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OFFICE OF RAIL REGULATION

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Dear Stakeholder

Policy framework for investments – guidance on station charges conclusions

1. In October 2005, we published our conclusions on a new policy framework for investments[1] which aims to facilitate investment in the railway (including stations) by addressing a number of barriers to efficient delivery. The framework establishes clear roles and responsibilities and, where appropriate, new approaches to enable barriers to be overcome. These conclusions are expanded on in our investment guidelines, published in March 2006[2], and the update to our investment guidelines, published in March 2007[3].

2. We noted in our latest update that we would be revising our guidance covering the regulatory treatment of changes to charges between periodic reviews due to investment at stations. This guidance was previously set out in our document 'A Fair Deal: Guidelines on Adjustments to Station Long-Term Charges'[4].

3. In July 2008 we published revised guidance for consultation, covering changes to the charges between periodic reviews, and asking stakeholders for their views in particular on the following policy areas:

(a) our proposals for self financing schemes;

(b) our proposed options for the regulatory treatment of hypothecated gains; and

(c) our policy proposals for a more focused and effective approval process.

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[1] Available at http://www.rail-reg.gov.uk/upload/pdf/255.pdf

[2] Available at http://www.rail-reg.gov.uk/upload/pdf/277.pdf

[3] Available at http://www.rail-reg.gov.uk/upload/pdf/invest-guide-let-020307.pdf

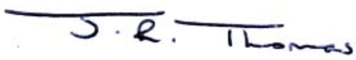
[4] Available at http://www.rail-reg.gov.uk/upload/pdf/76.pdf

4. We received 11 responses to our consultation. We have since discussed the issues raised with stakeholders where we required clarification. Following the consultation process the paper attached to this letter provides revised guidance on the regulatory treatment of changes to charges between periodic reviews due to investment at stations.

5. This guidance document is aimed at parties seeking to invest at stations, and is necessarily technical. The paper should be read in conjunction with other key ORR publications relating to the investment framework (all of which are available on our website under the heading "Investments in the industry" [5]) and Network Rail's document Investing in the Network[6]. Readers seeking clarification on any point relating to investment at stations should contact either Bill Davidson (Bill.Davidson@networkrail.co.uk) or Geoff Jones (Geoff.Jones@networkrail.co.uk) at Network Rail, or Chris Littlewood at ORR (chris.littlewood@orr.gsi.gov.uk).

6. Copies of this document can be found in the ORR library and on our website (www.rail-reg.gov.uk).

Yours sincerely



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5 See http://www.rail-reg.gov.uk/server/show/nav.190

6 Available at http://www.networkrail.co.uk/documents/3802_Section13AccompanyingMaterial.pdf

Policy framework for investments – guidance on station charges conclusions

Introduction

1. If rail services are to develop to meet the needs of users, it is essential that there is an effective framework for delivering infrastructure investment. Much of the investment taking place between periodic reviews takes place at stations, and can be funded by

- government[7];
- franchised train operators (where the franchises are let by government); or
- other investors, for example local funders such as TfL and PTEs, open access operators or businesses neighbouring a station site.

2. Most investments are funded as part of periodic reviews. These reviews determine Network Rail's outputs, revenue requirement and access charges for a set period (currently five years). It is important however that investment schemes arising between periodic reviews have processes established that enable efficient delivery. Our investment framework is designed particularly to facilitate the delivery of schemes over and above those funded through periodic reviews.

3. In October 2005, we published our conclusions on our policy framework for investments[8]. This aimed to facilitate investments in the railway by addressing a number of barriers to the delivery of efficient investment. We have implemented the framework by establishing clear roles and responsibilities and, where appropriate, new approaches to enable barriers to investment to be overcome. These are set out in our investment guidelines, published in March 2006 and updated in March 2007.

4. This paper updates, where appropriate, our guidance in the specific area of the regulatory treatment of charges at stations resulting from station investments between periodic reviews[9]. This guidance was previously set out in our document 'A Fair Deal for Stations'[10].

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[7] Department for Transport or Transport Scotland.

[8] This is accessible on our website at http://www.rail-reg.gov.uk/upload/pdf/255.pdf.

[9] Including investment which is not directly related to railway operation, for instance station car parks.

