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OFFICE OF **RAIL REGULATION**

21 July 2008

To: see attached list

Dear Stakeholder

Policy framework for investments – guidance on station charges

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 these barriers to be overcome. These are set out 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 that update that we would be revising our guidance covering the regulatory treatment of changes to charges between periodic reviews due to investment at stations, previously set out in our document 'A Fair Deal: Guidelines on Adjustments to Station Long-Term Charges'[4]. The paper attached to this letter sets out this revised guidance for consultation, asking stakeholders for their views on specific policy areas.

3. The attached paper should be read in conjunction with other key publications relating to the investment framework, all of which are available on our website under the heading "Investments in the network"[5]: Other than the above documents this includes Network Rail's document "Investing in the Network"[6], the final version of which was published in November 2006.

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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

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

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

4. We would welcome your views on any of the issues raised in the attached paper and, in particular, on:

(a) our proposals for self financing schemes (from paragraph 23 of this document);

(b) our proposed options for the regulatory treatment of hypothecated gains (from paragraph 34); and

(c) our policy proposals for a more focused and effective approval process (set out from paragraph 53).

5. Comments should be sent in electronic format (or, if not possible, in hard-copy format) by ***Friday 3 October 2008*** to:

Chris Littlewood
Office of Rail Regulation
One Kemble Street
London WC2B 4AN

E-mail: chris.littlewood@orr.gsi.gov.uk

6. We will make your response available in our library, publish it on our website and may quote from it. If you wish all or part of your response to remain confidential to us then please indicate this clearly. We may also publish the names of respondents unless a respondent indicates that they wish their name to be withheld.

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

8. Subject to responses to the consultation questions raised in this paper, we expect to publish final guidelines in autumn 2008.

Yours sincerely

J. R. Thomas

John Thomas

Director of Competition and Regulatory Economics

Policy framework for investments – guidance on station charges

Introduction

1. If rail services are to develop so that they meet better the needs of users, it is essential that there is an effective framework for delivering infrastructure investment. This includes investment at stations, which might involve significant investment either by Government or by non-government funders including train operators, local funders such as PTEs or other investors, for example businesses neighbouring the station site.

2. Many investments are funded as part of periodic reviews which we carry out generally on a 5 yearly basis. These reviews determine Network Rail's outputs, revenue requirement and access charges for a forthcoming 5 years. It is important however, that investment schemes arising between periodic reviews have processes for efficient delivery and our investment framework is designed particularly to facilitate the delivery of schemes between periodic reviews. In October 2005, we published our conclusions on a policy framework for investments[7]. This aims to facilitate investment in the railway by addressing a number of barriers to the delivery of efficient investment.

3. 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 our guidance in the specific area of the regulatory treatment of changes to charges at stations as a result of station investments[8], and sets out some issues for consultation. This guidance was previously set out in our document 'A Fair Deal for Stations'[9].

5. We will be producing a separate document on the treatment of shared value in relation to enhancement schemes (both relating to stations and elsewhere) later in the summer 2008.

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

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

9 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

6. The recent work by the Network RUS (stations) Working Group has produced a separate guidance document examining different aspects of station investment. This is targeted at scheme promoters and developers interested in investing in additional or enhanced station facilities, and supersedes a previous document published by the Strategic Rail Authority and has a similar title to this guidance. However, the purposes of the documents are different.

Structure of the paper

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

(b) **Funding scenarios and charging principles** – We set out how (additional) investment costs incurred between periodic reviews should be treated and how they should be recovered in terms of charges. This section asks for consultees' views on a number of issues including a new proposal to allow some flexibility in the cost recovery period for investments.

(c) **Hypothecated gains** – We describe a number of options for 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). This section asks for consultees' views on the most appropriate approach.

(d) **Station access documents and approval process** – We set out the process relating to changes to station access documentation, and our proposals for a more focused and effective approach to our approval of changes to station charges. We ask for consultees' views on this more focussed approach.

