



Charging framework for the Heathrow Spur

**Consultation on proposals and
invitation to comment**

11 February 2016

Contents



Introduction	3
Summary	3
Purpose of the consultation	3
Legal framework	6
Application of the legal framework to the Heathrow Spur	13
Invitation to comment	20
Annex – Heathrow Spur Charging Framework	22

Introduction

Summary

Heathrow Airport Limited (HAL) owns and operates the Heathrow Spur, which is a stretch of railway infrastructure linking Heathrow Airport to the Great Western Main Line to Paddington. When Crossrail services begin in 2018, Crossrail trains will access the Heathrow Spur to take passengers to and from Heathrow Airport. HAL intends to charge the Crossrail train operator for that access.

The focus of this consultation is not whether HAL can charge users for access to the Heathrow Spur, but whether it can charge them for one specific type of cost – the historical costs of constructing the Heathrow Spur itself. This decision hinges on the interpretation of a piece of EU-derived law which says that charges for such construction costs can only be levied on train operators if the project could not have gone ahead without them. It is the interpretation of “*could not have gone ahead*” which is crucial in this case.

What makes this case unusual is that it is being applied to a project that is already built and was indeed built before the relevant law came into force. This has resulted in evidential issues caused by the fact that there is no explicit evidence setting out the basis for the investment from the time when the investment decision was made. In the absence of *explicit* evidence, we have had to decide what inferences can be drawn from the *available* evidence considered in the round.

In our view, HAL has not provided sufficient evidence to show that it should be able to levy charges relating to the historical costs of constructing the Heathrow Spur. As a result, we propose not to allow HAL to levy such charges. This does not however prevent HAL levying other charges provided that they are in accordance with and permitted by the legislation.

Purpose of the consultation

1. The purpose of this consultation by the Office of Rail and Road (ORR) is to seek stakeholders' views on the proposed charging framework for the 8.6km of railway infrastructure which Heathrow Airport Ltd (HAL) owns and operates and which links Heathrow Airport to the Great Western Main Line (the Heathrow Spur). ORR is required to establish the charging framework and specific charging rules in

accordance with Regulation 12 of the Railways Infrastructure (Access and Management) Regulations 2005, as amended¹ (the Regulations).

2. HAL's approach to charging for the Heathrow Spur is set out in its network statement which was published for the first time in Autumn 2015². Pursuant to a Deed of Undertaking in connection with the Crossrail project dated 30 May 2008 between, among others, HAL and the Secretary of State for Transport (the Deed of Undertaking)³, it was agreed that the advent of Crossrail services in 2018 would bring the Heathrow Spur fully within the scope of the Regulations.
3. When the Department for Transport (DfT) initially issued guidance on the Regulations in November 2005⁴, it indicated that the Heathrow Spur would be covered by the exemption from the specific charging, allocation of capacity and access to services provisions of the Regulations applicable to networks intended only for the operation of urban or suburban passenger services⁵.
4. In November 2007, DfT revised the guidance to indicate that the exemption would not appear to apply to the Heathrow Spur if Crossrail were to provide passenger services to Heathrow from further afield than Paddington station. At that point DfT ceased to continue to offer any view on the application of the Regulations to the Heathrow Spur⁶.
5. In accordance with the Deed of Undertaking, HAL wrote to ORR on 27 November 2012 to seek confirmation that the Regulations applied to the Heathrow Spur. We confirmed on 10 January 2013 that the Regulations did apply to the Heathrow Spur⁷.

¹ In particular by the Railways Infrastructure (Access and Management) (Amendment) Regulations 2009.

² Heathrow Network Statement: Rail - June 2015
http://www.heathrow.com/file_source/Company/Static/PDF/Companynewsandinformation/rail-network-statement-june15.pdf.

³ Deed of Undertaking, dated 30 May 2008 between the Secretary of State for Transport, BAA Limited, HAL and Heathrow Express Operating Company Limited.

⁴ Department for Transport - Guidance on the scope of the First Rail Package Transposition Regulations.

⁵ Regulation 4(4)(b).

⁶ Department for Transport - Guidance on the scope of the First Rail Package Transposition Regulations, footnote 2.

⁷ Letter from Brian Kogan, Deputy Director, Railway Markets and Economics, ORR to Allan Gregory, Surface Access Director, HAL, dated 10 January 2013.

Since then, HAL has been working towards compliance with the Regulations, including by publishing its network statement for the first time as set out above.