[10] A fair deal, guidelines for changes to station long term charges, Office of the Rail Regulator, London, November 1998. This is accessible on our website at http://www.rail-reg.gov.uk/upload/pdf/76.pdf

Structure of the paper

(a) **Background** – By way of context, we explain how station charges have been set in the 2008 periodic review (PR08) and describe how the investment framework has developed since the previous review of charges in 2003.

(b) **Funding scenarios and charging principles** – We set out how investments occurring over and above those funded in periodic reviews should be treated, and how their costs should be recovered through charges.

(c) **Hypothecated gains** – We set out the regulatory treatment of 'hypothecated gains' – that is, new assets or enhancements to assets accepted by Network Rail from developers in lieu of cash (for example in return for land).

(d) **Station access documents and approval process** – We set out the process relating to changes to station access documentation, and a more focused and effective approach to our approval of changes to station charges.

Background

Periodic review 2008: *recovery of station costs and the setting of station charges*

5. In PR08 we reviewed the approach to the recovery of costs at stations for control period 4 (CP4). Our PR08 determination[11] made a change to the structure of station charges. Station long term charges (LTC)[12] have been set to recover the efficient maintenance, repair and renewal costs at the stations. The charges however no longer include the return on the capital value of stations.

6. Costs are incurred at stations for their operation, maintenance, repair, renewal and enhancement. In setting charges in PR08 we distinguished between:

(a) Operating costs. These are payable to the station facility owner (or to Network Rail for a managed station) and are recovered through 'qualifying expenditure' (QX), the level of which we do not regulate.

(b) Maintenance, renewal and repair costs. These costs are recovered through the station LTC in station access contracts.

(c) Enhancement capital costs. The initial capital costs of PR08 funded enhancements are added to the regulatory asset base (RAB). Network Rail then

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[11] See chapter 21 in the determinations document, available at http://www.rail-reg.gov.uk/upload/pdf/383.pdf

[12] LTCs are access charges paid directly, or contributed to, by all passenger train operators using those stations. The station facility owner is liable for the LTC, but can then recover contributions from other train operators that use the station.

receives a return calculated as a percentage of the value of its RAB to reflect its cost of capital. All costs associated with periodic review enhancements to stations and the network are recovered through fixed charges contained in franchised passenger operators' track access contracts.

The investment framework

7. The investment framework sets out guidelines to facilitate investment for particular categories of schemes. Most relevant to station investment are:

(a) Government promoted schemes that were not funded in the most recent periodic review can be funded via a RAB addition and an adjustment to charges or grants, generally at the subsequent periodic review.

(b) "Self-financing" schemes: an approach to funding schemes promoted by someone other than government (usually a franchised train operator) and which do not require government financial support. These are further explained from paragraph 13 below.

(c) A framework for the efficient delivery of schemes promoted by third parties (someone other than Network Rail or government - for example a PTE or TfL), establishing default terms and conditions for these schemes.

8. This guidance paper explains how these new approaches and other relevant elements of the investment framework should be applied to the recovery of station costs, taking into account the methodology for recovery of station costs set out in our PR08 determinations.

Funding scenarios and charging principles

9. The method for recovering the costs of station enhancements through charges outside a periodic review depends on the scheme promoter (and their relationship with Network Rail) and on the funding and financing arrangements (in particular whether the scheme is RAB financed).

10. In this section we set out charging guidance for station enhancements for the most common categories of scheme.

11. Between periodic reviews, schemes can be promoted by:

- government;
- franchised train operators; or
- other third parties.

Government sponsored schemes

12. Government sponsored schemes are those which are promoted by DfT or Transport Scotland that were not required by their high level output specifications (and so were not funded in the periodic review). The approach to cost recovery for these schemes mirrors the approach taken to setting stations charges in PR08.

(a) For the capital costs associated with the enhancement itself, the efficient spend is logged up to the RAB. It is then expected that this would be reflected in an increase in fixed track access charges or government grants at the next periodic review[13].

(b) Any incremental maintenance, repair and renewal costs arising from the scheme would be recovered from a change to the LTC, either

- from the point in time when the costs occur (if the operators at the station accrue the benefit of the enhancement); or
- from the start of the next control period[13].