Background – station charges and the investment framework

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

7. Costs are incurred at stations in their operation, maintenance, repair, renewal and enhancement. In setting charges in a periodic review, the important distinctions are between:

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

(b) Other non-capital costs, that is maintenance and some types of repair.

(c) Capital costs, that is the capital element of repair costs, as well as renewals, and enhancements.

8. Station long term charges (LTCs) enable Network Rail to recover its maintenance, renewal and repair costs at stations. These are access charges paid directly, or contributed to, by all passenger train operators using stations[10]. Network Rail also currently recovers a return on an estimated capital value of the station portfolio. The level of the station long term charge at each station is approved by us and can be revised at a periodic review. The current structure and level of charges for the ~2,500 stations in Great Britain owned by Network Rail[11] were set at the 2000 periodic review. At that review the methodology for allocating the overall cost estimate to individual stations was based on 1995 asset valuations (gross book value) and other metrics, such as the number of platforms. The resulting charges have been uplifted by RPI since 2001, and also amended at some stations by additional charges relating to recovery of enhancement costs where specific enhancement schemes have been undertaken. In total, station access charges account for 13% of the access charges received by Network Rail[12].

9. We have reviewed the approach to the recovery of maintenance, repair and renewals costs at stations for control period 4 (CP4) as part of PR08. Network Rail has been working with industry to develop station charges proposals that better match charges with spending across the portfolio of stations for each TOC over a control period.

10. We consider that Network Rail's intention to create a structure which enables a more joined up approach to deciding where expenditure should be targeted across a franchisee's station portfolio is a positive step. This provides train operators with more information on the total expenditure planned across the portfolio and allows them greater influence as to how the expenditure is distributed between the stations.

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[10] The SFO is liable for the LTC but can then recover contributions from other train operators who use the station based on the number of departures from the station.

[11] There are around 10 stations not owned by Network Rail.

[12] Or 5% of Network Rail's total revenue once grants are included. Source: Network Rail's 2007 Regulatory Accounts, available at http://www.networkrail.co.uk/browse%20documents/regulatory%20documents/regulatory%20compliance%20and%20reporting/regulatory%20accounts/regulatory%20financial%20statements%20for%20the%20year%20ended%2031%20march%202007.pdf

11. However, as set out in chapter 21 of our PR08 draft determinations[13], our draft decision on which we are now consulting was that moving to this more joined up and transparent approach did not require the removal of the LTC (as proposed by Network Rail in its SBP update), but simply a change to what the charge covers. Retention of the LTC addresses the concerns of a number of stakeholders relating to transparency and accountability. The proposed LTCs are set out in the draft determinations price list[14].

12. The CP4 LTCs would therefore continue to recover the maintenance, renewals and repair costs at stations, reflecting expected expenditure across a portfolio of stations in the year incurred. The charge would however no longer include the return on capital, which would instead be recovered through the fixed track access charges paid by franchised passenger train operators and direct grant from government.

13. Capital costs associated with CP4 enhancements approved as part of the periodic review 2008 will be recovered through additions to Network Rail's regulatory asset base (RAB)[15], with these costs amortised over the same period as the rest of the RAB (30 years) and earning a rate of return we determine. These costs are therefore recovered as part of the revenue requirement determined at PR08.

14. Under the proposed new CP4 approach, enhancement costs which would have previously been reflected in the station long term charge would now need to be reflected in the train operator's track access contract as an additional permitted charge. Where appropriate this can be ringfenced and continue to be paid by the relevant operator beyond periodic reviews.

15. This new approach is reflected in how we propose that enhancement costs between periodic reviews are recovered.

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[13] PR08 draft determinations, Office of Rail Regulation, London, June 2008. This is accessible on our website at http://www.rail-reg.gov.uk/upload/pdf/368.pdf.