6. In proposing the charges set out in its network statement, HAL has sought to rely on the exception to the charging principles contained in paragraph 3 of Schedule 3 to the Regulations in order to levy a charge to recover the historical capital costs of constructing, in particular, the tracks, tunnels and stations comprising the Heathrow Spur (the Historical Long-Term Costs). DfT and Transport for London (TfL), in their capacity as Crossrail sponsors (the Sponsors), disagree with HAL's approach to charging and do not believe HAL has satisfied the criteria to make use of that exception in respect of the Historical Long-Term Costs.
7. We have considered this question as part of our function in establishing a charging framework for the Heathrow Spur and our proposed decision is set out in detail in this consultation document. For the reasons set out below, our view is that HAL has not provided sufficient evidence to enable it to levy a charge to recover the Historical Long-Term Costs from rail users. This decision has required careful scrutiny of an incomplete evidential record, and it should be noted that the decision set out in this document is based on the evidence that has been provided by the parties to date. In reaching our final decision, we will carefully consider any additional evidence that may be made available in the consultation process and which goes to the determination of the issue.
8. Details of how to comment are set out in the "Invitation to comment" section. The deadline for comments is 5 p.m. on **10 March 2016**.
9. The proposed charging framework, if and when adopted, will have immediate effect. To the extent necessary, HAL would be expected to update its network statement as soon as possible thereafter.

Legal framework

Functions in relation to charging frameworks

10. Regulation 12(1) of the Regulations requires ORR to “*establish the charging framework and the specific charging rules governing the determination of the fees*” which the infrastructure manager must charge.
11. Regulation 12(2) of the Regulations requires an infrastructure manager to “*determine the fees to be charged for use of the infrastructure in accordance with the charging framework, the specific charging rules, and the principles and exceptions set out in Schedule 3*”. It must then collect the fees from users of its infrastructure.
12. Accordingly, it is for the infrastructure manager to set fees for the use of that infrastructure that comply with both the framework and charging rules set by ORR and the principles and exceptions set out in Schedule 3 of the Regulations.
13. Regulation 28(2) of the Regulations provides that ORR is responsible for ensuring that the charges levied by the infrastructure manager comply with the requirements of Part 4 (Regulations 12 to 15) and Schedule 3 to the Regulations.
14. Therefore, an infrastructure manager is given discretion to determine the fees to be charged for the use of its infrastructure in the way it deems most appropriate to recover its costs, but it must exercise that discretion in accordance with ORR’s charging framework and the specific charging rules, which must themselves comply with the Regulations’ charging principles and exceptions. It is for ORR to be satisfied that the charges being levied comply with the requirements of the Regulations and to adjudicate on any appeals that may be brought by applicants in relation to such charges.

The test for recovery of long-term costs

15. The principles of access charging are set out in paragraph 1 of Schedule 3 to the Regulations. The starting point is that “*charges for the minimum access package and track access to service facilities... shall be set at the cost that is directly incurred as a result of operating the train service*”.
16. Where an infrastructure manager wants to levy charges to recover costs above those that are directly incurred, two exceptions apply:

- a) in order to obtain full recovery of the costs incurred, the infrastructure manager may levy mark-ups on the basis of efficient, transparent and non-discriminatory principles⁸; and
- b) for specific investment projects, where three criteria are fulfilled, the infrastructure manager may set or continue to set higher charges on the basis of the long-term costs of the project⁹.

17. The second exception has been the focus of disagreement between HAL and the Sponsors. It should be noted that Directive 2012/34/EU, which recasts the first railway package, is due to be transposed by the DfT soon (although the specific date is not known). The provisions of that Directive do not materially change the wording of the second exception.

18. The full wording of the exception is set out in Paragraph 3 of Schedule 3 to the Regulations as follows:

“(1) Subject to sub-paragraph (2), for specific investment projects completed--

(a) since 15th March 1988; or

(b) following the coming into force of these Regulations,

the infrastructure manager may set or continue to set higher charges on the basis of the long-term costs of the project.

(2) For sub-paragraph (1) to apply--

(a) the project must increase efficiency or cost-effectiveness¹⁰; and

(b) the project could not otherwise have been undertaken without the prospect of such higher charges.

(3) A charging arrangement to which sub-paragraph (1) applies may incorporate agreements on the sharing of the risk associated with new investments.”

⁸ See Paragraph 2 of Schedule 3 to the Regulations.

⁹ See Paragraph 3 of Schedule 3 to the Regulations.

¹⁰ The Railways Infrastructure (Access and Management) (Amendment) Regulations 2009 replaced the words “the effect of the higher charges must be to increase the efficiency or cost-effectiveness of the project” as shown in the Regulations as enacted, with the words “the project must increase efficiency or cost-effectiveness” as shown here.

