(1) New Southern Railway Limited
and
London & South Eastern Railway Limited

(2) Network Rail Infrastructure Limited

ADP35 and ADP36
Reference to ADP in respect of expenditure at Managed Stations.
Skeleton argument in respect of insurance and staff costs

1. SUMMARY OF CURRENT POSITION

1.1 This reference has been made by New Southern Railway Limited and London & South Eastern Railway Limited (together the "**Claimants**"). It relates to a dispute between the Claimants and Network Rail Infrastructure Limited (the **"Respondent"**) regarding the correct calculation and allocation of Qualifying Expenditure (**"QX"**), and the operation of the inspection and adjustment process for QX, at five stations where one or both of the Claimants are Passenger Operators (being Victoria, Charing Cross, London Bridge, Cannon Street and Gatwick Airport) (together the **"Relevant Stations"**). The dispute has arisen following an ongoing inspection of books, records and accounts relating to the 2006/7 financial year undertaken on behalf of the Claimants in accordance with Condition 38 of the Railtrack Independent Station Access Conditions (**"RISAC"**).

1.2 The background to the dispute is set out in the Claimants' preliminary submission dated 11 May 2009 and is not repeated here. The preliminary submission also summarises (at Section 4) the process by which QX is calculated and inspection can take place as set out in Part 6 (Conditions 32 to 43) of RISAC.

1.3 This skeleton argument addresses two elements of the wider dispute referred to in the preliminary submission; namely insurance and staff costs. Pursuant to an order made by the Chairman of the Access Disputes Panel (the **"Panel"**) at the directions hearing on 20 May 2009, the Respondent has made substantial disclosure of documentation and information as a result of which the Claimants currently anticipate that all other issues referred to in the preliminary submission can be resolved by an expert and those issues are therefore not addressed in this skeleton argument. However, in the event that the appointed expert does in due course identify issues of principle which he is not able to determine, the Claimants will seek to refer any such issues back to the Panel.

1.4 The decisions sought from the Panel at the forthcoming hearing relate to the 2006/7 financial year, which is the year in relation to which an inspection is being undertaken on behalf of the Claimants. The Claimants are not at this stage seeking any determination from the Panel in relation to earlier financial years, but this is without prejudice to their ability to do so in future.

1.5 In relation to the claim for the 2006/7 financial year, the Claimants note the Respondent's contention that any such claim is time-barred under RISAC 71.1 (see, for example, paragraph 14.13.3 of the Respondent's submission served on 30 June 2009). There are at least two fundamental difficulties with this argument, which are as follows:-

1.5.1 RISAC 71.1(A) requires notice of a claim to be given *"… within 6 months after the facts giving rise to such claim first became known by the claimant or could, with reasonable diligence, have become so known"*. An inspection of books, records and accounts was undertaken on behalf of the Claimants by Messrs Kavanagh Knight & Co Ltd between August 2007 and March 2008, following which Kavanagh Knight's report arising out of those inspections was supplied to the Respondent on 27 March 2008. On this basis alone, the claim was notified within the required six month timeframe.

1.5.2 In any event, and as stated above, the Claimants' inspection is ongoing because, particularly following the 20 May 2009 order, significant further disclosure has been made by the Respondent to the Claimants. As explained in the preliminary submission, prior to the 20 May 2009 hearing the Claimants' access (by means of their appointed agent) to relevant information was either limited or refused entirely by the Respondent. The Claimants made repeated efforts to secure such access and

the Respondent frequently indicated that it would be prepared to, and was taking the steps necessary to, provide the requested information but failed in many cases to do so. It is not credible for the Respondent to seek to argue that the Claimants are out of time given the extraordinary delay encountered by the Claimants in obtaining documents relevant to the dispute from the Respondent. Furthermore, even if such an argument was available to the Respondent (which it is not), it would have waived its right to rely on it both by its conduct in relation to the disclosure of documents and its consent to the Claimants' continuing inspection.

