

Further regulatory statement on Crossrail charging

Background

1. The Crossrail project is jointly sponsored by the Secretary of State (SoS) and Transport for London (TfL) (together the Sponsors), for the development, design, procurement, construction, commissioning, integration and completion of a railway transport system that is capable of operation for services from Maidenhead in the County of Berkshire and from Heathrow Airport in the London Borough of Hillingdon through central London to Shenfield in the County of Essex and Abbey Wood in the London Borough of Greenwich (the Crossrail Project). In addition to the construction of the new central tunnelled section being directly delivered by Crossrail Ltd (CRL), the project requires enhancements and alterations to existing infrastructure and stations above ground on the existing network owned by Network Rail Infrastructure Limited (Network Rail), the On Network Works (ONW).
2. The SoS, CRL and Network Rail have agreed, with the approval of the Office of Rail Regulation (ORR), the Crossrail-Network Rail Programme Protocol (the Protocol), which states how the ONW will be developed and delivered by Network Rail, including appropriate governance and incentive arrangements.
3. The Protocol provides that Network Rail will finance its own programme costs in delivering the ONW, and describes the process for identifying costs and the requirements for logging the programme costs to Network Rail's Regulated Asset Base (RAB). We agreed in a letter dated 27 November 2009 to Network Rail, CRL and DfT, that the process set out in the Protocol would be used to determine the actual amount to be added to the RAB and that this could be treated as an efficient price. This RAB addition and the way we will treat the financing costs associated with the ONW will ensure that Network Rail is appropriately remunerated for its investment in the ONW, as it will form part of the determination by ORR of Network Rail's total revenue requirement for each Control Period.
4. During the passage of the Crossrail Bill in Parliament, the then-Secretary of State formally laid in Parliament heads of terms for Crossrail that had been agreed between the Department for Transport and TfL, setting out the intended sources of funding for Crossrail¹.
5. Consistent with these heads of terms, the Sponsors and Network Rail proposed that certain capital costs from the ONW will be met through a Crossrail Supplementary

¹ <http://www.publications.parliament.uk/pa/ld200708/ldhansrd/text/71126-wms0001.htm>.

Access Charge (CSAC) paid by the option holder of the Crossrail track access option dated 22 September 2008 (the TAO). Subject to any buy back as described in paragraphs 23 and 24 below, the option holder will remain liable for the payment of the CSAC to Network Rail.

6. For the period when the CSAC is in operation, ORR, having calculated Network Rail's total revenue requirement taking into account the value of the RAB, will offset from that total the anticipated value of CSAC payments from the option holder under the TAO, as well as the value of any Network Grant, before it determines the income that Network Rail is entitled to recover through the usual fixed and variable track access charges levied on passenger and freight train operators.
7. The CSAC payments will be calculated net of an amount (the User Pays Offset) which reflects the benefit of the ONW to other network users and not on the basis of the total ONW programme costs (as determined by the Protocol). Network Rail will be remunerated for the User Pays Offset through the regulatory framework. This is to ensure that the ONW benefits received by passengers on the wider network will be paid for from passenger revenues from that wider network.
8. The TAO grants the SoS a 30 year option to exercise access rights over the Crossrail route and the CSAC payment would be paid throughout this period. It is anticipated that the SoS will novate his rights and obligations under this TAO to TfL.
9. Any element of the net value originally logged to the RAB as a result of the investment in the ONW but implied by the calculation method of the CSAC to remain unamortised will fall to be remunerated as part of the normal process for determining Network Rail's regulated income. On expiry of the TAO, a second generation CSAC or some other Crossrail related mechanism may be agreed.
10. In relation to the ongoing operational costs of the ONW, a Crossrail Track Access Agreement is expected to be based on the Model Clauses published by the ORR. This would require the Crossrail passenger train operator to pay access charges determined by ORR in a similar manner as those for other passenger train operators.

Characterisation of the CSAC under the Railways Infrastructure (Access and Management) Regulations 2005 (the 2005 Regulations)

11. Paragraphs 1(3) and 3 of schedule 3 of the 2005 Regulations provide an exception to general charging principles and allow an infrastructure manager to set or continue to set higher charges on the basis of the long-term costs of a project, in relation to "specific investment projects completed...following the coming into force of these Regulations".
12. For this exception to apply paragraph 3(2) requires that:-
 - (a) the project must increase efficiency or cost effectiveness; and
 - (b) the project could not otherwise have been undertaken without the prospect of such higher charges.

13. Network Rail and the Sponsors regard the CSAC as falling within the exception in paragraphs 1(3) and 3 of schedule 3 of the 2005 Regulations for the reasons set out below.

The On-Network Works amount to a qualifying “specific investment project” (Paragraph 3(1) of schedule 3 of the 2005 Regulations)

14. The ONW are self-evidently part of a specific investment project. The works are well defined involving infrastructure construction works which required considerable up-front investment prior to new rail services becoming operational. The overall capital cost of the ONW is expected to be in the region of £2 billion.