At the next periodic review these maintenance, renewal and repair costs of the enhancement will be considered together with those of other assets in determining Network Rail's revenue requirement and charges.

(c) Operating costs are recovered through QX, the level of which we do not regulate.

Franchised train operator sponsored schemes

13. Schemes promoted by franchised train operators but financed by Network Rail can qualify for treatment as self-financing schemes. The term "self-financing" is applied to schemes that:

(a) do not require government's financial support; and

(b) do not otherwise generate liabilities for government.

14. Under this approach, schemes are financed through additions to Network Rail's RAB, the costs being recovered by Network Rail through a facility charge. This approach can facilitate schemes promoted by a franchised passenger operator with a strong business case but which do not pay back within the remainder of a single franchise period. Figure 1 shows a flow chart that describes the process and the approach.

[13] Note that for financeability reasons, Network Rail may require payments to begin before the start of the next control period.

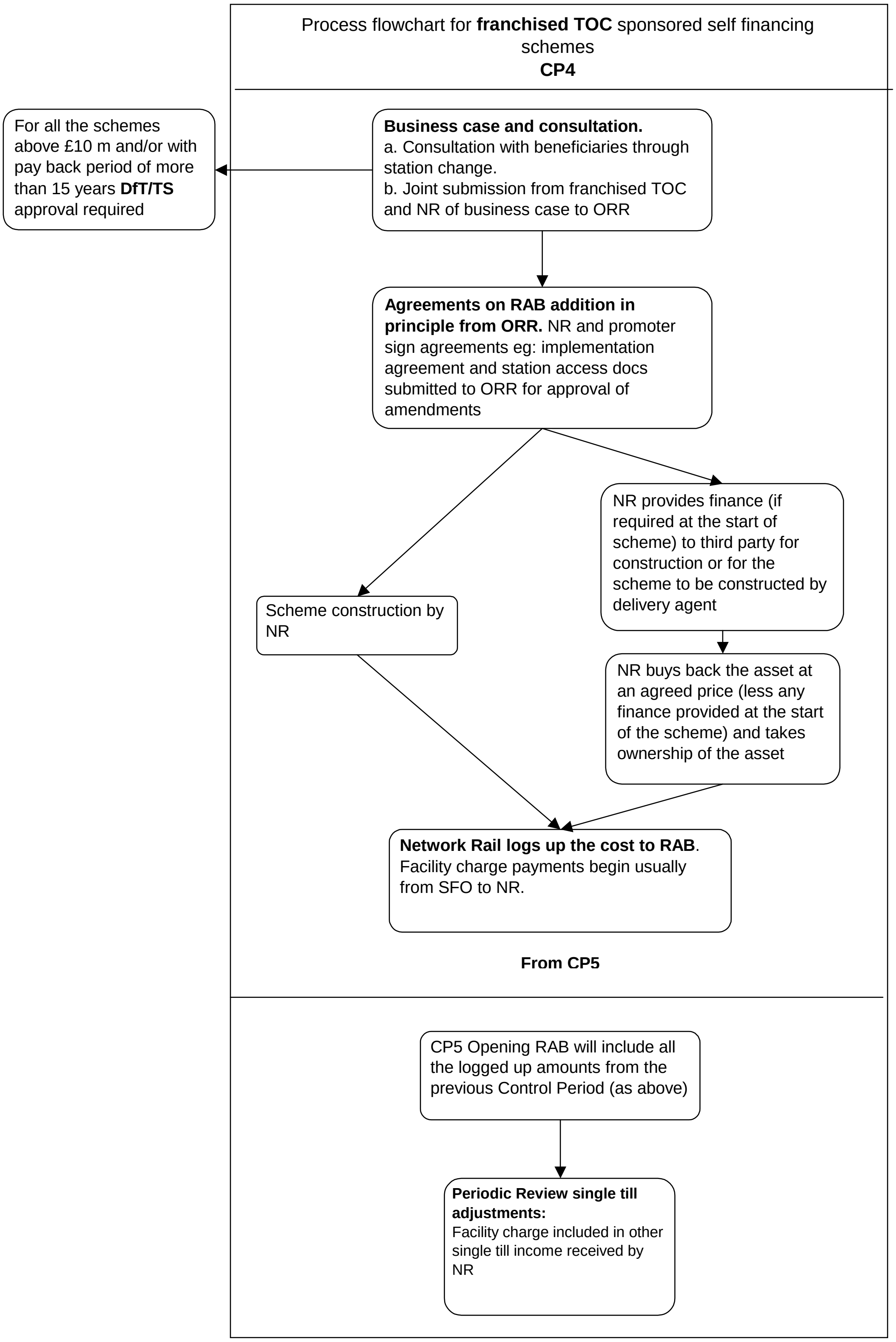

Figure 1: Franchised TOC sponsored self financing schemes

15. The eligible schemes should meet the following key criteria/conditions.

i. The value (estimated cost) is generally less than £10 million, although schemes above this value can be included on a case-by-case basis with government approval.

ii. The scheme promoter prepares the business case and must pay for all the costs resulting from the scheme (including any relevant incremental maintenance, renewal and repair costs) for an agreed period. For franchisees this will generally be the remaining term of the franchise agreement, which should have at least two years remaining – successor franchisees then usually take on the payment obligations at the end of the promoter's franchise. Franchisees with less than two years remaining can qualify if government supports the case.

iii. Network Rail must confirm its support for the scheme in writing and confirm that the scheme is consistent with other relevant policies (particularly its business planning criteria) and strategies (including its delivery plan and relevant route utilisation strategies).

iv. The scheme must satisfy our criteria for adding investment expenditure to the RAB, i.e. efficient expenditure on the scheme that enhances the economic value of the network.

16. In this self financing model, the initial capital costs and incremental maintenance, repair and renewal (MRR) costs of the enhancement will be recovered through a facility charge paid only by the promoter of the scheme.

17. In our consultation we suggested an alternative means of recovery in circumstances where the benefits of an enhancement fell to more than one station user. In these cases we suggested that all costs (including initial capital costs) could be recovered through a change to the LTC.

