



OFFICE *of the*
RAIL REGULATOR

**NOTICE OF PROPOSED NETWORK
LICENCE MODIFICATIONS, FOLLOWING
THE ACQUISITION OF RAILTRACK PLC
BY NETWORK RAIL LIMITED**

October 2002

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1. Introduction

Notice under section 12(2) of the Railways Act 1993

- 1.1 This document constitutes a notice pursuant to section 12(2) of the Railways Act 1993 (“the Act”). The Rail Regulator (“the Regulator”) hereby gives notice that he proposes to modify the network licence granted to Railtrack PLC (“Railtrack”) under section 8 of the Act (“the network licence”) by:
- (a) modifying Condition 6;
 - (b) modifying Condition 7;
 - (c) modifying Condition 11;
 - (d) modifying Condition 12;
 - (e) modifying Condition 15;
 - (f) adding a new Condition 27 (Corporate Governance);
 - (g) adding a new Condition 28 (Management Incentive Plan); and
 - (h) making a number of other minor modifications.
- 1.2 The texts of the proposed modifications are reproduced at Annexes A – F.
- 1.3 The reasons why the Regulator proposes to make the licence modifications and the effects they would have are set out in Chapters 3 to 8 of this document. Railtrack has consented to the proposed modifications.
- 1.4 The Regulator requests that any representations or objections to the proposed modifications to the network licence are made in writing before 5.00 pm on 6 November 2002. Please address responses to:

Gill James
Manager, Network Enhancements
Office of the Rail Regulator
1 Waterhouse Square
138 – 142 Holborn
London EC1N 2TQ

It would be helpful if responses could also be e-mailed to gill.james@orr.gsi.gov.uk

- 1.5 Respondents should indicate clearly if they wish all or part of their responses to remain confidential to the Office of the Rail Regulator (ORR). Otherwise it is expected that they will be placed in the ORR library and on the ORR website and may be quoted from by the Regulator. Where a response is made in confidence, it should be accompanied by a statement summarising the submission but excluding the respondent's confidential information. This statement may be published, placed in the ORR library and on the ORR website and quoted from by the Regulator. The Regulator may also publish the names of respondents in future documents or on the ORR's website unless a consultee indicates that he wishes his name to be withheld.
- 1.6 Following the close of the consultation period on 6 November 2002, the Regulator will consider any representations and objections received. Subject to his consideration of any representations and objections, the Regulator will proceed with the modifications.
- 1.7 Copies of this document can be seen on ORR's website (www.rail-reg.gov.uk) and in the ORR library.

2. *Background*

- 2.1 In June 2002, the Regulator made a statement¹ setting out his views on a number of regulatory matters in connection with the proposed acquisition of Railtrack by Network Rail. In that statement, the Regulator outlined the licence modifications which he proposed to make on completion of the acquisition and clarified how, in general terms, Railtrack's successor will be regulated.
- 2.2 The key features of Network Rail's acquisition of Railtrack are set out in that statement. Network Rail is a company limited by guarantee, owned by members rather than shareholders, and financed entirely by debt. It therefore has a very different financial and corporate structure from Railtrack's previous owner, and the Regulator considers that these differences and the need to continue with his regulatory reform programme to improve the accountability of Railtrack require certain changes to the regulatory framework, including the network licence.
- 2.3 Network Rail's acquisition was completed on 3 October 2002 and the Regulator believes that it is important to proceed with the proposed modifications as quickly as possible. In proposing modifications to the licence holder's network licence, the Regulator is seeking to ensure that the accountability of Railtrack to its customers and funders is not diminished or weakened.
- 2.4 In summary, the proposed modifications comprise:
- (a) modification of Condition 6, intended to transfer Railtrack Group PLC's role in relation to the Independent Railway Safety Activity to the licence holder's new ultimate parent company, in order to make sure that contractual arrangements continue to be in place to ensure that the safety requirements of Condition 6 are met;
 - (b) modification of Condition 7, intended better to align the licence holder's business planning process with the regulatory requirements;
 - (c) modification of Condition 12, to ensure that the licence holder is properly ring-fenced from other businesses within the Network Rail group, and, as a

¹ *The proposed acquisition of Railtrack PLC by Network Rail Limited – a statement by the Rail Regulator*, Office of the Rail Regulator, London, June 2002

consequential amendment, changes to the cross subsidy and accounting separation rules in Condition 11;

- (d) modification of Condition 15, dealing with the publication of information in circumstances where the licence holder's owner is not a listed company,
- (e) a new condition on corporate governance (Condition 27), in order to ensure that there is transparency in the accountability of Network Rail's management;
- (f) a new condition on management incentives (Condition 28), intended to ensure that management have clear personal incentives in the absence of shareholders to improve efficiency, deliver contractual commitments and meet other regulatory obligations; and
- (g) other minor modifications.

- 2.5 The licence holder has consented to the proposed modifications and Network Rail has also undertaken that the licence holder will act as if these conditions have effect immediately. The proposed modifications also have the support of the Strategic Rail Authority.
- 2.6 The effect of, and reasons for, each proposed modification are set out in Chapters 3 to 8 of this notice.

3. Proposed modification to Condition 6 (Safety and Standards)

Reasons for the proposed modification

- 3.1 Railway Safety was established under Condition 6 of Railtrack's network licence as the Independent Railway Safety Activity (IRSA) on 31 December 2000 as a wholly owned subsidiary of Railtrack Group PLC. It carries out a number of key safety-related activities, in particular the production of Railway Group Standards, formerly carried out by Railtrack's Safety and Standards Directorate.
- 3.2 At the same time as its acquisition of Railtrack, Network Rail acquired Railway Safety from Railtrack Group PLC, and now holds it as a separate subsidiary within the Network Rail group. In his June 2002 statement, the Regulator emphasised that he expects these arrangements to be amended further in due course to establish a new, independent, Rail Industry Safety Body (RISB), as recommended by Lord Cullen.
- 3.3 In the meantime, however, the Regulator notes that Condition 6 currently refers to Railtrack Group PLC as the owner of Railway Safety and he considers that it is necessary to amend the references to Railtrack Group PLC in the licence in order to avoid Network Rail being in breach of its licence during the transition to RISB simply as a result of the change of ownership. The proposed modification to Condition 6 is intended to achieve this.

Effect of the proposed modification

- 3.4 The proposed modification to Condition 6 of the network licence is at Annex A. The effect of the proposed modification will be to:
- (a) transfer Railtrack Group PLC's role in relation to Railway Safety, to the licence holder's new ultimate holding company; and
 - (b) require the licence holder to enter into an agreement (to replace the existing tripartite agreement between the licence holder, Railway Safety and Railtrack Group PLC) with Railway Safety and the ultimate holding company, to secure Railway Safety's compliance with the requirements of Condition 6.

- 3.5 Pending the making of this modification, the Regulator would not expect to take enforcement action against Network Rail for breach of its licence in respect of references to Railtrack Group PLC.

4. Proposed modifications to Condition 7 (Stewardship of the Licence Holder's Network) and Condition 15 (Provision of Information to the Regulator and the Authority)

Reasons for the proposed modifications

- 4.1 The Regulator considers that a number of modifications need to be made to Condition 7 (Stewardship of the Licence Holder's Network) and Condition 15 (Provision of Information to the Regulator and the Authority) of the network licence in the light of the acquisition of Railtrack by Network Rail and of experience with the operation of the conditions to date.
- 4.2 The Regulator considers that the arrangements for the annual statement of the licence holder's plans to deliver its stewardship obligations (which Railtrack has called the Network Management Statement) required under paragraph 4 of the existing licence condition need to be changed because:
- (a) there needs to be greater specificity as to the core content of the plans, so as better to meet the needs of the Regulator, the SRA and other stakeholders;
 - (b) the Regulator wishes to minimise the risk of duplicated effort by requiring the licence holder to produce a single document which deals both with the issues currently provided for through the Network Management Statement and those which would normally be covered in a company's annual business plan;
 - (c) to the extent that the Regulator and the SRA have similar requirements in respect of the business plan, the specifications need to be aligned; and
 - (d) to enable better alignment with Network Rail's business planning process, there needs to be a formal procedure for the Regulator to specify additional requirements and the level of detail.
- 4.3 The Regulator also considers that it is necessary to make other amendments to Condition 7 because:

- (a) the general stewardship duty in paragraph 1 of the existing licence condition does not explicitly cover the operation of the network, which is a key aspect of its stewardship;
- (b) the current general stewardship duty does not cover the reasonable requirements of stakeholders other than train operators (*i.e.* other providers of services relating to railways as defined in the Transport Act 2000);
- (c) the existing criteria for compliance with Condition 7, which the licence holder is required to produce under paragraph 3 of the licence condition, need to be revised following the acquisition, and experience has shown there is a need for greater clarity as to the purpose of the criteria (including prioritisation between different activities and different parts of the network); and
- (d) the transitional provisions in paragraph 9, which were required in 1998 when Condition 7 was last amended, are no longer required.

