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## **NETWORK and VEHICLE CHANGE COMMITTEE**

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### **Determination NV44**

*Hearing held at Kings Cross on 27<sup>th</sup> September 2002*

*[Note: previous published determination was determination NV35:  
there was a previous note for guidance in respect of NV44]*

1. The Committee was asked jointly by Great North Eastern Railway (GNER) and Railtrack to resolve their differences as to the revenue loss compensation payable by Railtrack to GNER as a consequence of the introduction of the Leeds 1<sup>st</sup> Network Change. What was at issue between the parties was the amount of revenue loss because, although they had reached broad agreement on a methodology for assessing such loss, they differed in their views on how, in certain aspects, it should be applied.
2. The Committee had before it the benefit of a joint submission which set out three outstanding issues about which the parties could not agree. Before addressing the issues as presented the Committee took note of the following considerations;
  - 2.1. Track Access Condition G1.2 requires that

*“Any Train Operator so consulted shall, as soon as and so far as reasonably practicable, provide to Railtrack an estimate of those costs, losses and expenses... which may be incurred by the Train Operator as a result of the implementation of the proposed Network Change”*;
  - 2.2. the parties confirmed that, in respect of the matter of costs, there had been an agreement, in the context of the procedures laid down by Track Access Condition G, that these would be compensated on the basis of emerging costs, as revealed by a full exchange of detailed information;
  - 2.3. the parties were unable to present any evidence of having, at the same time, reached any such understanding in respect of a methodology, with an equivalent degree of transparency, for validating GNER’s claims for revenue losses; the joint submission made no reference to this absence of compliance with the provisions of Track Access Condition G1.2 (as set out above);
  - 2.4. the parties had sought the adjudication of the Committee on this matter before, but on that occasion had been unable to present any clear perspective on the nature or extent of their differences. As a consequence they had been given guidance as to how to resubmit the case; in general the new submission reflected that guidance.
3. In respect of the specific issues that it was being asked to determine, all of which related ultimately to the amount of compensation for revenue loss to be paid, the Committee was pleased to note that the parties were in agreement that some such compensation was payable; what was in question was the gross amount of the loss that should be admitted, and the extent that any actual payment should be subject to other deductibles.

4. It was unfortunate that the methodology for the assessment of compensation for revenue loss, upon which both the measure of agreement, and the specific differences, between the parties was based, was one which had only been devised and debated since the earlier approach to the Committee, that is after the conclusion of all the disruption to which GNER's claim refers. Specifically it was not a methodology that had been agreed before the event as means of fulfilling Track Access Condition G1.2.
5. The Committee was faced with the question as to whether or not such a methodology, devised and applied wholly after the event, could realistically generate a statement of loss compliant with the provisions of Track Access Condition G2.1, and containing "*such detail as is reasonable to enable Railtrack to assess the merits of the Train Operator's decision*". Furthermore, this question was not addressed in the Joint Submission. After careful consideration, the Committee concluded that Railtrack's preparedness, as evidenced in their written arguments and their participation in the joint submission, to accept this methodology (with reservations) meant that the Committee could not rule either it, or the totality of GNER's claim for revenue loss, as inadmissible.
6. The Committee was clear that the parties' approach could not be treated as any sort of precedent in respect of this area of the Track Access Conditions. A methodology devised and applied in the way described in the parties' evidence was at best a "broad brush" framework, to give a context to still unresolved commercial negotiations. It would be inappropriate therefore to subject either the methodology at large, or several of the specific differences between the parties, to any of the "fine brush" scrutiny that might have been warranted for resolving differences about the application of a process pre-agreed as a fulfilment of Track Access Condition G1.2 and G2.1.
7. Within the cases presented by the parties, the Committee was asked to address ten specific questions, under the cover of three specific issues. The issues related broadly to the calculation of gross revenue loss, the extent to which that loss should be deemed to be offset by benefits accruing to the Train Operator, and the amount that the Train Operator could be deemed to have already been compensated, for the disruptions from Leeds 1<sup>st</sup>, by the operation of the Schedule 8 Performance Regime within the Track Access Agreement.
8. In principle the possible answers to each of the questions were represented as having specific cash consequences. In practice the quantifications presented were not necessarily exact, or indeed consistent one with another. The Committee has therefore determined in relation to the individual questions, and then provided an overall determination of the impact that those findings have on the total compensation payable.

