WHITE & CASE
LIMITED LIABILITY PARTNERSHIP

RAILWAYS ACT 1993

STATIONS REFORM

23 June 2011

Scope of this paper

1. This paper concerns the steps which ORR has taken and may be about to take in connection with the reform of the National Station Access Conditions 1996 (NSACs), following its March 2010 decision not to proceed with the establishment of the stations code.

2. It is concerned exclusively with the parts of ORR's proposals which deal with third party investment in stations.

3. It is divided into two parts, concerning the **procedure** which ORR is following, and the **substance** of the proposals which are being made.

4. In summary:

(a) the procedure which ORR is presently following is flawed and illegal because ORR has announced, in advance, its satisfaction with the results of the Network Rail's work on the reform of the NSACs, in breach of its public law obligations and its announced commitments to maintain an open mind and carry out an open and transparent process, and has done so without first consulting to the standard required by public law those interests likely to be affected by the proposals; it has also failed to provide reasons for its proposals or the required statement of applicable criteria so that consultees can make an intelligent assessment of what is said to be proposed;

(b) the proposals themselves are inconsistent and cannot be reconciled with ORR's section 4 duties, and are not in accordance with ORR's own published standards for the approval of documents which require regulatory approval, particularly inasmuch as they raise rather than lower barriers to investment by increasing the uncertainty, complexity, cost and delays of third party investments in and at stations; in devising these proposals, ORR has adopted and endorsed a focus of interest which is narrower than is required by the Railways Act 1993.

PROCEDURE

General

5. The procedure which ORR has adopted in this further phase of reform of the station access regime is flawed and illegal because ORR has failed adequately to consult companies with interests which are central to the private sector development and enhancement of stations, it has failed to provide reasons for its proposals, and it has pre-judged the consultation by announcing at its commencement its satisfaction with the proposals which it has been asked to accept by Network Rail, one of the consultees, before it has heard from others.

6. This significantly undermines the integrity of the purported March – June 2011 consultation and addressees of ORR's March 2011 document will rightly have regarded it as no valid consultation purely because ORR has already endorsed what Network Rail has proposed.

Exclusion of key players

7. In 2007-09, this firm submitted to ORR substantial and fully reasoned representations in connection with ORR's investment framework, which includes stations. It also made detailed representations on the reform of the stations regime, in particular the notion that the stations code should be abandoned. And it put in a separate and lengthy paper on shared value. ORR was well aware of the weight and depth of what was said, which probably constituted the most detailed and extensive set of representations made to ORR in these respects.

8. Despite this, following its March 2010 decision to drop the stations code, ORR remitted the stations regime – including, significantly, the reform of the third party enhancement regime in the stations code – to a working party comprising only those companies which had already publicly disclosed that they were against the stations code, and against the code's third party enhancement regime in particular.

9. In ORR's letter of 12 March 2010, it said that it regarded the third party enhancement regime to be important "and one that should be adopted in any reform of the access conditions". ORR said that it had "asked Network Rail to produce a specific plan by the end of March 2010 for taking this contractual reform work forward". It said that it had set a deadline of October 2010 for the planned changes to be submitted to ORR for approval. It added: "Given our requirement that provisions be developed to give third parties enforceable rights, we expect a wide range of stakeholders to be consulted as proposals are developed."

10. This was the correct procedure. Regrettably, it has not been followed, and it appears ORR has done nothing about it. The companies represented by this firm in the investment framework review had a legitimate expectation that they would be consulted when the proposals were being formulated, and they were not. Neither we nor, as far as we are aware, any of the companies on whose behalf we submitted substantial representations in the investment framework review were ever approached by ORR, Network Rail or anyone else, to take part in this work.

11. In April 2010, an article by a partner of this firm, the former Rail Regulator, in *Modern Railways* journal was published on the subject of the reform of the stations code and the third party enhancement regime in particular. It said:

> "The industry has been sent away to come up with its own proposals, with some general marching orders from ORR. They're supposed to get it all done by October 2010. … The danger is that the industry players who wanted to kill off the Station Code's third party funding regime will cut back hard on the strong, effective and efficient regime in the [stations] code, and produce something far weaker. ORR said third parties should be consulted, but it needs to go further and bring the key ones into the process as full negotiating parties, to ensure that the regime is not wrecked."

12. Did ORR not establish how wide (or rather narrowly) Network Rail was involving third party developers? Why not? ORR could and should have checked to see whether Network Rail was disregarding the clearest possible necessity that the companies which had engaged so deeply in the process up to that point should be involved in the work. That is what ORR explicitly told Network Rail to do. Network Rail did not do it, and in its March 2011 document ORR offers no comment on that material failure on the part of Network Rail. The result is a materially flawed consultation process, with (exactly as predicted) a substantially weaker third party enhancement regime.

13. It is clear from Network Rail's letter to ORR of 8 October 2010, published by ORR as an annex to its March 2011 document, that Network Rail consulted only one developer. Appendix 2 to Network Rail's letter says: "Additionally Network Rail met with a developer who has experience of seeking to invest at railway stations to understand their perspective." That developer was Muse Developments. As far as we know, Muse Developments took no part whatsoever in the investment framework review process, and made no representations. By contrast, five of the largest property developers in the UK, represented by this firm, expended considerable resources in making representations, and yet they were never approached. Network Rail plainly did not want to hear from them, or from this firm. The integrity of Network Rail's consultation process is thereby fatally undermined, and ORR should not have endorsed it. It deserves no weight.

14. It is clear from ORR's March 2011 document that a great deal of work on the third party enhancement elements of the NSACs has been done behind closed doors, with some involvement by ORR. Papers were produced and discussed. ORR engaged in correspondence, and possibly attended meetings. None of that material has been disclosed to us. All addressees of the March 2011 document are entitled to see it. As far as we aware, only the persons involved in those pre-March 2011 private discussions have seen that material.

15. The picture which emerges is plainly one of a closed consultation involving no third party who might have offered strong, contrary views to what Network Rail and the train operators were known to want to achieve.

Regulatory withdrawal from statutory functions

16. Moreover, it is quite wrong for ORR to adopt the stance that it is not for ORR to dictate to the railway industry what the terms of its access contracts are to be[1]. This is quite contrary to the explicit terms of the Railways Act 1993 and the decision of the Court of Appeal. Paragraph 37 of this paper expands on that point.