19. The test for recovery of long-term costs in paragraph 3 of Schedule 3 to the Regulations (the Paragraph 3 Test) consists of three criteria. Where those three criteria are satisfied, the infrastructure manager has a discretion (“*may set or continue to set*”) to set charges that go beyond “*the cost that is directly incurred as a result of operating the train service*”, on the basis of “*the long-term costs of the project*”.
20. The first criterion of the Paragraph 3 Test requires that the project was completed since 15 March 1988 or following the coming into force of the Regulations. We consider this to be clearly satisfied in the case of the Heathrow Spur as we understand construction did not begin until 1993 and services did not start until 1998.
21. The second criterion of the Paragraph 3 Test requires that the project increases efficiency or cost effectiveness. We also consider this to be satisfied for the Heathrow Spur. We considered factors such as reductions in journey times (compared to driving or taking the Piccadilly Line) brought about by the project, potential for the relief of congestion on roads or other modes of transport and potential beneficial environmental effects were relevant in establishing that the criterion was met.
22. The third criterion of the Paragraph 3 Test requires that the project “*could not otherwise have been undertaken without the prospect of such higher charges*” (i.e. charges calculated on the basis of the long-term costs of the project) being levied. In this case, this has been the most contentious of the three criteria and has therefore been our main focus in deciding on the content of the proposed charging framework.
23. There is no case law, at either a domestic or European level, to provide assistance in interpreting the requirements of the Paragraph 3 Test in relation to historical projects. Equally, neither the explanatory memorandum to the Regulations, nor the recitals to the Directives provide further assistance in interpreting this provision. As such, we have taken a view based on a plain English reading of the legislation and principles of EU law, together with our overall understanding of the purpose of the Regulations and European Directives.
24. Our consideration of the third criterion of the Paragraph 3 Test and how the Paragraph 3 Test as a whole may apply to HAL is set out below.

The third criterion of the Paragraph 3 Test

25. The third criterion of the Paragraph 3 Test raised several issues which we considered in determining whether or not the criterion was satisfied. These were: by whom should the higher charges be paid; what level of recovery of higher charges is required or permitted; and what is needed to evidence that the project *could not have*

been undertaken but for the prospect of such higher charges? Our analysis is set out below.

The recovery of higher charges

26. The Regulations do not expressly identify the person or persons by whom the '*higher charges*' referred to in the third criterion of the Paragraph 3 Test should be paid, but we consider it is clear from the statutory context that it must be intended to confer a discretion on the infrastructure manager to increase its fees "*for use of the infrastructure*" in accordance with Regulation 12(2) of the Regulations. We therefore consider that the exception should be read as conferring a discretion to levy higher charges from rail users of that infrastructure (as against third parties who may obtain commercial benefits from such use), given that the exceptions to the charging principles relate to charges payable by railway undertakings for use of the railway infrastructure. We consider this to be consistent with our role under the Regulations in establishing the charging framework that the infrastructure manager will comply with when setting the fees for rail operators using the Heathrow Spur. As an alternative, we did consider whether it could be intended to permit higher charges to be recovered generally, through any mechanism. However, given the scope of the Regulations, we consider the former is the better interpretation. Indeed, we do not think the infrastructure manager is given any power under the Regulations to levy charges on third parties.

Prospect and level of recovery of higher charges

27. We considered whether the *prospect* of higher charges envisaged by the third criterion of the Paragraph 3 Test requires actual cost recovery from those higher charges to match any expectation of cost recovery forecast at the outset of the project.
28. The Regulations require that any higher charges that the infrastructure manager may decide to impose must be set on the basis of the long-term costs of the project. However, they do not oblige an infrastructure manager to make use of this exception at all. Equally, we do not see any reason to require that, if the infrastructure manager does decide to make use of the exception, it must then set charges at a level that recovers the full amount of the project costs. In other words, the "*long-term costs of the project*" imposes a maximum but not a minimum level at which any higher charges may be set.
29. We consider it follows that, for the purposes of the third criterion, the infrastructure manager must be able to demonstrate that the project could not have gone ahead without the prospect of levying charges on rail users that made at least some

contribution to the “*long-term costs of the project*”. However, we do not consider that the Regulations require an infrastructure manager to demonstrate that the project could not have gone ahead unless the higher charges imposed were sufficient to recover *all* the long-term costs of the project from rail users, if it is to be permitted to levy *any* higher charges under this exception. As such, partial recovery of the long-term costs is permitted, provided that an infrastructure manager is able to satisfy the elements of the Paragraph 3 Test. The total amount of long-term costs would, however, likely be relevant to the extent we needed to understand the higher charges to be paid, and in particular to the extent we needed to impose a limit on the discretion of the infrastructure manager in setting such charges.

