the first place, that is required and can be justified.
4. Integration of TAOs with TACs

4.1 A TAO should encompass a broad envelope of access rights containing the minimum characteristics necessary to provide sufficient flexibility to enable both the AOH and the infrastructure manager to plan their businesses with a reasonable degree of assurance. These should be limited to the quantum of services (per day/hour), departure and arrival points, calling patterns and rolling stock specification, rather than to specific characteristics (such as timings) which, unless these are critical to the financial viability of the proposal, might only serve to constrain the future capacity of a network in an inefficient way. The reserved rights should be time-limited over a period between the first possible date on which they might formally be used through to the end of the term of the TAO. This will allow:

(a) available capacity to be utilised by other operators up until the date that the services fully commence operation (taking into account any potential slippage in the construction programme);

(b) the AOH flexibility to more clearly define its access rights closer to the time that they would actually be used, and enable an informed view to be taken of service pattern requirements, how these might better fit with existing operators, and ensure the optimum use of capacity;

(c) greater integration of TAO rights with any relevant RUS; and

(d) sufficient flexibility for an infrastructure manager to make best use of available capacity over a potentially long period of time.

4.2 However, TAO rights should be expressed sufficiently precisely to ensure that there is no uncertainty about routes that are unaffected by the TAO (i.e. through stating the rights too broadly).

4.3 We envisage that an application for a TAO would generally be approved in advance of the commencement of any significant works (i.e. other than preparatory works) and either prior to or in parallel with the entering into of key commercial contracts connected with the project. This approach would provide sufficient certainty to enable the investor not only to arrange for the financing of the scheme to be put in place, which we expect will in many
cases be dependent upon the capacity of the network being reserved, but also to make the necessary preparations for the building work itself to be carried out.

4.4 In association with the TAO, but not necessarily approved at the same time, we would require an application to be made, by the train operator who will operate the services, to reflect the TAO rights into a TAC once they are in a position to be used. This would occur when there is greater certainty over the date on which the services should commence operation, and could therefore arise a number of years after the TAO is entered into. It would effectively be a utilisation of the rights in the TAO, thus ensuring that, overall, there is no greater commitment of capacity over and above that which the infrastructure manager has already committed to provide.

4.5 In the event of an option running for many years, we do not envisage that an access contract would necessarily run until the end of a TAO, although clearly this may be appropriate in certain circumstances. Rather, we consider that a series of access contracts would be put in place over the period to:

(a) allow the AOH adequate flexibility to change both the services being operated under the TAO, and the provider of those services;

(b) take account of RUSs that might require the flexing of the rights within the limits established by the TAO (although this would not impact on the AOH’s ability to exercise the rights granted to it under a TAO);

(c) encourage competition between train operators where that is appropriate; and

(d) provide the infrastructure manager with adequate flexibility to ensure capacity, maintenance and performance issues can be adequately addressed.

4.6 Where a TAO has been granted for a duration in excess of 10 years, it has been granted to support large-scale and long-term investment. It is this level of certainty that we believe will be of primary importance to AOHs and provide the necessary assurance for them to invest in the network. We do not therefore believe that there would be a need to grant a TAC lasting more than 10 years unless such a requirement could be justified by some further benefit. This means that we would envisage the rights within a 20-year TAO, for
example, being reflected in at least 2 consecutive TACs. When all the rights have been reflected in the TAC that runs up to the end of the TAO term, or beyond, and the AOH is satisfied that this is the case, the TAO would fall away. This will facilitate increased transparency and remove uncertainty.

4.7 Where a prospective TAO is likely to be of a significant size, complexity and importance to the industry, but where the capacity utilisation plans have not yet been sufficiently developed, it might be necessary to reserve the ability to adjust any newly approved TAC rights which might compete with the finalised TAO rights. Accordingly, where new TACs seek rights which could potentially conflict with such undefined TAO rights, we would consider, having regard to our statutory duties and any legislation relating to such works, whether or not greater benefit would be obtained from incorporating into such contracts a provision to enable adjustment of rights to address any conflict of rights, with compensation where appropriate.

