



OFFICE of the
RAIL REGULATOR

THE REGULATOR'S DRAFT CONCLUSIONS ON THE PROPOSED TENTH SUPPLEMENTAL AGREEMENT BETWEEN RAILTRACK PLC AND WEST COAST TRAINS LTD

(THE "PUG 2" AGREEMENT)

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Summary

1. In this document the Regulator sets out, for consultation with train operators, funders of the railway and the parties to the agreement, his proposed conclusions as to the terms on which he would be prepared to approve the proposed Tenth Supplemental Agreement between Railtrack PLC and West Coast Trains Ltd (Passenger Upgrade 2 or PUG 2).

The Regulator's proposed decision

2. The Regulator is proposing to conclude that in view of the significant benefits of the proposed agreement to passengers on the route and the achievement of wider transport policy objectives, he would presently be minded to approve the proposed agreement. He notes in particular the faster trains and higher frequencies entailed by the proposal. He is however setting out what he considers to be requirements on Railtrack in terms of capacity on the network which he would expect to enforce under Railtrack's Network Licence. He is also proposing to require a number of amendments to the proposed agreement, essentially to protect the interests of other rail users.

Capacity on the route

3. In terms of capacity on the route, the Regulator proposes to require Railtrack, under the requirement in its Network Licence to develop the network to meet the reasonable requirements of train operators and funding bodies, to provide spare capacity for additional passenger and freight services (which could potentially, for instance, accommodate a doubling of freight traffic on key parts of the route). He is expecting an immediate commitment from Railtrack to this to reinforce that made at the Hearing held on 6 March 1998.

4. Beyond that however he considers that Railtrack should carry out a number of Reviews to establish the further reasonable requirements of train operators and funding bodies in respect of freight; routes in the West Midlands; routes in South Manchester and faster services between Euston and Northampton. He expects it to report on what action is needed to meet those reasonable requirements, and to produce details of the processes by which it intends to carry out the necessary Reviews before the end of April 1998. He expects that these Reviews will lead to enforceable commitments in the 1999 Network Management Statement to make Railtrack compliant with the licence requirement in respect of train operators and funding bodies. He is inviting the Board of Railtrack to give undertakings to this effect in order to provide assurances to the parties affected.

5. The Regulator recognises, however, that approving the current PUG 2 agreement would make it impossible, on current infrastructure plans, for Railtrack to renew the existing access rights on the route for Silverlink Train Services, Connex South Central and Central Trains (on behalf of Centro PTE) after they expire. In the case of Silverlink Train Services and Connex South Central, the Franchising Director has accepted that the rights can be adjusted at the time of refranchising in a manner which still meets the needs of the vast majority of passengers on the route. In the case of the Central Trains rights, the Regulator is minded to conclude that the benefits of the proposed quarter-hourly service between Great Britain's two largest cities outweigh the disbenefits to the local services on the Birmingham to Coventry route. However, this conclusion should be seen against the background of the further Reviews - and action plans - the Regulator is requiring from Railtrack.

Moderation of Competition and new services for North Wales and Edinburgh

6. The Regulator is minded to accept some additional protection for West Coast Trains from competition from other operators on the route, reflecting the scale of the investment being made. He is not however prepared to accept constraints which do not appear to be required by the business case for the upgrade, or which will unduly constrain services for markets not currently well served (for instance introduction of new cross-London services). In the case of the proposal to limit competition between North Wales / Chester and London, the Regulator would be prepared to consider such protection if Virgin as the franchisee on the route were to make enforceable commitments to significant service improvements to the Franchising Director, and the Franchising Director were to advise him that this was the best way of securing those passenger services on the route.

7. The proposed agreement contains new rights to operate services between Euston and Edinburgh. The Regulator is minded to approve these rights, provided that West Coast Trains makes appropriate commitments to the Franchising Director about increased provision of services between Euston and Glasgow.

Revenue sharing

8. The proposed agreement contains a number of innovative features. In particular it incorporates a revenue sharing arrangement between Railtrack and the train operator. A number of other operators and funding bodies on the route have expressed concern that this proposal may lead Railtrack to discriminate against their interests and in favour of Virgin's. The Regulator has concluded that the existing contractual and licence protections against this are adequate, and that in the light of this the benefits of the revenue sharing arrangement outweigh the disbenefits.

Other aspects of the proposed agreement

9. The Regulator is however proposing to require, before approving the proposed agreement, a number of changes designed to ensure that the interests of other users of the route are appropriately protected.

Planning and implementation

10. The implementation of Passenger Upgrade 2 will have significant implications in terms of changes to the infrastructure, services during disruption, and restructuring of the timetable. Railtrack has committed to taking these forward through the contractual processes in the Track Access Conditions, which give other operators rights of consultation and appeal. In addition, the Regulator proposes that Railtrack should review its environmental policies in the light of the possible impact on the environment of the work on the route.

Structure of this document and next steps

11. In this document, Chapter 1 sets out the Regulator's proposed conclusions and the reasons for them. Chapter 2 sets out the proposed conclusions on capacity on the network. Chapter 3 sets out the Regulator's proposed conclusions on Moderation of Competition, access rights to Edinburgh and revenue sharing. Chapter 4 sets out the Regulator's proposed conclusions on other matters in relation to the agreement. Chapter 5 sets out various matters in relation to the implementation of the upgrade.

12. Chapter 6 sets out the next steps. The Regulator is seeking comments on his draft conclusions from train operators, funding bodies and the parties to the proposed agreement by Friday 17 April.





1. Introduction and the Regulator's Proposed Decision

Introduction

13. The Regulator has considered the draft Tenth Supplemental Agreement to the Track Access Agreement between Railtrack PLC and West Coast Trains Limited (negotiated by the Virgin Rail Group as franchisee of West Coast Trains). The draft supplemental agreement was submitted to the Regulator in November 1997 for his comments prior to a formal submission for approval. The proposal which Railtrack and West Coast Trains have developed, and of which the proposed Agreement is part, has become widely known as "Passenger Upgrade 2" or "PUG 2".

14. This document sets out in draft the conclusions the Regulator is minded to reach on the terms under which it would be appropriate for him to approve a supplemental agreement in relation to PUG2 pursuant to section 22 of the Railways Act 1993.