[14] PR08 draft determinations, price lists, June 2008. This is available on our website at http://www.rail-reg.gov.uk/upload/pdf/pr08-dft_determin-price_list.pdf

[15] Network Rail's regulatory asset base is a regulatory assumption of the value of the company. The company earns a return on its RAB and the RAB is increased to take account of efficient enhancements and decreased to reflect amortisation.

The investment framework

16. Since the last access charges review, which took effect from April 2004 and made no change to LTCs, we have established an investment framework. That framework has the purpose of removing barriers to capital investment and therefore facilitating appropriate, efficient investment in the rail network. This document updates the guidance on the treatment of investments at stations, to ensure consistency with our overall investment framework and other relevant regulatory policy.

17. The investment framework has introduced several new approaches to facilitate investment for particular categories of scheme. The new approaches most relevant to station investment are:

(a) A framework for the efficient delivery of schemes promoted by someone other than government, establishing default terms and conditions for these schemes and two new risk funds to cover certain unforeseen costs:

    (i) legitimately incurred by Network Rail; or

    (ii) costs arising as a result of rail industry risks, such as the impact of an operational emergency on schemes.

(b) "Self-financing" schemes: a new approach to funding schemes promoted by someone other than government (usually a passenger train operating company (TOC)) which do not require government's financial support. These are further explained from paragraph 23 below.

(c) the Network Rail discretionary fund (NRDF), a fund for minor schemes totalling £200 million in control period 3 (CP3), which was established to fund schemes with a strong industry business case, to be designed and delivered by Network Rail, with an estimated cost of less than £5 million per scheme. Government is continuing to fund the NRDF at the same level and under the same criteria in CP4.

18. 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 in CP4.

Funding scenarios and charging principles

19. During a control period, the method for recovering the efficient costs of station enhancements through adjustments to charges could be affected by the nature of the scheme, the funding arrangements, and the station ownership.

20. In this section we will describe the appropriate treatment for enhancements where Network Rail is providing the finance. At the end of this section we will summarise how costs are recovered in the most common other cases (ie where the finance is provided by another party or by a grant of cash).

21. There are two common classes of scheme that arise between periodic reviews where Network Rail provides finance:

- Government sponsored schemes.
- Self financing schemes.

Government sponsored schemes

22. For Government sponsored schemes the approach to cost recovery mirrors the proposed 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. This is then reflected in an increase in fixed track access charges or government grants at the next periodic review.

(b) Any incremental capital renewals or repair costs arising from the scheme (for instance, renewals brought forward from a future control period) are recovered in the same way, that is they are capitalised and added to the RAB.

(c) Any incremental maintenance or non-capital renewals or repair costs arising from the scheme would be recovered from the Government (via the appropriate train operator) from the point in time when they occur until the next periodic review, after which they are recovered through the LTC from all station users at that station; and

