Periodic Review 2013 – Conclusions on the Station Long Term Charge Consultation

January 2013

NetworkRail

INTRODUCTION

This document sets out Network Rail's conclusions on the structure of the Station Long Term Charge (LTC) for CP5 following our consultation published on 26 September 2012[1]. In addition to publication of the consultation document, we held two workshops – one in Manchester and one in London. The consultation closed on 16 November 2012.

Our high level proposal was that the structure of the current LTC remains broadly the same as for CP4. The only exceptions were proposals to:

- move Station Information and Security Systems (SISS) from the Fixed Track Access Charge (FTAC) to the LTC; and

- introduce portfolio charging, but providing percentages by station so that Station Facility Owners (SFOs) can charge beneficiaries.

In an email dated 23 October 2012, we subsequently also asked whether there was agreement that, for Managed Stations, SISS maintenance and repair should be brought together as a landlord responsibility, and therefore be included in the LTC for CP5 (previously it was included in QX[2]).

The consultation also requested views on the process for calculating the LTC from our expenditure projections, submitted as part of the Strategic Business Plan (SBP).

OVERVIEW OF THE RESPONSES TO NETWORK RAIL'S CONSULTATION

In total, responses on behalf of 15 Train Operators, two owning groups, ATOC, Transport for London (TfL) and Transport Scotland were received.

Most respondents were generally supportive of the principle to keep the current structure broadly the same and to include SISS. There was not a great deal of support, however, for portfolio charging. These issues are covered in detail, below.

ATOC raised a number of fundamental issues around the overall structure of station charges, which are summarised below:

- That we provided little/no assessment/explanation of the fundamental purpose of the station LTC. In ATOC's view, the charge is there to strengthen the alignment of funding and expenditure associated with stations, and should create effective signals that enable Network Rail and train operators to evaluate options available for station assets.

- The consultation makes no reference to the outputs we are proposing, and does not explore the relationship between station outputs and the charges.

[1] http://www.networkrail.co.uk/WorkArea/DownloadAsset.aspx?id=30064783639
[2] QX at managed stations covers costs such as station cleaning, refuse collection and disposal, retail telecoms, insurance, utilities, and provision of competent and suitably trained staff. The QX charge is fixed throughout the control period in real terms, but is not determined by ORR. We expect to start the process of renegotiating QX for CP5 with our customers shortly.

- In relation to the treatment of the cost of capital, we do not set out the rationale for the current approach (recovery through the fixed charge), and that as charges should be fully cost reflective in order to provide appropriate economic signals, the case for excluding it is unclear.

These issues are considered in detail, below.

Whilst we understand ATOC's concerns, if these were to be addressed for CP5, they would need to have been raised earlier during PR13. Whilst ORR did not ask explicit questions about the structure of the LTC in its earlier consultations – notably its first consultation[3] and consultation on incentives[4] – we consider that it would have been appropriate to raise fundamental concerns in responses to these consultations. Network Rail sought to present its views on the structure of the charge at those opportunities. It should also be noted that these issues were generally not raised by any of the train operators. We expect a full review of the structure of charges to be undertaken early in CP5 (for implementation in CP6), which could take account of these points.

Transport Scotland noted its disappointment that there appeared to be no new incentives or plans to reduce ongoing costs or to improve environmental sustainability. It also stated that it believed the approach for CP5 needs to better link to cost and value, which is vital if better value for money is to be achieved. It should be noted that the scope of this consultation related only to structure the LTC, and that these other issues are dealt with in other consultations. The SBP will set out Network Rail's plans to deliver its CP5 outputs, and the efficiencies that it expects to achieve. We continue to work with ORR to develop a number of mechanisms that will incentivise Network Rail to increase its efficiency, such as regulatory targets and the Route-based Efficiency Benefit Sharing (REBS) regime. We expect ORR's Draft Determination to provide a fuller picture of these, which will also give stakeholders further scope for comment. Transport Scotland did, however, broadly agree with keeping the current CP4 structure.