15. In reaching these proposed conclusions, the Regulator has had regard to his statutory duties under section 4 of the Railways Act, and to relevant statements of regulatory policy he has previously issued. These include: *Criteria for the Approval of Passenger Track Access Agreements* second edition, March 1995; and *Investment in the Enhancement of the Rail Network*, March 1996. In considering the proposed agreement against these criteria, the Regulator has considered among other things responses made by the parties to detailed questions he has asked about the proposed agreement; written responses to the consultation document he published in December 1997; and representations made at a Hearing attended by funders and providers of railway services and user representatives on 6 March 1998.

16. At the same time that the supplemental agreement was submitted for the Regulator's consideration, Railtrack and the Virgin Rail Group submitted a proposed track access agreement which would, if approved by the Regulator, have conferred track access rights on the Virgin Rail Group to run certain services on the West Coast Main Line in the period between 2012 and 2027. The Regulator's consultation document invited views on this agreement as well as on the proposed supplemental agreement between Railtrack and West Coast Trains. The parties informed the Regulator on 20 February that they no longer wished to proceed with the agreement for 2012-27, and accordingly it no longer falls to the Regulator to consider such a proposal. The Regulator is therefore issuing no conclusions or comments in relation to that agreement.

17. The Regulator has also considered two Vehicle and Route Acceptance Agreements agreed between Railtrack PLC and respectively West Coast Trains Ltd and CrossCountry Trains Ltd. He has informed the parties that he is willing to approve those agreements as submitted.

18. On March 26 1998 the parties sent the Regulator a revised draft incorporating amendments and corrections to the draft PUG2 agreement. The Regulator has not had time to consider these. If any of them were in his opinion likely to have a material effect on other parties, he would expect to consult further.

The Regulator's proposed decision

19. The Regulator would presently be minded, subject to the results of this consultation, to approve a Tenth Supplemental Agreement to the Track Access Agreement between Railtrack PLC and West Coast Trains Limited in the terms of the proposed agreement submitted to him by the parties, if it reflected the points made below, and subject to the actions also specified in this document.

Public interest benefits of PUG 2

20. The Regulator believes that the objectives which the PUG2 agreement are intended to achieve are in the public interest. He believes that PUG2 can bring about a step change in the quality of service provision between many of the country's major cities, offering benefits in terms of frequency, journey time, and reliability. Subject to his conclusions on future provision and allocation of capacity (see Chapter 2 below) he considers that the enhancement of West Coast Main Line infrastructure provided for under PUG 2 will create benefits for users of the network other than West Coast Trains. The PUG 2 proposals can benefit the railway as a whole, its customers and its funders, by creating confidence that major projects for enhancement investment are capable of being brought forward, by providing important new services and by bolstering overall public confidence in the railway as a modern, high quality mode of travel. PUG 2 can make a significant contribution towards the Government's integrated transport policy objective of

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promoting the use of public transport - an objective consistent with one of the Regulator's own objectives under section 4 of the Railways Act of promoting the use of the railway network for the carriage of passengers and goods. The Regulator has concluded that in the absence of the PUG 2 agreement there would be little prospect of these benefits being achieved on the route served by the West Coast Main Line in the foreseeable future.

21. The above conclusion is consistent with, and reflects, representations made to the Regulator *inter alia* by the Franchising Director, and by groups representing the interests of passengers (including the Rail Users' Consultative Committees), and a number of local authorities on the route.

22. The Regulator notes that the West Coast Main Line is designated as a TENS project under the European Union transport policy. It is for the parties before entering into the PUG2 agreement to satisfy themselves that it is in fact compliant with such matters but the Regulator does not consider, in the light of his views expressed above, that the proposed agreement is in itself incompatible with the purposes of the TENS policy and the requirements of European Union law.

23. There are, however, certain changes to the proposal which the Regulator would wish to see before he would be willing to grant his approval and a number of important commitments by Railtrack external to the proposed agreement itself. These are explained and discussed below.



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2. Capacity on the Route

24. As the Regulator's consultation document explained, the future provision and allocation of capacity for all users of the West Coast Main Line has been a key issue in considering the proposed agreement. The West Coast Main Line is a vital artery for a wide variety of traffic. Before approving an agreement which allocates access rights to one particular operator, therefore, the Regulator has sought to satisfy himself that the interests of other users of the West Coast Main Line will be properly considered and addressed by Railtrack over the course of the agreement.

25. In this context the Regulator notes and welcomes the proposal that Railtrack's plans for the West Coast Main Line involve enhancement investment to provide significantly more additional capacity than would be needed solely to meet the access rights which West Coast Trains would acquire under the proposed agreement, and the existing access rights of other users of the route. The investment proposals to which Railtrack intends to commit while carrying out the PUG 2 agreement are additional to other proposals committed in the Core Investment Programme for renewal of the West Coast Main Line.

Impact of PUG 2 on other operators.

26. Despite Railtrack's plans in respect of extra capacity, a number of passenger and freight operators and funding bodies affected by the proposal have informed the Regulator that Railtrack does not have satisfactory proposals in place which will meet their reasonable requirements in the first decade of the twenty first century and beyond. This is a matter of considerable concern to the Regulator, who would expect Railtrack when agreeing plans for a major enhancement of services with one operator to have in place a shared understanding with other operators of their reasonable aspirations so that synergy and economies of scale can be sought in investment plans. Following the Regulator's conclusions on the PUG 1 agreement, a consultative process was begun, but this does not appear to have been effectively followed through as the PUG 2 agreement was finalised.

27. Thus, whereas there is a strong shared understanding between Railtrack and West Coast Trains as to the requirements of that particular operator up to 2012, and Railtrack proposes to enter into contractual arrangements under which it commits to satisfying those requirements, the position in respect of other operators is much less satisfactory. While Railtrack's plans to meet other operators' requirements are not undeveloped, they are, as they stand, inadequate to allow the Regulator to be assured that Railtrack has in place a suitable strategy for the West Coast Main Line to secure its "improvement, enhancement and development so as to satisfy the reasonable requirements of persons providing services for the carriage of passengers or goods by railway and funders in respect of the quality and capability of the network" - as Railtrack is obliged, under its Network Licence, to do.

28. Currently Railtrack has in place access agreements with train operators on the route giving them access rights to operate their train services. These train operators and their funders will expect Railtrack to honour these agreements as does the Regulator. However, the vast majority of these agreements expire before the full effect of PUG 2 is felt in 2005. The process of regulatory consultation and scrutiny has established that with Railtrack's current infrastructure plans and its commitments to West Coast Trains under PUG 2 it will not in some cases be possible for Railtrack to renew the access rights from 2005 on the same basis as at present.