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

Self financing schemes

23. The term “self-financing” is applied to schemes that do not:

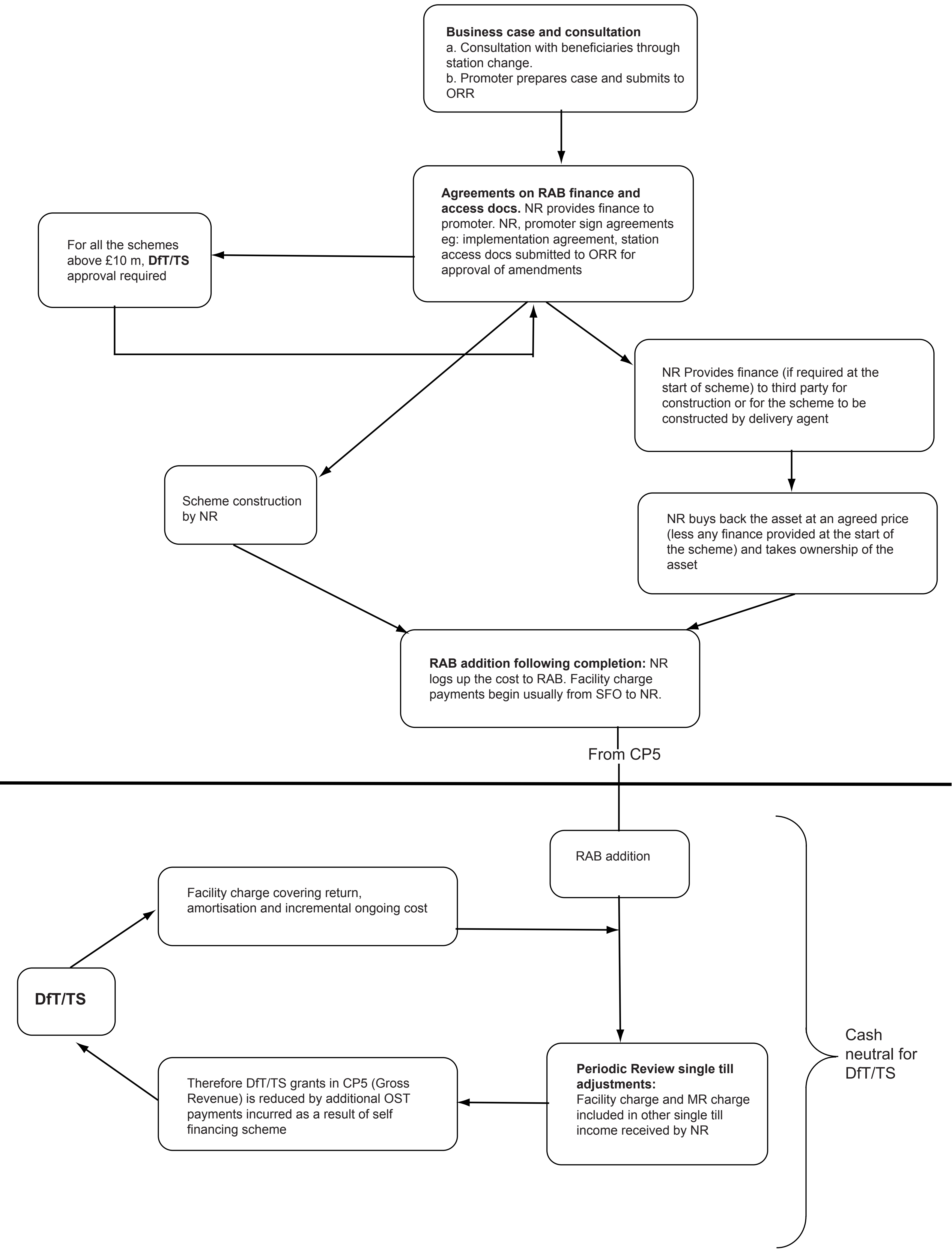
(a) require government’s financial support; or

(b) otherwise generate liabilities for government.

24. Under this approach, schemes are financed through additions to Network Rail's regulatory asset base (RAB)[16], the costs being recovered by Network Rail through a facility charge. This approach facilitates schemes 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.

[16] Network Rail's regulatory asset base is our valuation of Network Rail. Network Rail earns an allowed return on its RAB (including additions for enhancements). Depreciation (or amortisation) is applied to the RAB.

Figure 1



Business case and consultation
a. Consultation with beneficiaries through station change.
b. Promoter prepares case and submits to ORR
Agreements on RAB finance and access docs. NR provides finance to promoter. NR, promoter sign agreements eg: implementation agreement, station access docs submitted to ORR for approval of amendments
For all the schemes above £10 m, **DfT/TS** approval required
NR Provides finance (if required at the start of scheme) to third party for construction or for the scheme to be constructed by delivery agent
Scheme construction by NR
NR buys back the asset at an agreed price (less any finance provided at the start of the scheme) and takes ownership of the asset
RAB addition following completion: NR logs up the cost to RAB. Facility charge payments begin usually from SFO to NR.
From CP5
RAB addition
Facility charge covering return, amortisation and incremental ongoing cost
DfT/TS
Periodic Review single till adjustments:
Facility charge and MR charge included in other single till income received by NR
Therefore DfT/TS grants in CP5 (Gross Revenue) is reduced by additional OST payments incurred as a result of self financing scheme
Cash neutral for DfT/TS