1.6 The outcome of the disclosure process required by the 20 May 2009 order is that the Respondent has already identified errors exceeding £170,000 in the Certificates for 2006/7 in the papers provided to the Claimants on 30 June 2009. In light of this it is wholly inconsistent for the Respondent now to seek to argue that the Claimants have no standing to bring these claims, which relate to the same Certificates and to the same subject-matter.

2. INSURANCE

2.1 The Respondent places insurance to cover all activities and operations at the Relevant Stations. The Claimants understand that approximately one-third of the insurance premiums relate to buildings, contents and rent, with the remainder being for personal accident insurance. For the 2006/7 financial year and previous years the Respondent included in QX the whole of the insurance premiums for the Relevant Stations, despite accepting for the 2007/8 financial year that a proportion (proposed by the Respondent to be 12%) of such insurance relates to non-QX liabilities and should not therefore be included in QX.

2.2 Whilst the Respondent has therefore now accepted the principle that a proportion of insurance premiums should be allocated to non-QX, it refuses to apply that principle to 2006/7. The Claimants do not understand why the Respondent has so refused and the Respondent has not disclosed any material change in the coverage of insurance between 2006/7 and 2007/8 which might provide a basis for differentiating the allocation between QX and non-QX in each of those years. Instead, the Respondent appears to have put forward two main arguments:-

2.2.1 **Year on Year Improvements** – the Respondent appears to argue that the introduction of the 12% non-QX allocation represents an improvement by the Respondent in the provision of its services. The Respondent believes that this improvement should not be seen as evidence that the previous arrangements were unacceptable and also argues that, if its decision for 2007/8 is back-dated, it would be discouraged from considering such improvements in the provision of QX services in future for fear of train operating companies (**"TOCs"**) claiming that all improvements should be back-dated within the relevant limitation period (see paragraph 14.19.21 of the Respondent's submission).

As is acknowledged in the Respondent's submission (paragraph 14.19.20), its change in position for 2007/8 was as a result of queries being raised by TOCs in relation to the allocation of insurance premiums, and was not the result of a unilateral decision by the Respondent. However, even if the change had been entirely of its own initiative, it would be untenable for the Respondent to argue that such a change should not be considered to be applicable to previous years. Whilst such an argument may be defensible where any changes represent genuine efficiency gains/improvements in working practices by the Respondent, the issue under consideration here is the allocation of costs between QX and non-QX, not the improvement of a service that the Respondent provides – it is not an efficiency gain to apportion costs correctly.

2.2.2 **No Loss Suffered** – at paragraph 14.19.23 of its submission the Respondent argues that no loss has been suffered by the Claimants in relation to the allocation of insurance premiums. This argument is not understood. Unless the Respondent correctly apportions the insurance premiums for 2006/7 to reflect the split between QX and non-QX activities, the Claimants will have to pay more than they should be required to pay under RISAC and their station access agreements. This will clearly cause the Claimants to suffer loss and would be a breach of, among other things, the Respondent's obligations under RISAC 33 and 34.

2.3 With regard to what the current allocation should be, the Claimants have requested, but not received, documentary evidence to support the 12% allocation and they have not therefore been able to form a view as to whether this apportionment is in fact fair and equitable as per the obligation in RISAC 98. However, the Claimants believe that the value of the percentage relating to non-QX has been increased by the Respondent's decision to change the insurance coverage to provide a lower deductible[1]. The effect of reducing the deductible is to make a greater number of claims subject to the insurance cover. The Respondent should take into account that a number of those claims would not have been eligible to be charged to QX and therefore amend the split between QX and non-QX in respect of insurance. No adjustment has been made to take account of any claims that the reduced deductible will cover that may arise from the Respondent's failure to perform an obligation and which therefore do not fall within QX.

2.4 Insurance costs should be included in QX to the extent that they relate to QX liabilities. However, where the Respondent elects to place insurance beyond the scope of QX liabilities (and therefore in excess of the obligations to procure insurance required by RISAC Part 5) in order to protect itself (rather than the relevant TOC) from claims, the proportion of the cost associated with such additional insurance is not a cost from which TOCs gain any benefit. These costs therefore fall outside QX (see Rail Industry Dispute Resolution 6.5/16) and so should not be charged.