29. In the case of access rights held by Silverlink Train Services and Connex South Central there will be a need to restructure the rights currently held to make them compatible with current infrastructure plans and PUG 2 commitments. The Franchising Director has told the Regulator at the Hearing that he believes this can be done in a way which retains the vast majority of the passenger benefits currently in place, and therefore the Regulator proposes to approve the PUG 2 arrangements without requiring a commitment from Railtrack to meet these rights rolled forward in their current form.

30. In the case of access rights for stopping services between Coventry and Birmingham New Street held by Central Trains to operate services on behalf of West Midlands PTE, the Regulator has established that on current infrastructure proposals it is unlikely to be possible to accommodate existing journey times. The Regulator accepts that disbenefits will result from this: a possible increase of 6 minutes in journey times for stopping services; and additional resource costs to the PTE. However, the proposal will also bring benefits for rail users in the West Midlands: in particular a quarter-hourly high speed train service linking Great Britain's two largest cities. West Coast Trains confirmed at the Regulator's Hearing that its services would be available to passengers making short trips in the West Midlands, and it will therefore be possible for passengers travelling to local stations to take advantage of these faster times by changing between services at Birmingham International. The Regulator therefore considers that the public interest benefits of the proposal outweigh the disbenefits, subject to commitments being made by Railtrack in order to seek to address the problems which PUG 2 gives rise to. The Review - described in paragraph 40 - which he requires Railtrack to undertake of options for developing

infrastructure in the West Midlands will be the starting point for a programme of improvements designed to cater for local services. The Regulator understands that Railtrack recognises that the PUG 2 proposals as they stand disadvantage some rail users in the West Midlands, and that Railtrack has therefore agreed if PUG 2 proceeds to commit to expenditure of up to £10 million (with arrangements for any excess) on works in order to satisfy the reasonable requirements of West Midlands PTE, as required by Railtrack's network licence. The Regulator welcomes this commitment, which he proposes to enforce.

31. Over and above existing rights carried forward, a number of operators, both passenger and freight, have indicated that they wish to seek additional rights on the route. To some extent these plans have been allowed for in Railtrack's plans under PUG 2, but to some extent the position is less clear.

32. Given these concerns of other operators and funders, one option available to the Regulator would be to decline to approve the proposed PUG 2 agreement until such time as he is satisfied about the adequacy of Railtrack's overall strategy for the West Coast Main Line addressing these concerns. The Regulator considers, however, that such an approach would be mistaken because the opportunity for step change investment of the type contemplated in PUG 2 might be lost. The finite length of passenger franchise terms is particularly relevant here. The ability of operators to undertake to finance major investment necessarily declines over the course of the franchise period, and in that sense there is a window of opportunity which may close if there is significant delay before investment can go ahead. The effect of this may be to make the railway incapable of financing an investment which it would otherwise have been able to achieve.

33. Therefore, the Regulator considers that delaying or declining his approval for the PUG 2 agreement would not be an effective way of securing the provision of an adequate overall strategy by Railtrack for the West Coast Main Line.

34. The proposed agreement is, moreover, not the most appropriate vehicle by which to create and enforce obligations in respect of such a strategy. This is because access agreements are only enforceable by the parties to them, not by the Regulator. Accordingly, the obligations which Railtrack would take through the agreement would be to West Coast Trains and would be enforceable only by West Coast Trains; but the obligations with which the Regulator is concerned are to third parties. Inclusion of such obligations in an access agreement would be unlikely to achieve the Regulator's purpose.

Railtrack's licence requirements and undertakings sought by the Regulator

35. The Regulator considers that the appropriate means to secure that Railtrack has in place an appropriate strategy for the West Coast Main Line as a whole is through enforcement of Railtrack's Network Licence obligations as steward of the national rail network. Railtrack is obliged under Condition 7 of its Network Licence to improve, enhance and develop the national rail network "**so as to satisfy the reasonable requirements of persons providing services for the carriage of passengers or goods by railway and funders**", in terms both of network quality and capability. Railtrack has a general duty to achieve this purpose, having regard to all relevant circumstances including its ability to finance its licensed activities.

36. The Regulator believes that Railtrack must develop an appropriate strategy for the West Coast Main Line as a whole, if it is to be compliant with this obligation in its Network Licence. The Regulator has therefore set out in the Annex to this document his requirements as to how Railtrack should conduct itself in order to achieve compliance. **In the Regulator's view satisfying all of the objectives which the requirements listed in the Annex would achieve is a necessary condition of Railtrack being compliant with its Network Licence. He is seeking from Railtrack undertakings that it accepts this view in order to provide assurances to the parties affected. It would nonetheless be the Regulator's intention, if necessary, to enforce their delivery.**

37. The requirements of Railtrack listed in the Annex are of two kinds. **The first set of requirements** deals with commitments to provision of capacity for third parties already envisaged in the PUG 2 project itself. Railtrack has made important public statements about "spare capacity" which PUG 2 will create (that is to say, capacity which is additional to that needed to accommodate the access rights of West Coast Trains and, broadly, to accommodate existing rights and services on the West Coast Main Line, with access rights rolled forward as necessary but subject to the adjustments noted in paragraphs 29 and 30 above). As noted in paragraph 25, the Regulator believes it is right that PUG 2 should include the provision of such additional capacity. For step change infrastructure investment to occur without provision for the general growth of rail businesses would be extremely undesirable. It would in particular cast blight on the growth potential of rail freight, to which the Regulator and the Government attach great importance.

38. The requirements in respect of capacity give the Regulator, and through him the industry, enforceable assurances in respect of Railtrack's public undertakings about the PUG 2 project, notably, the commitment to provide 2 spare high speed paths per hour on the fast lines, and 42 spare paths per day on the slow lines for freight or passenger use between Euston and Rugby (with appropriate ability to continue beyond Rugby). The use of the spare paths will be determined by future access agreements which will be subject to the Regulator's approval; in considering such agreements the Regulator would expect *inter alia* to have regard to the importance of the route for freight.

39. **The second set of requirements** derives from the Regulator's view, on the basis of submissions from other operators, that over the longer term demand will exceed available capacity on the West Coast Main Line even with the PUG 2 proposal and that Railtrack has not yet fully established the reasonable requirements of train operators and funding bodies.