Pre-judged consultation

17. In paragraph 3.6 of its March 2011 document on the proposals for the reform of the NSACs, ORR discloses that it has already decided that what Network Rail and some train operators have produced – without any involvement of key players, contrary to ORR's requirements – "constitute the streamlined and efficient Station Change process that we requested the industry develop". It added: "Although we acknowledge the objections raised by ATOC to a number of elements of the proposal, we consider that the draft modified Station Change process satisfies our requirements and that we could support its implementation under our existing … powers." Having announced its decision that the Network Rail proposals are acceptable and satisfactory, ORR then purports to open them to further consultation.

18. Since paragraph 3.6 of its March 2011 document, and the remainder of it, admits that ORR has already decided that the stated amendments to the NSACs meet its requirements, its subsequent invitation for views comes too late. The sequence of decision-making has been inverted to: decide first, consult later. ORR plainly does not have an open mind on the issue whether the stated amendments meet its policy of streamlining and simplification, because it

[1] ORR's letter of 12 March 2010 stated that it was not proceeding with the stations code because to do so would "disempower the industry by imposing on it a contractual regime that it no longer considers is appropriate", and that "the industry should develop its own solutions, and [ORR] should become involved only where [it] can add value".

has announced in the plainest terms that they do. (The second part of this paper shows how manifestly they do not.) Contrary to the rules of public law, the formative stage of decision-making on these NSAC amendments ended before the March 2011 document was published.

19. There can be little credibility given to a purported consultation when the decision-maker has announced at the outset that it has decided that the proposals it was asked to consider by some parties – after exclusion of some of the most important players – are sound and meet its requirements for implementation. The most elementary rules of public law state in the clearest possible terms that such an approach is illegal and cannot stand. It would therefore be no surprise if ORR were to say, in reply, that no-one else has contradicted ORR's statement. A decision made is a decision made.

Absence of reasons or criteria for the proposal

20. Reasons to the standard required by public law have not been given. The most which ORR has said in its March 2011 document is that it believes that the draft amendments to the NSACs achieve the simplification and streamlining which it desires. It repeatedly states that this is the effect of the proposed amendments (for example in paragraphs 3.6 and 5.1). In paragraphs 6.9 – 6.12, ORR only describes what is proposed for third parties. A statement of the effect of a policy or a decision is not a reason.

21. In the case of the third party enhancement regime, ORR has failed to say <u>why</u> it believes that the stated amendments would achieve its objectives. The law requires it to do so.

22. ORR has also failed to state the criteria which it will use when deciding on the amendments to be made. Whilst unlawful (see paragraph 24(e) below), that is unsurprising, since by its own admission it has already taken the decision.

Case law

23. The law on adequate consultation is long-established and well-developed. Despite this, in this case ORR has contravened virtually all of it.

24. The law provides that:

(a) consultation must take place at a time when proposals are still at a formative stage (R –v– North & East Devon Health Authority ex p Pow (1998) 1 CCLR 280);

(b) the decision-maker must embark on the consultation process prepared to change course if persuaded to do so (R –v– Barnet LBC ex p B [1994] ELR 357, 375C);

(c) the decision-maker cannot make a decision in principle and then consult (R (Sardar) –v– Watford BC [2006] EWHC 1590 (Admin));

(d) the proposer must give sufficient reasons for any proposal to permit of intelligent consideration and response, and the reasons given must be the true reasons (R (Madden) –v– Bury MBC [2002] EWHC 1882 (Admin));

(e) consultees should be told the criteria intended to be adopted and what substantially important factors are intended to be considered (R (Capenhurst) –v– Leicester CC [2004] EWHC 2124 (Admin) at 46).

25. In R –v– North & East Devon Health Authority ex p Coughlan [2001] QB 213, Lord Woolf said:

> "To be proper, consultation must be undertaken at a time when proposals are still at a formative stage; it must include sufficient reasons for particular proposals to allow those consulted to give intelligent consideration and an intelligent response; adequate time must be given for this purpose; and the product of consultation must be conscientiously taken into account when the ultimate decision is taken."

26. In R (Sardar) –v– Watford BC, the Court said that there is a requirement that consultation must be "both substantively fair and have the appearance of fairness", and held that a decision in principle, followed by consultation, is manifestly unlawful, since the consultation is undertaken after the end of the formative stage of the policy. That is what ORR has done in this case, as evidenced by its statement in paragraph 3.6 of its March 2011 document. In Sardar, the Court described such an approach as "fatal".

27. In R (Beale) –v– Camden LBC (2004) LGR 291, the Court held: "Proper consultation requires sufficient reasons to be given for particular proposals to enable those consulted to give intelligent consideration and an intelligent response to the proposals."

28. The other failures in adherence to the minimum standards of public law are stated above.

29. The remedial steps which it is submitted that ORR needs now to take are stated in paragraph 105

POLICY AND SUBSTANCE

Policy environment

30. On 2 October 2009, this firm wrote to ORR in connection with the proposal which ORR had been asked to consider, to drop the stations code. We wrote in the context of stations change in particular, and made the points in paragraphs 31 – 42 of this paper. In the light of what is now proposed, those points need to be re-emphasised.

31. The physical environment of the railway is a matter of material importance to users of railway services – the travelling public. Stations are a vital part of that environment. For many different reasons, some of Britain's stations are still in a poor state - run-down, neglected and forbidding places, especially for lone and vulnerable people, particularly women and unaccompanied children. They need money spent on them, and money is never in abundance. We know that the more inviting, attractive and secure the station environment, the more people will be happy to use the railways. If others – commercial enterprises or public authorities – are willing to spend their own money on improving stations, we should welcome that, and ensure that the barriers to their doing so are as low as they can be made to be.

32. For too long, and for substantial and bad reasons, getting improvements done at stations has been bedevilled with complexity, bureaucracy, expense and delay. Dealing with Network Rail can be dreadful, and train operators, with little money and perhaps little time left on their franchises, may have no interest in making improvements. It is for these reasons that, in the development of the policy on stations between 2000 and 2004, ORR decided that the stations change procedure should be broadened, to allow third parties – who may not be train operators – to have their own locus in the stations change process. If such a person is prepared to make real improvements at a station, protect the railway companies concerned from risks and pay for the change itself, then the long-standing presumption in favour of improvement (which has been a central part of the stations change process since 1994) should embrace and encourage that, not drive it away. No longer should it be necessary for such a person to plead (usually in vain) with Network Rail or a train operator to front a proposal for change, with exorbitant transaction costs and intolerable delays.