30. This interpretation appears to us to reflect common sense and commercial reality. To take a simple example: if a Member State or a commercial third party offered to “match fund” the long-term costs of an infrastructure project, it might well be the case that the project could not go ahead unless higher charges could be levied to recover at least half of those long-term costs from rail users – we do not see anything in the wording or the legislative scheme that would prevent such an arrangement.
31. Further, the Regulations do not require the long-term costs of the project to be recovered in line with the initial forecast figures. Accordingly, and in light of the above, even if forecast traffic did not materialise over the early years of the project, this should not be fatal to long-term cost recovery under this exception. Instead, as costs are recovered over the long-term, charges may be levied over a longer period than initially forecast, in recognition of the fact that forecast traffic has not materialised. The operative requirement is, however, that the undertaking of the project was contingent on the prospect of higher charges being levied.
32. Our view is that it is appropriate for long-term costs to be assessed prospectively and over a specified duration. Therefore we consider an important factor in determining whether charges can be levied under the long-term costs exception is the basis on which the investment was made (i.e. expected returns / traffic forecasts rather than the actual amount recovered). As noted, the exception imposes a limit on the higher charges that can be recovered by reference to the “*long-term costs of the project*”: charges could not therefore be imposed that went beyond such cost recovery on a prospective basis; but we do not see any objection in principle to this maximum figure being subject to review over the relevant “*long-term*” period, which will vary from project to project.

Could not otherwise have been undertaken – standard of evidence and burden of proof

33. The Regulations do not provide any further assistance in determining what evidence is required in order to demonstrate that the project “*could not*” have been undertaken but for the prospect of such higher charges being levied. Equally, the Regulations provide no further assistance regarding the standard of evidence required.
34. The ability to set higher charges to contribute to the long-term costs of infrastructure projects is an exception to the general principle that charges should be based on the cost that is directly incurred as a result of operating train services. As a result, the burden of proof is on the infrastructure manager to demonstrate that the project could not have been undertaken without the prospect of higher charges.
35. So far as what has to be proved and the standard of such proof, we do not think the wording “*could not*” can have been intended to set a standard of absolute impossibility. Given that major rail infrastructure projects frequently involve the actual or potential provision of public funds, the fact that a project could in principle have been funded by the relevant Member State on public policy grounds could otherwise preclude use of this exception. Applying the same logic in a private commercial context, we do not think a different or more demanding approach should be adopted in relation to a theoretical possibility that a project might be funded by a third party pursuing its own commercial interests. We think a realistic commercial standard should be applied to an issue of this kind. As a result, we considered the relevant question was whether HAL had showed that, when the decision was taken to approve the project, there was no realistic commercial possibility of the project going ahead without the prospect of levying charges on rail users that contributed to the Historical Long-Term Costs.
36. So far as the issue of evidence is concerned, we consider the best evidence of this would be explicit evidence from the time of the planning and financing of the project. In principle, the relevant evidential issues would focus on identifying (i) the decision to proceed with the project and (ii) the commercial basis on which that decision was made.
37. Such explicit evidence might include, for example, a board paper giving approval for the project that is contingent on the expectation of recovery of higher charges, or loan documents containing covenants requiring the project to recover a certain level of charges by reference to its long-term costs (for example, the long-term financing costs of any initial investment).

38. Although explicit, contemporaneous, evidence is likely to be the strongest evidence of the position at the time of investment, we consider it is appropriate to consider *all* the evidence, in the round, in deciding whether the test is met. In particular, for projects constructed before the Regulations existed such as the Heathrow Spur, explicit, contemporaneous evidence may not be available. Therefore, in the present case we have considered what inferences should be drawn from the *available* evidence when viewed in the round, in order to determine whether the project could not otherwise have gone ahead. We think it is appropriate to consider subsequent evidence if it casts light on the basis on which the original decision was taken. We do however consider such subsequent evidence is likely (but not certain) to be of less weight than the contemporary documentary record.
39. Where the evidence is such that it is possible to *infer* that the project could not have gone ahead without the prospect of higher charges, this can be sufficient to satisfy the Paragraph 3 Test. In drawing such an inference, one may consider a range of evidence, including evidence of commercial conduct reflecting an expectation of cost recovery from rail users, such as actual recovery of '*higher charges*' since the investment was made.