18. However, in its response to our consultation ATOC pointed out that this approach could lead to operators incurring costs for enhancements they did not support. This is because their objections to station change could be overcome through the use of a Financial Undertaking, and outside of an access charges review they would not be protected from an increase in costs through their franchise agreements. It is for this reason that we have concluded that this alternative approach is inappropriate. This does not preclude station users themselves arranging to share the costs of an enhancement through joint promotion of a scheme. For some investments, promoters may also be able to secure a financial contribution from users of infrastructure which they have enhanced, as set out in our conclusions on a rebate mechanism[14].

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[14] See http://www.rail-reg.gov.uk/upload/pdf/cns-rebatemech-finconc.pdf

19. The facility charge should be calculated with reference to the following guidelines:

A. Recovery period

20. The default maximum recovery period for self-financing schemes is 15 years. This period was set in consultation with government to ensure that where a franchisee is the promoter of the scheme, it would generally pay for a reasonable proportion of scheme costs, depending of course on how long the franchise has left to run. This should give government confidence that the risk of being left with a liability at the end of a franchise will be low. However, we recognise that there may be good schemes for which a longer recovery period is appropriate and we are prepared to approve schemes with longer payback periods. Where a scheme promoter believes that a longer payback period is appropriate and required to make the scheme viable it should provide a clear justification to Network Rail. Government must also be content with any recovery period longer than 15 years (up to a maximum of 30 years) and we require a letter stating this support.

21. The facility charge should be paid by the franchisee and its successor(s) for the agreed recovery period.

22. In our consultation we suggested that the default maximum recovery period could be longer than 15 years – without the need for the explicit approval of government – where a franchise had significant franchise-term remaining. This proposal was supported in principle by a number of consultees. We considered what rules might apply in practice to allow such a variation in the recovery period to take account of remaining franchise-term. It seemed to us that there was no obvious objective method of establishing these rules which would be preferable to the existing process, where promoters in any case have the option of securing government support for recovery periods longer than 15 years.

23. Some consultees expressed a related concern, that 15 years was too short for the recovery of enhancement costs of much longer-lived assets. We believe that requiring government approval of longer payback periods provides a mechanism that addresses this concern while protecting government from the potential risk of liabilities at the end of franchise terms.