### **Gross Revenue Loss (questions 1 and 2);**

9. The Committee noted that the central feature of the methodology was a high level comparison of the movements of passenger revenue for both the North Yorkshire and West Yorkshire service groups over the period of the works and final implementation of the Leeds 1<sup>st</sup> Network Change. The methodology assumes that, whereas, during the period in question, the traffic in both passenger service groups was subject to a

number of adverse factors, West Yorkshire was the only one directly subject to Leeds 1<sup>st</sup>, and therefore that the difference in performance between the two service groups can be used to compute a revenue impact for Leeds 1<sup>st</sup>.

10. The Committee noted that the parties agreed that this calculation would result in a value for gross revenue loss of around £6.0M. Railtrack however contended that this figure should be marked down to around £4.7M, to take account of the following factors:

10.1. (Question 1) the Leeds 1<sup>st</sup> period was also the period of significant disruption on Arriva Trains Northern (ATN) services, services which contribute significant connecting revenues to both GNER service groups. It was Railtrack's view that the effect on the two service groups differed in scale, and that, were that difference factored into the calculation the gross revenue loss would come down by over £0.6M; and

10.2. (Question 2) the parties agreed that the calculation of revenue loss should include a period following the completion of the final Leeds 1<sup>st</sup> works; this is in line with principles set out in the Passenger Demand Forecasting Handbook (PDFH), namely that "*a change in performance takes about six months to feed through to the revenue – the case both for deteriorations in reliability and the recovery back to normal*". However, there were differences of view as to precisely which date "*about six months*" should be measured from, and therefore whether the end date for the North Yorks/ West Yorks comparison should be the end of the year 2001 (as GNER had used in its calculation) or 4 weeks earlier, as contended by Railtrack. It appeared that this difference could impact on the total by about a further £0.7M.

11. The Committee was concerned that arguments should be advanced relating to the impact on GNER of the revenue performance of a third party Train Operator (ATN), without any attempt to consult with ATN as to the validity of those arguments. The Committee was anyway of the view that each of these contentions implied a level of precision that was not compatible with the "broad brush" nature of the methodology, and therefore considered that the calculation of gross revenue loss should be based upon the broad difference between the total performance of the two service groups, for a period which, consistent with "*about six months*", should be deemed to terminate at the end of GNER's 2001 financial year.

### **Possible Future Benefits (questions 3 to 6)**

12. The Committee considered carefully the force of Track Access Condition G2.3 "***Benefits to be taken into Account***" and in particular the requirement to take into account

“(a) *the benefit (if any) to be obtained or likely in the future to be obtained by the Train Operator as a result of the proposed Network Change; and*

(b) *the ability or likely future ability of the Train Operator to recoup any costs, losses and expenses from third parties including passengers and customers” .*