Applicability of Section 4 duties

40. Regulation 28(1) of the Regulation applies section 4 of the Railways Act 1993 (Section 4) to ORR's functions under the Regulations, to the extent consistent or relevant with the European legislation. As Section 4 applies to exercise of ORR's functions under the Regulations, it will therefore have effect, to the extent that it is relevant, in our determination of the charging framework for the Heathrow Spur.
41. Notwithstanding the above, we do not consider the section 4 duties are applicable to the decision of whether the Paragraph 3 Test is met, which turns on the application of the evidence to the three criteria set out above. The language of the Paragraph 3 Test must be considered in the context of the Regulations as a whole (i.e. taking a purposive interpretation as to its meaning). The application of the Paragraph 3 Test is essentially one of factual appreciation by reference to the evidence.
42. In light of the above, we have not had regard to our Section 4 duties in deciding that the Paragraph 3 Test has not been met. We consider it would not have been lawful to have had regard to our Section 4 duties in a way that would enable us to reach a different decision from the result that we would reach by applying the Paragraph 3 Test to the available evidence.

Application of the legal framework to the Heathrow Spur

43. We consider that the construction of the Heathrow Spur satisfies the requirements of the first and second criteria of the Paragraph 3 Test. We have not gone into further detail on those points in this document.
44. In considering the third criterion of the Paragraph 3 Test on whether the Heathrow Spur project “*could not*” have gone ahead without the prospect of higher charges being levied, it is worth noting that in this case there does not appear to be explicit evidence from the time of the key investment decisions. This has meant that deciding whether or not HAL is entitled to set charges at a level that will enable it to recover the Historical Long-Term Costs has required the careful assessment of an incomplete documentary record.
45. The Paragraph 3 Test is an exception to the charging principles and the onus is on HAL to show that it has satisfied the test. We have not been provided with evidence such as HAL board papers approving investment in the Heathrow Spur; documents recording its inclusion on the airport regulatory asset base (RAB); or any CAA documentation regarding approval of the scheme which determines the question. Whilst other, different, evidence might have been desirable, we have had to make our decision based only on the evidence available to us.
46. We have taken into account that the Paragraph 3 Test did not exist at the time of construction of the Heathrow Spur. In light of this, we have viewed the available evidence in the round, to see whether we should reasonably infer that the Heathrow Spur project could not have been undertaken without the prospect of higher charges being levied. We find the documents with which we have been provided, and from which we have been asked to draw such an inference, to be inconclusive on that point. As a result, following our assessment of evidence produced by HAL and the Sponsors, we do not consider the available evidence to be sufficient to demonstrate that HAL has satisfied the Paragraph 3 Test in respect of the Historical Long-Term Costs and as such, HAL cannot be considered to have discharged its burden of proof.
47. We have summarised below our consideration of the evidence in this case.

48. The arrangements for the construction of the Heathrow Spur are set out first in a Memorandum of Understanding¹¹ and then in an agreement between BAA plc (BAA), HAL and British Railways Board (BRB) dated 16 August 1993 (the Joint Operating Agreement). Those arrangements were structured as a joint venture between the private sector (HAL and its then parent company BAA) and the public sector (BRB), pursuant to which HAL provided funding for the project in return for the right to receive revenues from the operation of train services on the new infrastructure. In both of these documents the arrangements provide for the transfer of the project to a legally distinct special purpose vehicle referred to as Newco.
49. Clause 12 of the Joint Operating Agreement sets out a clear intention that HAL and BRB would transfer the assets and liabilities of the Heathrow Spur project to Newco. The Joint Operating Agreement states further that: *“it is agreed that the objective of the Parties is to finance the discharge by Newco of the HAL Indebtedness [incurred by HAL to fund the Heathrow Spur project]... by way of secured loans undertaken on reasonable commercial terms on the basis that the lenders to Newco have no recourse to BRB, HAL or BAA”*¹². As HAL submitted further, if Newco failed to do this, it would have been required to issue a loan note in HAL’s favour for the outstanding balance of the HAL Indebtedness, which would bear interest equivalent to HAL’s funding costs¹³. The Joint Operating Agreement goes as far as to attach both a form of a “hiving-down agreement” setting out the mechanics of the transfer to Newco¹⁴ and a form of a shareholders’ agreement to be entered into between the parties and Newco¹⁵. We infer from this that while the transfer to Newco was expressed as being merely an option, it was in fact the primary option for the parties.
50. We have seen no evidence that Newco, as a standalone special purpose vehicle, had any realistic commercial source of income to contribute to Historical Long-Term Costs other than revenue from rail users. Accordingly, we are persuaded that, had the Newco structure proceeded, the third criterion of the Paragraph 3 Test would very likely have been satisfied.
51. However, at some point after 1993, the arrangements for financing the Heathrow Spur changed and the Newco option was not pursued by the parties. Instead, the

¹¹ The version provided to ORR was unsigned, however we have no reason to suspect it was not signed by the parties.