24. We will publish contact details for Department for Transport and Transport Scotland for enquiries concerning approvals on our website[15]. This should help reduce the time and cost involved in securing such approval.

25. Recovery periods of less than 15 years can be agreed between Network Rail and promoters, for instance where the asset life of the enhancement is shorter than 15 years.

[15] http://www.rail-reg.gov.uk/server/show/nav.190

B. Depreciation

26. The current default approach is that the depreciation should be calculated on a straight-line basis over the recovery period. This approach means that the capital recovery element of the charge reduces over the recovery period.

27. Our consultation suggested that, in order that the charges for enhancements would better reflect the likely timing of benefits arising from schemes, we should also allow an option to reprofile the charge (keeping its net present value constant) so that payments are constant in real terms over time. All consultees who responded on this point supported the proposal, and so we have decided to allow this option at the promoter's discretion.

C. Allowed return

28. To prevent any disincentive to invest towards the end of a control period arising from expectations of a change to the rate of return in a pending periodic review, we have made a change to the current guidance. Network Rail should offer the promoter the following options for recovery of initial capital costs:

- to use the (pre-tax, real) return on the RAB, set at the most recent periodic review[16], for the duration of the charge; or
- to use the (pre-tax, real) rate of return set at the most recent periodic review but to move to the rate of return determined at the next periodic review when the conclusions of the review are implemented; this rate is then the basis for the charge for the remainder of the recovery period.

D. Incremental MRR costs

29. Incremental MRR costs should also be included in the facility charge paid by the scheme promoter to Network Rail (and not recovered through a change to the LTC) for the recovery period. If the anticipated MRR costs are not the same in every year, the charge can be reprofiled so that it has a constant real annual value. This value should be calculated so that the charge has the same present value as the MRR costs over the recovery period.

[16] Set out for CP4 in a letter to Network Rail available at http://www.rail-reg.gov.uk/upload/pdf/cp4-pretax_ror4invfrmwrk.pdf

E. Minimum threshold for incremental MRR costs

30. For third party schemes where Network Rail does not provide the finance, an existing threshold of £50,000 applies: actual annual incremental ongoing costs for a scheme which are below this level are borne by Network Rail until the next periodic review, when it is expected that they would be included in the periodic review settlement. This approach is set out fully in our March 07 investment guidelines update[17] (from paragraph 52).

31. In our consultation we asked whether this threshold should be extended to cover the incremental MRR costs of self financing schemes.

32. Most consultees said that this £50,000 threshold should apply to franchise operator promoted self financing schemes. Network Rail explained that in the case of third party schemes the reason for the £50,000 threshold was that, for most third parties, there was no existing ongoing billing relationship, and so for relatively small ongoing costs it was not worth establishing a long term charge. However, we do not think that this is a sufficient reason for different charges to apply to different investors, and conclude that the £50,000 threshold should apply for franchised TOC sponsored self financing schemes as well as for third party schemes where Network Rail does not provide the finance. If the annual MRR cost associated with a scheme is below £50,000 then that cost need not be included in the facility charge.

33. This extension will mean that Network Rail has to bear MRR costs where they are lower than the £50,000 threshold until it is funded for the enhanced assets at the subsequent periodic review. This is already the case for other third party schemes. If Network Rail can provide us with evidence that this cost is becoming material, given its experience of the type and number of schemes being promoted through the investment framework, then we will review the threshold level.

34. Since this threshold is intended to obviate the cost of negotiating small MRR charges, it should apply for each station change application (rather than at the level of an individual project within a station change application, or at a broader programme-level).

F. What happens at the end of the recovery period?

35. In the periodic review prior to the control period in which the charge expires, it is expected that allowance will be made for the enhanced asset, as for all other Network Rail assets. Network Rail would therefore be funded either to manage the asset beyond the recovery period of the charge, or to decommission it.

[17] http://www.rail-reg.gov.uk/upload/pdf/invest-guide-let-020307.pdf

G. Station access contracts

36. In order to take account of facility charge income at periodic reviews, the initial capital and incremental MRR charge components need to be calculated and shown separately in the station access contracts (in annex 9). This is because at a periodic review Network Rail would look to calculate a revenue requirement to manage all its assets (including new/enhanced assets arising from investment framework enhancements).