33. It is particularly important that ORR is fully seized of the fact that the difficulties which Network Rail's stakeholders – including its neighbours and potential investors in the improvement of railway assets – experience in trying to reach fair and affordable terms with Network Rail in connection with stations are a substantial deterrent. The railway environment is regrettably but justifiably regarded by even the most determined and well-resourced companies as a forbiddingly complex, hostile place. It is extremely important that

this changes. These companies have been burned by their experiences, some of them badly. They need more than ordinary efforts of well-intentioned reassurance; they need to see substantial practical action – with clear and enforceable rights and remedies – which will dissolve the blockages. Network Rail and others publishing friendly codes of practice, whilst the minefield of concealed tripwires is left undisturbed, is far from sufficient. The stations code is one important and substantial way in which this can and should be done.

34. ORR should, as it did before, balance its statutory duties in a way which recognises that the development of stations is certainly in the public interest as exemplified by the section 4 duties. There are many development opportunities in towns and cities which could and should go ahead in partnership with the railway as a welcoming, co-operative and facilitative neighbour.

35. Urban development opportunities whereby stations and adjacent land can be improved together, in harmony, making the whole more than the sum of its parts, are very much in the interests of the railway, its funders and, most importantly, its users. Railway assets and the railway environment can be significantly improved using outside investment. This is a prize which should be seized and exploited; it is not an opportunity which, through the maintenance or intensification of a commercially and regulatorily detrimental or deficient environment, should be allowed in many cases to turn to dust. The experience of some players in trying to negotiate appropriate contracts with railway companies, and the immense difficulties in establishing them in individual cases, is contrary to everything ORR has been trying to achieve. And other companies who might have invested will look on with disquiet, and many will turn away.

36. Making the railway's commercial and regulatory environment unforbidding, and conducive to improvement, is an essential step to achieving all the things which the section 4 duties point towards.

37. This is not a self-regulating environment. Parliament has decided that ORR is in charge of the access regime, not the regulated companies. This was affirmed in the plainest terms by the Court of Appeal in 2002[2]. ORR reinforces the point in paragraph 2.29 of its document on criteria and procedures for the approval of station access contracts (December 2010), where it says:

> "It is for ORR to determine the fair and efficient terms of access, regardless of whether or not the parties have reached agreement on all pertinent points in negotiations. We will base our decision on the public interest as defined by our

[2] Winsor –v– Special Railway Administrators of Railtrack PLC [2002] EWCA Civ 955

statutory duties. We are required, if appropriate, to put the public interest above the private commercial interests of the facility owner and the applicant. For instance, we may have to take into account considerations that may be of little or no concern to the parties, but which affect the interests of third parties, for example rail users, funders or other potential users of the facility."

38. It is not appropriate for ORR to allow the narrow interests of some of the incumbent railway companies to usurp its supervisory and proactive role in the establishment of access contracts, of which the SACs are an integral part. Sections 17-22, Railways Act 1993, do not allow that, and ORR should not acquiesce in it. The wider interests of those who may fund the railway – such as third party developers – and the public who use it need ORR to discharge the much wider role which Parliament has given it. ORR has no power to abdicate that role to anyone, least of all the facility owners whose power ORR has been established to check and restrain. That would be an inversion of the regulatory function (as also stated in the 2002 Court of Appeal case).

39. The station change regime is there to protect and promote beneficial improvement. The third party enhancement and participation regime in the stations code is the way in which that needs to be done, even if the regulated companies do not much like the idea.

40. If ORR shrinks back now and surrenders to the wishes of those who wish to weaken and tangle up such a major enhancement to the stations regime, it will prolong and intensify the impedance of station development, and do a disservice to all users of stations, commercial and public. That would be a conspicuous violation of ORR's statutory purpose, and would deservedly attract severe criticism.

41. The companies and institutions who have the resources and the expertise to make significant improvements to the stock of Britain's railway stations have a very fragile and wholly insufficient confidence in the protections of the existing regime, if they have any confidence in it at all. They will justifiably regard any such step by ORR as affirmation of their long-held and firm belief that the railway is a substantially closed industry, uninterested in efficient external participation on fair and affordable terms, and content to perpetuate a regime which has left too many stations in poor condition.

42. Especially at a time of tightening public finances, this is no time for regulatory retreat. It is time that the barriers to station investment were dismantled.

Weaker system

43. In its March 2011 document, ORR's declared policy is stated to be the clarification, simplification and acceleration of the station change regime, which "should give change sponsors more certainty in progressing schemes". ORR says that the proposed new procedures should "also include clearly defined rights of third parties involved in station change, with the aim of encouraging more third-party-led development". ORR also says that the contractual arrangements for station change must support and encourage better efficiency and different ways of working, and they must not act as a barrier to investment by third parties.

44. These are sound policy objectives, which we endorse. They are consistent with – in fact, almost identical to – regulatory policy in 2002-04. Regrettably, the changes which ORR is now proposing, and with which it has already said it is satisfied, make the station change regime materially weaker and more bureaucratic, uncertain, costly and time-consuming than the regime in the stations code, and are a significant step backwards.

45. It appears that ORR, in endorsing these significant dilutions of the strength of the present regime, is siding firmly with incumbent railway interests who have always been known to be against directly enforceable rights of third parties in station enhancement. They see it as the railway's business only, and do not see either the wider public interest (as exemplified in the section 4 duties) or the significant potential for new money coming into the improvement of railway facilities, something which the taxpayer and the railway industry cannot presently provide.

46. ORR has given no coherent reasons why these proposals satisfy the requirements that they be at least as good as if not better than the regime in the stations code, or even why they will encourage third party-led development (as to which see also paragraphs 20 - 22, 24(d) and 27 of this paper). This part of this paper explains why in substantive terms they are materially worse, and should not be proceeded with.

