

## Request for approval of the recalibration of track access charges for CP6, led by Network Rail

The purpose of this letter is to seek ORR’s formal approval of Network Rail’s methodology for recalibrating the track access charges for CP6. This methodology is included in the charging models that Network Rail has shared with ORR, and the draft price lists that we have published, consistent with ORR’s 2018 Periodic Review (PR18) Draft Determination.

### Context

At the start of PR18, ORR delegated the recalibration of the existing track access charges for CP6<sup>1</sup>, set out in the table below, to Network Rail.

Track Access Charge	Purpose of charge
Variable Usage Charge (VUC)	To recover the variable track, civils and signalling ‘wear and tear’ costs that Network Rail incurs.
EAUC	To recover the variable costs (costs that vary with changes in the level of electrified traffic) of maintaining and renewing electrification assets.
EC4T, including losses mark-ups for metered operators	To recover the costs of traction electricity supplied by Network Rail to train operators to power electrified services.
Fixed Track Access Charge (FTAC)	To recover Network Rail’s net revenue requirement after accounting for the income received from variable track access charges, station charges, other single till income and network grants.
Managed Stations LTC	To recover Network Rail’s efficient maintenance, repair and renewal (MRR) costs for each of the managed stations it owns.
Franchised Stations LTC	To recover Network Rail’s efficient maintenance, repair and renewal (MRR) costs for each of the franchised stations it owns.

<sup>1</sup> As set out in ORR’s December 2016 consultation on changes to charges and contractual incentives (page 6), available here: [http://orr.gov.uk/data/assets/pdf\\_file/0019/23482/charges-and-incentives-consultation-document.pdf](http://orr.gov.uk/data/assets/pdf_file/0019/23482/charges-and-incentives-consultation-document.pdf)

## Recalibration of track access charges for CP6

Over the past two years, Network Rail has led the recalibration of the above track access charges for CP6. We have summarised in the table, below, the process that we have adopted for the recalibration of each of these charges.

Step	Date	Description of step in the process
1	May 2016 – July 2017	Proposed an approach to the recalibration of each of the track access charges to the industry.
2	May 2016 - September 2017	Discussed the approach with stakeholders at RDG hosted working groups (for many of these charges there have been multiple discussions with industry on the recalibration).
3	July 2017 - September 2017	Published formal consultations which set out the proposed approach to the recalibration of the variable, station and fixed charges.  This provided the industry with an opportunity to formally set out their views on our proposals.
4	November 2017 – May 2018	Considered the responses received and updated our proposed approach to the recalibration of the charges to reflect industry comments, where appropriate.
5	May 2018	Discussed our proposed conclusions with stakeholders at an RDG hosted working group and sought views on our emerging proposal.
6	May 2018	Published formal conclusion documents setting out our conclusions to the recalibration of variable, station and fixed charges.  We highlighted any changes to our proposed methodology following industry feedback.
7	April 2018 – August 2018	Recalibrated the track access charges, consistent with ORR policy decisions and our conclusion documents.
8	May 2018 - July 2018	Procured consultants to provide external assurance of the recalibration of the track access charges for CP6, by completing an independent audit of the models (more detail set out in the section, below).

In addition to the process, described above, we have undertaken further work for the recalibration of EAUC, Managed Stations LTC and Franchised Stations LTC for CP6, following the publication of our May 2018 conclusions documents. This was because our May 2018 conclusions document made a few additional proposals for these charges. As part of this work, we made minor changes to the methodology for the recalibration of these charges for CP6 to address a few outstanding issues<sup>1</sup> which we discussed in our May 2018 conclusions documents (for example data limitations which impacts the recalibration of franchised stations LTC has resulted in a change in approach). ORR requested further information regarding aspects of the station LTC recalibration, in particular:

- Further information regarding the assurance that Network Rail has undertaken of data from the Operational Property Asset System;
- Further information regarding the model used to estimate long-run annual average renewal estimates for operational property assets; and
- Further information regarding the classification of franchised stations.

We have provided this information to ORR. We have also engaged with industry on several occasions to ensure that they are fully sighted of these changes.

### **Industry involvement in recalibration**

We have worked closely and collaboratively with ORR and industry stakeholders to recalibrate the track access charges for CP6. We consider that the industry's involvement in this process has been hugely valuable and we have welcomed the input that we have received from the industry throughout the recalibration of the track access charges for CP6. We have welcomed ORR's attendance at the RDG hosted stakeholder meetings that have taken place during this process.