An example of a calculation of a facility charge is shown in the spreadsheet at Annex A.

Other third party sponsored schemes

37. Other third parties include any scheme promoter other than government (DfT or Transport Scotland) or franchised operators promoting a self financing scheme. Examples might be a PTE, a local authority, Transport for London or a train operator promoting a scheme where the 'self financing' criteria described above do not apply. For schemes promoted by other third parties we will consider applications for RAB financing according to our published criteria[18].

38. Where a RAB addition is approved, third parties must pay for all capital costs associated with schemes they promote. The terms of repayment are a matter for negotiation between Network Rail and the promoter, and will depend on the costs and the risks involved.

39. The incremental ongoing costs should be paid for by the promoter subject to the *de minimis* threshold of £50,000 per annum, or through a change to the LTC where operators benefit from the enhancement. This flexibility, which is a difference from our guidelines for self financing schemes, is necessary to prevent a barrier to investment for parties that do not have access contracts with Network Rail.

40. Table 1 summarises funding and delivery models used for station enhancements as described above, and shows how costs are recovered in each case.

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[18] See http://www.rail-reg.gov.uk/upload/pdf/255.pdf

Table 1: Models for investments in stations

Model	*Finance source*	*Promoter*	*Delivery Agent*	*Initial capital cost recovery method*	*Incremental maintenance renewal and repair cost recovery method and period*
1.Government sponsored	NR (via RAB addition)	Government	NR	RAB addition.	MRR charge paid by the operator(s) that benefits from the enhancement unless determined or agreed otherwise. MRR set for the duration of the control period only and at the subsequent control period the costs are incorporated in to revised LTC.
2.Government sponsored	Grant/cash	Government	NR	Already paid.	MRR charge paid by the operator(s) that benefit from the enhancement unless determined or agreed otherwise. MRR set for the duration of the control period only and at the subsequent control period the costs are incorporated in to revised LTC.
3. Franchised TOC sponsored (self financing)	NR (via RAB addition)	Franchised TOC	NR/3rd party	Specific facility charge for the duration of the recovery period.	MRR charge paid for the duration of the recovery period by the promoter as part of the facility charge (£50k threshold applies).
4. Other 3rd party providing own finance	3rd party	3rd party	NR/3rd party	Already paid.	MRR charge paid for by the promoter (£50k threshold applies) unless agreement reached with other beneficiaries that the costs are incorporated in to a revised LTC. At the subsequent periodic review these costs are considered in setting the LTC.
5. Other 3rd party using Network Rail finance	NR (via RAB addition)	3rd party	NR/3rd party	Negotiated between promoter and NR. ORR will consider approving RAB additions according to its published criteria. NR would need to confirm it was confident of recovering costs from the promoter (and that there would therefore be no liability to government or other stakeholders).	MRR charge paid for by the promoter (£50k threshold applies) unless agreement reached with other beneficiaries that the costs are incorporated in to a revised LTC. At the subsequent periodic review these costs are considered in setting the LTC.

Hypothecated gains

41. Hypothecated gains occur where a developer offers to carry out an enhancement in return for, for instance, acquiring Network Rail land for development. If Network Rail instead accepted cash from the developer, it would benefit directly from those receipts, whereas the value of enhanced assets taken instead of cash typically falls to other parties such as TOCs, passengers and funders.

42. Network Rail had previously proposed an approach[19] to recognising these gains through additions to the RAB, with the objective of incentivising investment through these gains. Key in such an approach is to balance the need for an administratively simple process with the need to provide a level of incentives on all parties that achieves efficient outcomes, and in the process recognises the economic value added through these investments.

43. Since Network Rail's proposal, we have worked with government and Network Rail to develop the approach, and Network Rail's strategic business plan (SBP) established a forecast level of hypothecated gains for the next control period (2009-2014).

44. Our focus when deciding on the treatment of these projected gains at periodic review was to ensure that there is no possibility of customers and funders paying twice. First, if there is an alternative cash value to the hypothecated gain, forgoing this cash would lead to a lower single till income and higher access charges. Second, if projected hypothecated gains are then added to the RAB, Network Rail would receive additional income through the allowed rate of return.