47. It is far from clear why ORR has not required the replication in the NSACs of the third party enhancement regime in the stations code. As much was recommended in an article by a partner of this firm, the former Rail Regulator, in *Modern Railways* journal in April 2010. That article stated: "The best way of protecting the third party funding scheme is for ORR to tell the [stations contract reform] working group that it should copy and paste that part of the Stations Code into the new reforms, and not waste time trying to reshape something which was meticulously designed and will work, if someone would just give it a chance." It is very regrettable that this request has been disregarded, and instead a great deal

of work has gone into producing a system which is much worse, and will need substantial additional work simply to bring it up to the standard of the one it is to replace.

48. It is to be hoped that, despite ORR having pre-judged the outcome of the present process, it will reconsider its decision to support these reforms and replace them with a regime which does meet the stated objectives, and which much more closely follows the third party funding regime established so carefully and comprehensively in the stations code. If it fails to do so, it should provide the most cogent reasons why it has chosen a significantly weaker and more bureaucratic system.

Rights and position of Specific Contributors

49. The provisions concerning the ability of a Specific Contributor to propose a change and follow it through do not, as a matter of the law of contract, work.

50. The definition of "Specific Contributor" states that the person in question must have "an interest in the enhancement or alteration of the Station …". It is very likely that a court or tribunal will interpret that as a legal interest. What it appears the draftsman meant is a person who wishes to have the change in question made. It should be amended accordingly.

51. Condition C4 confers no rights on a Specific Contributor. This is because the Specific Contributor is not a party to the contract. In the stations code regime, Condition 7.3 explicitly conferred on Station Funders (the equivalents of Specific Contributors) rights to enforce directly the rights granted or expressed to be granted to it as a Station Funder, and that was done under the authority of the Contracts (Rights of Third Parties) Act 1999. That is what needs to be done here.

52. Under Condition C4.1.7, even though a Specific Contributor gives the required unconditional undertaking to comply with and be bound by Part C, it acquires no rights under Part C simply because Part C confers none. Even though Condition C4.4 provides that, if there has been no response from a Material Change Consultee, there is to be a deemed acceptance of the proposal and an agreement (presumably with the Specific Contributor) to enter into a Co-operation Agreement at the end of the Consultation Period, there is still no enforceable right in the hands of the Specific Contributor if the Material Change Consultee refuses to sign the Co-operation Agreement. It is true that the Material Change Consultee has an obligation under Condition C4.4 to enter into a Co-operation Agreement, but that is not an obligation owed by the Material Change Consultee to the Specific Contributor simply because the Specific Contributor has no rights under the SACs. So if the Material Change Consultee refuses to enter into the Co-operation Agreement, there is nothing the Specific Contributor can do about it.

53. Similarly, in the circumstances contemplated by Condition C4.6 – unconditional acceptance of the Material Change Proposal – there is the curious concept of a deemed contract binding on the Proposer and the relevant Consultee. But we cannot see how in law this works. The contractual nexus is apparently created by Condition C4.6, but if the Co-operation Agreement is not signed, the Specific Contributor still has no rights under it because it has no rights under the SACs.

54. If there are objections (Condition C4.3.3) or Network Rail gives a conditional acceptance (Conditions C4.3.2 and C5), there is no deemed contract (if any were possible) between the Specific Contributor and anyone else. Instead, the Specific Contributor has to deal with the objections and, if necessary, go through the dispute resolution procedure. But, again, he has no rights to do so. So he cannot invoke Condition C4.8 or C4.10. The same situation arises under Condition C5.4.

55. If there is an invalid objection under Condition C4.7, the Specific Contributor has no right to challenge it, again because he has no rights under the SACs.

56. For this regime to have any prospect of working, the Specific Contributor must be given enforceable rights in the Part C mechanism. The existing mechanism simply does not work under the law of contract. It is for that reason that Condition 7.3 of the stations code conferred rights on third parties, using the legal mechanism which Parliament explicitly provided for use in such situations in the Contracts (Rights of Third Parties) Act 1999. This is what should be done here. The stations code did this because it was necessary. The law on privity of contract has not changed; it is still necessary.

Multiplicity of documents

57. In the case of station change, under the NSACs, devised in 1994, regulatory policy was – and, as far as we believe, remains – that there should be a strong presumption in favour of beneficial development of stations, and that none of the landlord, the facility owner nor the users of the station (passenger or freight) should have the ability capriciously, arbitrarily or otherwise abusively to obstruct such development. At the time, it was then recognised that the differing characteristics – temporal and commercial – of incumbent station interests could very well lead to the detrimental blocking of development, for example because a train operator was coming to the end of its franchise and could not or would not contribute to the costs of change, or it saw no real benefit to it (*i.e.* its narrow interests) in a particular change. There were also fears that some train operators would cynically impede developments simply in order to extract ransom payments from those who wished them to proceed and would eventually pay up simply to be able to get on with a project. And of course there were concerns that Railtrack, as landlord, would have insufficient direct commercial interest in

passenger-facing improvements, or its level of commercial sophistication and competence would otherwise frustrate change. In that design, ORR's objective was ensuring that the facility owner should not be able to frustrate or unduly delay beneficial improvements to the asset, its environment or the services provided to those who interface with the railway, as direct users or otherwise. Nor should the facility owner be in a position to demand and secure unreasonable terms. What ORR did, in designing those change regimes, was replicate the principles of restraint of monopoly abuse which are so firmly embedded in the sections 17-22 access regime.

58. The result was station change policy designed and developed entirely by ORR – with some input from the industry – which created a regime for station change which was both strongly supportive of beneficial development and provided sufficient protection for those with sound reasons for objecting.

59. One of the strongest features of that regime was that it was deliberately anti-bureaucratic. In this respect, the regulatory concern was that if the proposer and supporters of a change had to negotiate anything at all with the other parties (howsoever motivated) likely to be affected by the scheme, or simply other station parties with an eye to the main chance, that would lead to high transaction costs, delays, unnecessary compromises or watering down of schemes, the payment of ransoms and generally the hindering or even suffocation of proposals which ought in the public interest to go ahead. These results would be directly contrary to several of the section 4 duties, including the duties concerning the protection of the interests of users of railway services, the promotion of the use and development of the railway network, the promotion of efficiency and economy and the enablement of railway service providers to plan the futures of their businesses with a reasonable degree of assurance.