4.4 The Regulator also proposes to modify Condition 15 of the network licence because:

- (a) in order to comply with principles of good corporate governance, it is important that Network Rail publishes information on its activities which would be required if it were a listed company. This modification is consequential on the implementation of a new licence condition on corporate governance (see Chapter 6); and
- (b) the provisions for the reconciliation statement (setting out what Railtrack has achieved on the work programmes set out in the business plan) are part of the annual return required under Condition 15, and are therefore best placed there rather than in Condition 7.

Effect of the proposed modifications

4.5 The proposed modification to Condition 7 of the network licence is at Annex B. This provides that:

- (a) the purpose (to which the general duty is directed) will include the requirement to secure the operation, as well as the maintenance, renewal and enhancement (as at present) of the network;
- (b) the purpose will include the requirement to satisfy the reasonable requirements of persons providing services relating to railways – this concept was

introduced by the Transport Act 2000. It includes, in addition to the services provided by Railtrack to the TOCs, freight operators and funders:

- (i) rolling stock provision and maintenance;
 - (ii) development, maintenance and renewal of networks, stations and light maintenance depots; and
 - (iii) the development, provision and maintenance of ancillary information systems;
- (c) the licence holder must develop and publish the criteria which it will apply to comply with the Condition 7 duty (to replace the existing criteria applied by Railtrack), by a date specified by the Regulator and no later than 31 March 2003;
- (d) the licence holder must prepare, provide to the Regulator and publish, an annual business plan covering the following ten years, by no later than 31 March each year (unless the Regulator specifies another date);
- (e) the business plan must demonstrate how the licence holder expects to carry out the duty and satisfy the criteria. It will include:
- (i) a detailed explanation by asset category of how the licence holder will carry out relevant activities;
 - (ii) projections of future network quality and capability requirements;
 - (iii) planned activities and volumes of work;
 - (iv) the expected effect of relevant activities;
 - (v) a plan for identifying and managing material risks;
 - (vi) a statement of expected expenditure, forecasts of cashflow, profit and loss and balance sheets and how the licence holder plans to secure necessary finance;
 - (vii) details of the licence holder's decision making processes; and
 - (viii) a statement of material changes compared to the previous year's business plan;

- (f) following consultation with the licence holder and by no later than 15 December in the year prior to production of the business plan, the Regulator will specify any additional information to be included within and the format of the business plan (if notice is not given in any year, the notice last given by the Regulator will apply); and
- (g) the Regulator may consent to the exclusion of confidential information from the published version of the business plan.

4.6 The proposed modification to Condition 15 of the network licence is also at Annex B. This has the effect that:

- (a) the licence holder must publish such information on its activities as would be required if it were a listed company; and
- (b) the annual return which the licence holder must prepare and provide to the Regulator must include information to reconcile the works carried out by the licence holder during the year against the business plan for the preceding year (this obligation is at present contained in Condition 7 of Railtrack's network licence).

5. Proposed modifications to Condition 12 (Ring-fencing and Accounting Records) and Condition 11 (Prohibition of Cross-subsidy)

Reasons for the proposed modifications

- 5.1 In order for there to be as much confidence as possible about the robustness of the licensed business's finances, there needs to be a clear ring-fence between the regulated entity and other companies within the Network Rail group. The Regulator believes that a modification to Condition 12 of the network licence is needed to ensure that funding intended for the regulated entity is spent on operation, maintenance, renewal and enhancement of the railway infrastructure, rather than diverted to support unregulated activities.
- 5.2 The Regulator first consulted on a strengthening of the existing ring-fencing network licence condition in September 2000², and received input from a number of parties within the industry. He has since discussed the proposed licence modification with Railtrack, Network Rail and the SRA, and confirmed that both the SRA and Network Rail wish to proceed with the change.
- 5.3 The Regulator also proposes to make a minor technical amendment to Condition 11 of the network licence, to reflect the changed corporate and financial structure of Network Rail. The reason this modification is necessary is to ensure that the prohibition on unfair cross-subsidy as between the Network Business and other businesses in the licence holder's group, and the requirements of accounting ring-fencing of the Network Business, reflect the new definitions in Condition 12.

Effect of the proposed modifications

- 5.4 The proposed modification to Condition 12 of the network licence modification is at Annex C. It incorporates a number of changes which emerged from the consultation and subsequent discussions with Network Rail and the SRA. The proposed modification is based as far as possible on best practice in other regulated industries

² *Consultation on proposed modifications to Railtrack's network licence: Disposal of assets and ring-fencing*, Office of the Rail Regulator, London, September 2000

and reflects developments since September 2000 (e.g. in relation to other predominantly debt-financed companies). The proposed modification will have the following effects:

- (a) the licence holder will be prohibited from carrying on, holding, or acquiring any business other than Permitted Business beyond a *de minimis* limit without the Regulator's consent (paragraphs 1 to 5 of the proposed modification);
- (b) there will be limitations on the licence holder entering into transactions with other companies within the same group except on an arm's length, commercial basis or with the Regulator's consent, and a more general prohibition on entering into any agreement containing cross-default provisions except with the Regulator's consent (paragraphs 6 and 7);
- (c) the licence holder will be required, at all times, to have sufficient resources to carry on its activities, and must submit annual certificates to the Regulator confirming the adequacy of these resources for the following 18 months (paragraphs 8 to 13);
- (d) the licence holder will be required to use all reasonable endeavours to maintain an investment-grade credit rating at all times (paragraphs 14 and 15);
- (e) the licence holder will be required to procure undertakings from its parent company that, except with the Regulator's consent, no other company within the group will do anything to cause a breach of the network licence, and that all other companies will provide information to the licence holder as is necessary to comply with requirements to provide information to the Regulator (paragraphs 16 to 19); and
- (f) the licence holder will be required to ensure that it does not, except with the Regulator's consent, pay dividends to its parent unless pre-determined criteria are satisfied to ensure that the sustainability of the business is not compromised (paragraphs 20 and 21).

5.5 The proposed modification to Condition 11 of the network licence is also at Annex C. It requires the licence holder to ensure that there is no unfair cross-subsidy as between the Network Business and any other business or activity of the licence holder or its affiliates (unless the Regulator determines otherwise) and to maintain separate accounting records for the Network Business.

6. Proposed modification: Condition 27 (Corporate Governance)

Reasons for the proposed modification

- 6.1 Network Rail's acquisition of Railtrack is intended to bring more effective management to the rail network. In the absence of shareholders, the Regulator considers it important that the licence holder's board is properly and transparently accountable for the decisions it makes on a day-to-day basis. He also wishes to ensure that important decisions are not influenced by the interests of other companies in the Network Rail group.
- 6.2 In order to achieve this, the Regulator considers that it is necessary, by way of a licence condition, that the licence holder complies with specified principles of good corporate governance. He believes that the measures contained in the proposed new Condition 27 meet this purpose and will ensure that decision-making is transparent and effective.

Effect of the proposed modification

- 6.3 The proposed condition is set out at Annex D. It will require the licence holder to:
- (a) comply with Principles of Good Governance and Code of Best Practice (or any successor document) as approved for the purposes of the Listing Rules of the UK Listing Authority;
 - (b) publish such information on its activities as would be required if it were a listed company (this particular requirement is contained in Condition 15, set out at Annex B);
 - (c) maintain a majority of non-executive directors on the board, at least two of whom must have substantial relevant railway industry experience; and
 - (d) conduct itself as if it were independent from any other company in the Network Rail group.

7. Proposed modification: Condition 28 (Management Incentive Plan)

Reasons for the proposed modification

- 7.1 In a company limited by guarantee, such as Network Rail, it is essential that the personal incentives to improve efficiency, to deliver contractual commitments to customers, and to meet regulatory targets for outputs, should be no less effective than in a more conventional corporate structure with equity shareholders. It is not clear that members without a direct financial interest in Network Rail will fully replicate the pressures provided by shareholders. Lenders, for their part, are concerned to ensure that the company does not become insolvent, not that managers maximise operating surpluses. Indeed, they will prefer the management to avoid any risk which could compromise their investment and, in the absence of other controls, this could stifle innovation.
- 7.2 Given the absence of those pressures which would apply in a more conventional corporate structure, some other mechanism is required in order to incentivise management to meet the reasonable requirements of customers and funders. The Regulator believes it is appropriate that the network licence should be modified to ensure that the executive directors of Network Rail have appropriate incentives and that a high proportion of their bonuses should be contingent on achieving customer objectives.
- 7.3 The Regulator wants as far as possible to ensure that annual remuneration will be determined by the same factors that affect returns available to shareholders under the equity model. In particular, he considers that it is essential for the management to be incentivised in relation to their long-term stewardship role as well as the short-term performance of the network.
- 7.4 The proposed Condition 28 is intended to achieve this purpose.

Effect of the proposed modification

- 7.5 The proposed condition is set out at Annex E. It will require that the licence holder has a Management Incentive Plan which:
- (a) is sent to the Regulator and published on an annual basis; and

- (b) has regard to its achievement of certain regulatory and contractual outputs as reflected, for example, in the Regulator's annual statement on Network Rail's stewardship of the network.