### **Audit of the recalibration of the track access charges**

It is important that the industry is assured that the recalibration of the track access charges is consistent with ORR's policy decisions and our conclusions on the methodology for the recalibration of each of the track access charges for CP6. We also recognise that there is a risk of inadvertent errors occurring in the recalibration of each of the track access charges. Therefore, to mitigate against these risks, we have had the models externally audited by Steer Davies Gleave (SDG)<sup>2</sup>. The purpose of these audits was to:

- Provide assurance to ORR and stakeholders that the spreadsheet models developed by Network Rail reflect the intended methodology for each charge (consistent with ORR's policy decisions and our conclusions on the methodology for the recalibration of each of the track access charges for CP6); and
- Provide assurance to ORR and stakeholders that the models are free from errors.

We worked closely with ORR in the development of the remit for the independent audit, to ensure that SDG's review meets ORR's assurance requirements of the recalibration. The links to the results of the independent audits of each of the track access charging models is set out in Annex 1 of this letter.

The audit of the CP6 VUC model was carried out by the Independent Reporter Arup<sup>3</sup>. Network Rail and ORR worked closely together throughout this review, including jointly developing the scope of work. The Arup audit was carried out before ORR decided to cap VUC rates payable by freight and charter train operators for CP6. Therefore, in addition to the assurance work carried out by Arup, Network Rail will also perform its own assurance to confirm that ORR's policy of capping freight and charter VUC rates is implemented correctly. This Network Rail assurance will comprise a member of the Regulatory Economics Team (who has not been involved in calculating VUC rates) confirming the following:

<sup>2</sup> On 16<sup>th</sup> July 2018, Steer Davies Gleave changed its name to Steer.

<sup>3</sup> Available here: <https://cdn.networkrail.co.uk/wp-content/uploads/2018/07/Arup-Review-of-Network-Rails-CP6-Variable-Usage-Charge-Assessment-July-2018.pdf>

- Checking that, in aggregate, CP6 freight and charter VUC rates result in the transition profile to uncapped rates that ORR is seeking to achieve; and
- Spot-checks on individual rates to confirm that these also follow ORR's desired transition profile.

### **Publication of draft CP6 price lists**

On 31 July 2018, Network Rail published draft CP6 price lists for all variable track access charges. On 24 August 2018 Network Rail published draft CP6 price lists for fixed track access charges. The draft CP6 price lists have been calculated using the methodologies that we have previously concluded on and are consistent with the decisions on track access charges in ORR's Draft Determination<sup>4</sup> and ORR's April 2018 letter on charges and contractual incentives<sup>5</sup>. Alongside the draft price list we also published a document setting out the key assumptions that we made in calculating the price lists. We have invited the industry to provide comments on factual accuracy to the draft CP6 price lists by 28 September 2018. We will consider and reflect industry comments, where appropriate, in the final CP6 price lists which will be published after ORR's Final Determination.

### **Efficiency assumption**

The draft price lists described, above, reflect the efficiency improvements assumed in our February 2018 SBP. If ORR were to make higher efficiency assumptions in its Final Determination than we did in our SBP, this would serve to reduce the level of charging rates. If when we publish final CP6 price lists in December 2018 it is necessary to reflect new ORR efficiency assumptions, we will do this, and carry out internal assurance to confirm that any new efficiency assumptions have been incorporated correctly.

### **Next Steps**

By way of this letter, we ask ORR to approve Network Rail's work on recalibrating the track access charges for CP6, consistent with the methodology that we have concluded on and ORR's policy decisions.

To support ORR's formal approval of Network Rail's work on recalibrating the track access charges for CP6, we have included links to the following relevant documents in Annex 1 to this letter:

- Key presentations to industry on our proposed methodology for the recalibration of each of the track access charges for CP6 (including the subsequent conversations we have had with industry on EAUC, Managed Stations LTC and Franchised Stations LTC);
- Network Rail's formal consultation documents which explain our proposed methodology for the recalibration of each of the track access charges and accompanying draft results;
- Network Rail's conclusions documents to each of the consultation documents. These summarise the feedback that we received from the industry on each of our proposals, and set out the changes that we made to the methodology in response to that feedback;