60. And so the system was made specifically so that if the proposer of a station change had a fully developed, properly documented proposal, covering all the things which such a proposal needs – things such as what the scheme is, when it will be carried out, how it will be paid for, what the risk allocation is to be – then no more paper was needed. In particular, the system was adamant that it should not be necessary for the proposer to negotiate separate arrangements with anyone, whether Railtrack as landlord or the affected train operators as users of the station. It was a self-contained change process. The proposal would be made, everyone would have the right to review it and if there were objections – on very specific matters – those objections would be handled either by agreement or determined by the dispute resolution tribunal. But once any objections had been disposed of, the proposal could go ahead. No-one would need to sign anything, and of course no-one would need to give any further agreement or consent – all of that was already in the SACs. The entire scheme would be in the proposal which had gone through the change process, and once successfully out the

other end, there would be a clear, enforcdeable contractual right to carry out the scheme, or to have it carried out, and a clear specification of all attendant matters. The contractual rights are in the existing contract – nothing more is needed[3].

61. If it had been otherwise, proposals could easily be hindered or frustrated. That was the policy, and the scheme fully reflected it.

62. It is undoubtedly true – and ORR acknowledged this in its 2002 and 2004 stations reform documents – that in many cases railway industry participants simply did not operate the system as it was designed, despite its having been explained to them. That may be because they did not understand it, or that train operators and others proposing changes were wrongly but effectually misled by Railtrack or others into believing that more documents were required and those documents had to be negotiated (perhaps usually because the proposal for change was less than fully developed). In our view, both are correct. And of course when Railtrack or a facility owner was able to cause the proposers and supporters of change to believe that they needed more documentation – and that they were to have little or no regulatory protection in the establishment of that documentation – then of course proposals were hindered, sub-optimal solutions were arrived at and in some cases the proposals were never proceeded with. This is precisely the opposite result to that intended by regulatory policy, and indeed the policy and purposes of the Railways Act 1993. As explained in paragraph 57 of this paper, ORR modelled the station change procedure on the compulsory third party access regime in the Railways Act 1993 specifically to prevent Railtrack or others acquiring and using the leverage of the need for further, unregulated documentation. Indeed, regulatory policy on unregulated documents having an effect on regulated relationships (known as 'externalisation') has been hostile since 1994, as exemplified in the disapproving terms in every one of ORR's criteria and procedures documents concerning the approval of access contracts. That policy continues to be forcefully articulated in paragraphs 4.10 – 4.14 of ORR's December 2010 stations criteria and procedures document, and the corresponding parts of the track criteria and procedures document.

63. It is in that light and context that the station change regime was reviewed and reformed in the stations code. It remains extremely important that the need for additional documentation should be minimised (to zero), not enlarged.

64. It may be noticed that the stations code provides for one additional piece of documentation – the Station Funder Participation Deed, in Schedule 10. It may be said that

[3] By including in Figure 1 (bottom of second column) of its letter to ORR dated 8 October 2010 four of the specified six types of contract, Network Rail reveals that it too does not understand how the existing stations change regime works, despite the fact that it has been in every station contract it has since 1994.

that is inconsistent with regulatory policy that there should be no more documentation. That would be incorrect. ORR will recall that the Station Funder Participation Deed is an extremely short document, and contains nothing at all to be negotiated. It is no more than an instrument under which the Station Funder takes on obligations under the station change regime in the code. This was correctly considered by ORR to be necessary as the Contracts (Rights of Third Parties) Act 1999 allows a contract to confer rights on a third party – which the stations code did – but not obligations. So it is purely a mechanical document, and does not in any way introduce uncertainty or scope for awkward behaviour on anyone's part. That is entirely different from what ORR is now proposing.

65. Contrary to ORR's long-established anti-bureaucratic policy on stations change, the station change regime now proposed increases the need for additional unregulated documentation to a considerable degree. When asked why this is, we were told by ORR that these proposals simply "contractualise what happens at present". This is quite wrong. Documents whose terms and process of establishment carry little or no regulatory protection should not be cemented into the station change regime simply because these documents – or documents very like them – have been used for years. The point is that they should not have been, and that what ORR should be trying to do is sweep away and replace the discredited practices of the past with substantial improvements, not put a stamp of regulatory approval or resigned acquiescence on practices which for the last eleven years ORR has said are fundamentally objectionable and should be replaced.

66. In this context, it may also be objected that this anti-bureaucratic policy was departed from by ORR in July 2004 when it made amendments to the network code, in particular Condition GA3(b)(vi), which imposes on Network Rail an obligation to produce model terms and conditions for the implementation of network changes. Those model terms and conditions have to be approved by ORR. This therefore is a regime which provides for more documentation than is found in the body of the code itself.

67. There are two answers to that objection. First, the terms of all the documentation have to be approved by ORR, the policy being that they should then carry adequate regulatory protection. The second point is that this separate-documentation regime was adopted by ORR in 2004 as very much a second-best way of tackling the problem of network changes being insufficiently specifically documented in the code itself. Regulatory policy at the time was that it would be far better for the terms on which network changes were to be carried out to be in the code itself – and that would include all material matters such as risk allocation and liability – with the project-specific elements only in the proposal for network change. This approach would take down to the irreducible minimum the amount of customisation required, and, having put it all in the proposal for change itself, expose it to the established challenge procedure. There would therefore be nothing to be negotiated. The

reason why this was not done is simply that the term of office of the then Rail Regulator was about to end, and there was not enough time for the fully-developed regime to be put into the network code itself. The Rail Regulator at the time was determined to put in place what he then regarded as a workable regime, even though it was far from the best. The requirement for ORR approval of the templates was seen then as essential. It became a matter of severe regret for the then Rail Regulator that ORR then acquiesced in separate documentation which was materially weaker than it should have been, and in so many respects was contrary to ORR's own published policies and its section 4 duties. That issue remains a matter for further attention and correction by ORR, but it is beyond the scope of the present paper, which is concerned that ORR should not repeat the mistake in the case of stations.

Three new types of document

68. It is now proposed that there be at least three additional types of document in the station change process for Specific Contributors: a Co-operation Agreement (whose terms are dealt with in paragraphs 88 - 93 and 96 - 103 of this paper), a Property Agreement and an Asset Protection Agreement.