8. Additional minor proposed modifications to network licence

Reasons for the proposed modifications

8.1 The Regulator proposes to make a number of minor technical amendments to the network licence because:

- (a) where the licence currently refers to Railtrack or Railtrack Group PLC, it should be modified to reflect the change in ownership;
- (b) it is necessary to reflect the changes introduced by the Transport Act 2000 in the licence;
- (c) the Regulator believes it is helpful to clarify that the provisions of the Interpretation Act 1978 apply to the whole of the licence;
- (d) new definitions of “Network Business” and “Permitted Non-Network Business” are required, in the context of the ring-fencing provisions in the modified Condition 12 of the network licence, to clarify the scope of the licence holder’s Permitted Business;
- (e) the Regulator believes it is helpful to clarify that terms and expressions defined in the Railways Act 1993 shall have the same meaning throughout the licence, unless specified otherwise; and
- (f) it is necessary to correct a small typographical error.

Effect of the proposed modifications

8.2 The proposed minor modifications to the network licence are set out at Annex F. The effect of the proposed modifications will be to:

- (a) replace references to Railtrack and Railtrack Group PLC with language to reflect the new ownership of the licence holder;
- (b) clarify that the licence holder has obligations towards the SRA rather than “the Franchising Director” in Condition 6;

- (c) widen the licence holder's obligations to London Regional Transport in Condition 14 to include the Mayor of London and Transport *for* London;
- (d) in Part II of the network licence, provide clarity that, in respect of the whole of the licence, the provisions of the Interpretation Act 1978 apply, and that terms and expressions defined in the Railways Act 1993 shall, unless the contrary intention appears, have the same meanings in the licence;
- (e) amend the definitions of "Network Business" and "Permitted Non-Network Business", in Part II of the network licence so as to exclude the exploitation of land from Permitted Business; and
- (f) correct a minor typographical error in Condition 20 (Systems Code).

Annex A: Text of proposed modification to Condition 6 (Safety and Standards)

Condition 6: Safety and Standards

The Safety Activity

1. For the purposes of this Condition, Independent Railway Safety Activity means:
 - (a) the provision of advice to the Health and Safety Executive, the Regulator, the licence holder and stakeholders in respect of matters relating to safety of the operation and use of the licence holder's network;
 - (b) the activities in relation to the Railway Group Standards Code specified in this Condition;
 - (c) the discharge of any statutory obligation in relation to safety imposed on or in respect of any person carrying on the Independent Railway Safety Activity by or under the relevant statutory provisions or any Community obligation;
 - (d) the maintenance of any records (including databases) previously maintained by the Safety and Standards Directorate of the licence holder in respect of safety information relevant to the operation and use of the licence holder's network; and
 - (e) the promotion of research and development, of training and of the provision of information in each case in relation to all aspects of safety relevant to the provision of railway services on or relating to the licence holder's network,and such other safety related activities as the Regulator may, after consulting the licence holder, IRSA (as hereinafter defined) and the Health and Safety Executive, specify by notice.

IRSA

2. The licence holder shall procure that:
 - (a) the ultimate holding company (as defined in paragraph 22 of Condition 12) of the licence holder shall prior to the effective date establish and maintain a wholly owned subsidiary limited by guarantee (such subsidiary being referred

to in this condition as “IRSA”) for the purpose of carrying on the Independent Railway Safety Activity;

- (b) IRSA shall at all times comply with the requirements of paragraphs 4 and 5;
- (c) the licence holder can ensure that its affiliates comply with the provisions of sub-paragraphs (a) and (b) and with the relevant provisions of paragraphs 4 and 5.

3. The licence holder shall:

- (a) on the effective date transfer or make available to IRSA all assets previously held or used by the licence holder’s Safety and Standards Directorate which are necessary or expedient to enable IRSA to perform the Independent Railway Safety Activity from that date; and
- (b) at all times ensure that IRSA shall have funds which are sufficient for the proper carrying out of its functions.

4. The requirements of this paragraph are that:

- (a) IRSA shall have no commercial functions or responsibilities except to the extent that they are necessary for the performance of any activity specified in paragraph 1 or have been approved by the Regulator;
- (b) IRSA shall be provided with, or have made available to it, sufficient suitably qualified and experienced personnel to enable it to perform its functions;
- (c) except with the written approval of the Regulator and in accordance with the conditions of that approval, no relevant employee shall have a disqualifying interest;
- (d) the chairman and chief executive of IRSA shall be timeously provided with copies of relevant papers provided to the board of directors of the licence holder and of any of its affiliates which are relevant to the functions of IRSA save that the entitlement shall not extend to such documents or parts of documents which the licence holder or the affiliate concerned, as the case may be, could not be compelled to produce or give in evidence in civil proceedings in any court;

- (e) the chairman and chief executive of IRSA or (in either case) a duly appointed nominee shall be given due notice of and have the right to attend and speak at any meeting of the board of directors of the licence holder or of any of its affiliates which considers any safety matter, within the Independent Railway Safety Activity (save in relation to matters within paragraph 6(d)); and
- (f) IRSA shall maintain a list (approved by the Regulator) of stakeholders and bodies which are representative of stakeholders, with such list indicating which of the persons on the list shall be consulted as required under paragraphs 5(a), 7(d) and 9(b)(i).

Directors of IRSA

5. The requirements of this paragraph are that:

- (a) before any person is appointed to be a director of IRSA, the Regulator and bodies which are representative of stakeholders are consulted and, in relation to the directors on the effective date, have been consulted prior to the effective date in relation to their appointment;
- (b) there shall be not more than eleven directors at any time of IRSA of whom eight shall be non-executive directors and not more than one non-executive director shall be a person who has at any time within two years prior to the date of appointment as a director been an employee of the licence holder or any of its affiliates provided that, during any period in, or at any meeting at, which there shall not be a majority of non-executive directors, there shall be allocated to the chairman such additional votes as shall be necessary to enable the aggregate of the votes of the non-executive directors to constitute a majority;
- (c) persons who are appointed to be non-executive directors of IRSA shall be so far as is reasonably practicable persons who collectively have appropriate practical experience in relation to the functions of IRSA including experience of the business of any one or more of passenger train operation, freight train operation, rolling stock leasing, rolling stock manufacturing, infrastructure maintenance and repair and other relevant railway activities of stakeholders and persons having extensive current experience of the management of safety;
- (d) the person appointed to be chairman of IRSA and four other non-executive directors shall have extensive current knowledge or experience of the

management of safety and, unless otherwise agreed by the Regulator after consultation with the Health and Safety Executive, shall not have within two years prior to the date of appointment as chairman or non-executive director, as the case may be, been an employee of the licence holder or any of its affiliates, holder of a licence granted under section 8 of the Act, franchisee or franchise operator (as those terms are defined in section 23 of the Act), rolling stock leasing company, rolling stock manufacturer or railway infrastructure maintenance or repair company carrying on business in Great Britain or providing goods for use on the licence holder's network;

- (e) the person appointed to be chief executive of IRSA shall have extensive current experience of the management of safety and current knowledge of the operation of railways and shall not, for such period as he shall be chief executive, be a director of the licence holder or of any of its affiliates;
- (f) each non-executive director shall be appointed as director for a fixed term not exceeding three years but shall be capable of being reappointed and three of the non-executive directors shall be representative of the railway industry; and
- (g) the arrangements for the taking of decisions at the board of IRSA shall be such as to avoid or neutralise conflicts, or potential conflicts, of interests.

Agreement with IRSA

6. The licence holder shall:

- (a) procure that before IRSA starts to carry out any functions, IRSA and the ultimate holding company of the licence holder enter into a legally binding agreement ("the agreement"), approved by the Regulator, with the licence holder, respectively to comply and secure compliance by IRSA with paragraphs 7-13 of this Condition;
- (b) promptly notify the Regulator of any breach of any obligation under the agreement;
- (c) not waive any right of the licence holder under the agreement without and in accordance with any conditions contained in the written consent of the Regulator; and
- (d) enforce the obligations of IRSA and the ultimate holding company of the licence holder under the agreement whenever required, or whenever so

directed by the Regulator by notice, and in accordance with the terms of the direction.

Railway Group Standards Code

7. IRSA shall:
- (a) exercise the rights and perform the functions which were, before the effective date, exercised and performed by the Safety and Standards Directorate under the Railway Group Standards Code so far as comprising the Independent Railway Safety Activity;
 - (b) cause the Railway Group Standards Code to be amended to reflect the effect of sub-paragraph (a);
 - (c) comply with the provisions of that code as revised from time to time with the approval of the Regulator; and
 - (d) from time to time or when so directed by the Regulator and in consultation with bodies which are representative of stakeholders review the provisions of that code and its implementation and propose for the approval of the Regulator any revision thereto which may be necessary or appropriate having regard to the provisions of paragraph 8.