3. STAFF COSTS

3.1 The Claimants object to the split between QX and non-QX staff costs applied by the Respondent. At each Relevant Station a split has been applied to the allocation of staff costs (including basic pay, National Insurance Contributions and pension contributions) of 95% QX, 5% non-QX without any justification being provided to the Claimants. This is not acceptable because the Respondent has refused to supply the Claimants with supporting evidence to determine whether the proposed split is appropriate or whether, as the Claimants believe, the split is incorrect.

3.2 In its submission, the Respondent has conceded (paragraph 14.19.3) that the split imposed was assessed *"on a common sense basis…[t]he percentages were not based on any scientific study of the work actually carried out. There were therefore no accounting books or anything else to justify them beyond common sense and experience".*

3.3 The Respondent also acknowledges (paragraphs 14.19.4 to 14.19.6 of its submission) that it is in possession of a time and motion study into the allocation of staff costs between QX and

[1] The Claimants understand that the Respondent has changed the coverage of insurance provided for the Relevant Stations to reduce the deductible for each claim from £100,000 to £5,000 per claim (nil in relation to public liability). This has in turn increased the premiums and the amount charged by the Respondent to QX. The Claimants understand that non-QX public liability claims are often in the region of £10,000 and would therefore be payable by the Respondent under the old level of deductible (£100,000), but are met by the insurance under the new deductible (nil).

non-QX initiated by a number of other TOCs. Despite requests by or on behalf of the Claimants to make this study, or the results of this study, available to the Claimants, the Respondent has refused to do so.

3.4 The relevance of the time and motion study is that the Claimants have reason to believe that it evidences that the charge to QX in respect of staff costs in the accounting year 2006/7 was over-stated. This view is supported by the Respondent's submission – whilst the Respondent argues that it does not agree with the study's conclusions, it acknowledges (paragraph 14.9.7) that following completion of the study it reached a "commercial compromise", which included an apportionment of 75% of security costs to QX.

3.5 The Respondent has failed to explain how it believes it is complying with its obligation to apportion costs on a fair and equitable basis (RISAC 98) in circumstances where the percentage split it is applying to the Claimants' staff costs for 2006/7 is not based on any scientific study of the work actually carried out and, where such a study has been carried out on behalf of other TOCs, changes to the apportionment have been made. The Claimants contend that a comparable time and motion study should be carried out to allow the parties to accurately apportion the staff costs between them.

4. DECISION SOUGHT FROM THE PANEL

4.1 The Panel is asked to determine that:

4.1.1 the entries attributed to QX for insurance in respect of the Relevant Stations for the 2006/7 financial year be reduced by 12%, representing the split between coverage for QX and non-QX insurance liabilities and the relevant amounts be repaid to the Claimants;

4.1.2 the Respondent further adjusts the insurance charged to QX in the Certificates for 2006/7 to account for the impact of any changes in scope of the insurance cover implemented by the Respondent (such adjustments to be determined by expert determination if not agreed);

4.1.3 the split applied by the Respondent of 95% QX/5% non-QX in respect of staff costs for the 2006/7 financial year should not be applied;

4.1.4 the Respondent is directed to assess at its own cost the actual split between the charges in relation to staff costs for QX and non-QX subject to RISAC 98 at each Relevant Station and such splits be agreed with the Claimants for application to the QX charged in respect of each of the Relevant Stations for the 2006/7 financial year. Failing agreement the relevant splits to be determined by expert determination in accordance with RISAC 53.2; and

4.1.5 where any further issues of principle are raised by the expert in the expert determination proceedings in respect of the Certificates for the 2006/7 financial year which that expert is not prepared to determine, such issues of principle be referred back to the Panel in this dispute.

4 September 2009

SIGNATURES

For and on behalf of New Southern Railway Limited

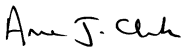
Signed 

Print name: David Walker

Position: Head of Franchise & Access Contracts

Date: 4th September 2009

For and on behalf of London & South Eastern Railway Limited



Signed

Print name: Anne Clark

Position: Head of Franchise & Access

Date: 4th September 2009