69. In a station change under the stated amendments, there will be several Co-operation Agreements – one between the Specific Contributor and each separate station user.

Property Agreement

70. In the case of the Property Agreement, there is no template at all. The SACs only tell us that it is to be an agreement between the Specific Contributor and Network Rail "for the creation or transfer of an estate or interest in land or for the grant or reservation of an easement, right or privilege[4] in or over land which is required by the Proposer in connection with a Material Change Proposal …". The definition goes on to add that there may well also be a shared value payment. (Shared value is dealt with in paragraphs 89 - 93 of this paper.)

71. There is no need whatsoever for any such agreement. If the Specific Contributor needs access to Network Rail land to have the works carried out, that should be a function of the SACs and the rights which they confer. That is the position now under the NSACs 1996, and it does not need to change.

72. The other terms of the Property Agreement are not stated, and the Specific Contributor has no ability to know in advance what they will be. Doubtless, as an unregulated document, Network Rail will demand very onerous terms, and the Specific Contributor will have no regulatory protection. This is the opposite result to that which

[4] It is not explained why an easement or a privilege is thought not to be a "right", which each plainly is.

would have prevailed under the stations code. ORR has provided no explanation why it is materially reducing regulatory protection in this case. There is no justifiable regulatory policy reason for it. It is contrary to the policy and purposes of the Railways Act 1993, to ORR's section 4 duties and to ORR's policy on externalisation (see paragraph 62 of this paper). It leaves the Specific Contributor exposed to the demand of unreasonable terms and ransom demands by Network Rail.

Asset Protection Agreement

73. In the case of the Asset Protection Agreement, the definition is also vague. We are told that it is an agreement "concerned with matters such as" the safe management of works, the protection of the operational integrity of train operations and so on. But the terms are not specified, and there is much that Network Rail could add or amplify.

74. Condition C5.2 says that Network Rail is entitled to require adherence to ORR's asset protection policies and guidelines, but in too many respects they are unspecific and provide Network Rail with plenty of scope to be difficult. We know that there are asset protection contract templates for network change, and it is assumed, but not known, that Network Rail will use them as a starting point in the case of stations. That is what it has done in the past. We are aware of bitter experiences of developers who have spent years trying to get Network Rail to agree terms of APAs, and have been driven to conditions of a commercially untenable nature.

75. Unlike the network code (Condition GA3(b)(vi)), the draft SACs do not even require the terms of the template asset protection (or property) agreements to be approved first by ORR. As with the proposed property agreement, this regime therefore falls foul of all the regulatory objections on externalisation, and it hard to see why ORR should depart so markedly from a policy it has pursued since 1994. It has certainly offered no reasons for doing so, and has not consulted on its proposed departure. There is a legitimate expectation that it will not do so.

Negotiation / determination of separate contracts

76. We expect it will be said that Condition C5 imposes limitations on how far Network Rail can go when negotiating these contracts. Conditions C5.2 and C5.3 say that Network Rail must "act reasonably" in relation to the settlement of the terms of these contracts. This is very far from enough.

77. First, the obligation applies only to Network Rail's pre-contract behaviour, not the terms of the contracts themselves.

78. Secondly, even if it were amended to apply to the terms of the contracts – *i.e.* requiring the contract terms themselves to be reasonable – it is an extremely vague obligation, and there may be many months of argument over whether Network Rail was acting, or had acted, reasonably. "Reasonable" from whose point of view? Network Rail (and Railtrack before it) have always asserted that they behave reasonably, and they never demand unreasonable terms. Regulatory and commercial experience over the last 17 years have demonstrated time and again how misconceived that self-belief has been. It is precisely because of the likelihood that a monopolist will demand unreasonable terms that section 17 of the Railways Act 1993 (compulsory third party access to railway facilities) was enacted. Section 17 does not meekly provide that facility owners (monopolists) must not demand unreasonable terms or behave unreasonably; it provides an entire scheme for taking the matter away from the facility owner and for the regulatory authority to determine all the terms on which access will be given.

79. As drafted, this obligation is excessively vague and will produce little if any reassurance to investors that they will not be given a very hard time by Network Rail, with considerable delays, high transaction costs and a very uncertain outcome. It is unsustainable for ORR to leave proposers of station change to the mercy of this extremely uncertain regime. To do so raises, not lowers, barriers to investment, and deters it.

80. Thirdly, for the reasons given in paragraphs 49 - 56 of this paper, the Specific Contributor has no remedy if Network Rail is considered not to be acting reasonably. It has no rights under the SACs, and so Network Rail owes it no obligation to adhere to Condition C5. The Specific Contributor cannot invoke whatever (inadequate) protection may be available under Condition C5.4 because it has no right to invoke the dispute resolution procedure in the first place. In view of ORR's outright rejection (without adequate reasons given) of this firm's representations on 5 February 2009 (attached) in connection with the proposed addition of third party developers to the category of persons to be protected under Condition 8 of Network Rail's network licence in their pre-contract negotiations with Network Rail, ORR will understand how little confidence third party investors will have in any other form of discretionary regulatory protection in these circumstances.

Dispute resolution tribunal to determine contract terms

81. In relation to Condition C5.4, which purports to provide a remedy of resort to the dispute resolution apparatus if Network Rail fails to agree acceptable terms of an Asset Protection Agreement or a Property Agreement, the proposed regime (apart from being unenforceable, for the reasons given in paragraph 80 of this paper), is unsatisfactory because it is vague and directly contrary to ORR's policy.