Purposes

8. The Railway Group Standards Code shall be a code whose purpose is to establish standards (and the procedures for modifying those standards) compliance with which will contribute significantly to the safe operation of the licence holder's network and the safe operation and interworking of railway assets used or to be used on or in connection with the licence holder's network ("the Purpose") having due regard to the need:
- (a) to promote the use and development of the licence holder's network;
 - (b) to promote efficiency and economy on the part of the licence holder and other persons providing services relating to railways on or in connection with the licence holder's network;
 - (c) to promote competition in the provision of such services for the benefit of users of railway services;

- (d) to impose on the licence holder and other persons providing such services restrictions which are proportionate to the achievement of the Purpose; and
- (e) to enable the licence holder and such other persons to plan the future of their businesses with a reasonable degree of assurance.

Contents

- 9. The Railway Group Standards Code shall be a code approved by the Regulator which shall:
 - (a) authorise the Railway Group Standards in force from time to time;
 - (b) establish a set of procedures for the grant or refusal of relevant authorisations which:
 - (i) provide for a fair and balanced representation and participation in such procedures by experienced and competent persons from all classes of stakeholders likely to be materially affected;
 - (ii) provide for proposals for relevant authorisations to be fully and fairly considered (other than any which are trivial or vexatious), and for full and proper consultation with the Health and Safety Executive;
 - (iii) provide an accelerated procedure for the grant of relevant authorisations in specified circumstances;
 - (iv) provide for the recovery of a fair proportion of the costs of any determination whether or not to grant a relevant authorisation from any stakeholder which has proposed such authorisation, whether or not the proposal in question shall have been successful; and
 - (v) provide for any stakeholder aggrieved in any material respect by a decision of IRSA to have the matter reconsidered by the board of directors of IRSA and thereafter, if dissatisfied with the results of such reconsideration, to have the matter referred to the Regulator for determination after consultation with the Health and Safety Executive;
 - (c) require IRSA, where there are reasonable grounds for considering that a relevant authorisation is necessary or expedient, to propose such action and

pursue it in accordance with the procedures referred to in sub-paragraph (b);
and

- (d) provide that the Railway Group Standards Code issued by the licence holder and in force prior to the modification of this Condition shall have effect for the purpose of this Condition until approved (whether or not after amendment) by the Regulator.

Publication

10. IRSA shall:

- (a) publish the Railway Group Standards Code and any modifications thereto in such form or manner and with such frequency as the Regulator may require;
- (b) provide a copy of the Railway Group Standards Code and any modification thereto to every licence holder, the Authority, the Health and Safety Executive and the Regulator;
- (c) publish a catalogue of current Railway Group Standards; and
- (d) provide a copy of the Railway Group Standards Code and any Railway Group Standard or proposed Railway Group Standard and of the catalogue referred to in sub-paragraph (c) to any person requesting a copy. IRSA may charge for the provision of copies under this sub-paragraph provided that such charge shall not exceed an amount which in the opinion of the Regulator is reasonable.

Assistance for stakeholders

11. IRSA shall establish, maintain and operate such procedures as shall be sufficient to ensure that any stakeholder which has applied to IRSA for the purposes of this paragraph shall be provided with such information, advice and assistance (excluding training) as may reasonably be required to determine the application of any Railway Group Standard to that stakeholder or to railway assets of which it is or proposes to be the operator or which it provides or proposes to provide for use on or in connection with the licence holder's network. IRSA may charge a fee for any such information, advice or assistance. Any such fee shall not exceed an amount which, in the opinion of the Regulator, is reasonable.

Annual report

12. IRSA shall, as soon as practicable after the end of each period of 12 months ending on 31 March, make to the Regulator and the Health and Safety Executive and publish a report on its activities in respect of the Independent Railway Safety Activity during that period, including a general survey of developments during that period in relation to safety on and in connection with the operation of the licence holder's network and the stations and depots served by that network.

Information

13. IRSA shall provide to the Regulator such information relating to its activities in respect of the Independent Railway Safety Activity as the Regulator may reasonably require for the purpose of carrying out any of his functions under Part I of the Act other than any information:
 - (a) for any purpose referred to in section 58 of the Act which it could not be compelled to provide under that section; or
 - (b) which it could not be compelled to produce or to give in evidence in civil proceedings in any court.

Records of compliance

14. The licence holder shall maintain such records concerning compliance with its obligations under this Condition as the Regulator may require.

Railway Group Standards

15. The licence holder shall comply with such Railway Group Standards or parts of such standards which are applicable to licensed activities.

Interpretation

16. In this Condition:

“all employee share scheme”

means any Inland Revenue approved employee share scheme established by a company under which it is a condition of such approval that participation is offered generally to all employees of the company and its participating subsidiaries or to all such employees fulfilling conditions as to length of service;

| | |
|--------------------------------------|--|
| “benefit” | includes any payment, profit, gain or advantage however expressed, established, given or made; |
| “disqualifying interest” | means an interest in any benefit which concerns or is determined by reference to the commercial activities or affairs of any person engaged in or likely to be engaged in the provision of services relating to railways but shall not include an entitlement to participate in an all employee share scheme established by any such person; |
| “effective date” | means 1 January 2001, or such other date as agreed with the Regulator; |
| “interest” | in relation to a benefit, includes the possession, receipt or expectation of or entitlement to an interest; |
| “Railway Group Standards” | means: <ul style="list-style-type: none">(i) technical standards with which railway assets or equipment used on or as part of railway assets must conform; and(ii) operating procedures with which the operators of railway assets must comply; |
| “relevant authorisation” | means authorisation of a new Railway Group Standard or the modification or abolition of an existing Railway Group Standard; |
| “relevant employee” | In relation to IRSA means: <ul style="list-style-type: none">(i) every director of the company and every other person who has decisive authority in respect of any aspect of IRSA’s activities (whether or not an employee of IRSA); and(ii) the spouse, partner and dependent children of any such person; |
| “relevant infrastructure controller” | has the meaning given by the Railways (Safety Case) Regulations 2000; |
| “relevant statutory provisions” | has the meaning given by Part I of the Health and Safety at Work etc Act 1974; |

| | |
|---------------------------------|---|
| “safety case” | has the meaning given by the Railways (Safety Case) Regulations 2000; |
| “services relating to railways” | has the meaning given by section 67(3ZA) of the Railways Act 1993; |
| “stakeholder” | means: <ul style="list-style-type: none">(i) any person having a safety case in respect of which the licence holder is the relevant infrastructure controller;(ii) any funder (having the meaning given in Condition 7 of this licence); and(iii) any person whose business activities or any goods which he manufactures must comply with Railway Group Standards; and |
| “subsidiary” | has the meaning given to it in section 736 of the Companies Act 1985. |

Annex B: Text of proposed modifications to Condition 7 (Stewardship of the licence holder's network) and Condition 15 (Provision of information to the Regulator and the Authority)

Condition 7: Stewardship of the licence holder's network

1. Purpose

The purpose is to secure—

- (a) the operation and maintenance of the network;
- (b) the renewal and replacement of the network; and
- (c) the improvement, enhancement and development of the network,

in each case in accordance with best practice and in a timely, efficient and economical manner so as to satisfy the reasonable requirements of persons providing services relating to railways and funders in respect of the quality and capability of the network.

2. General duty

The licence holder shall take such steps as are necessary or expedient so as to achieve the purpose to the greatest extent reasonably practicable having regard to all relevant circumstances including the ability of the licence holder to finance its licensed activities.

3. Criteria

3.1 The licence holder shall develop and publish the criteria which it will apply to comply with the duty including its method of determining the priority and timing of different types of work, the parts of the network on which it will be carried out and the basis for reviewing such priority.

3.2 The criteria provided for in paragraph 3.1 shall be published—

- (a) on such date as the Regulator shall specify after consultation with the licence holder; and

(b) in any event not later than 31 March 2003.

3.3 The licence holder shall from time to time—

(a) review the criteria to determine whether they are sufficient to comply with the duty; and

(b) revise the criteria so as to make them sufficient to comply with the duty,

and shall publish any such criteria.

4. *Annual business plan*

4.1 The licence holder shall prepare, provide to the Regulator and publish a business plan in respect of the next following ten years.

4.2 The business plan shall—

(a) be provided to the Regulator and be published no later than 31 March in each year or such other date as the Regulator may, after consulting the licence holder, specify;

(b) be prepared in such level of detail, in such format and structure, to such standard and in respect of such periods (within the ten-year period to which the business plan relates) as the Regulator shall by notice to the licence holder specify so as to enable—

(i) providers and potential providers of services relating to railways to plan their businesses; and

(ii) funders and potential funders of services relating to railways to plan their future financial and service requirements

in each case with a reasonable degree of assurance.

4.3 No notice of the Regulator under paragraph 4.2(b) shall be effective unless—

(a) it is given on or before 15 December in the year before the year in which the business plan is to be published; and

(b) the Regulator has first consulted the licence holder and taken into consideration any representations or objections timeously made and not withdrawn.

- 4.4 A notice given by the Regulator under paragraph 4.2(b) may specify different levels of detail, different standards and different periods in respect of different parts or aspects of the business plan.
- 4.5 If the Regulator has not given a notice under paragraph 4.2(b) in respect of any year, the notice last given under that paragraph shall apply to that year.
- 4.6 The licence holder shall be excused from the obligation to publish any part of the business plan to the extent that the Regulator—
- (a) is satisfied, after consultation with the licence holder, that publication would or might seriously and prejudicially affect the interests of the licence holder or any other person; and
 - (b) gives notice to the licence holder to that effect.