4.8 Where an investor wishes to secure future access rights that will utilise only the new capacity made available through its investment, we do not believe that any such restriction would need to be placed on new operator rights. Such enhancements would be progressed as a Network Change under Part G of the Network Code and any rights that cannot be accommodated during the works period would be subject to compensation paid in the normal manner.

4.9 As previously discussed, our view is that TAOs will be used to provide for the specific point at which the facility or enhancement will be completed and the TAO holder will exercise the right for its option to be converted into more precise contractual rights. There may, however, be some uncertainty at the outset as to when such a conversion will take place. This might be caused by a number of factors, including:

(a) delays in obtaining planning permission or other third party approvals;

(b) delays in finances being released;

(c) delays in the construction programme; and

(d) decisions taken by the investor/infrastructure manager not to use the finished facility.
4.10 As part of the UIOLI mechanism, TAOs should include a stabilisation period during which the AOH and nominated train operator would be able to build up its service operation over a period of time, if that were appropriate. During this period, the AOH may release a number of rights for use by other train operators. If, subsequently, the AOH wishes to either advance the introduction of services or change the phasing between different routes (i.e. by swapping one route for another), this can only be achieved if another train operator is not utilising the associated rights at the required time. We may therefore consider granting the use of associated rights to other operators on a contingent basis during the stabilisation period to provide flexibility if we believe there are sufficient grounds to do so.

4.11 It will be for the contract parties to consider and submit proposals for our approval, or determination, for the length of the stabilisation period within the TAO. We expect this to be done on a case-by-case basis based on the service implementation plans proposed by the investor. Once the stabilisation period has been agreed/determined, both the start and end dates should be formally included within the TAO. Whilst such a period may be shortened by agreement if, for example, the AOH is able to implement all of its services earlier than originally anticipated, we consider that it would be inappropriate to allow the stabilisation period to be lengthened as this might provide an opportunity for the AOH to restrict the infrastructure manager’s ability to seek the surrender of unused rights, and therefore reduce the effectiveness of the UIOLI mechanism. However, if the parties wished to seek such an extension, they could make an appropriate application under section 22 of the Act.

4.12 Any TAC to allow the operation of TAO rights would, of course, be subject to the normal approval requirements as set out in our appropriate C&Ps.

4.13 As previously explained in paragraph 4.6, we would not expect to grant a TAO-related TAC for more than 10 years. There may therefore be a number of consecutive TACs covering the period granted within the TAO. Our aim in doing this is not to ossify capacity on the network over an extended period. By limiting the length of TACs (in line with our normal approval procedures), it is assumed AOHs, train operators and/or the infrastructure manager will have the ability to flex service provision within each contract. We can also take a more accurate view on the use of available capacity and whether or not this should be bought out through the buy-back mechanism, and whether
sufficient flexibility will be available in order to take account of changes in the regulatory framework.

4.14 A TAO may include a flexible service implementation date to enable the AOH to exercise TAO rights earlier or later than originally planned, providing the necessary capacity is available. We will, however, need to understand, and be content with, how such a provision will operate and how it is tied into the TAO expiry date and any longstop termination provisions (see also paragraph 3.35).

4.15 Any rights that have been drawn down into a TAC and are subsequently unused will be subject to the normal UIOLI mechanisms set out in Part J of the Network Code. Any rights subsequently lost from a TAC through the Part J process should also be surrendered for an equivalent period from the TAO. Therefore, if the Part J UIOLI process results in unused rights being surrendered for the remaining duration of the relevant TAC, then the equivalent TAO rights should automatically be surrendered for the same period. The TAO stabilisation period would not apply to rights lost in such circumstances. Through this approach the AOH will be incentivised to manage the draw down process to ensure that TAO rights are either:

(a) drawn down at the commencement of a TAC, specifying the date on which the AOH plans to commence service operation; or

(b) drawn down through an amendment to that TAC to commence at an appropriate time,

thereby limiting the risk that they are lost unnecessarily through the Part J mechanism during the stabilisation period. Any proposed surrender under Part J may, of course, be subject to challenge under the grounds for objection set out under Condition J4.10 of the Network Code.