RESPONSES TO SPECIFIC QUESTIONS

1. Do you agree that the established LTC structure should be retained in broadly its current form in CP5?

All but one respondent agreed with the question.

The only respondent to query this was ATOC. It stated that Network Rail's consultation should have addressed the fundamental purpose of the LTC and whether this purpose is currently being fulfilled. ATOC believes that the LTC should create effective signals that enable Network Rail and train operators to evaluate the options available for station assets.

Whilst we understand ATOC's view, we consider that, if its concerns were to be fully addressed for CP5, this issue would need to have been discussed earlier in the

[3] ORR's consultation can be accessed at: http://www.rail-reg.gov.uk/pr13/PDF/PR13-first-consultation-document.pdf. Network Rail's response can be accessed at: http://www.networkrail.co.uk/uploadedFiles/networkrailcouk/Contents/Publications/Delivery_Plans/Control_Period_5_delivery_plan/Planning_for_CP5/ORRFirstPR13ConsultationFull.pdf.

[4] ORR's consultation can be accessed at: http://www.rail-reg.gov.uk/pr13/consultations/orr020.php. Network Rail's response can be accessed at: http://www.networkrail.co.uk/WorkArea/DownloadAsset.aspx?id=30064780543.

PR13 process. Whilst ORR did not ask explicit questions about the structure of the station LTC in its earlier consultations (notably its first consultation, and consultation on incentives), we consider that it would have been appropriate to raise fundamental concerns in responses to these consultations. Indeed, Network Rail sought to present its views on the structure of the charge at those opportunities.

Network Rail stated in the consultation that the station LTC allows it to recover the efficient maintenance, renewal and repair (MRR) costs associated with the stations it owns. In CP4 there is a separate LTC for each station but charges are set so as to provide a reasonable expectation of MRR spend over the course of the control period at the SFO portfolio level. There is also input from train operators through local delivery groups, and the integrated stations planning initiative.

ATOC stated that the consultation did not reference the outputs that Network Rail is proposing to offer in relation to stations expenditure in CP5. It also stated that Network Rail should have explored the relationship between station outputs in relation to the Station Stewardship Measure (SSM), and the charges that train operators pay for station assets.

Network Rail's policy interventions have been evaluated around maintaining existing average condition (at exit CP4). The assumptions around station outputs will be articulated in detail elsewhere in the CP5 submission (notably the Strategic Business Plan which was published in January 2013).

Northern asked for clarity regarding how station 'importance' is categorised. When we referred to station importance, we were referring to the station category and size banding used in CP4. It should be noted that, since our cost modelling has improved since PR08, we do not expect to rely on such measures during PR13.

Network Rail's proposed decision

Mirroring the views of the great majority of stakeholders, Network Rail proposes to retain the LTC structure in broadly its current form in CP5.

2. Do you agree that the cost of capital associated with stations should continue to be excluded from the LTC?

ATOC stated in its response that it wished to understand further the rationale for the current approach under which the cost of capital is recovered through the fixed charge. Transport Scotland also noted that the issue requires further consideration, including whether inclusion in the LTC would help to improve transparency and enable all beneficiaries to capital charges.

The cost of capital was removed from the Station Long Term Charge at the last periodic review (PR08) to give a more meaningful cost reflective charge, i.e. reflective of expected expenditure across the relevant SFO's stations portfolio.

We consider that the current approach is appropriate. In our view, it provides a more meaningful and transparent expenditure base (i.e. just MRR costs rather than a combination of MRR and financing costs) upon which to base charges. Moreover, since LTC income is 'ring-fenced' for expenditure at stations, it would be misleading to include financing charges in the LTC, which cannot be 'ring fenced' solely to stations. The current approach is also consistent with that of other track access charges (with the exception of the fixed track access charge which includes the recovery of our financing costs) and a movement away from this method would necessitate an examination of the suitability across all charges.

We note that this is an issue which could merit further consideration in ORR's full review of the structure of charges expected to be undertaken during CP5.