40. The Regulator requires therefore that, in line with its licence obligations, Railtrack should carry out strategic Reviews of options for further improvements in capacity for freight traffic on the routes served by or from the West Coast route; for all traffic on the routes serving Manchester Piccadilly (looking beyond existing commitments, including the South Manchester resignalling already committed); the routes in the West Midlands (where Railtrack have acknowledged that the proposal leads to a worsening of some local

services, and have agreed to make commitments to the PTE in respect of funding to redress this); and the Euston to Hanslope Junction section of the West Coast Main Line. The Regulator requires full consultation with stakeholders in these Reviews, consistent with the licence obligation. He expects that, under the terms of the licence obligation, these Reviews will lead to appropriate enforceable commitments (with appropriate plans and milestones) in the 1999 Network Management Statement, where appropriate seeking synergy and economies of scale with the work already committed on renewal and upgrade.

41. The Regulator also requires Railtrack to report to him on the procedural arrangements it has put in place to ensure that, in meeting its licence obligations in respect of maintenance, renewal and replacement, and improvement, enhancement and development of the network, it does have due regard to the reasonable requirements of the West Midlands PTE (Centro) and PTA as funders of services for the carriage of passengers. The Regulator takes very seriously the representations from Centro and from local authorities in the West Midlands about the inadequacy of Railtrack's planning for the growth of rail travel in the area, and, as with all the Reviews he has required Railtrack to undertake, he will be monitoring progress closely. The Regulator expects Railtrack to present to him by 30 April 1998 details of the processes by which it intends to meet the obligations contained in this and the preceding paragraph.

42. While the Regulator would consider on its merits any representation from Railtrack or a third party as to suitable alternative means to achieve the same objectives, or that the requirements in the Annex are not such that satisfaction of them is a necessary condition of compliance with its Network Licence, the status of these requirements as necessary conditions is not contingent upon the consent of Railtrack (or of any other party). It is for the Regulator to determine whether Railtrack has contravened or is likely to contravene its Network Licence. The Regulator believes, however, that it is desirable that so far as possible there should be agreement between the Regulator, Railtrack and stakeholders as to the steps to be taken if compliance with the Network Licence is to be achieved. This is very important in the case of PUG 2, where stakeholders have legitimate concerns that their interests in the West Coast Main Line should not be materially jeopardised by a step change in infrastructure quality and capacity. In particular, freight operators must have confidence that proper regard will be given, and action taken to support the development of their businesses in response to customer demand. Before approving the PUG 2 agreement, therefore, the Regulator seeks a formal response from the Board of Railtrack PLC that it accepts that satisfying the requirements listed in the Annex is a necessary condition of Railtrack being compliant with its Network Licence. He would expect to make public, when issuing his final conclusions, any response from Railtrack. **The Regulator will monitor Railtrack's compliance with its Network Licence obligations over time, using the requirements in the Annex as part of his criteria for this assessment; and he will take any necessary enforcement action to secure that compliance is achieved.**

43. Meeting the requirements in the Annex is not a *sufficient condition* for licence compliance because there are other requirements which Railtrack must satisfy in order to achieve compliance. It should in particular be noted that Railtrack's obligations to improve, enhance and develop the network - and the other obligations in the Network Licence - apply to the network as a whole. **Nothing in this document should be taken as indicating that in discharging its stewardship obligations Railtrack may give undue priority to the West Coast Main Line over any other part of the national rail network - or indeed over those aspects of the West Coast Main Line not explicitly referred to in the Annex.**

Eurostar access rights

44. The Regulator was concerned to note that Railtrack appears to have been unsure about its ability to satisfy its obligations under its track access agreement with Eurostar. The Regulator expects that as a matter of course any agreement presented to him (and any supporting submission about how Railtrack will execute its obligations under that proposed agreement) will be consistent with Railtrack's obligations under its existing agreements. In approving this agreement, he would not expect Railtrack to proceed with it unless it is satisfied that it is capable of fulfilling exercise of rights by Eurostar consistent with the provisions in the PUG 2 agreement itself and with satisfying the requirements for compliance with the Network Licence set out in the Annex.



3. Moderation of Competition, Edinburgh Services and Revenue Sharing

Moderation of Competition

45. The PUG 2 agreement proposes significant additional restrictions on new services competing with West Coast Trains on the route compared with the existing Passenger Upgrade 1 agreement. The main changes proposed are:

- Railtrack is prevented from selling new access rights from key West Coast Trains destinations to a range of additional alternative termini in London (Paddington (for West Midlands services), Marylebone, Waterloo, Wembley Central, St. Pancras and Kensington Olympia).
- Railtrack is prevented from selling new access rights from Milton Keynes to London (other than to Silverlink Train Services, the other major operator from Milton Keynes to London), and from Milton Keynes to other key West Coast Trains destinations.
- Railtrack is prevented from selling new access rights from West Coast Trains destinations in the West Midlands to London via Northampton (other than to Silverlink Train Services).
- Railtrack is prevented from selling new access rights for additional train services from North Wales stations and Chester to London.
- Provisions made under Passenger Upgrade 1 for Moderation of Competition protection to be reviewed by the Regulator in the case of material breach of the West Coast Trains Franchise Agreement are deleted.

46. In considering whether to approve these proposed additional protections for West Coast Trains, the Regulator has had regard to his published statements on *Competition for Passenger Railway Services* and *Investment in the Enhancement of the Railway Network*. He recognises the potential benefits of competition for passengers through more attractive services. However, he also notes the possible impact of competition on the profitability and viability of the PUG 2 project and thus the ability of West Coast Trains to provide new or more attractive services. He notes that a number of consultees have expressed concern about the lack of enforceable commitment on West Coast Trains to deliver the extra PUG 2 services; he also wishes to ensure that where there is Moderation of Competition protection this is not such as to prevent new services for markets not directly served, or poorly served, by West Coast Trains.

47. The Regulator has concluded that the proposed extension of protection from competition to cover services to a range of alternative London termini would be acceptable because these can be seen as direct alternatives to Euston, and such services would probably create a significant risk to the profitability of West Coast Trains services. In the case of Kensington Olympia he considers however that it is important that development of new cross-London services should not be prevented, and therefore that the protection should not cover services operating to or through Clapham Junction, Denmark Hill or Herne Hill stations and beyond.