25. 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 is promoted by someone other than government, who prepares the business case and must generally pay for all the costs resulting from the scheme (including any relevant incremental maintenance, renewals and repair costs and potentially some relevant liabilities) 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;

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 Business Plan and relevant route utilisation strategies); and

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

26. In this model, the initial capital costs of the enhancement are recovered through a facility charge paid only by the promoter of the scheme. Annex C of our March 2007 Policy Framework provides a table setting out the calculation for this element of the facility charge. In particular:

(a) *Recovery period*: In general, a default maximum recovery period for self-financing schemes of 15 years applies. This period is set 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 gives 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 do not want to preclude approving 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, and for the case of franchised operators government must also be content with any recovery period longer than 15 years.

(b) *Depreciation*: The default position is that the depreciation charge should be calculated on a straight-line basis over the recovery period, in line with the way in which the RAB is amortised. This approach means that the charge reduces over the recovery period. However, we believe that in order to facilitate investments 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. This approach is likely to be more reflective of the profile of revenues/benefits accruing from the enhancement scheme. **We would welcome consultees' views on this potential option.**

(c) *Allowed return*: The rate of return for the scheme will be the allowed (pre-tax) return on the RAB for the current control period, and will be fixed for the duration of the facility charge. For practical purposes and to prevent any disincentive to investment towards the end of a control period, once the rate of return is established at final determinations the promoter and Network Rail can agree to use this rate before the beginning of the next control period (the rate of return remaining fixed for the duration of the charge).

(d) *Inflation*: The facility charge should be inflated annually by RPI, as for track access charges.

27. In general, incremental ongoing costs – maintenance, renewals and repair costs arising from the enhancement – should not be apportioned to other users at the station, as the promoter should agree up-front to pay all these costs for the recovery period. This is based on the assumption that the scheme promoter is the sole or major beneficiary of the scheme. Therefore these costs should also be included in the facility charge paid by the scheme promoter to Network Rail (and not in a change to the LTC) for the recovery period.

28. For schemes in which Network Rail does not provide the finance, a *de minimis* threshold of £50,000 applies: annual incremental ongoing costs for a scheme which are below this level are borne by Network Rail until the next periodic review when they are included in the periodic review settlement. This approach is set out fully in our March 07 investment guidelines update[17] (from paragraph 52). **We would welcome consultees views as to whether this *de minimis* threshold should also apply to incremental ongoing costs of self financing schemes**.

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

29. Where scheme benefits are shared between station users, we believe that an alternative approach could be more appropriate, which would mirror the approach taken to cost recovery in the periodic review. Unless the multiple beneficiaries can agree jointly to fund the scheme (through separate facility charges paid to Network Rail as outlined above), the costs of the scheme could be recovered through (ring-fenced) addition to the LTC to recover all scheme costs (initial capital and incremental ongoing costs). This approach would recover costs from all station users who pay the LTC at the station. **We would welcome consultees' views on this alternative.**

30. For franchised operators, the facility charge will be a specific access charge to be paid by the franchisee and its successor(s) for the agreed recovery period of the scheme costs. Recovery periods of greater than the guideline maximum of 15 years - up to a maximum of 30 years - for these schemes can be agreed between the promoter and Network Rail, although each such case needs approval by government. Government (both in England and Wales and in Scotland) will provide appropriate contact points and more details on process for the final guidelines.