5. *Contents of business plan*

The business plan shall demonstrate the way in which the licence holder expects to carry out the duty and satisfy the criteria. In that respect and without prejudice to the generality of paragraph 4.2(b), the business plan shall include—

- (a) an explanation of how the licence holder will carry out its relevant activities, including details in respect of each relevant asset category as to—
 - (i) policies and practices for the carrying out of relevant activities;
 - (ii) policies and practices in relation to the resourcing of the carrying out of relevant activities;
 - (iii) policies and practices for acquiring and improving information about relevant activities, including the costs of carrying them out;
 - (iv) an assessment of the extent to which improvements may reasonably be made to such policies and practices;
- (b) projections of future network quality and capability requirements;
- (c) planned activities and volumes of work in respect of the carrying out of—
 - (i) relevant activities; and

- (ii) network services in relation to the licence holder's network to be carried out by any other person;
- (d) the expected effect of relevant activities on the quality and capability of the network, the quality of network services and the ability of users to provide improved services to their customers;
- (e) the expected effect of relevant activities on the outputs required of the licence holder and established in the last access charges review;
- (f) a plan for identifying and managing the material risks which are likely to be faced in carrying out relevant activities;
- (g) a statement of the licence holder's expected expenditure in carrying out relevant activities in the format used by the Regulator in that respect in the last access charges review;
- (h) forecasts of cashflow, profit and loss and balance sheets, prepared on a monthly basis for the first year, quarterly for the second year and on an annual basis for the remaining eight years, in the same format as required in the Regulatory Accounting Guidelines established under Condition 22;
- (i) the steps which the licence holder plans to take to secure the necessary finance to enable it to carry out the relevant activities, including details of the licence holder's—
 - (i) existing and planned borrowings; and
 - (ii) liquidity management and hedging policies;
- (j) the licence holder's processes for making decisions in relation to the carrying out of relevant activities;
- (k) a statement of the material changes to the business plan compared with the business plan for the immediately preceding year;
- (l) such further information as the Regulator may by notice to the licence holder require.

6. *Consultation*

The licence holder shall consult persons providing, or potential providers of, services for or in connection with services relating to railways and funders regarding their present and future proposals in the provision of such services relating to railways.

7. *Records*

The licence holder shall maintain adequate information as to the actions it has taken to comply with its obligations under this Condition.

8. *Interpretation*

In this Condition—

“business plan” means the plan provided for in paragraph 5;

“criteria” means the criteria referred to in paragraph 3;

“duty” means the duty set out in paragraph 2;

“funder” means the Strategic Rail Authority, each Passenger Transport Executive and any local, national or supra-national authority or agency (whether of the United Kingdom or the European Union) or other person who provides money by way of grant or loan with the primary purpose of securing the provision of services relating to railways;

“network” includes, where the licence holder has any estate or interest in, or right over a station or light maintenance depot, such station or light maintenance depot;

“the purpose” means the purpose set out in paragraph 1;

“relevant activities” means the activities which are necessary or expedient in order to carry out the duty; and

“relevant asset categories” means track, signalling and telecommunications, structures, electrification equipment, stations, maintenance depots, real and heritable property, information systems and such other categories of material asset as are necessary or expedient so as to facilitate compliance by the licence holder with the duty.

Condition 15: Provision of information to the Regulator and the Authority

1. Subject to paragraphs 3 and 4, the licence holder shall furnish to the Regulator and the Authority such information as the Regulator may reasonably require for the purpose of carrying out any of his functions under Part I of the Act, or the Authority may reasonably require for the purpose of carrying out any of its functions which relate to consumer protection conditions as defined in section 7A of the Act.
2. Information required to be furnished under this Condition shall be furnished in such form and manner and at such times as the Regulator or the Authority may reasonably require.
3. This Condition shall not require the licence holder to furnish to the Regulator or the Authority information for the purposes of any function of the Regulator under sections 69 and 71 of the Act, or any function of the Authority under section 71A of the Act.
4. Neither this Condition nor any other Condition shall require the licence holder to produce any documents or to furnish any information:
 - (a) for any purpose referred to in section 58 of the Act which it could not be compelled to produce or furnish under that section; or
 - (b) which it could not be compelled to produce or to give in evidence in civil proceedings in any court.
5. Subject to paragraph 4, nothing in this Condition shall prejudice any right of the Regulator or the Authority to require information under or pursuant to any other Condition. The right of the Regulator or the Authority to require information pursuant to this Condition shall not be affected by any right to require information under or pursuant to any other Condition.
6. Without prejudice to the generality of the preceding paragraphs of this Condition, the licence holder shall prepare on an annual basis and provide to the Regulator an annual return in a form previously approved by the Regulator which shall (without limitation) include:
 - (a) the regulatory financial statements prepared pursuant to Condition 22;
 - (b) a statement in a form compatible with the business plan published in the preceding year under paragraph 4 of Condition 7 (“the preceding year’s

business plan”) setting out in respect of the year ending on 31 March of that year:

- (i) the works carried out by it during the year;
 - (ii) the extent to which it has carried out the work set out in the preceding year’s business plan;
 - (iii) to the extent that it has not carried out those works or has done so in a materially different way from that set out in the preceding year’s business plan, the reasons therefor;
 - (iv) the extent to which the works referred to in subparagraph (i) have achieved the aims set out in the preceding year’s business plan; and
 - (v) to the extent that such works have not achieved those aims, the reasons therefor and the steps that the licence holder proposes to take to remedy such failure.
- (c) information in relation to enhancements and their logging up which may from time to time be required to be prepared and published pursuant to paragraph 4 of Condition 22;
- (d) any statistical and other data specified by the Regulator for the purpose of monitoring outcomes against the assumptions underlying the charges set by the Regulator; and
- (e) any statistical and other data specified by the Regulator.

7. The licence holder shall, at such times and in such ways as would, generally applied, from time to time be required by the listing rules of the Financial Services Authority, publish such information as is by those rules required to be announced by a company whose ordinary shares are for the time being admitted to the Official List of the UK Listing Authority. This obligation is without prejudice to paragraph 6 of this Condition.

8.1 The annual return referred to in paragraph 6 shall be provided to the Regulator as soon as reasonably practicable and in any event not later than 1 July following the end of the financial year to which it relates (or a later date approved by the Regulator).

- 8.2 Within one calendar month of delivery to the Regulator, subject to any modification (including deletions on the grounds of confidentiality) approved by the Regulator, it shall be made available to any member of the public on request.
- 8.3 The obligation in paragraph 8.2 to make the annual return available to any member of the public on request shall not apply in respect of information in the annual return to the extent that:
- (a) the information relates to material in the preceding year's business plan; and
 - (b) as a result of the application of paragraph 4.6 of Condition 7, that material was not published.
9. Without prejudice to the generality of the preceding paragraphs of this Condition, the licence holder shall prepare monthly returns in a form approved by the Regulator to be provided to the Regulator as soon as reasonably practicable and in any event not later than 14 days after the end of the month to which the information relates (or a later date approved by the Regulator).

Annex C: Text of proposed modifications to Condition 12 (Ring-fencing and accounting records) and Condition 11 (Prohibition of cross-subsidy)

Condition 11: Prohibition of cross-subsidy

1. The licence holder shall, except in so far as the Regulator may otherwise determine:
 - (a) not give any unfair cross-subsidy to, nor receive any unfair cross-subsidy from, any affiliate or related undertaking of the licence holder; and
 - (b) ensure that there is no unfair cross-subsidy as between the Network Business and any other business or activity of the licence holder or its affiliates.
2. The licence holder shall:
 - (a) maintain accounting records for the Network Business which are separate from those of the other businesses and activities of the licence holder and its affiliates; and
 - (b) maintain such other accounting records as the Regulator may reasonably require for the purpose of monitoring compliance with this Condition.

Any accounting records maintained pursuant to this paragraph shall comply with such accounting policies as the Regulator may reasonably require. The licence holder shall, when the Regulator so requires, allow such records and information to be audited (at the expense of the licence holder) by a person approved by the Regulator for the purpose of assessing compliance with this Condition.

3. In this Condition, "unfair cross-subsidy" shall not include investment capital provided by the licence holder for any new enterprise or project which does not or is not likely to have an initial rate of return at normal commercial levels.
4. This Condition shall not apply to any access charge.
5. Nothing which the licence holder is required to do or not do pursuant to this licence (apart from this Condition 11), or pursuant to any enactment shall be regarded as cross-subsidy for the purposes of this Condition.