48. In the case of Milton Keynes to London the Regulator, noting the support of the Franchising Director for the protection, the limited spare capacity of the route, and the existence of Silverlink as a competitor, would on present evidence be prepared to accept the proposed restriction. He notes that the effect of granting the protection to West Coast Trains is that Silverlink and West Coast Trains will be the only operators on the Milton Keynes to London flow, and thus Silverlink as well as West Coast Trains would *de facto* have protection from competition. However he would not be prepared to allow such protection for flows to the north of Milton Keynes, since he believes these could be linked to possible cross-London or other services.

49. In the case of Birmingham via Northampton to London, the Regulator understands that this is a relatively small element of the business case for Pug 2 and would not on present evidence be prepared to accept the proposed protection.

50. In the case of North Wales/Chester to London, the Regulator notes the passenger needs set out by user representatives at the Hearing for additional services. He notes the North West Trains franchise plan commitment to operate 4 services per day (in addition to West Coast Trains existing 3) between 2000 and 2004 (possibly starting in 1999). He also notes that subsequent to the Hearing, Virgin Rail Group as West Coast and CrossCountry franchisee has indicated that it would be willing to commit to operate 6 through services per day from North Wales to London from 2001. This would represent a material improvement to services in an area currently poorly served by direct trains to London. The Regulator has concluded that he would be minded to accept protection from competition for West Coast Trains from the end of the North West Trains franchise provided that Virgin Rail Group, as franchisee of West Coast Trains, makes a commitment to the 6 trains per day. Before doing so, he would expect this to be a Franchise Agreement commitment, and to receive advice from the Franchising Director

that in his opinion this is the best way of securing the passenger services from North Wales to London.

51. As far as the provisions concerning review of Moderation of Competition protection in the event of a material breach of the Franchise Agreement are concerned, the Regulator would not on the information currently available be prepared to accept a change from the PUG 1 situation, because he considers that the concerns which led to the PUG 1 requirement remain valid. He further notes that at this stage there is only limited commitment through the West Coast Trains Franchise Plan to deliver the enlarged PUG 2 output. Access rights to run between London Euston and Edinburgh

Access rights to run between London Euston and Edinburgh

52. The PUG 2 agreement proposes that West Coast Trains should acquire access rights to run services between London Euston and Edinburgh, using the WestCoast Main Line, as well as services between Euston and Glasgow. The rights are configured in such a way that West Coast Trains may bid to vary the relative level of service to Edinburgh and Glasgow, subject to the constraint that there is a maximum number of trains which may be run to Edinburgh.

53. The proposal that West Coast Trains should acquire rights to run to Edinburgh has been objected to (in a qualified form) by Strathclyde PTE, and opposed by Great North Eastern Railway (GNER).

54. In considering the representation made by GNER, the Regulator would expect to apply the test for assessing the benefits of new services set out by Chris Bolt, Director, Economic Regulation Group, in his letter to Train Operating Companies dated 21 February 1997. This letter set out how the Regulator expected to reach conclusions on the overall benefit of proposed new services:

provided the operator seeking new access rights can demonstrate that there is a reasonable expectation of additional passenger benefits, and the Regulator considers that the impact on existing services is not sufficiently great that the overall outcome is likely to be to the detriment of rail passengers, the Regulator would normally expect to approve these rights, subject to them also satisfying other existing criteria (paragraph 5).

55. In making his assessment, the question for the Regulator is the balance between passenger benefits on the one hand and revenue abstraction on the other of the services in their own right.

56. The Regulator accepts the case from GNER that if the proposed Edinburgh services were to be introduced there would be some loss of revenue to the East Coast Main Line franchise. While a precise estimate of the value of revenue is difficult to achieve, the Regulator has seen submissions from both GNER and West Coast Trains which suggest a broad figure, and considers that these submissions are not inconsistent with each other. The submission from GNER argued that the proposed rights were indeed primarily abstractive. However, the Regulator considers that the proposed new services between Euston and Edinburgh could deliver genuine benefits to passengers. These include:

- increased capacity and frequency on the flows between London and Edinburgh, and between London and Scottish destinations in general;
- improvements to journey times between London and Scotland;
- improved direct services between Edinburgh and stations on the West Coast Main Line.

57. Turning to the question of relative levels of service to Edinburgh and Glasgow, the Regulator notes that the proposals submitted to him contain a measure of flexibility for West Coast Trains to vary the service pattern between the major Scottish cities. He believes that the inclusion of such flexibility is desirable, given the difficulty of predicting the precise balance of demand over the course of the agreement. The Regulator is, however, sympathetic to the concern that PUG 2 should deliver improved services to Glasgow, historically the Scottish destination primarily served by the West Coast Main Line. The views of the Franchising Director as to the services the franchisee should offer are of importance in this context, and the Regulator understands that the Franchising Director would wish to see some guarantees about service improvements to Glasgow through PUG 2.

58. On balance, the Regulator's view is that guarantees as to a minimum - and increased above existing - level of service to Glasgow are in the public interest. He considers, however, that the most practicable way to achieve this would be through commitments in West Coast Trains' Franchise Plan, rather than in the access agreement itself. Accordingly, **the Regulator will wish to establish from the Franchising Director that in his view satisfactory commitments in respect of minimum levels of service between Euston and Glasgow have been made by Virgin Rail Group as franchisee of West Coast Trains before he approves the PUG 2 agreement.**

Revenue sharing

59. The Regulator has considered carefully the proposal that the PUG 2 track charges should contain a revenue sharing element. He notes that consultees generally saw advantages and disadvantages to this proposal. While, on the one hand, the principle that Railtrack's income should be in part dependent on the railway's success in attracting customers was welcomed, concern was expressed on the other hand that revenue sharing provided incentives on Railtrack to discriminate in favour of West Coast Trains and against other operators in the running of the network. The Regulator's relevant statement of policy (*Investment in the Enhancement of the Railway Network*, paragraph 2.4) says that the Regulator does not rule out the possibility of "the infrastructure owner having an interest in the operation of trains".

60. The Regulator considers that while it is true that a revenue sharing agreement does provide incentives to Railtrack to discriminate in favour of West Coast Trains, the interests of other operators are properly safeguarded by provisions in the

Track Access Conditions and by Railtrack's Network Licence obligations. It is open to operators who consider that any discriminatory treatment has occurred to make complaints through the channels provided, and the Regulator will be monitoring developments closely. If any allegation against Railtrack of undue discrimination were substantiated, the Regulator would regard the matter as most serious, and would expect to take appropriate strong action against Railtrack. He is therefore prepared to approve the proposed revenue sharing arrangements.