31. We are considering whether or not, for franchisees, the maximum recovery period should be related to the remaining term of the franchise. For franchises with significant franchise term remaining, a longer maximum recovery period (instead of 15) could be permitted without the need for explicit approval by Government. This approach would allow greater flexibility and may encourage some investments that would otherwise not have a business case. **We would welcome consultees' views on this proposed approach.**

Other schemes

32. For schemes for which Network Rail does not provide the finance, the incremental maintenance, renewals and repair costs should be paid for by the promoter (subject to the *de minimis* threshold mentioned in paragraph 28 above).

33. For the financing and delivery models described – government sponsored and self financing schemes, as well as for other common models where Network Rail does not provide finance, the table below summarises funding and delivery models used for station enhancements, and shows how costs are recovered in each case.

Table 1: Models for investments in stations

Model	*Finance source*	*Promoter*	*Delivery Agent*	*Initial capital cost recovery*	*Incremental maintenance renewal and repair cost recovery*
1. RAB, Government sponsored	NR (RAB)	government	NR	General TACs[2]/grants	MR & R long-term charge
2. Self-financing	NR	3rd party[5]	NR/3rd party	Specific facility charge	Specific incremental MR & R facility charge (we are consulting on whether a de minimis threshold should apply[3])
3. 3rd party providing own finance	3rd party	3rd party	3rd party/NR	If NR delivers –use approved templates	MR & R charge (de minimis applies[3])
4. Cash/grant funded[4]	Cash	Gov/3rd party	NR/3rd party	Already paid	MR & R charge

Notes to table

1. For schemes, which have more than one funding source, such as schemes where some grant funding is provided by a regional Government, each element of funding should be treated separately as described above.
2. TACs are track access charges.
3. See paragraphs 28 and 32 above
4. Assuming under model 4 that NR owns the enhanced asset.
5. A 3rd Party could include either a train operator or a commercial developer.

Hypothecated gains

34. Hypothecated gains occur where a developer offers to carry out an enhancement in return for, for instance, acquiring Network Rail land for development, instead of making

cash payments to Network Rail. If Network Rail accepts cash from the developer, it benefits directly from these receipts (usually through property income), whereas the value of enhanced assets taken instead of cash typically falls to other parties such as TOCs, passengers and funders.

35. Network Rail had previously proposed an approach[18] 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, recognising the economic value added through these investments.

36. 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) has established a forecast level of hypothecated gains in the next control period.

37. Network Rail estimated in its SBP that these gains could be worth up to £296m in CP4. We have considered how these gains should be treated in the PR08 settlement and in our draft determinations have set out our view that it is not appropriate to add any hypothecated gains in CP4 to the RAB up to the forecast figure of £296m. This is because we have not counted the value of these forecast hypothecated gains as income in our draft determinations (which would have had the effect of reducing the revenue Network Rail required in CP4).

38. However, in order to provide incentives to Network Rail to seek further gains, a proportion of any hypothecated gains over and above this forecast figure of £296m will be eligible for addition to RAB, subject to the process outlined in our March 2007 Investment Guidelines Update.

39. 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 remove any incentive on Network Rail to take cash when acceptance of a hypothecated gain would be of greater whole industry benefit. In March 2007 we outlined Network Rail's proposed approach of adding the value of the hypothecated gain (ie the efficient delivery price of the enhanced asset) to the RAB. This would more than compensate Network Rail for the foregone cash, since the value of the gain must exceed this cash value.

40. An alternative approach would be to add the foregone cash value to the RAB. This could leave Network Rail with a small incentive to take cash instead of a more beneficial

[18] 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

hypothecated gain because of the extra costs associated with acceptance of an asset (for example, surveying costs). So to make the decision neutral, a third possibility would be to add an amount to the RAB between the foregone cash value and the value of the hypothecated gain, with the extra amount above the cash value designed to compensate Network Rail for the costs of accepting the gain. The total value added to RAB would then be given by:

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

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

And therefore (I_V-C_V) is the incremental gain

x% is the agreed variable percentage depending on the case.