Condition 12: Ring-fencing

Restriction of activities and financial ring-fence

1. Subject to paragraphs 3, 4 and 5, except with the written consent of the Regulator, the licence holder shall not, and shall procure that its subsidiary undertakings shall not, conduct any business or carry on any activity other than the Permitted Business.
2. The licence holder shall not acquire or retain, without the written consent of the Regulator, shares in any related undertaking after the relevant date except:
 - (a) shares in any body corporate which is a subsidiary of the licence holder, such shares having been acquired or retained only for a permitted purpose;
 - (b) shares in a body corporate which conducts business only for a permitted purpose; and
 - (c) investments acquired in the usual and ordinary course of the licence holder's treasury management operations, subject to the licence holder maintaining in force, in relation to those operations, a system of internal controls which complies with best corporate governance practice as required (or, in the absence of any such requirement, recommended) from time to time for a company whose ordinary shares are for the time being admitted to the Official List of the UK Listing Authority.
- 3.1 The licence holder shall use reasonable endeavours to cease to conduct or carry on any such business or activity prohibited by paragraph 1 of this Condition which it was conducting or carrying on at the acquisition date.
- 3.2 The licence holder shall submit to the Regulator by 30 June in each year a report setting out details of the endeavours it has made to cease to conduct or carry on such business or activity in the period of twelve months ending on the preceding 31 March, provided that for so long as the licence holder is making such reasonable endeavours, it may continue to conduct any such business or carry on any such activity.
- 3.3 The obligations in paragraphs 3.1 and 3.2 shall not apply to discrete projects consisting of the exploitation of land (which includes the disposal of land within the meaning of Condition 26) carried on at or before the acquisition date so long as, in respect of each such project, at the acquisition date:
 - (a) the works carried out are substantially in progress or have been completed; or

- (b) the licence holder is subject to a legally binding obligation substantially to carry out the works or to complete the works.

4. Nothing in this Condition shall prevent:

- (a) any affiliate in which the licence holder does not hold shares or any other investment from conducting any business or carrying on any activity;
- (b) the licence holder from holding shares as, or performing the supervisory or management functions of, an investor in respect of any body corporate in which it holds an interest consistently with the provisions of the licence;
- (c) the licence holder from performing the supervisory or management functions of a holding company in respect of any subsidiary in which it holds an interest consistently with provisions of the licence;
- (d) the licence holder from carrying on any business or conducting any activity to which the Regulator has given his consent in writing.

5.1 Where the Regulator has not given his consent under paragraph 1, paragraph 2 or paragraph 4(d), the licence holder and any subsidiary of the licence holder shall, notwithstanding paragraphs 1 to 3, be entitled to conduct any business and to carry on any activity which is not for a permitted purpose (in this paragraph “relevant other business”) as long as such relevant other business is *de minimis* business, is not and does not involve the disposal of land, and does not infringe any condition of any consent given by the Regulator under this licence.

5.2 The relevant other business will be “*de minimis* business” if the aggregate amount of all investments (determined in accordance with sub-paragraph 5.3 below) made by the licence holder or any of its subsidiaries in all the relevant other business does not exceed, in the year commencing with the acquisition date or in any single year commencing with the anniversary of the acquisition date, £100 million.

5.3 For the purpose of paragraph 5.2, “investment” means any form of expenditure or commitment to spend (whether of a capital or revenue nature) or liability (whether present, future, actual or contingent, each contingent liability being valued at the best estimate of the value of the liability that may result multiplied by the best estimate of the probability that it will result), including any liability pursuant to any guarantee or indemnity.

- 5.4 The Regulator may in writing designate any business or activity as not being a *de minimis* business for the purpose of the limitations in this paragraph 5. Such designation may be subject to conditions.

Ring-fence: prohibition on cross-default, encumbrances and intra-group transactions

- 6.1 From the relevant date, the licence holder shall not without the written consent of the Regulator:

- (a) enter into an agreement or arrangement incorporating a cross-default obligation; or
- (b) continue or permit to remain in effect any agreement or arrangement incorporating a cross-default obligation subsisting on the relevant date save that any cross-default obligation in existence at that date may remain in effect for so long as and provided that the cross-default obligation is solely referable to an arrangement or agreement entered into prior to the relevant date and the terms on which that loan or those facilities have been made available or of that agreement or arrangement as subsisting on that date are not materially varied to the detriment of the licence holder or otherwise made more onerous or, where there is such material variation of those terms, such change is outside the licence holder's effective control.

- 6.2 Paragraph 6.1 shall not prevent the licence holder from giving any guarantee permitted by and in compliance with the requirements of paragraph 7(a)(i) of this Condition.

7. Save with the written consent of the Regulator, the licence holder shall not after the relevant date:

- (a) create or continue or permit to remain in effect any mortgage, charge, pledge, lien or other form of security or encumbrance whatsoever, undertake any indebtedness to any other person or guarantee any liability or obligation of another person other than:
 - (i) on an arm's length basis, on normal commercial terms, for a permitted purpose and (where relevant) in accordance with Condition 26; or
 - (ii) indebtedness incurred by the licence holder to the Authority;

- (b) transfer, lease, license or lend any sum or sums, asset, right or benefit to any affiliate of the licence holder otherwise than by way of:
 - (i) a dividend or other distribution out of distributable reserves, subject to paragraph 20;
 - (ii) repayment of capital;
 - (iii) payment properly due for any goods, services or assets provided on an arm's length basis and on normal commercial terms;
 - (iv) a transfer, lease, licence or loan of any sum or sums, asset, right or benefit on an arm's length basis and on normal commercial terms;
 - (v) repayment of any loan or payment of any interest on a loan not prohibited by paragraph 7(a)(i);
 - (vi) payments for the surrender of group corporation tax relief on a basis not exceeding the value of the benefit received; or
 - (vii) an acquisition of shares in conformity with the restriction on the acquisition of shares set out in this licence, made on an arm's length basis and in accordance with normal commercial terms,

and provided always that (where relevant) such transfer, lease, licence or loan is made in accordance with Condition 26.

Sufficiency of resources

8. The licence holder shall at all times act in a manner calculated to secure that it has sufficient management resources, financial resources and financial facilities to enable it to carry on the Permitted Business and to comply with its obligations under the Act and this licence.
9. On the date 45 days after the acquisition date or (if later) the date on which this Condition comes into force and thereafter at the same time as the licence holder provides to the Regulator the business plan required under Condition 7, the licence holder shall send to the Regulator a certificate as to the adequacy (or otherwise) of its management resources and financial resources and facilities for the period of 18 months commencing on the date of the certificate. Each certificate shall be approved

by a resolution of the board of directors of the licence holder and signed by a director of the licence holder pursuant to that resolution.

10. Each certificate shall be in one of the following terms:

(a) “After making enquiries, and subject to the outcome of any access charges review which is due to be concluded within the 18 month period referred to in this certificate, the directors of the licence holder have a reasonable expectation that the licence holder will have available to it, after taking into account in particular, but without limitation:

- (i) any dividend or other distribution, loan repayments or other sums due which might reasonably be expected to be declared or paid;
- (ii) any mortgage, charge, pledge, lien or other form of security or other encumbrance; and
- (iii) any indebtedness or guarantee,

sufficient management resources and financial resources and financial facilities to enable the licence holder to carry on the activities authorised by its network licence in accordance with its obligations under the Act and under its network licence for the period of 18 months referred to in this certificate.”

(b) “After making enquiries, and subject to the outcome of any access charges review which is due to be concluded within the 18 month period referred to in this certificate, the directors of the licence holder have a reasonable expectation, subject to the factors set out below, that the licence holder will have available to it, after taking into account in particular, but without limitation:

- (i) any dividend or other distribution, loan repayments or other sums due which might reasonably be expected to be declared or paid;
- (ii) any mortgage, charge, pledge, lien, or other form of security or other encumbrance; and
- (iii) any indebtedness or guarantee,

sufficient management resources and financial resources and financial facilities to enable the licence holder to carry on the activities authorised by its network

licence in accordance with its obligations under the Act and under its network licence for the period of 18 months referred to in this certificate. However, they would like to draw attention to the following factors which may cast doubt on the ability of the licence holder to carry on the activities authorised by its network licence as aforesaid.”

- (c) “In the opinion of the directors of the licence holder, the licence holder will not have available to it sufficient management resources and financial resources and financial facilities to enable the licence holder to carry on the activities authorised by its network licence in accordance with its obligations under the Act and under its network licence for the period of 18 months referred to in this certificate.”
11. The licence holder shall submit to the Regulator with that certificate a statement of the main factors which the directors of the licence holder have taken into account in giving that certificate. In the case of a certificate of the kind contemplated by paragraph 10(b) of this Condition, the licence holder shall also submit with the certificate a description of the factors which may cast doubt on the ability of the licence holder to carry on the activities authorised by this licence as specified therein.
12. The licence holder shall -
- (a) notify the Regulator in writing immediately if its directors become aware of any circumstance that causes them no longer to have the reasonable expectation expressed in the certificate in the terms set out in paragraph 10(a) or 10(b) of this Condition; and
 - (b) subject to complying, as if it were a company whose ordinary shares are for the time being admitted to the Official List of the UK Listing Authority, with the listing rules of the Financial Services Authority acting in its capacity as a competent authority for the purposes of Part VI of the Financial Services and Markets Act 2000, publish its notification to the Regulator in such form and manner as the Regulator may direct.
13. Save in so far as they relate to management resources, the licence holder shall use its best endeavours to obtain and submit to the Regulator with each certificate provided for in paragraph 10 of this Condition a report prepared by its Auditor and addressed to the Regulator stating whether or not the Auditor is aware of any inconsistencies between, on the one hand, that certificate and the statement submitted with it and, on the other hand, any information which he obtained during his audit work.