61. The Regulator does not consider that the proposed agreement constitutes an interest of the form which would require consent under Condition 11 of Railtrack's Network Licence.



4. The Proposed Agreement

Commercial purpose and self-modification provisions

62. The Regulator has considered carefully the application of the concept of *commercial purpose* in the proposed agreement. He noted in his consultation document that this was without precedent in track access agreements, and he invited views from the rail industry on its use. The balance of opinion among consultees was, strongly, that the concept of commercial purpose could be a helpful one in the context of track access agreements. The Regulator is inclined to share this view, and he considers that there are no adverse consequences of this commercial purpose clause which could subvert established industry processes or which would otherwise be likely to cause Railtrack to discriminate in favour of West Coast Trains in its treatment of different operators.

63. The Regulator proposes, however, some amendments to the commercial purpose as drafted, in order that it should be made explicit that rights and obligations derived from the commercial purpose are to be exercised in a manner which pays due regard to other rights and obligations (whether in bilateral or multilateral agreements or in licences).

64. The proposed agreement also makes provision for some degree of self-modification. The Regulator's policy on self-modification in agreements is that, used properly, it is a sensible way of achieving flexibility: but its use should not trespass upon legitimate regulatory concerns. His guidance requires that "Any flexibility enabling the parties to make material changes to the agreement should be subject to the Regulator's approval..." (*Criteria for the Approval of Passenger Track Access Agreements*, paragraph 17).

65. The Regulator is satisfied that the self-modification procedures in respect of changes to the Infrastructure and Rolling Stock parameters are a reasonable provision which will allow necessary flexibility in technical design, and any impact on other operators would be subject to the contractual protections set out in Chapter 5 below. He does not believe that changes made under the given procedures will be of regulatory concern. The provisions which allow the parties to agree amendments to the Schedule 5 access rights are, by contrast, of considerable potential interest to third parties. The Regulator would not expect to approve agreements which allow significant changes to be made to access rights in a way which circumvents regulatory approval. **Accordingly, where the agreement provides for negotiation in certain situations of "Best Achievable Access Rights", the Regulator would wish to see the insertion of provisions to ensure that the amendments are subject to his approval; the same applies in respect of the negotiation of changes to the access rights in the event of a "failure situation" (such as, for instance, the failure to implement Transmission Based Signalling), and the opening of a new maintenance depot.**

Exclusivity of fast line use

66. One provision in the commercial purpose as drafted in the proposed agreement is that the use of the West Coast Main Line fast lines between London Euston and Rugby shall under phase 2 of PUG 2 with specified exceptions be reserved in the daytime for use by high-speed operators. The Regulator accepts that such exclusivity of use of the fast lines may in practice provide the optimal allocation of capacity on the West Coast Main Line. Nevertheless, the provision is a highly unusual one in a track access agreement, and it goes against the presumption that track access agreements should not unduly limit the flexibility with which capacity may be used. For example, paragraph 36 of *Criteria for the Approval of Passenger Track Access Agreements* noted that while provisions which eat into the available level of capacity may in some circumstances be appropriate, it may be best for such restrictions to be in the Rules of the Plan (which are subject to consultation with the affected operators) rather than in a bilateral agreement.

67. Railtrack takes on through the PUG 2 agreement obligations to West Coast Trains in respect both of maximum journey times and quality of service. In the Regulator's view the proposal in the access agreement that use of the fast lines should be limited to high-speed operators goes beyond what is necessary as a commitment to West Coast Trains by Railtrack in the access agreement; and in so far as it is necessary to the future efficient operation of the West Coast Main Line is not a matter for a bilateral track access agreement. The Regulator notes that at his Hearing on 6 March a number of operators expressed concern about the rigidity of this provision, not least because of possible changes in railway technology over the next fourteen years. **The Regulator therefore would wish the exclusivity of fast line use in the proposed agreement to be removed.**

Nature of proposed access rights

68. The PUG 2 agreement proposes that the access rights acquired by West Coast Trains should be Firm Contractual Rights (ie. rights which Railtrack must meet if exercised during the relevant part of the timetable bidding process). The Regulator's guidance to the industry has in essence been that Firm Contractual Rights should not be aggregated in a way which unduly constrains the rights which

may be available to other operators, and that parties to proposed agreements should satisfy themselves that there is a genuine need for the extent of Firm Contractual Rights sought (cf *Criteria for the Approval of Passenger Track Access Agreements*, paragraph 39). The Regulator notes that the PUG 1 agreement conferred Firm Contractual Rights in the same respects as those proposed under PUG 2. He notes further that the proposed rights contain a reasonable measure of flexibility for Railtrack in determining the specific departure times of services. In this case, therefore, the Regulator has concluded that the grant of Firm Contractual Rights to West Coast Trains as proposed is reasonable. **The regulator considers, however, that the extent to which Firm Contractual Rights are Firm in access agreements is a function of the expression of the rights themselves and that the explicit provision that the rights are Firm Contractual Rights made in clause 1.3(a) of Schedule 5 of the proposed agreement is inappropriate (it was not a feature of the PUG 1 agreement).**

69. The PUG 2 agreement also proposes that the access rights acquired by West Coast Trains should be Protected Rights - that is to say, rights which would entitle West Coast Trains to prevent any modification to the Track Access Conditions proposed by the Regulator under his power (Condition C8) to change the conditions from taking effect in relation to those rights. The Regulator has previously declared that he "will wish to be satisfied that any protected rights and protected obligations have been drawn as narrowly as possible...it is likely, for example, that a protected right to the basic quantum of train slots required to meet the Passenger Service Requirement, and other key commercial needs, might well be acceptable, but the Regulator would be concerned about the impact of protected rights over and above this". The Regulator has made clear that constraint, via Protected Rights, on his use of the change power he has under the Track Access Conditions should be minimised. (cf *Criteria for the Approval of Passenger Track Access Agreements*, paragraph 24)