41. Another option, which would be a simpler approach, would be to adopt a policy of making a RAB addition of a fixed percentage (for example, 50%) of the asset value. This approach might be preferable in any case where it proved impossible to estimate the foregone cash value reliably.

42. To reiterate, the options for addition to the RAB are:

(a) The value of the cash foregone (so for example, if the hypothecated gain is accepted in lieu of cash for a land sale, then the cash value of the land). This option risks leaving Network Rail with an incentive to take cash instead of a more beneficial hypothecated gain, because of the additional costs associated with acceptance of an asset. It may also be difficult practically to estimate the foregone cash value in some cases.

(b) The value of the hypothecated gain (ie the efficient delivery price of the enhancement to the asset). This could more than compensate Network Rail for the extra costs of accepting an asset, but has the practical advantages that no forecast of forgone cash income is required.

(c) An amount T_{VRAB} between the cash value and the value of the hypothecated gain, with a percentage, set to cover both the foregone cash value and any additional costs to Network Rail associated with acceptance of the asset.

(d) A simple percentage (e.g. 50%) of the value of the hypothecated gain. This could be applied in cases where the value of the cash forgone proved impossible to estimate robustly.

43. In deciding which of these options to implement there is a balance between ensuring there are no perverse incentives on Network Rail (for instance to take cash instead of far more valuable assets), and keeping the process simple and workable.

44. To summarise the proposed approach, assets received as hypothecated gains by Network Rail above the forecast CP4 level of gains 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 hypothecated gain per scheme of £5 million (as established in our March 07 investment guidelines update), with all gains above this value requiring specific approval from us, in consultation with Government;

(c) An annual cap on such hypothecated gains of £50 million, again any gains above this value can be recognised as long as ORR provide specific 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.

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

46. We intend to keep the approach under review and monitor it with assistance as required from the independent Rail Reporter. We would expect that the number of projects reviewed would decline over time as confidence in the approach grows.

47. We would welcome consultees' views on the proposed approach to hypothecated gains described above.

Changes to station access documents, and related processes

48. In general, an investment at a station will require the station change process to be followed[19], such that physical changes at the station are recorded and agreed by all users of the station through the station access agreement. Previously station investments have resulted directly in changes to station charges, which have also been part of the station change process.

49. Under the approach outlined above, 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, so that all users of the station will be consulted on the physical changes to the station assets. Where other users of the station are required to pay for a share of the incremental costs arising from an investment, those users will also be consulted before any changes in access charges are implemented.

50. 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

51. 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. For example, information submitted as part of a proposal to add expenditure to the RAB for a station scheme will need to explain clearly any increases in station charges: these charges should reflect exactly the charges proposed for the scheme in the application to increase station charges. The relevant regulatory processes for a scheme may include:

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

(b) as noted above, the station change proposal; and

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

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[19] Note that Government cannot promote a station change.

52. 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.

Focussed approach to approval of station charges

53. 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 is focusing 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.

54. 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 agreed between the parties. Rather, we should focus on major applications, or those cases where parties (including any relevant beneficiaries) disagree and seek formal resolution of their disagreement under Section 17 (or Section 22A) of the Railways Act.

55. We therefore propose 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.

56. This approach is consistent with our more general policy framework for investments. Under our current approach for adding enhancement expenditure to the RAB[20], we generally only expect to carry out an assessment for any enhancement schemes with a value above £5 million. We will keep this threshold level under review and consider whether it should be modified in future. **We would welcome consultees' views on this proposed approach.**

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[20] The criteria are set out in Chapter 3 of our investment framework policy conclusions and Chapter 4 of the March 2006 investment framework implementation guidelines.

OFFICE OF RAIL REGULATION

List of Consultees

Association of Train Operating Companies

Department for Transport

Freight Operating Companies

Treasury

Network Rail

National Assembly for Wales

Passenger Focus

Passenger Transport Executive

Rail Freight Group Members

Rail Industry Association

ROSCOs

Train Operating Companies

Transport for London

Transport Scotland