Network Rail's proposed decision

Mirroring the views of the great majority of stakeholders, Network Rail proposes to continue to exclude the cost of capital associated with stations from the LTC.

3. Do you agree that SISS costs should be recovered by means of the LTC rather than fixed charges in CP5?

The majority of respondents agreed that SISS costs should be recovered through the LTC rather than through FTAC. They noted that this would make the SISS spend more transparent.

East Coast Main Line Company Limited (ECMLCo) believed it should not be the case, as it believed that different circumstances at different stations would give rise to discrepancies within the charging mechanism. It also wanted to know how these variations would be addressed to ensure all operators are on a level playing field. CrossCountry questioned whether there would be a direct reduction in the fixed charge as a result of recovering SISS costs through the LTC and what would happen where the SFO has responsibility for SISS systems.

Currently there can be different arrangements in place for different stations, and just as the station spend over a train operator's portfolio of stations will be different from one train operator to another and reflected in the LTC, so this would be the case with SISS. Currently SISS spend is spread between all franchised train operators, and therefore some train operators are likely to be subsiding others.

All respondents wanted to make sure, however, that there would be transparency and clear visibility, and also to ensure that where a train operator or third party has responsibility for SISS equipment, train operators would not be double charged.

It is important to note that for franchised stations, it is the train operator's responsibility to update the Station Access Condition Annexes where new SISS equipment is added (whether it has been funded by the operator or a third party), so that there is an accurate reflection of what SISS equipment is on the station and where responsibility for the maintenance, renewal and repair of such equipment sits. Over the last year, Network Rail has carried out comprehensive surveys to establish what SISS equipment exists at each station and whose responsibility it is, which involved extensive engagement with operators. Where our records show that a train operator has sole responsibility for SISS assets at its station, there would be no charge for these assets within that station's LTC.

A number of respondents also stated that they wanted confirmation that moving SISS from FTAC to the LTC would not incur any additional costs. Throughout the periodic review process, ORR will be analysing our data to confirm that values represent efficient spend. As CP5 is a new control period, the actual values will be different from CP4, but the total SISS spend will be no different whether it is charged as part of FTAC or within the LTC. There will be a difference by train operator, however, as currently it is spread amongst franchised operators along with the rest of FTAC.

Alliance Rail stated that, as a result of the SISS costs being recovered as part of the LTC, it would expect that all stations would have a minimum quality of SISS to ensure a greater passenger experience even at smaller stations. Network Rail believes that by including the SISS costs in the LTC, the work plans will be more transparent to all train operators and debate can take place at a local level regarding where this spend should occur. It should be noted that LTC does not provide for the addition of equipment at stations where there is currently none.

Network Rail's proposed decision

Network Rail will move recovery of SISS costs from the fixed charge to the LTC in CP5.

4. As a general principle, do you agree that the industry should move to a portfolio charging structure for the LTC in CP5? and
5. Do you agree with the specific approach to portfolio billing described in the consultation?

The majority of respondents were against portfolio charging, citing additional administrative burdens on train operators. Some stakeholders stated that Network Rail was trying to solve a problem that did not exist (or if it did, it was not LTC that was the problem; rather Network Rail's billing systems).

Go-Ahead (on behalf of Southern, Southeastern and London Midland) was more supportive of the proposal, as long as there would not be additional administrative burden on the train operators (especially with any franchise remapping etc). ECMLCo was happy in principle, but wanted to understand further how it would work. ATOC queried Network Rail's rationale for portfolio billing.

Network Rail's proposed decision

In view of the responses received to this question, Network Rail proposes not to move to a portfolio charging structure for the LTC in CP5, and continue to raise an individual station charge. It should be noted, however, that Network Rail is effectively setting charges at a portfolio level. We expect the charge at individual station level will be set on the basis of the long term modelled expenditure from Network Rail's top-down stations expenditure model. Individual station charges will not be fully reflective of the specific spend at each station within the control period.