70. West Coast Trains has made no case that all its access rights should (as is proposed) be protected rights, beyond a general assertion that protection of this scope is in its commercial interests. The Regulator has seen no evidence that an attempt has been made to confine the scope of protection as closely as possible, as his criteria require. The Regulator does not consider that the possible use of Access Condition C8 presents undue risk to the rights bestowed under PUG 2. The use of Condition C8 is subject to consistency with the Regulator's statutory duties under section 4 of the Railways Act, which include enabling persons providing railway services to plan the future of their businesses with a reasonable degree of assurance. **In the Regulator's view the proposal for protected rights unduly constrains his ability to use an important power in the public interest, albeit one the use of which is already heavily constrained, and he would not be willing to approve it unless it only applied to the rights to quantum of trains.**

"Use-it-or-lose-it" provision

71. The Regulator has been asked to approve two sets of access rights, for services which are not intended to run until 2002 (in the case of phase 1 of the PUG 2 project) and until 2005 (in the case of phase 2). The Regulator notes that the revenue sharing agreement provides incentives to West Coast Trains to run the services provided for in the agreement and Railtrack to enforce this, and that West Coast Trains has obligations to the Franchising Director which might be compromised by failure to run services. Nevertheless, the Regulator believes that the railway's users and customers are entitled to protection from the possibility that scarce capacity may go to waste because West Coast Trains does not take up some of its rights under this agreement, and as a result Railtrack is unable to sell capacity which is unused but "booked".

72. **The Regulator believes the most appropriate way of achieving this objective is by the inclusion of "use-it-or-lose-it" provisions similar to those in the PUG 1 agreement.** He will discuss with the parties modifications to the agreement to achieve this objective before issuing final conclusions.

Future periodic reviews

73. The Regulator is not satisfied that the drafting of the proposed agreement is sufficiently clear to ensure that effects of the Regulator's Periodic Reviews of track access charges are passed through to the Franchising Director via the Franchise Agreement. He understands from the Hearing that this is the intention of the parties, and will want to discuss the necessary modifications with the parties.

Proposed drafting of changes to the agreement

74. The Regulator believes that there are a number of changes to the proposed PUG 2 agreement which should be made prior to his giving his approval. He considers that these changes, if made, would not be such as to change materially the impact of the PUG 2 agreement on third parties. Therefore, these drafting changes, and also suggested drafting to deal with the points made in this document, will be sent separately to the parties and are not included in this document.



5. Planning and Implementation of PUG 2

Environmental Impact of PUG 2 Works

75. The Regulator's statutory duties under section 4 of the Railways Act include having regard to the effect on the environment of activities connected with the provision of railway services and he takes very seriously Railtrack's and train operators' obligations to the community. PUG 2 is capable of yielding benefits to the environment by causing modal shift from road to rail use. It is clear, however, that the works necessary to achieve PUG 2 are of a significant scale, and may have impacts for local environments - as may the increase in train speed and frequency which will eventually result.

76. The Regulator considers therefore that there are a number of actions which Railtrack and West Coast Trains need to undertake to demonstrate compliance with the Environmental Matters condition in their Network and Passenger Licences respectively. **The Regulator considers it is appropriate, as set out in paragraph 1 of the Environmental Matters condition, for Railtrack and West Coast Trains to review their environmental policies, operational objectives and management arrangements in the light of the PUG 2 proposals.** In particular, the Regulator notes that Railtrack's existing Environmental Objectives state that it will 'carry out an environmental appraisal or assessment for all new major projects ... to show that the best practical environmental options within the constraints of current technology and resources are being adopted'.

77. Railtrack and train operators' statutory planning and other environmental obligations are not overridden by the Regulator's conclusions on the PUG 2 access agreement.

Planning and Timetabling of PUG 2 Works

78. Train operators and rail users alike have understandably expressed concern that their interests should be taken properly into account in planning the infrastructure work needed to enable the PUG commitments (and the renewal programme and Passenger Upgrade 1 to which Railtrack is also committed). This covers both the changes to the network to be carried out and the timetabling of services during periods of engineering disruption.

79. It is particularly important for these purposes to note that the PUG 2 agreement does not in any way undermine the multi-party provisions of the Track Access Conditions, which give train operators on the route rights to be consulted and compensated, and give them rights of appeal ultimately to the Regulator. The Regulator notes the assurance given at the Hearing by Mr Curley (Performance Director, Railtrack) that Railtrack does indeed intend to use the Track Access Conditions to develop appropriate arrangements. Part G of the Track Access Conditions covers changes to the network, and compensation; Part D covers timetabling arrangements. The Regulator would wish Railtrack to bring forward a firm timetable for the operation of the Part G process as soon as possible.

80. It is the Regulator's understanding that the parties have not intended in the PUG 2 agreement to secure for West Coast Trains favourable treatment during the construction phase, and this understanding was confirmed by the parties at the Hearing.

Maintenance arrangements under PUG 2

81. The Regulator recognises that the operation of the West Coast Main Line following PUG 2 will require different infrastructure maintenance arrangements. He would expect these to be developed in consultation with affected train operators and funding bodies under the Access Conditions procedures.

Access rights between 2002 and 2005

82. The Regulator's expectation, based on the information given to him, is that during the period of PUG 2, Phase 1 (2002-2005) Railtrack will be capable of satisfying both its contractual obligations (ie its obligations to West Coast Trains and to other operators, with existing access rights rolled forward as necessary) and its obligation under its Network Licence to meet the reasonable requirements of train operators and funding bodies on the West Coast Main Line.

Restructuring the timetable to accommodate PUG 2

83. The process of restructuring the timetable to accommodate PUG 2 must involve all users of the route via the Track Access Conditions processes. The Regulator recognises that the current processes in Part D of the Access Conditions do not facilitate major

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timetable reconstructions of this kind, and will shortly be asking Railtrack to make detailed proposals to remedy this. For the present the Regulator has asked the parties to include in the PUG 2 agreement a provision that the relevant section of the agreement will be reviewed in the light of changes to the Access Conditions.

Consultation with passenger representatives

84. The Regulator expects that, throughout the process of implementation of the upgrade, Railtrack and Virgin will obtain the views of the Rail Users' Consultative Committees as to how the work can be planned in a way which best meets the needs of passengers.



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Next Steps

Publication of final conclusions

85. The Regulator intends to publish final conclusions on the proposal shortly. In order for any responses to this document to be considered properly, he is seeking comments from train operators, funding bodies and parties to the proposed agreement by 10.00am on Friday 17 April. Comments should be addressed to Dominic Lake at these offices (fax 0171 282 2042). The Regulator would expect any representations he receives in response to these draft conclusions to be placed in the ORR library (subject to his previously stated guidelines on confidentiality). Whether or not the Regulator decides to make any changes to these draft conclusions as a result of this consultation or that with the parties, he would presently expect to issue his final conclusions without further general consultation.