45. In arriving at out PR08 determinations we considered whether to count at least part of the forecast hypothecated gains benefits as income, as if they were cash from sales, in order to remove any possibility of over funding in CP4 if Network Rail subsequently decided to take cash instead of enhancements in return for land. Network Rail explained that there is expected to be no alternative cash opportunity from the forecast hypothecated gains in CP4 because the developments are in the main above stations. This means that, without prior development of the station, there is no development site for sale.

46. We considered Network Rail's explanation and believed it to be reasonable. We therefore did not assume that there is an alternative cash value to hypothecated gains which would otherwise be included in single till income, but neither will we add the forecast hypothecated gains to the RAB. Since Network Rail included the forecast gains as part of its plan for CP4, no additional incentive was required for it to pursue these gains. To the extent that the forecast gains do not materialise, we will ask Network Rail to explain the reasons for this.

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[19] Set out more fully in paragraphs 61 – 67 of our March 2007 Investment Guidelines Update, available at http://www.rail-reg.gov.uk/upload/pdf/invest-guide-let-020307.pdf

47. However, in order to provide incentives to Network Rail to seek <u>further</u> gains where appropriate, a proportion of any hypothecated gains over and above the PR08 forecast figure of £255m[20] will be eligible for addition to the RAB according to the policy described below.

48. When a hypothecated gain is approved for RAB addition, we face a question of what value to add to the RAB? The intention of the policy of RAB addition is to incentivise Network Rail to accept a hypothecated gain rather than cash when the former would be of significant greater benefit to the industry.

49. In July 2008 we consulted on a number of options for a RAB addition related to hypothecated gains, ranging from adding the value of cash forgone in acceptance of the asset, up to the economically efficient value of the asset. This range of options was expressed in a formula for the total value added to the RAB:

$$T_{VRAB} = C_V + x\% \, (I_V - C_V)$$

Where:

T_{VRAB} is the total value added to the RAB

C_V is the forgone cash equivalent

I_V is the economically efficient value of investment (usually the efficient intial capital cost)

And therefore $(I_V - C_V)$ is the incremental gain

x% is a percentage as set out below.

50. Most consultees supported this approach, and we remain of the view that the appropriate level for addition to the RAB is the value of the cash forgone plus an amount that outweighs the additional costs and risks for Network Rail of accepting assets in lieu of cash. We believe that the least bureaucratic and hence least cost approach will be to establish a fixed value of x for all schemes, rather than attempt to derive its value on a case by case basis.

51. Network Rail in its response raised an objection to the approach set out in our consultation on the grounds that the forgone cash value was a notional amount, with the value for the developer often created through the enhancement itself. (For example, a footbridge across a station taken as a hypothecated gain could provide access to a commercial development; without the bridge there would be no commercial value.)

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[20] If the proposed developments at Euston and Victoria do not proceed in CP4, this figure of £255m reduces to £109m as set out in Chapter 23 of our determinations. They are available at http://www.rail-reg.gov.uk/upload/pdf/383.pdf

52. While we accept that the equivalent cash value might in some cases be zero, this poses no difficulties in terms of application of the formula above. Where Network Rail can demonstrate that the equivalent cash value is either zero or impossible to estimate, the formula set out in paragraph 49 should apply with C_V set to zero.

53. Consistent with our policy of rewarding Network Rail for capex efficiencies achieved above our PR08 determination[21], we consider that a value of x of 25% will provide a powerful enough incentive on Network Rail to accept assets where their value materially exceeds any cash alternative. The closer the equivalent cash value is to the value of the asset, the stronger the incentive on Network Rail to take cash; where the value of the asset is significantly greater than the equivalent cash value Network Rail faces a strong incentive to take the asset.

54. We acknowledge that there will be some additional transaction costs when Network Rail accepts assets in lieu of cash, but think that in most cases these will be small when compared with the value of the RAB addition. We will monitor the effect of the new policy and keep the value of x under review.