¹² Joint Operating Agreement, Clause 12, paragraph D.

¹³ Initial submission of Heathrow Airport Limited (HAL) to the Office of Rail and Road (ORR) regarding HAL’s charges for track access to the Heathrow Spur, dated 1 September 2015, paragraph 29.

¹⁴ Joint Operating Agreement, Schedule 5.

¹⁵ Joint Operating Agreement, Schedule 8.

Heathrow Spur was included in the airport RAB, although we have not seen any explicit evidence setting out the basis on which this occurred. We do not consider that inclusion on the RAB necessarily precludes the application of the third criterion of the Paragraph 3 Test. However, in most regulated sectors, a rate of return on the RAB is included in the calculation of the charges a regulated entity is permitted to make to its customers and, as such, this could provide an alternative source of funding for a project enabling it to go ahead even without a contribution to capital costs from users of the project infrastructure. In the case of the Heathrow Spur, the addition of the project to the airport RAB could, at least in principle, be viewed as having created a realistic commercial possibility of funding the project through airline charges (or other single till income) even if there were no prospect of higher charges to rail users contributing to Historical Long-Term Costs. We therefore consider the addition of the project to the airport RAB to be important when considering the basis on which the investment was made. As such, we have examined the available evidence to establish whether the addition of the Heathrow Spur to the airport RAB is or is not consistent with the Paragraph 3 Test being satisfied.

52. HAL has told us that the CAA was unlikely to have agreed to the Heathrow Spur project (and funding through the RAB) if there was not a prospect of the charges being recovered over time through revenues from use of the new infrastructure¹⁶. We have, therefore, looked to see whether there is any evidence from which we should infer that the investment in this case was treated in a way which distinguished it from other assets on the RAB. Such treatment could, for example, include allocation of specific income to fund specific costs or some form of ring-fencing of that investment. However, we have not seen any evidence of distinct treatment of the project on the airport RAB.
53. Instead of HAL levying access charges (in the form set out in the Regulations) on either the Heathrow Express (HEX) operating company or the Heathrow Connect services, HEX and some Heathrow Connect revenues have contributed to the airport's "single till". In the context of Heathrow Airport, we understand that the single till is defined as taking account of revenue, costs and assets from non-aeronautical activities when calculating the price of aeronautical activities, i.e. airport charges.
54. In explaining how the single-till mechanism works in the context of the airport, HAL submitted that "*CAA...takes the current value of the Airport RAB (which includes rail assets), total airport forecast opex, and commercial income in order to calculate*

¹⁶ Initial submission of Heathrow Airport Limited (HAL) to the Office of Rail and Road (ORR) regarding HAL's charges for track access to the Heathrow Spur, dated 1 September 2015, paragraph 39.

*airport charges evolution*¹⁷. HAL has also separately submitted that “*although train service revenues are not formally matched to costs associated with the Heathrow Spur, the effect is that such costs are reflected in airline landing charges only to the extent that the train service revenues are insufficient to cover them*”¹⁸. We consider that both of these positions are consistent with a view that the Heathrow Spur project, once added to the RAB, would be treated in the same way as any other RAB addition. That is, airline charges would fund a rate of return on that project without any specific correlation to any contribution from rail users to Historical Long-Term Costs. We consider that this signifies a clear difference between the Heathrow Spur project as it is today and the standalone Newco structure that was originally proposed in the Joint Operating Agreement.

55. We have noted that, in 2001, in arguing against moving from a “single till” to a “dual till structure”, BAA submitted to the Competition Commission that the Heathrow Spur was not a standalone commercial investment¹⁹. We understand that the “dual till” structure under consideration would have separated airport activities into two pots (aeronautical and commercial) where prices would be set independently of each other. In our view, these submissions are consistent with the analysis set out above regarding the significance of the addition of the Heathrow Spur to the airport RAB and the inference that this provided a realistic commercial possibility of alternative funding for the project. We accept BAA and HAL did intend to recover Historical Long-Term Costs from rail users of the HEX services when the Newco structure was proposed and that there was a continued expectation of cost recovery from rail users. However, we consider that BAA’s submissions regarding the project, when viewed alongside its addition to the airport RAB, indicate that the project could have gone ahead without the prospect of recovering the Historical Long-Term Costs from rail users.
56. Further, in an exchange of letters between BAA and DfT dating from 2006²⁰ (the 2006 Letters), it appears BAA was prepared to enter into negotiations with DfT about recovery of the Historical Long-Term Costs. We acknowledge that the 2006 Letters

¹⁷ Detailed Answers to ORR emailed questions of 20 November 2015, provided 24 November 2015.