4.16 If an infrastructure manager considers that the TAO rights should be surrendered for longer than this equivalent surrender period, then it will need to initiate the specific surrender provisions within the TAO UIOLI process to achieve this.

4.17 We consider that transparency of TAO right usage is necessary to enable other operators to understand what network capacity is available for alternative use, and over what period. We consider that the status of the
TAO/TAC relationship is something that should be documented separately, and maintained, by the infrastructure manager, and published alongside the other contractual documentation on our website.

**Performance issues**

4.18 It would be inappropriate to include a performance regime within a TAO on the basis that the TAC performance regime and associated incentives will be:

(a) related and potentially constrained by the level of performance of the relevant routes at the time that the rights are reflected within a TAC; and

(b) related to any associated targets for improving performance further.

4.19 It will however be important to establish within a TAO the principles on which any associated performance regime will be constructed in a TAC, including management of performance across interfaces (including development of associated connection agreements), and how the responsibility for managing risks will be allocated between the respective parties.

4.20 In accepting (under sections 18 or 22) that capacity is available to enable a TAO to be approved, the infrastructure manager is effectively confirming that the exercised access rights will not have a material effect on performance. The TAO should therefore set out the obligations of the AOH and infrastructure manager in introducing services to agreed performance levels, possibly allowing for fine-tuning through a short calibration period at the commencement of the stabilisation period. Once capacity is confirmed as being available, performance calibration is not a process that can be used to establish that capacity is or will become available. The infrastructure manager will therefore need to consider the performance implications at the outset of the TAO process and bear the risk of being able to provide what has been agreed.

4.21 ORR will need to be content that any performance issues associated with new infrastructure are adequately addressed. Clearly the TAC will need to involve a detailed performance regime which is likely to involve bespoke provisions but we also consider that it is important that the TAO sets out, as a minimum, the basis on which any performance concerns (in particular the impact on third parties) will be addressed.
4.22 It would not, however, be appropriate for the infrastructure manager to bear the risk of impact on network performance if the enhancement promised under the TAO was not delivered as expected when the application was agreed, unless the infrastructure manager was responsible for impacting upon the delivery of the enhancement.

**Access charges regime**

4.23 For a TAO we will consider the inclusion of fixed charges on a case-by-case basis. Where services and fixed charges are transferred from an existing TAC and if fixed charges are not included in the TAO then we would expect alternative arrangements to be made to ensure that there is not a shortfall in Network Rail's revenue.

4.24 When the rights from a TAO are drawn down into a TAC we would expect the charges to be the same as for other TACs and include:

(a) short term variable costs (as recovered through variable charges);

(b) any other incremental costs of the TAO, for example additional fixed or variable costs of accommodating the option;

(c) a contribution towards existing fixed costs, where existing services and fixed charges transfer to an TAO, and also where it is considered to be appropriate, for example where services in TACs under a TAO operate and compete with existing services on the Network Rail network. In such circumstances we would expect the holder of the TAO/TAC to contribute towards fixed charges, subject to the ability to bear such charges; and

(d) other additional permitted charges

4.25 We would expect the charges in a TAC to be met by the holder of the TAC.

**Rebate for third party use of enhanced infrastructure**

4.26 On 28 June 2007 we published our final conclusions on the introduction of a rebate mechanism to allow third party investors to recover a fair proportion of the costs incurred in funding an investment scheme from which other parties
benefit.\textsuperscript{15} As we might expect the application for a rebate to be in conjunction with an application for a TAO, we would expect to co-ordinate information requests and timeframes.

\textit{Access charges reopener}

4.27 A TAO is an access contract that will last for a significant number of years, during which time many new changes to the regulatory regime could be introduced. In order to provide protection for the AOH, Network Rail and other operators, we would expect all TAOs to incorporate an access charges reopener provision to allow changes in approach to be adopted in an appropriate and consistent manner.

\textsuperscript{15} Available on the ORR website at \url{http://www.rail-reg.gov.uk/upload/pdf/cns-rebatementech-finconc.pdf}.