82. ORR policy on mechanisms in regulated contracts for the agreement of matters subsequently between the parties is stated in paragraphs 6.10 – 6.11 of ORR's document on criteria and procedures for the approval of track access contracts[5]. Paragraph 6.10 says:

> "Applicants [that is, access contract parties] may wish to include provisions in their access contracts for certain matters to be agreed subsequently between the parties … In such cases we [ORR] will be concerned to ensure that there are no loose ends in the contractual provisions that would allow matters to drift unresolved. We will therefore expect the contract to make clear provision:
>
> "(a) for the process through which the parties are expected to arrive at an agreement, including time limits;
>
> "(b) for the issue to be resolved in a timely manner should the parties fail to reach agreement;
>
> "(c) if the parties fail to agree within the specified time, for the matter to be referred for determination to an independent third party – such as an arbitrator or expert – who is required to apply clear, adequate and appropriate criteria (including, in suitable cases, current regulatory policy on the matter in question). It is very important that the criteria are specified in the contract or arrived at through an objectively justifiable process; **we will expect to refuse our approval in cases where the parties merely ask the third party to make a contract for them, which is not part of the role of such a tribunal;** …" [Emphasis added]

83. Moreover, this point was emphasised in the clearest possible terms by the Rail Regulator in the case of Network Rail Infrastructure Ltd –v– Eurostar (UK) Ltd [2003] RR 1. Paragraph 108 says:

> "… [the tribunal against which the appeal was taken] contemplated that, if the parties have failed to negotiate an appropriate amendment of their contract, they could … refer that failure to dispute resolution under Clause 11 of their contract … This too displays a failure on the part of the [tribunal] to understand basic principles of the law of contract and its own jurisdiction. As explained [elsewhere in the determination], it is not for a tribunal to make a contract for the parties. Therefore the suggestion that the dispute resolution procedure in their contract could be used for that purpose is inept."

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5 *Criteria & Procedures for the Approval of Station Access Agreements*, Office of Rail Regulation, London, December 2010

84. Condition C5 fails both of these tests because it requires the dispute resolution tribunal to make a contract for the parties and no criteria are given for the tribunal to apply.[6]

85. The far better approach is for the SACs to take from the Asset Protection Agreement regime – and the proposed Co-operation Agreement – the terms which, in commercial and regulatory terms, are necessary, and put them in an annex to the SACs as standard terms which apply to any proposed station change. As such, there will be complete regulatory protection for proposers, users and Network Rail because they will be in the SACs themselves. The things which are specific to a particular change will be in the change proposal itself, as is the case under the existing regime. If those things are objected to on specified (and narrowly defined) grounds, then they and they alone will be subject to the challenge procedure.

Legal effect of "acceptance"

86. Condition C4.11 says that a Material Change Proposal is "accepted" if there have been no valid objections. It is not stated what the legal consequences of "acceptance" are, and that is a serious omission. It appears that it means that the proposal can go ahead, and no-one can prevent it. This needs to be stated. There should be no ambiguity about this.

Network Rail to do the works

87. Condition C10.7 provides only that the proposer of the change will carry it out. The regime fails to provide – as the NSAC 1996 do – that the proposer of a change can require Network Rail to carry it out on terms specified in the proposal. This is a major omission in the new regime, and should be corrected. There may be many circumstances in which it would be best for Network Rail to do the works in question, particularly when the interface with the live operational railway is a close and substantial one.

Change proceeding without financial terms known

88. Condition C4.11 provides for physical works on the station to begin even though a term as material as the amount of compensation to be paid to other station parties is not yet known. This is wholly unrealistic. By definition, a Material Change Proposal involves material change. It therefore follows that the amount of compensation which may be payable to others could be significant. We know of no commercially rational party which would start to carry out major works at a station without knowing what the project is likely to cost. Its directors duties to act in the best interests of the company would prevent it. And no financial

[6] The same is true of Condition C10.3 and clause 8.2(A) of the draft Co-operation Agreement.

institution would allow such works to proceed with such material uncertainty. We notice that in its letter of October 2010, ATOC agrees with us and states that a parallel process for determining compensation could take "many months" (paragraph 3.2).

Shared value

89. The suggested regime specifically endorses the practice of Railtrack and now Network Rail to try to extract shared value (ransom) payments from developers and other third parties as a condition of allowing them to proceed with works on, over or near the railway. It does this in the definition of "Property Agreement" and, in the draft Co-operation Agreement, in the definition of "MCC Costs" (paragraph (B), which is stated in the draft (correctly) to "need further input and drafting").

90. This is untenable. On 29 July 2008, this firm provided to ORR a 196-paragraph detailed analysis of how this practice of extracting shared value payments, in the case of Network Rail's practice in a number of specified development instances, is both objectionable on policy grounds (as contrary to the great weight of ORR's section 4 duties) and illegal. This submission was made as part of ORR's consultation on the establishment of its investment framework policy and guidelines. Despite the depth of its analysis and reasoning (including extensive citation and analysis of applicable case law), ORR has never responded to us on this set of representations. In its October 2010 investment framework policy document, paragraphs 159-162, ORR adopted an uncommitted position on shared value, saying that Network Rail must comply with relevant legislation and should not frustrate or delay developments, and should have regard to direct or indirect rail-related benefits when negotiating with developers.

91. Since October 2010, we have heard nothing from ORR on shared value until now, when it appears that ORR has got off the fence and specifically endorsed the practice, despite the weight and detail of the policy and legal representations we have submitted, and without giving any reasons why, or consulting on its change of policy.

92. The representations on shared value which we made in July 2008 stand, and it is contrary to ORR's own standards for the conduct of policy and the rules and principles of public law for ORR to proceed to establish this policy of supporting shared value unconditionally without proper engagement with potentially affected parties on the issue. Ordinary courtesy also requires it. ORR might also reflect on how it can expect consultees to prepare detailed and fully reasoned representations when they are not responded to, and then many months later, without engagement or notice, they are rejected and the position taken by the opponents of the representations is accepted without question and without reasons given.

93. The annotation in the definition of "MCC Costs" in the draft Co-operation Agreement may, however, indicate that ORR's mind is not yet closed on shared value,. We hope so, and look forward to ORR's detailed and substantive response to our paper of 29 July 2008.

Grounds of objection

94. Under Condition C4.7.3(d), it is untenable for a change proposal to be stopped simply because a Relevant Operator or Network Rail "considers" that it would imperil safety or efficiency. That is too low a test. If they have such objections and there is a dispute about them, that should be tested by an impartial tribunal. Simply thinking that something is unsafe or inefficient should not be a conclusive bar to a proposal proceeding.

95. Moreover, it is incorrect for proposals by third party developers to be made subject to significantly more onerous criteria, by means of wider grounds of objection, that proposals by other station interest holders (Condition C4.7.3). Public law requires like cases to be treated alike, and proposals should be considered on their merits, not on the identity of the companies who make them. (See in particular Lord Hoffman in Matadeen –v– Pointu [1999] 1 AC 98, in which he said that it is an axiom of rationality that like cases will be treated alike and unlike cases will be treated differently.)