Office of the Rail Regulator
April 1998



Annex

Capacity of the Network

1. Having regard to the statements made by Railtrack during the consultation on this proposed agreement, on completion of the PUG2 project the West Coast Main Line should provide as a minimum:

(i) in addition to the train paths for which West Coast Trains will have rights under its access agreement, at least 2 train paths per hour on the fast lines in each direction between Euston and Crewe between 0700 and 2100 Monday - Friday, 0700 - 1900 Saturday and 1300 - 2100 Sunday, subject to the Rules of the Route; and

(ii) capacity which broadly can accommodate, with a standard of operational performance meeting the reasonable requirements of train operators and funding bodies:

- (a) the "existing quantum" of rights held by passenger operators; and
- (b) the existing level of freight services (including Post Office services) normally being provided at present (having regard to the information provided at the Regulator's Hearing on 6 March 1998); together with
- (c) between Willesden and Rugby an additional 42 train paths per day in each direction on the slow lines; and
- (d) between Rugby and Crewe an additional 42 train paths per day in each direction of which 34 train paths per day in each direction will be available via the Trent Valley (or at night subject to diversion via alternative routes in accordance with the Rules of the Route) and 8 train paths will be available in the daytime in each direction via Coventry and Stetchford;

in respect of (c), and (d) such paths to be capable of being suitably distributed over the day (or daytime as the case may be) in accordance with the reasonable demands of customers, and to have other characteristics consistent with those reasonable demands. (This capacity is to be additional to any capacity required for trains run in connection with the maintenance or renewal of Railtrack's infrastructure.)

2. (i) For the purpose of paragraph 1(ii) (a) above the "existing quantum" means the access rights of passenger operators under access agreements and access contracts as at 6 March 1998 on the basis that they would, if they expire before 1 January 2013, continue to that date; subject to:

- (a) adjustments reasonably required to accommodate those rights held by Silverlink Train Services Limited and Connex South Central Limited, having regard to Railtrack's current plans in respect of the West Coast Main Line network, and the requirements of the Franchising Director, in respect of which Railtrack shall consult with the relevant funding bodies and affected train operators and notify them of its proposed adjustments by 15 May 1998; and
- (b) adjustments reasonably required to accommodate those rights held by Central Trains Limited to operate services on behalf of West Midlands PTE (Centro), having regard to Railtrack's current plans in respect of the West Coast Main Line network, and the requirements of Centro the Franchising Director; and subject to the works in the paragraph below being agreed and carried out so as to enable the existing pattern and frequency of Central Trains services and journey times for passengers travelling on these services in the West Midlands being retained as set out in the passenger service requirement.

(ii) Railtrack will undertake in consultation with West Midlands PTE studies to identify a cost effective infrastructure solution to meet the requirement in paragraph 2(i)(b) above. This infrastructure solution will be implemented by Railtrack within the timescales for PUG 2. Railtrack will undertake works up to the value of Â£10m to achieve the infrastructure solution. In the event that further works are required, Railtrack and West Midlands PTE will collaborate to secure the necessary funding from passenger operators, and the public and private sectors. In the event that a funding package for the additional costs cannot be achieved, then Railtrack will use reasonable endeavours to minimise the impact of PUG2 on the ability of the PTE to achieve its statutory objectives in the West Midlands and to further this Railtrack will invest an additional Â£10m on infrastructure improvements on the Central Trains network in the West Midlands in a manner to be agreed with West Midlands PTE.

(iii) for the purposes of paragraph 2(i)(b), the maximum extent of such adjustments can be to cause journey times for which rights are held in respect of trains calling at all intermediate stations between Birmingham New Street, Birmingham International and Coventry, to be increased by 6 minutes.

3. The Regulator considers that it will be necessary for Railtrack to carry out strategic Reviews, in consultation with freight operators, passenger operators and funders (and other parties who can provide relevant assistance) of:

(i) options for enhancing freight capacity on the West Coast Main Line and alternative routes in respect of the origins and destinations on or reached via the West Coast Main Line route in respect of the reasonable requirements of freight operators both now and in the future, including investigation of gauge enhancements;

(ii) the rail network in the West Midlands in respect of the reasonable requirements of passenger and freight operators and funders of rail services both now and in the future. The study should include the development of plans and, where required to comply with the licence condition, proposals to provide adequate capacity to meet these requirements for the Rugby - Wolverhampton route, and routes affected by the operation of services on that route (including the renewal of Proof House Junction) and include the seeking of cost-effective options to enable the existing journey times of the local services between Birmingham New Street and Coventry to be maintained;

(iii) the routes serving Manchester Piccadilly from Wilmslow and Stockport in respect of the reasonable requirements of passenger and freight operators and funders of railway services both now and in the future; and

(iv) the route between Euston and Hanslope Junction in respect of the reasonable requirements of operators and funders of rail services for the future operation of higher speed trains between Euston - Milton Keynes - Wolverton - Northampton than currently operate,

in each case the requirements for additional capacity arising from these Reviews will be in addition to that set out in paragraph 1 above.

4. Having regard to the concerns which have been expressed, each study should be completed in sufficient time to enable its results and firm plans for implementation of requirements identified in order for Railtrack to be compliant with the General Duty in Condition 7 of the Network Licence to be incorporated in the 1999 Network Management Statement. For the avoidance of doubt, these should include plans for infrastructure enhancement where the Reviews indicate that this is an appropriate means of meeting the requirements of the Licence Condition. In advance of publishing its proposals, Railtrack needs to have finalised arrangements for funding such proposals and explain these in the Network Management Statement.

5. In order to demonstrate that it will be able to comply with the above, Railtrack should provide to the Regulator by 30 April 1998, after consultation with the relevant parties referred to above, details of the process by which it intends to carry out these Reviews, with a proposed timetable.

6. The Regulator will also expect Railtrack to report to him by 31 May 1998 on the procedural arrangements it has put in place to ensure that, in meeting its licence obligations in respect of maintenance, renewal and replacement, and improvement enhancement and development of the network, it meets the reasonable requirements of the West Midlands PTE and PTA as funders of services for the carriage of passengers.