¹⁸ Initial submission of Heathrow Airport Limited (HAL) to the Office of Rail and Road (ORR) regarding HAL’s charges for track access to the Heathrow Spur, dated 1 September 2015, paragraph 50.

¹⁹ BAA’s response to The ‘Single Till’ and the ‘Dual Till’ Approach to the Price Regulation of Airports (March 2001).

²⁰ Letter from BAA to DfT, dated 6 January 2006, letter from DfT to BAA, dated 26 May 2006, letter from BAA to DfT, dated 5 June 2006.

are marked “without prejudice”, do not demonstrate any agreement was made, do not provide any background or context to the negotiations that were ongoing, do not clarify the context of the offer not to recover Historical Long-Term Costs from the Crossrail operator, and that the first of the letters is unsigned. We also accept that the letters were superseded by the Deed of Undertaking. However, we take the view the 2006 Letters are relevant insofar as they demonstrate that in 2006, HAL was willing to offer an arrangement that would see it unable to recover the Historical Long-Term Costs from rail users. In isolation, for the reasons set out above, we would not attach much weight to the 2006 Letters. However, when viewed in the context of the evidence as a whole we consider the 2006 Letters are at least consistent with an inference that recovery of the Historical Long-Term Costs from rail users was not critical to the viability of the project, and that the Heathrow Spur was no different from any other RAB addition.

57. HAL has told us that the full recovery of the Historical Long-Term Costs from rail users was, in effect, a requirement of the CAA at the time of investment and that HAL’s understanding of CAA policy was that surface access investment costs should be recovered by way of revenues from use of the relevant infrastructure, and should not, over the long term, be recovered by way of airport charges. ORR notes that no one can provide a copy of CAA’s surface access policy from the time which might support HAL’s submissions. The only document containing a surface access policy that any party can locate is CAA’s consultation paper entitled “Airports review – policy issues” published in December 2005²¹. The consultation paper only requires airport operators to seek to offset the costs of surface access projects “as far as practicable against revenues from those directly using the new surface access infrastructure/services. As a result, airport charges would only fund the residual costs not covered by rail fares or road tolls or charges”²². The policy does not however go so far as to preclude investment where this is not the case. Equally, the policy does not make clear whether revenues (to the extent recovered) need to offset capital costs such as the Historical Long-Term Costs, or simply operating costs. As a result, we do not feel the evidence that has been provided to us on this issue is sufficient to demonstrate that the addition of the project to the airport RAB was only permitted on

²¹ UK Civil Aviation Authority Airports Review Policy Issues

http://webarchive.nationalarchives.gov.uk/20140713054907/http://www.caa.co.uk/docs/5/ergdocs/erg_ercp_airportsreview_dec05.pdf.

²² UK Civil Aviation Authority Airports Review Policy Issues, Paragraph D.23

http://webarchive.nationalarchives.gov.uk/20140713054907/http://www.caa.co.uk/docs/5/ergdocs/erg_ercp_airportsreview_dec05.pdf.

the basis that the Historical Long-Term costs would be recovered, over time, through rail charges.

58. Schedule 11 of the Joint Operating Agreement contains a financial model demonstrating how the HEX service would provide a return on HAL's investment in the Heathrow Spur. HAL has shown ORR figures which it argues shows the Heathrow Spur has generated revenues which are equivalent to approximately 80% of the full operating and Historical Long-Term Costs in each year, on average, over the last 10 years. HAL also argues that *"given that the contribution would increase in the coming years (so that, in the years after 2018, the revenue figure would exceed the cost figure, and would do so to an increasing extent), it is reasonable to project that, absent the commencement of Crossrail services, 100% of the long term costs of the Spur would be recovered from Heathrow Express revenues"*²³. HAL considers that this level of cost recovery, when taken together with its initial recovery assumptions²⁴, indicates HAL has met the Paragraph 3 Test.
59. As set out above, we understand that any shortfall in Historical Long-Term Cost recovery has been recovered through airline charges calculated on the basis of the RAB. While we consider the recovery of costs from rail users to be rational commercial behaviour, given that the Heathrow Spur was financed through the airport RAB and has been (at least partially) funded through airport charges since its inception, we do not consider the mere expectation of recovery (even when coupled with actual recovery), to be determinative of whether HAL has met the requirements of the Paragraph 3 Test. As such, whilst we recognise HAL took steps to recover revenues from users of the Heathrow Spur (something which appears consistent with CAA's 2005 surface access policy), it is not sufficient to establish that the project could not have gone ahead without the prospect of such cost recovery.
60. In determining the significance of the HEX revenues to the decision to invest in the Heathrow Spur, we have also considered documents provided by HAL to ORR²⁵ which show that Crossrail in the form originally conceived²⁶ expected early on to

²³ Response from HAL to queries from ORR dated 11 September, received 05 October 2015.