Ring-fence: credit rating

14. The licence holder shall use all reasonable endeavours to ensure that the licence holder as issuer of any corporate debt maintains at all times an issuer credit rating which is an investment grade rating.
15. For the purpose of paragraph 14 of this Condition “investment grade rating” means a rating recognised as investment grade by Standard and Poor’s Rating Group (or any of its subsidiaries), by Moody’s Investors Service Inc. (or any of its subsidiaries) or by Fitch Ratings Limited (or any of its subsidiaries) or by any other reputable credit rating agency which, in the Regulator’s opinion, notified in writing to the licence holder, has comparable standing in the United Kingdom and the United States of America.

Undertakings from ultimate holding company

16. *Undertaking not to put the licence holder in breach:*
 - 16.1 The licence holder shall, unless the Regulator otherwise consents, procure from each company and any other person which is at any time an ultimate holding company of the licence holder a legally enforceable undertaking in favour of the licence holder. The undertaking shall provide that the person giving that undertaking (“the Covenantor”) will refrain from any action, and will procure that every subsidiary of the Covenantor (other than the licence holder and its subsidiaries) will refrain from any action, which would then be likely to cause the licence holder to breach any of its obligations under the Act or this licence.
 - 16.2 The undertaking shall be in a form specified by the Regulator.
 - 16.3 The undertaking shall be obtained within seven days of the company or other person in question becoming an ultimate holding company of the licence holder and shall remain in force for so long as the licence holder remains the holder of the licence and the Covenantor remains the ultimate holding company of the licence holder.
17. *Undertaking to provide information:*
 - 17.1 The licence holder shall, unless the Regulator otherwise consents, procure from each company or any other person which is at any time an ultimate holding company of the licence holder a legally enforceable undertaking in favour of the licence holder. The undertaking shall require the person giving that undertaking (“the Covenantor”) to give to the licence holder, and to procure that each subsidiary from time to time of the

Covenantor (other than the licence holder and its subsidiaries) will give to the licence holder, all such information as may be necessary to enable the licence holder to meet its obligations under the Act and under this licence to provide documents and furnish information to the Regulator and such additional information as the Regulator may require about the activities of the Covenantor and its subsidiaries and the financing of them.

- 17.2 The undertaking shall be in a form specified by the Regulator.
- 17.3 The undertaking shall be obtained within seven days of the company or other person in question becoming an ultimate holding company of the licence holder and shall remain in force for so long as the licence holder remains the holder of this licence and the Covenantor remains the ultimate holding company of the licence holder.
18. The licence holder shall:
- (a) deliver to the Regulator evidence (including a copy of all such undertakings) that the licence holder has complied with the obligation to procure any undertaking pursuant to paragraphs 16 or 17;
 - (b) inform the Regulator immediately in writing if the directors of the licence holder become aware that any undertaking procured pursuant to paragraphs 16 or 17 has ceased to be legally enforceable or that its terms have been breached; and
 - (c) comply with any direction from the Regulator to enforce any of the undertakings procured pursuant to paragraphs 16 or 17.
19. The licence holder shall not, save with the Regulator's written consent, enter (directly or indirectly) into any agreement or arrangement with any ultimate holding company of the licence holder or any subsidiary of such ultimate holding company (other than a subsidiary of the licence holder) at a time when (a) an undertaking required pursuant to paragraphs 16 or 17 is not in place or (b) there is an unremedied breach of such undertaking.

Payment of dividends

- 20.1 The directors of the licence holder shall not, without the Regulator's consent, declare or recommend a dividend and the licence holder shall not make any other form of distribution, within the meaning of section 263 of the Companies Act 1985, unless prior to the declaration, recommendation or making of the distribution (as the case

may be) the licence holder shall have issued to the Regulator a certificate complying with the following requirements of this paragraph.

20.2 The certificate shall be in the following form:

“After making enquiries, the directors of the licence holder are satisfied:

- (i) that the licence holder is in compliance in all material respects with all obligations imposed on it by Condition 12 of its network licence;
- (ii) that the payment of a dividend or making of a distribution of [] on [] will not, either alone or when taken together with other circumstances reasonably foreseeable at the date of this certificate, cause the licence holder to be in breach to a material extent of any of these obligations in the future; and
- (iii) that such payment of dividend or making of distribution will not impair the ability of the licence holder to finance the Permitted Business.”

20.3 The certificate shall be signed by a director of the licence holder and approved by a resolution of the board of directors of the licence holder passed not more than 14 days before the date on which the declaration, recommendation or payment will be made.

20.4 Where the certificate has been issued in respect of the declaration or recommendation of a dividend, the licence holder shall be under no obligation to issue a further certificate prior to payment of that dividend provided such payment is made within six months of that certificate.

21. The Regulator in deciding whether to give his consent under paragraph 1 or paragraph 2 of this Condition may have regard, among other matters, to the risks imported to the Network Business by the activity in question and the benefits accruing, or likely to accrue, to the Network Business out of that activity.

Interpretation

22. In this Condition there shall be inserted the following definitions:

“acquisition date” means the date on which the licence holder becomes a subsidiary of Network Rail Holdco Limited

- “auditor” means the licence holder’s statutory auditor from time to time;
- “corporate debt” means any unsecured and unsubordinated borrowing of money having an initial maturity of five years or more;
- “cross-default obligation” means a term of any agreement or arrangement whereby the licence holder’s liability to:
- (a) pay or repay any debt or other sum; or
 - (b) do anything pursuant to a term of any agreement or arrangement to which the licence holder is a party
- arises or is increased or accelerated or is capable of arising, increasing or of being accelerated by reason of a default (howsoever such default may be described or defined) by any person other than the licence holder, unless that liability:
- (i) can arise only as a result of a default by a subsidiary of the licence holder; and
 - (ii) the licence holder holds a majority of the voting rights in that subsidiary and has the right to appoint or remove a majority of its board of directors; and
 - (iii) that subsidiary carries on business only for a permitted purpose;
- “indebtedness” means all liabilities now or hereafter due, owing or incurred, whether actual or contingent, whether solely or jointly with any other person and whether as principal or surety, together with any interest accruing thereon and all costs, charges, penalties and expenses incurred in connection therewith;

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| “information” | shall include any documents, accounts, estimates, returns, forecasts or reports (whether or not prepared specifically at the request of the Regulator) of any description specified by the Regulator; |
| “permitted purpose” | means the purposes of the Permitted Business; |
| “relevant date” | means the date 90 days after the acquisition date or, if this Condition has not come into force within 90 days after the acquisition date, the date on which this Condition comes into force; |
| “subsidiary” | shall bear the same meaning as that attributed to it in section 736 of the Companies Act 1985; |
| “subsidiary undertaking” | shall bear the same meaning as that attributed to it in section 258 of the Companies Act 1985; and |
| “ultimate holding company” | means each of: <ul style="list-style-type: none">(i) a holding company of the licence holder which is not itself a subsidiary of another company;(ii) where a holding company of the licence holder which is not a subsidiary of another company has entered into an agreement relating to the exercise of voting rights in or the appointment or removal of directors of the licence holder or any company of which the licence holder is a subsidiary, every party to that agreement; and(iii) where the exercise of voting rights in or the appointment or removal of directors of a holding company of the licence holder which is not a subsidiary of another company is controlled by an agreement, every party to that agreement. |

Annex D: Proposed modification: Condition 27 (Corporate governance)

Condition 27: Corporate governance

1. The licence holder shall conduct the Permitted Business as if it were substantially the licence holder's sole business and the licence holder were a separate public limited company.
2. Without prejudice to the generality of paragraph 1 of this Condition 27:
 - (a) the licence holder shall ensure that each of its directors discloses to the licence holder and the Regulator any conflicts that in that director's reasonable consideration do or may arise between that director's duties as a director of the licence holder and other duties that that director may have; and
 - (b) in fulfilling its obligation under paragraph 1 of Condition 27, the licence holder shall have regard, among other matters, to the dividend policy adopted by the licence holder in the light of paragraph 20 of Condition 12.
3. The licence holder shall comply, as if it were a company whose ordinary shares are for the time being admitted to the Official List of the UK Listing Authority, with the Principles of Good Governance and Code of Best Practice (or any successor document having a similar purpose and content) as may from time to time be incorporated into or approved for the purposes of the listing rules of the Financial Services Authority.
- 4.1 Subject to paragraph 4.2 below, the licence holder shall ensure that at all times the board of directors of the licence holder contains a majority of non-executive directors who shall be persons of standing and of which at least two shall each have satisfied the Regulator that he or she has substantial relevant experience of working in the railway industry.
- 4.2 If at any time the licence holder is, by virtue of any person ceasing to be a director of the licence holder, unable to ensure the outcome in paragraph 4.1, the licence holder shall take such steps as are necessary to ensure that that outcome is achieved as soon as reasonably practicable after that event and in any case within one month of that event.