55. To summarise the proposed approach, a proportion of the value of assets received as hypothecated gains by Network Rail above the PR08 forecast level of gains for CP4 would be eligible for addition to the RAB, subject to certain conditions:

(a) Confirmation from Network Rail that the value of each asset represents an efficient price for delivery of the investment received, and adds to the economic value of the rail network by an amount greater than the cash contribution Network Rail has foregone. For hypothecated gains which result in physical changes to a station, all users of the station would also be consulted through the station change process;

(b) A maximum RAB addition for hypothecated gains of £5 million per scheme (as established in our March 07 investment guidelines update), with all gains above this value requiring explicit approval from us, in consultation with government;

(c) An annual cap on such RAB additions for hypothecated gains of £50 million (over and above the PR08 forecast), again any gains above this value can be recognised as long as ORR provides explicit approval, having consulted government; and

(d) Other incremental costs resulting from the hypothecated gain would be treated as set out in the section on funding scenarios and charging principles above.

56. We expect Network Rail to set out details of expected hypothecated gains in its annual plans, to inform customers and funders.

[21] See chapter 15 of our determinations, available at http://www.rail-reg.gov.uk/upload/pdf/383.pdf

Changes to station access documents, and related processes

57. In general, an investment at a station will require the station change process set out in Station Access Conditions to be followed, so that physical changes at the station are recorded and agreed by all users of the station.

58. Under the approach outlined in this guidance, any increase in access charges (for example, through an amendment to a station access agreement) will continue to be directly linked to the station change process. This is so that all relevant users of the station are consulted on the physical changes to the station assets, which might result in incremental costs arising from an investment, leading to any changes in access charges.

59. The dispute resolution processes currently in place will continue, so that there will be no diminution in the rights of other station users in this respect.

Interactions with other regulatory processes

60. As well as submitting appropriate changes to station access documents, Network Rail needs to ensure that applications for changes to station charges are fully consistent with other relevant regulatory processes. If there are any inconsistencies between different submissions, this is likely to delay our consideration of the application. The relevant regulatory processes in addition to the station change procedure may include:

(a) a proposal to add expenditure for a scheme to the RAB;

(b) an application under Licence Condition 26, where land is disposed of as part of the scheme.

61. We need to have visibility of any proposed changes to station charges, and any corresponding RAB additions, as early as possible in the process. This would usually be at the stage that a scheme is taken forward as a single option. Early sight of proposals will facilitate our consideration of the full application later in the process.

Focused approach to approval of station charges

62. We are committed to adopting best practice regulation by identifying any opportunities to limit our involvement in access approvals, encouraging the industry to take greater responsibility for its own contracts, and focusing on areas where we add the most public interest value and where we can reduce the regulatory burden and cost on the industry. For example, our review of our criteria and procedures for the approval of freight and passenger track access contracts has focussed on the level of regulatory scrutiny to ensure that we adopt a proportionate response to applications and that we withdraw where it makes sense to do so with the industry taking more responsibility.

63. Best practice regulation suggests that there is limited value in us continuing to approve those station access applications where changes to agreements are minor and are agreed between the parties. Rather, we should focus on applications where parties

disagree and seek formal resolution of their disagreement under Section 17 (or Section 22A) of the Railways Act.

64. In our consultation we proposed to apply our General Approval powers more widely so that in all cases where a station access application concerns an investment of value less than £5 million and the parties agree, we would expect to use General Approval to approve the changes to the agreement.

65. In order to reduce the regulatory burden we conclude that when an investment at a station has a capital value of less than £5 million, any consequent changes to the station long term charge should be approved under a General Approval. This approach is consistent with our more general policy framework for investments. Under our current approach for adding enhancement expenditure to the RAB, we generally only expect to carry out an assessment for any enhancement schemes with a value above £5 million. We intend to keep the threshold of £5 million under review.

66. Also as a part of our separate recent consultation "*A more focused approach to stations and depots access*", we are in parallel considering how we can use our powers to generally approve more station and depot access agreements. Our consideration includes how we approve station charges, and we will decide as part of that consultation whether charges related to investments at stations with a capital value of more than £5 million should also be approved under a General Approval. We will also review our procedures relating to self-financing schemes and decide whether a General Approval should also cover the charging arrangements for such schemes. We will issue our conclusions on that consultation in due course. We will implement any changes to our published General Approvals arising out of both consultations together.

Link to Annex A: Example facility charge calculation