13. In this connection the Committee noted that
  - 13.1. GNER contended that that provision related to NET benefits, and that a calculation of NET benefits should take account of a range of considerations, including the extent to which improved facilities might allow other Train Operators to compete more effectively with GNER (Question 3), as well as the extent to which, whilst GNER might itself be enabled to run more services, it would also be required to meet higher costs (specifically the provision of an incremental (Eurostar) train set (Question 4). By contrast
  - 13.2. Railtrack contended that, on the basis of MOIRA data supplied by GNER, there was direct evidence of immediate revenue benefits to GNER (Question 5), benefits that should be acknowledged, along with other less definite benefits that were harder to quantify (question 6).
14. The Committee considered that the interpretation of benefits as axiomatically being NET benefits was not justified, and that the provisions of Track Access Condition G2.3 stand as a protection to Railtrack to ensure that the Train Operator is required to acknowledge that Network Change does not only bring short term aggravation.
15. The Committee considered that GNER had gained considerably in the line capacity and other facilities that had accrued to it as a result of the Leeds 1<sup>st</sup> works, and that nothing had been done in any way to reduce the ability of GNER to compete for passengers in such markets as it might choose. The suggestion that the benefit from the improvements should be set at £NIL value because the new capacity will, or might, lead to the advent of competing services was rejected. In particular the Committee noted the extent that GNER had exploited the opportunity to operate a more frequent London to Leeds service from the earliest possible date. That said, the Committee recognised that Railtrack had not sought to impute any specific value to the benefits to GNER, over and above those derived by MOIRA and addressed below.
16. The Committee dismissed the argument from GNER (Question 4) that the costs involved in providing a Eurostar set in order to run an increased frequency should be offset against any calculation of benefits. The Committee's grounds were that the decision whether or not to run such a service is, with the increased capacity now on offer, a matter for GNER to decide taking account of its own commercial interests.
17. The Committee noted that the MOIRA runs for the totality of the allocated revenues to GNER, compared the revenues from the summer 2000 timetable with the Summer 2002 timetable, (i.e. before and after Leeds 1<sup>st</sup>) and identified a gross revenue benefit to GNER of over £0.5M per annum. The Committee considered that within the context of the overall approach of the parties to the matter of compensation, this was an appropriate method of calculation. It was noted that
  - 17.1. GNER wished to represent that the bulk of the change could be identified with growth in the Stevenage market, and that this was only incidentally a product of Leeds 1<sup>st</sup>;
  - 17.2. Railtrack considered that it was entitled (Question 5) to insist that this gross change in GNER's revenue, following Leeds 1<sup>st</sup>, could be adjudged a revenue benefit to Leeds 1<sup>st</sup>, and therefore should be offset against the revenue compensation;

- 17.3. Railtrack proposed that the revenue gain should be assessed as lasting for two years, until the current Track Access Agreement with GNER expired, although the case could be made that GNER would actually receive the benefit until the conclusion of its franchise agreement;
- 17.4. Railtrack believed (Question 6) that there were other benefits for GNER in Leeds 1<sup>st</sup>, but at the hearing could not propose what they might be or what they might be worth.
18. In respect of this last question the Committee was clear that no part of its determination should be concerned with matters outside the strict and particular circumstances of this case, and therefore, as there was no specific proposition to be determined, no further consideration was to be given to this question.
19. In respect of those revenue benefits that could be construed from the MOIRA print outs, the Committee noted that there were several flows where the assessed change, whether positive or negative, ran to a six-figure sum. The Committee could find no valid grounds, in the context of the general “broad brush” approach, for suggesting that the overall assessment of revenue benefit should be adjusted by the suppression of individual flows. In general the Committee endorsed Railtrack’s view that a positive value should be set on the revenue benefits, which, over the two years proposed by Railtrack, would equate to a deductible of roundly £1.0M.

### **Schedule 8 Compensation**

20. The Committee was pleased to note that the parties were in complete agreement that the Schedule 8 compensation for the period of the Leeds 1<sup>st</sup> overrun between 2<sup>nd</sup> and 15<sup>th</sup> January 2001, should be assessed at £1.6M and that the whole of that sum should be treated as a deductible from the revenue loss claim. The parties were however separated as to the treatment of 4 other items which were represented as a difference of £0.8M on the total amount of deductibles. Those 4 items were respectively
- 20.1. (Question 7) can a distinction be drawn between delays specifically identified with the introduction of the new Leeds 1<sup>st</sup> layout, and a “normal” level commensurate with the natural propensity of signalling and other infrastructure to fail?
- 20.2. (Question 8) delays attributed to Leeds 1<sup>st</sup> have affected GNER service groups other than West Yorkshire; should a special exercise be conducted to abstract these non West Yorkshire delays from the amount to be deemed to have been paid, and therefore to be deducted from the revenue loss claim?
- 20.3. (Question 9) industry charges, including Schedule 8 Performance Regime payments, have been changed as a consequence of the implementation, since April 2001, of Control Period 2 charging arrangements; if such actual payments are counted towards the Schedule 8 deductible, this will be a greater sum than if it continued to be assessed at CP1 rates. Should this be the case?
- 20.4. (Question 10) Railtrack, in calculating the value of CP2 Schedule 8 payments, had used values reflecting the average over a long time period; any such calculations should be based on averages relating to a single 4 week financial period.