Annex E: Proposed modification: Condition 28 (Management Incentive Plan)

Condition 28: Management Incentive Plan

- 1.1 The licence holder shall send to the Regulator a plan (a “Management Incentive Plan”) under which the level of remuneration of the executive directors of the licence holder and such other persons as the Regulator shall from time to time specify is expressly related to specified standards concerning their personal performance and the performance of the licence holder in such a way as to enhance their incentives to improve those standards.
- 1.2 The licence holder shall send the Management Incentive Plan to the Regulator at least once a year and a new Management Incentive Plan shall be sent to the Regulator whenever there is any material change to the Management Incentive Plan’s contents during the course of the year to which it relates.
2. Every time that the licence holder sends a Management Incentive Plan to the Regulator under paragraph 1, the licence holder shall, at the same time, send to the Regulator and publish a statement summarising the principal terms of the Management Incentive Plan and the principles underlying it. Without prejudice to the generality of the foregoing, the statement shall include:
 - (a) details of the categories of persons to whom the Management Incentive Plan applies;
 - (b) the maximum entitlement of any such category of persons; and
 - (c) an indication of the criteria which are applied in determining the level of remuneration (with particular regard and making express reference to each of the objectives set out in paragraph 3) and the relative weighting given to each such criterion.

Without prejudice to paragraph 7 of Condition 15, the obligation in this paragraph does not entail an obligation to publish the levels of remuneration paid to specified individuals.

3. When formulating a Management Incentive Plan, the licence holder shall have regard in particular to:

- (a) achievement of the purpose in paragraph 1 of Condition 7 and any statement issued by the Regulator in connection with Condition 7, including in particular operational performance, asset serviceability and condition, efficiency and economy, and safety;
 - (b) achievement of the purpose of Condition 25 and compliance with any code of practice approved by the Regulator and in force in connection with Condition 25;
 - (c) the extent to which the licence holder is subject to orders made under section 55 of the Act and to statements by the Regulator on non-compliance with the licence;
 - (d) the extent to which the licence holder has infringed any conditions in its access agreements; and
 - (e) without prejudice to the generality of paragraphs (a) and (b), any other objectives that the Regulator may specify from time to time, after consulting the licence holder and the Authority, specifically in connection with the Management Incentive Plan.
4. Information required to be sent to the Regulator under this Condition shall be provided in such form and manner and on such dates as the Regulator may require.

Annex F: Additional minor proposed modifications to the network licence

(Proposed modifications are marked in bold and underlined type)

Part II - Interpretation

1. In this licence:

- "access charge" means any amount payable or proposed to be paid under an access contract or an installation access contract;
- "affiliate" in relation to the licence holder means any holding company or subsidiary of the licence holder or any subsidiary of a holding company of the licence holder, in each case within the meaning of sections 736, 736A and 736B of the Companies Act 1985;
- "control" shall be construed in accordance with sub-sections (2) and (4) to (6) of section 416 of the Income and Corporation Taxes Act 1988 with the following modifications namely:
- (i) for the words "the greater part" wherever they occur in the said sub-section (2) there shall be substituted the words "30 per cent or more"; and
 - (ii) in the said sub-section (6), for the word "may" there shall be substituted the word "shall", the words from "and such attributions" onwards shall be omitted and in the other provisions of that sub-section any reference to an associate of a person shall be construed as including only a relative of his (as defined by section 417(4) of that Act), a partner of his and a trustee of a settlement (as defined by section 681(4) of that Act) of which he is a beneficiary;

- "licence holder's network" means the network of which the licence holder is the operator pursuant to this licence;
- "licensed activities" means things authorised to be done by the licence holder in its capacity as operator of a network or trains pursuant to this licence;
- "Network Business" means:
- (i) the business of providing and operating the licence holder's network, **including the maintenance, renewal, replacement, improvement, enhancement and development of the network;** and
 - (ii) any ancillary service **related to the business and activities in sub-paragraph (i);**
- and without prejudice to the generality of the foregoing, includes:**
- (a) the purpose of financing the business in paragraph (i) and the services in paragraph (ii); and**
 - (b) any payment or transaction lawfully made or undertaken by the licence holder for a purpose within sub-paragraphs (i) to (vii) of paragraph 7(b) of Condition 12;**
- "Permitted Business" means the Network Business and the Permitted Non-Network Business;
- "Permitted Non-Network Business" means any business, other than the Network Business **and the exploitation of land (which includes the disposal of land within the meaning of Condition 26),** of the type transferred to the licence holder pursuant to the Railtrack Transfer Scheme;

"Railtrack Transfer Scheme" means the transfer scheme in respect of which the licence holder is the transferee made by the Board under section 85 of the Act and as varied pursuant to section 97 of, and Schedule 8 to, the Act;

"related undertaking" in relation to the licence holder means any undertaking in which the licence holder has a participating interest (and for this purpose "undertaking" has the meaning given by section 259 of the Companies Act 1985, and "participating interest" is to be construed in accordance with section 260 of that Act).

2. Any reference in this licence to a numbered paragraph is a reference to the paragraph bearing that number in the Condition in which the reference occurs.
3. In interpreting this licence, headings shall be disregarded.
4. Where in this licence the licence holder is required to comply with any obligation within a specified time limit, that obligation shall be deemed to continue after that time limit if the licence holder fails to comply with that obligation within that time limit.
- 5. Where in this licence there is provision for the Regulator to give his consent, the Regulator may give such consent subject to conditions.**
6. The provisions of section 149 of the Act shall apply for the purposes of the service of any document pursuant to this licence.
- 7. The Interpretation Act 1978 shall apply to this licence as if it were an Act.**
- 8. Terms and expressions defined in the Railways Act 1993 shall, unless the contrary intention appears, have the same meanings in this licence.**

Condition 13: Restriction on interests in train operating and rolling stock companies

1. Subject to paragraph 2, the licence holder shall not, except in so far as:
 - (a) at any time when the licence holder is a public sector operator, the Secretary of State;
 - (b) at any other time, the Regulator,may otherwise consent, be directly or indirectly interested in the ownership or operation of any railway vehicle in Great Britain.
2. Paragraph 1 shall not apply in respect of any railway vehicle:
 - (a) used for any such purpose as is mentioned in sub-paragraph 1(b) or (c) of Part I of this licence; or
 - (b) forming part of the Royal Train.
3. The licence holder shall, without limitation to the generality of paragraph 1, be regarded as directly interested in the ownership or operation of railway vehicles where the licence holder:
 - (a) has any legal or beneficial interest in any railway vehicle (in whole or in part); or
 - (b) has the right to manage the affairs of another person who has any such interest in, or operates, any railway vehicle.
4. The licence holder shall, **without prejudice to the generality of** paragraph 1, be regarded as indirectly interested in the ownership or operation of any railway vehicle which is operated by **any of its affiliates or in which the licence holder or any of its affiliates** has any legal or beneficial interest (in whole or in part).
5. In this Condition:

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| "holding company" | has the meaning given in section 736 of the Companies Act 1985; |
| "a substantial minority" | means a holding of, or an interest in, 10 per cent or more of the securities or of any class of securities in a body corporate, other than a subsidiary. |

6. For the purposes of determining whether a person has a substantial minority holding in a body corporate:
 - (a) it is immaterial whether that holding is direct or through a nominee or trustee;
 - (b) such holdings of the subsidiaries of a body corporate shall be treated as its own; and
 - (c) where a body corporate is as a consequence of this Condition to be treated as having more than one such holding in another body corporate, the holdings shall be aggregated and treated as a single holding.

Condition 14: Co-operation with the Mayor of London, London Regional Transport and Transport for London

1. The licence holder shall co-operate with the Mayor of London, London Regional Transport and Transport for London for the purpose of:

- (a) ensuring the efficient provision of railway services and of railway facilities;
and
- (b) coordinating where possible anticipated investment projects,

to the extent that such matters affect or may affect both the licence holder's **provision of railway services and those in respect of which the Mayor of London, London Regional Transport and Transport for London have responsibility.**

Condition 20: Systems Code

In paragraph 6, the words “ “Railway Group Standards” has the same meaning as in Condition 3;” shall be replaced by the words “ “Railway Group Standards” has the same meaning as in Condition 6”.

Condition 23: Appointment and Role of Reporter

In paragraph 9, the words “Unless the context otherwise requires, words and phrases shall bear the same meaning as those ascribed to them in the Railways Act 1993.” shall be deleted.

Condition 24: Asset Register

In paragraph 21, sub-paragraphs (b) and (d) shall be deleted, and paragraph (c) shall in consequence be redesignated as paragraph (b).

Condition 25: Code of Practice on Railtrack’s dealings with dependent persons

The words “Code of Practice on Railtrack’s dealings with dependent persons” (the heading) shall be replaced by the words “Code of Practice on the licence holder's dealings with dependent persons”.

In paragraph 21, the words “words and phrases shall bear the meanings ascribed to them in the Railways Act 1993; and references to the singular include the plural and *vice versa*.” shall be deleted.