6. Do you agree with the proposed methodology for translating expenditure into charges at franchised stations in CP5?

Respondents raised a number of specific questions in relation to the proposed methodology.

ATOC asked why 35 years was chosen as the proxy for reasonable long-term cost estimates in CP4, and Northern queried why franchised stations should be based on 35 years whereas Managed Stations are based on 100 years, and believed there should be more consistency.

35 years was chosen as a proxy for reasonable long term cost estimates for franchised stations in PR08. 100 years was used for Managed Stations in order to even out some of the extremes of spend found at these very large facilities. This volatility is more noticeable for Managed Stations due to the small number of stations and high renewal costs mainly due to the size of the Managed Stations, with no

ability to average across a larger diverse portfolio. As we anticipate a full review of the structure of charges to be undertaken early in CP5, we would anticipate reviewing this again at that stage. In addition, we consider that it would not be practical to produce 100 year plans for all the franchised estates.

One response queried the need for Step 1 in the methodology, when Step 4 adjusts the charges to ensure the CP5 charge is equal to projected CP5 expenditure. Step 1 helps ensure that charges set at individual station level reflect long-term expenditure.

Transport Scotland raised the issue that the accuracy of long run costs is likely to be uncertain, so accuracy may be low and there is a risk, therefore, of inflating these costs. We consider that this is not really an issue for franchised stations as the charges for CP5 will reflect expected efficient spend for CP5. For managed stations, we expect ORR to review our cost models. Furthermore, no alternatives were suggested by any respondents.

There was also some confusion which related to a perceived link to portfolio charging.

SSWT/EMT also raised a subsequent issue around alliancing, and asked whether any consideration had been given as to how LTC might be structured in respect of current or potential further alliance arrangements. Network Rail has not taken into account any alliance arrangements when considering how the LTC should be structured. Any alliancing arrangement, including the scope of what is included in such an arrangement, would be locally agreed.

Network Rail's proposed decision

Network Rail proposes to use its cost models to propose LTCs that recover efficient CP5 spend at portfolio level and reflect long term (35 year) average spend at the individual franchised station level. We intend to publish draft price lists in March 2013. This will involve a procedure akin to the one described in the consultation.

7. Do you agree with the proposed methodology for translating expenditure into charges at managed stations in CP5?

The majority of responses agreed with this proposal. Northern queried why franchised stations should use 35 years whereas Managed Stations should use longer, and believed there should be more consistency.

For franchised stations 35 years was chosen as a proxy for reasonable long term cost estimates at the last control period. 100 years was used for Managed Stations in order to even out some of the extremes of spend found at these very large facilities. This volatility is more noticeable for Managed Stations due to the small number of stations and high renewal costs, with no ability to average across a larger diverse portfolio. As we anticipate a full review of the structure of charges to be undertaken early in CP6 we would anticipate reviewing this again at that stage.

Network Rail's proposed decision

Network Rail proposes to use a methodology akin to that described in the consultation document to translate expenditure into charges at managed stations in CP5, and use 100 years to calculate the average long term cost. We intend to publish draft price lists in March 2013

8. What are your views about the LTC in light of the transfer of MRR activities to SFOs on some routes?

Most responses stated that it would be a useful exercise to calculate a LTC for those stations which have been transferred for the purpose of benchmarking.

TfL raised a number of issues surrounding the actual transfer of responsibilities. Whilst these points are important, we consider that they are outside the remit of this consultation. We believe this should be discussed once the DfT publishes its re-franchising policy for its future franchises.

ECMLCo welcomed the idea of a shadow LTC but raised the point that it would only be a useful benchmarking tool, if, when a train operator took on all the responsibility at stations they categorized their costs in the same way as the split is currently.

ATOC requested an understanding as to why Network Rail would calculate the LTC for stations no longer within its responsibility. Our 'top down' expenditure models allow us to forecast modelled costs for stations across the network, including those for which we are no longer responsible. We recognised in our July 2012 consultation that LTCs will not be applied in full to these stations although continuing to calculate a 'shadow' LTC may be useful. We consider that this would be in the interests of transparency and for benchmarking purposes, in particular, it would provide an indicative comparison with other LTCs (for those stations where Network Rail continues to have responsibility) across the network.