21. The Committee was pleased to note that Railtrack had undertaken the further calculations implied by Question 10 and that it reduced the total of payments for the period in question by £62,000.
22. The Committee noted (Question 7) that the delay attribution process used during the Leeds 1<sup>st</sup> works had allocated delays caused by failures of equipment to the Leeds 1<sup>st</sup> project, but only until the equipment was accepted and signed off to the local Infrastructure Maintenance Contractor, whereupon delays ceased to be attributed to Leeds 1<sup>st</sup>. The deductible claimed by Railtrack was calculated in relation to the Schedule 8 payments made in respect of delays attributed to Leeds 1<sup>st</sup>, and, in the opinion of the Committee that was the more appropriate way to calculate this.
23. In respect of Question 8 the Committee was disinclined to take any different view than it had in relation to other aspects of this case, namely that “broad brush” assessment techniques should not be set aside because, at certain points, use of a finer brush would bring one party a different order of advantage. It did not therefore agree with the representation from GNER that some elements of that deductible should be picked out.
24. In respect of Question 9, the Committee could see no good reason for assessing this deductible on any other basis than that of the actual payments made by Railtrack under Schedule 8. Thus payments made at CP1 rates should be deducted at CP1 values, and payments made at CP2 rates should be deducted at CP2 values. The Committee was of the view that, where this assessment at CP2 rates creates an apparent anomaly it is one that the Train Operator should address with the Regulator, or the SRA, and should not be a charge on Railtrack.

## **The Determination**

25. In summary, therefore, the Committee determined that
  - 25.1. this appeal, which fundamentally arises because of the failure of one or both parties to comply appropriately with the provisions of Track Access Condition G1.2, can only be judged on the merits of the efforts made by the parties to make good that earlier omission; as such it can have no bearing on any other case where the issues in cause arise out of the due observance of Track Access Condition G;
  - 25.2. the parties are to be commended to the extent that, in order to make good the earlier omission, they have derived a representative model against which to benchmark an assessment of both the gross revenue loss, and the various deductibles;
  - 25.3. the methodologies upon which the Committee has been asked to determine can be no more than broad approximations, subject, as the substance of the points put at issue has confirmed, to much potential criticism at the level of detail;

25.4. it would be inappropriate for the Committee to employ, in its determination, a degree of precision that is disproportionate to the degree of precision in the cases brought; therefore the Committee determines that in respect of the GNER claim for revenue compensation in relation to the Leeds 1<sup>st</sup> Network Change

25.4.1. the gross value of the revenue loss (i.e. questions 1 and 2), before deductibles should be set at **£6.0M**;

25.4.2. the total value of the deductibles should be assessed at **£3.6M** being composed of

- i. **£1.0M** in respect of the identified revenue benefits (question 5) with NO abatement in respect of other Train Operator competition (question 3) or of Eurostar hire costs (question 4);
- ii. **£1.6M** in respect of the agreed value of Schedule 8 payments in relation to the overrun between 2<sup>nd</sup> and 15<sup>th</sup> January; and
- iii. **£1.0M** in respect of Schedule 8 payments for other Leeds 1<sup>st</sup> related delays, with NO adjustments conceded in relation to so called “normal” delays (question 7), delays to other than West Yorkshire services (question 8) or, other than in respect of the re-calculation of period rates undertaken by Railtrack, in relation to that time when CP2 rather than CP1 rates applied (questions 9 and 10); and that therefore

26. the total compensation to be paid by Railtrack to GNER in final settlement of all claims in respect of revenue loss as a consequence of Leeds 1<sup>st</sup> shall be **£2.4M**.

27. The Committee emphasises to all parties the importance of following the procedures set out in the Track Access Conditions, which exist to avoid the issues that arose in this instance at some cost to all.

Tony Holland

Chairman