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<sup>4</sup> Available here: [http://orr.gov.uk/\\_data/assets/pdf\\_file/0005/27788/pr18-draft-determination-charges-and-incentives.pdf](http://orr.gov.uk/_data/assets/pdf_file/0005/27788/pr18-draft-determination-charges-and-incentives.pdf)

<sup>5</sup> Available here: [http://orr.gov.uk/\\_data/assets/pdf\\_file/0010/27469/orr-variable-usage-charge-update-letter-april-2018.pdf](http://orr.gov.uk/_data/assets/pdf_file/0010/27469/orr-variable-usage-charge-update-letter-april-2018.pdf)

- The additional information shared with industry, following the publication of our conclusions documents, in relation to the recalibration of EAUC, Managed Stations LTC and Franchised Stations LTC; and
- The results of the audits of the recalibration models produced by SDG and Arup.

Should you have any questions about this letter or require any further information to approve Network Rail's work on recalibrating the track access charges for CP6, please do not hesitate to contact me.

Yours sincerely,

## Annex 1: Summary of key documents shared with industry stakeholders during the recalibration of the track access charges for CP6

Track Access Charges	Initial discussion at RDG Working Group	Network Rail consultation on methodology	Conclusions to Network Rail's consultation on methodology	Audit of recalibration
Variable track access charges and station charges	<p><u>Variable charges</u></p> <ul style="list-style-type: none"> <li>NR consultation on variable and station charges slides available <a href="#">here</a> (18 September 2017)</li> </ul> <p><u>Electricity charges</u></p> <ul style="list-style-type: none"> <li>NR consultation on EC4T and EAUC slides available <a href="#">here</a> (20 September 2017)</li> </ul> <p><u>Station charges</u></p> <ul style="list-style-type: none"> <li>Update on CP6 station charges slides available <a href="#">here</a> (27 September 2017)</li> </ul>	<ul style="list-style-type: none"> <li>Consultation available <a href="#">here</a></li> <li>Annex to consultation available <a href="#">here</a></li> <li>Industry responses available <a href="#">here</a></li> </ul>	<ul style="list-style-type: none"> <li>Conclusions document available <a href="#">here</a></li> <li>EC4T CP6 DSLFs Methodology and Assumptions report available <a href="#">here</a></li> <li>VUC vehicle characteristics spreadsheet available <a href="#">here</a></li> <li>CP6 Station long term charge calculation available <a href="#">here</a></li> </ul>	<ul style="list-style-type: none"> <li>SDG Report available <a href="#">here</a></li> <li>Arup review of VUC available <a href="#">here</a></li> <li>Network Rail assurance of freight and charter VUC caps</li> </ul>
Fixed track access charges <sup>6</sup>	<ul style="list-style-type: none"> <li>Cost allocation pilot study – RDG update available <a href="#">here</a> (26 May 2016)</li> <li>Cost allocation GB roll-out update available <a href="#">here</a> (14 November 2016)</li> <li>Cost allocation GB roll-out update on results available <a href="#">here</a> (27 March 2017)</li> <li>NR consultation on fixed costs consultation slides available <a href="#">here</a> (9 October 2017)</li> </ul>	<ul style="list-style-type: none"> <li>Consultation available <a href="#">here</a></li> <li>Industry responses available <a href="#">here</a></li> </ul>	<ul style="list-style-type: none"> <li>Conclusions document available <a href="#">here</a></li> <li>Detailed Avoidable Fixed Cost Breakdown, available <a href="#">here</a> (under Network Rail publications on PR18 – consultation conclusions).</li> </ul>	<ul style="list-style-type: none"> <li>SDG report available <a href="#">here</a></li> </ul>
Further update on electricity and station charges	<ul style="list-style-type: none"> <li>Station charges slides available <a href="#">here</a> (18 June 2018)</li> <li>Email on methodology for Station Long Term Charge (25 June 2018)</li> <li>CP6 EC4T and EAUC (18 June 2018)</li> <li>Email on methodology for EAUC (31 July 2018)</li> </ul>	N/A	N/A	<ul style="list-style-type: none"> <li>SDG report available <a href="#">here</a></li> </ul>

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<sup>6</sup> Full details of Network Rail's engagement with industry on Fixed Track Access Charges is set out in Annex A to Brockley Consulting's report: A new method for allocating network fixed costs, available here (Page 105): <https://cdn.networkrail.co.uk/wp-content/uploads/2017/01/Brockley-Consulting-report-A-new-method-for-allocating-network-fixed-costs-September-2017.pdf>