15. Neither the ONW nor the wider Crossrail Project, of which the ONW form part, are yet completed. It is expected that those works will be fully operational by December 2019.

The CSAC is based on the long term costs of the project (Paragraph 3(1) of schedule 3 of the 2005 Regulations)

16. The CSAC relates wholly to part of the capital costs incurred by Network Rail in carrying out the construction works which are required for the ONW. These costs include major capital expenditure which is expected to be recovered over a period of up to 50 years. The mechanism by which the CSAC would be paid is described in paragraphs 6-8 above. The CSAC is based on the remuneration of Network Rail for these long term costs for the duration of the 30 year TAO access rights. Thereafter the arrangements described in paragraph 9 above will apply.

17. Network Rail will recover its operational, maintenance and renewals costs related to the ONW incurred after the CSAC comes into operation through the Track Access Charges determined by the ORR as part of the normal regulatory process.

The project increases efficiency or cost effectiveness (paragraph 3(2)(a) of schedule 3 of the 2005 Regulations)

18. Connecting the railways to the east and west of London by means of the Crossrail Project clearly increases the efficiency of the railway network. The ONW are a necessary part of the overall Crossrail Project, without which this cannot be achieved.

19. The case that Crossrail improves efficiency and cost effectiveness has been made in detail through the Crossrail business case. ORR has recognised that the Crossrail Project fulfils this condition in our Regulatory Statement in respect of the Crossrail Central Section published in November 2008². In paragraph 15 of that statement we said “[a]t this stage we are satisfied in principle that the Crossrail Project should increase the efficiency of London’s Transport network through the additional capacity generated and reduction in journey times and, on the basis of evidence put forward, should make substantial contribution to the wider economic growth.” It follows therefore that this condition would be met.

² http://orr.gov.uk/_data/assets/pdf_file/0017/10745/crossrail-reg-statmnt-131108.pdf

The project could not otherwise have been undertaken without the prospect of such higher charges (paragraph 3(2)(b) of schedule 3 of the 2005 Regulations)

20. ORR understands that the Sponsors always considered it necessary to implement higher charges in order to fund the Crossrail Project. Sponsors have highlighted Heads of Terms between the SoS and TfL agreed on 26 November 2007 which set out the intention (at clause 8.3.5) that *“TfL and/or the Crossrail TOC will be responsible for the payment of any charges payable for the use of the Central Tunnel Section and subject to [a cap of £2.3bn] any additional access or other charges payable to Network Rail for use of the enhanced capacity of the NR Network following completion of the Crossrail Project”* and stated (at clause 8.3.10) that *“TfL will be entitled to receive farebox revenue from the Crossrail Services...”*.
21. Our November 2008 Regulatory Statement in respect of the central Crossrail section states, in paragraph 5, that *“Network Rail has agreed in principle to finance the costs of the on-network works, which subject to [ORR] approval would be added to the RAB and amortised over time, through track access charges paid by the Crossrail train operator.”*
22. Given the well-publicised level of investment required for Crossrail it is clear from this statement that the access charges for use of the parts of Network Rail’s network that form part of the Crossrail Project route would need to be considerably higher than the default charges under the 2005 Regulations. While this statement refers to access charges paid by the Crossrail train operator, the CSAC will, in fact, be paid by the option holder of the TAO, principally to deal with Network Rail’s concerns over the creditworthiness of the payer and the need to secure a long term contractual commitment to pay the CSAC recognising that track access agreements may be of a shorter duration. This does not alter the underlying principle, implicit in our statement, that higher charges would be payable.

Transfer of CSAC payment obligation in the event of buy back

23. The TAO includes provisions (in Part B of schedule 11) which envisage that in certain circumstances the option holder may be deprived of some or all of the track access rights granted by Network Rail under that TAO if the ORR considers that the public interest is better served by Network Rail granting those rights to a third party. These provisions include the payment to the Option holder by Network Rail of a *“Compensation Amount”* (as amended to reflect both changes that are consequential to the implementation of the CSAC and any relevant variances in the outturn scheme cost), with Network Rail in turn receiving *“Buy Back Reimbursement Payment(s)”* from the third party.
24. In addition, where any rights are transferred by the Option holder, Network Rail and the Sponsors envisage that (i) the Option holder will cease paying the portion of the CSAC which corresponds to the rights which have been allocated to the third party and (ii) any third party to whom such rights are allocated will be required to pay the corresponding portion of the CSAC. This ensures that the CSAC is borne by the beneficiary of the access rights. If this did not occur the shortfall would then form part of the unamortised element of the value originally logged to the RAB which would fall to be remunerated as part of the normal process for determining Network Rail’s regulated income.

Conclusion

25. ORR is content that the CSAC, as currently envisaged, complies with all the conditions for it to be characterised as a charge levied under paragraph 3 of schedule 3 to the Railways Infrastructure (Access & Management) Regulations 2005.

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