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OFFICE *of the*  
RAIL REGULATOR

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1 Eversholt Street  
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16 May 2003

*Dear Sir,*

**PROJECT RIO: NETWORK LICENCE CONDITIONS 12 AND 13 - CONSENT OF THE RAIL REGULATOR**

1. The Regulator has today consented under Conditions 12 and 13 of Network Rail's network licence to a proposed funding arrangement whereby Network Rail Infrastructure Limited (Network Rail) will make payments to Midland Main Line Limited (Midland Mainline). Please find attached a copy of the relevant consent document.

The Regulator's consent will allow Network Rail to make the payments to Midland Mainline in consideration of Midland Mainline providing passenger train services between London St Pancras and Manchester Piccadilly. Such services are to be operated at the request of the Strategic Rail Authority (SRA) as part of the West Coast Route Modernisation (WCRM) project. The services will provide an alternative through service between London and Manchester and reduce disruption to railway passenger services between the two cities arising from engineering blockades on the West Coast main line (WCML). The overall arrangements for the services are known as "Project Rio".

2. The SRA has identified three key objectives of "Project Rio". These are:

- (a) to support and enable a different possession pattern ensuring efficiency on the WCML Route Modernisation project and a reduction in overall disruption for passengers;
- (b) to maintain a quality alternative train service from London to the North West of England; and
- (c) to sustain the overall revenue for this market and create a higher base for the new WCML services to build on than might otherwise have been the case.

3. On the basis of the information concerning the funding arrangements for Project Rio, provided to the Regulator by Network Rail, SRA and Midland Mainline, the Regulator has considered whether:

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- (a) his consent to Network Rail's participation in Project Rio is required under any of the following Conditions of Network Rail's network licence:
- (i) Condition 10 (non-discrimination);
  - (ii) Condition 13 (restriction on interests in train operating and rolling stock companies);  
or
  - (iii) Condition 12 (ring-fencing and accounting records); and
- (b) if so, whether such consent should be granted.

#### **Condition 10 of Network Rail's network licence**

4. Condition 10 of Network Rail's network licence provides that, except in so far as the Regulator may otherwise consent, the licence holder shall not unduly discriminate between particular persons or between any classes or description of person.

5. Network Rail has indicated to the Regulator that it would be prepared to consider similar funding arrangements with other train operating companies in the future, albeit that it considers the circumstances in this case are unlikely to arise often in other cases. In the light of this, the Regulator has no grounds for considering that Network Rail's participation in Project Rio constitutes undue discrimination. The Regulator has therefore concluded that his consent to the proposed arrangement is not required under Condition 10 of the network licence.

#### **Condition 13 of Network Rail's network licence**

6. Condition 13 of the network licence provides that the licence holder shall not, without the Regulator's consent, be directly or indirectly interested in the ownership of any railway vehicle in Great Britain (unless used for the purposes as set out in paragraphs 1(b) and (c) of Part I of the network licence, or forming part of the Royal Train).

7. The Regulator has taken the view that the funding arrangements being proposed for Project Rio fall within the ambit of Condition 13 and that his consent is therefore required. This is because Network Rail has an interest in the profitability of the trains involved in the additional services being provided by Midland Mainline under Project Rio. If the costs of operating the train services are higher than expected, the additional costs will be met by Network Rail. Conversely, if the revenues from the operation of the services are higher than expected, Network Rail may benefit from increased revenue, subject to the details of the associated funding arrangements for work on the WCML as yet to be agreed between Network Rail and the SRA. These factors could affect Network Rail's overall profitability (even though the amounts involved are relatively small in the context of the total WCRM project).

8. Network Rail's concern that it should not have "open-ended liabilities" at the discretion of the SRA supports this view. It is for this reason that Network Rail has sought a cap on the amount of additional costs that the SRA can approve under the funding arrangements, without Network Rail Board approval being required.



## Condition 12 of Network Rail's network licence

9. Condition 12 of Network Rail's network licence provides that, except with the written consent of the Regulator, the licence holder shall not conduct any business or carry on any activity other than the Permitted Business (which is defined in Part II of the network licence). There is provision for the licence holder to conduct business which is not for a permitted purpose, provided that it is *de minimis* business and does not infringe any condition of any consent given by the Regulator under the licence. However, Network Rail has not proposed that these funding arrangements should be counted against its *de minimis* business limit.

10. The Regulator has taken the view that although the proposed arrangements sit within the overall arrangements for upgrading and renewing the WCML which are themselves part of Network Rail's Permitted Business, the funding arrangements go beyond Permitted Business by giving Network Rail a financial interest in the use of roiling stock. The Regulator's consent is thus required.

## The Regulator's consent

11. The Project Rio arrangement is an SRA initiative. The SRA will have a number of decision making powers in the project and will specify the level and frequency of the service. The SRA has confirmed that it wishes Network Rail to enter into the agreement for the reasons stated in paragraph 3 above.

12. In addition, the Regulator understands that if Network Rail did not enter into the Project Rio arrangements, it is likely that Virgin and possibly other train operators would need to arrange replacement coach services, and receive compensation from Network Rail for the cost of so doing. The Regulator understands that the proposed Project Rio is expected to provide a more cost-effective approach.

13. The Regulator has considered carefully the funding arrangements for Project Rio in the light of the above and in the context of his duties under section 4 of the Railways Act 1993 (the Act). Having regard to the reasons set out above, he has consented for the purposes of paragraph 1 of Condition 12 and paragraph 1 of Condition 13 of Network Rail's network licence to Network Rail's participation in the Project Rio funding arrangements.

14. It is the judgement of SRA and Network Rail that Project Rio will contribute to the efficiency of achieving the outputs of the WCRM project. However, the Regulator is not in a position at this stage to confirm this judgement; it is an issue which will be more properly addressed within the context of the Regulator's work to assess the efficient scope, specification and cost of delivering the outputs of the WCRM project. The Regulator therefore wishes to make it clear that he is not, at this stage, taking a view on the efficiency of the proposed arrangement.

15. The Regulator has also considered and approved today the 18<sup>th</sup> supplemental agreement submitted to him by Network Rail and Midland Mainline under section 22 of the Act on 14 May 2003. The agreement grants track access rights to Midland Mainline to operate services between Manchester Piccadilly and London St Pancras from the commencement of the Summer 2003 timetable until the end of the Winter 2003/04 timetable.



16. The consent enclosed with this letter will be placed on the Regulator's public register. A copy of the consent and of this letter will also be placed on the ORR web site. I have copied this letter to Paul Plummer at Network Rail, Doug Desmond at SRA and Malcolm Brown at Midland Mainline.

*Yours faithfully,*

*Steve Gooding*

STEVE GOODING