Division of change costs

96. Under the NSAC 1996 and the stations code, it was always possible for a proposal for station change to provide that the costs of carrying out the works, and any increase in the running costs of the station afterwards, should be shared between the proposer and some or all of the station parties. That was a function of the contents of the change proposal. It could of course be challenged by an objector, but it was a possibility. Objections could be overridden under the balance of interest test in the NSACs, and unwilling parties compelled to contribute.

97. The present proposal abandons that regime – which provides considerable potential flexibility – and puts the proposer of change into a straitjacket of having to pay all the net costs. ORR has not explained why it proposes to take away that degree of flexibility. It should not remove it. If it does propose to do so, it should say why and then it should consult on it.

Unlimited financial obligations

98. In the definition of "MCC Costs" in the draft Co-operation Agreement, paragraph (A), the extent of the financial undertaking which the proposer of change must give is unlimited, *i.e.* not capped. Whilst there is provision for the payment of a fixed sum, there is no right of a

Specific Contributor to that method of proceeding, and if there is appreciable uncertainty about the costs then it is more likely that a station party will insist on the benefit of an uncapped liability. The same is true of the indemnity to be provided to Network Rail. This is a material change from the regime under the stations code, where capped liability was expressly provided for (see the definition of "Relevant Indemnity" in the draft stations code).

99. At the time of the design of the stations code, ORR expressed considerable concerns about the notion that the proposer of a change may be required to provide an unlimited indemnity. It said[7]:

> "The Stations Code would require that each proposer [of station change] will be required to offer each stakeholder an indemnity in respect of their relevant losses incurred as a result of the implementation of the works which are the subject of the change proposal. …
>
> "The Regulator considers that risks should be carried by the parties best placed to manage them. However, the Regulator is also concerned that the application of an unlimited indemnity regime could inhibit the enhancement and development of the railway. This is because parties to the Stations Code may be unwilling to take the risk of an unlimited indemnity, and may find it difficult to insure such a risk. In order not to create a disincentive to undertake works, the Regulator therefore considers that it would be appropriate, in the case of station works, for indemnities to be capped at an appropriate level consistent with the optimum allocation of risk but without placing an undue burden on those seeking to carry out major works."

100. In ORR's final policy conclusions on the stations code[8], ORR said, in this context:

> "The Regulator considers that it is important for industry parties, and their insurers, to have a level of certainty about the risks to which they will be exposed, including when undertaking works. He therefore proposes to include the £5 million per incident cap as the default liability cap for station change. However, it would be open for a station change proposer to propose a different cap in a station change proposal, setting out the reasons why the proposed cap is preferable to the default cap. This could then be considered and, if they thought it appropriate, challenged by consultees."

101. These were coherent, commercially positive and realistic policy decisions by ORR, for the reasons which ORR then gave. In the current document, ORR has departed from this

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7 *The Stations Code – Draft Conclusions*, Office of the Rail Regulator, London, January 2004

8 *The Stations Code – Final Policy Conclusions*, Office of the Rail Regulator, London, June 2004

policy without explaining why. ORR should amend the current proposals to revert to its 2004 announced policy, for the reasons which were given then. If ORR decides not to do so, it should provide cogent reasons why it was wrong in 2004 and an unlimited indemnity is now commercially realistic. It is not.

102. It should also be noticed that the definition of "MCC Costs" contains the unsatisfactorily opaque formulation "but not consequential costs, losses or expenses". It is far from clear how, in this context, costs or expenses are not losses, but their separate mention raises the implication that something different is intended. What is it?

103. More importantly, the railway industry has long struggled with the concept of consequential losses. This was discussed and analysed at length by ORR in its provisional conclusions on model access contracts[9], and the policy decision was taken to avoid the use of the term "consequential loss" and to specify with far greater precision what was and was not included. ORR should adhere to that policy, or explain why it intends to depart from it.

NECESSARY ORR ACTION

104. It will be appreciated that the objections raised in this paper – both as to procedure and substance – are material. They deserve full and proper consideration, and an answer.

105. As to procedure, in view of the above, it is submitted that ORR should now:

(a) publicly withdraw its statements of satisfaction with Network Rail's proposals;

(b) state the criteria which it will apply to its decision on the proposals, and the reasons (not statements of effect) why it these proposals may (not will) satisfy its section 4 objectives, and restart the consultation so that all those with an interest in the decision which ORR may make on the reform of the NSACs can respond in the knowledge of those criteria;

(c) publish the communications and papers of the working group which has devised the present set of amendments, and of the relevant communications which ORR has had with any of the members of that working group;

(d) explain why the third party participation regime in the stations code has not simply been transplanted into the NSACs, since it was developed by ORR and met its section 4 objectives;

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9 *Model Clauses for Track Access Agreements: Provisional Conclusions*, Office of the Rail Regulator, London, July 2000; see paragraphs 6.13 – 6.56

(e) require and ensure proper opportunities for the full and active participation of all parties with an appreciable interest in the development of amendments to the NSACs, in particular the property and development companies whose money and expertise may be brought to improve stations, in the development of suitable amendments to the NSACs; and

(f) plainly and transparently consult on new amendments with an open mind.

106. If ORR fails to do this, it will, in the eyes of potential funders and investors in stations, conspicuously discredit whatever reforms to the NSACs are eventually made; their confidence in the regulatory process has already been undermined by the present procedural flaws. More widely, by its failure to take the necessary remedial action ORR will also demonstrate to the railway industry, investors and others that its commitments – and its public law obligations – in relation to procedural fairness are without meaningful effect, are not taken seriously, and may not be relied upon.

107. Regulatory credibility and respect require that every effort should be taken to avoid such an outcome.

108. On both procedural and substantive issues, ORR's response to these criticisms and representations will have a material effect on:

(a) the confidence of investors who may put substantial resources into the improvement of stations;

(b) their willingness to devise and proceed with imaginative and substantial schemes for the benefit of the users of railway services; and

(c) the economical development of railway facilities and the efficiency and economy of the provision of railway services.

109. Those are considerations which ORR should also take very seriously.

WHITE & CASE

23 June 2011