Northern responded stating that the value calculated should be added into the franchise agreement, to ensure that transparency and spend should then be tracked against portfolio value. It also believed it would be beneficial to include the standard to which assets need to be maintained to provide a benchmark for these MRR activities.

While Network Rail believes this to be a franchising issue and that we would expect the DfT to consider it as part of its refranchising process, we are aware of the current lack of alignment regarding asset condition on stations between the Station Access Conditions; the Stations Stewardship regulated output; and other requirements that are stipulated in franchised operators' franchise agreements with DfT / Transport Scotland. We would welcome further discussions with ORR and the governments on improving such alignment, as we consider this would avoid unnecessary complexity and confusion about the standards to which assets must be maintained on stations. We anticipate working at local and national levels to improve alignment in this area.

SSWT/EMT responded saying that mechanisms should be in place to ensure that in the event of any return to the "traditional" lease and MRR arrangements between SFO and Network Rail, the LTC can be accurately and efficiently re-introduced. Whilst we understand this point, we do not consider that it would be appropriate or efficient for Network Rail to maintain detailed asset information on assets that would be outside of its MRR remit.

Network Rail's proposed decision

Network Rail proposes to keep open the possibility of computing LTCs for the Greater Anglia stations, which are the only stations to have been transferred, using existing data. We do not propose renewed modelling of costs at these stations.

9. What are your views about our proposals for industry engagement as part of the process to set LTCs in CP5?

The majority of the respondents welcomed the industry engagement so far and the proposals for the future. FirstGroup stated, however, that they had not heard of the VTAC meeting. The Variable Track Access Charge (VTAC) development meeting is an open forum which meets once a month, and where any charging issues can be discussed. Operators which would like to attend should contact Ben Worley, Senior Regulatory Economist at Network Rail (Ben.Worley@networkrail.co.uk).

As there is separate accounting and funding of Network Rail in Scotland, Transport Scotland said there needed to be Scotland-specific dialogue to ensure that any specific issues can be reflected in final CP5 arrangements. We understand this point and are engaging extensively with Transport Scotland. We believe that it is important for charging arrangements to be consistent across GB.

ATOC said it would be extremely useful for Network Rail to produce a timetable setting out the details of key milestones of this process as well as the relationship with the wider PR13 process. We have produced a timetable, which is attached as an appendix to this document.

TfL requested that consideration should be given to gaining greater industry involvement in the process (for example through a working group). Working with stakeholders, as the process progresses, Network Rail will review its industry engagement plan and will consider whether a working group would be helpful, although we consider that the current VTAC development meeting is an effective forum in which to discuss LTC proposals.

10. Do you agree that for Managed Stations SISS maintenance and repair should be bought together as a landlord responsibility, and therefore be included in the LTC for CP5?

Other than ECMLCo, all other respondents agreed that this was a sensible solution.

ECMLCo was concerned about the impact on franchised stations, and whether changing the allocation at Managed Stations would lead to a blurring of responsibility at franchised stations.

Currently the maintenance of SISS assets at Managed Stations is captured through the QX charge, which is paid by operators to Network Rail. The proposed change in responsibility at Managed Stations reflects existing contractual reality, and would not be relevant for franchised stations. The maintenance and repair of other key assets at Managed Stations, such as lifts and escalators, are already brought together as a landlord responsibility, with the associated costs being recovered through the LTC. We consider, therefore, that the proposed approach is appropriate.

The responsibility for the maintenance and repair of SISS assets at franchised stations is set out in the Station Access Conditions. We do not believe, therefore, that any change in the approach at Managed Stations will confuse franchised station responsibilities.

Network Rail's proposed decision

Network Rail proposes to bring together SISS maintenance and repair as a landlord responsibility and to therefore include it in the LTC for CP5 for Managed Stations.