²⁴ Contained within the Joint Operating Agreement.

²⁵ Letter from Network Southeast to Chris Stokes enclosing draft, dated 13 August 1992 (including CrossRail Project Control Group: CrossRail and Heathrow Express report, dated 14 August 1992); Transportation Issues – CrossRail Services to Heathrow Airport, dated 30 September 1992; Memo re: Financial Effect of Running CrossRail services to Heathrow, dated 1 February 1994.

²⁶ It should be recognised that the Crossrail project referred to in the contemporaneous documents is not the exact same project as it is now. That proposal was intended to be wholly privately financed (and recovered

compensate what was then BAA for the capital costs of modifying Airport Junction²⁷, the turnaround facility at Heathrow Airport, and for any reduction in revenue to the HEX operator resulting from passengers transferring onto a Crossrail service.

61. Whilst the documents relating to the early development of Crossrail show that the costs of modifications to enable Crossrail services to run were explicitly contemplated at an early stage, the much larger elements of Historical Long-Term Costs are not explicitly referred to in the documents (for example, the costs of tunnelling and station construction). We note that the documents refer to compensation payable for loss of HEX revenue, however that loss of revenue is not explicitly calculated by way of reference to those Historical Long-Term Costs. Given the detail set out in relation to recovery of other capital costs in those documents and, in the absence of this information, we do not consider it possible to infer that the compensation for loss of HEX revenue was necessarily intended to recover the Historical Long-Term Costs in relation to the tunnelling works and stations.
62. In conclusion, we are not satisfied that HAL has provided sufficient evidence to demonstrate that the project could not have gone without the prospect of higher charges to rail users. In reaching this conclusion, we consider that the addition of the Heathrow Spur project to the RAB was a significant factor, as this provided a realistic alternative source of funding for the project which could have allowed it to go ahead even if there were no prospect of higher charges to rail users contributing to the Historical Long-Term Costs. We have taken into account that the Paragraph 3 Test did not exist at the time the decision to construct the Heathrow Spur was taken. However, in considering all the evidence in the round, we are not satisfied that HAL has met the test. Whilst we accept that there was an expectation of cost recovery from rail users from the outset of the project, and that HAL has demonstrated it has recovered revenue from rail users, we consider this to be rational commercial behaviour and not determinative of the Paragraph 3 Test.

from rail users), but the Bill that would have given the go ahead to the scheme was rejected by Parliament in 1994.

²⁷ the railway infrastructure where the Heathrow Spur meets the Great Western Main Line.

Invitation to comment

63. For the reasons set out in this document, we propose to establish a charging framework for the Heathrow Spur that permits HAL to recover any charge permitted by the Regulations. Charges under the costs exception in paragraph 3 of Schedule 3 to the Regulations to recover the Historical Long-Term Costs are specifically excluded.
64. It should be noted that while this charging framework prohibits HAL from recovering the *Historical* Long-Term Costs from rail users, to the extent that HAL satisfies us that it has met the Paragraph 3 Test in respect of any future investment in railway infrastructure, the charging framework would not prohibit HAL from recovering future long-term costs from rail users.
65. We invite your comments on the charging framework set out in the Annex and our analysis of the issues discussed in this consultation. We will take any comments into account before we finalise our decision on the charging framework for the Heathrow Spur and the recovery of the Historical Long-Term Costs.
66. Please email your comments to john.trippier@orr.gsi.gov.uk by 5 p.m. on **10 March 2016**. Please say whether you are responding as an individual or representing the views of an organisation (making clear whom the organisation represents).

Freedom of information

67. Information provided in response to this consultation, including personal information, may be subject to publication or disclosure in accordance with the Freedom of Information Act 2000 (FOIA) or the Environmental Information Regulations 2004.
68. If you want information that you provide to be treated as confidential, please be aware that, under the FOIA, there is a statutory Code of Practice with which public authorities must comply and which deals, amongst other things, with obligations of confidence.
69. In view of this it would be helpful if you could explain to us why you regard the information you have provided as confidential. If we receive a request for disclosure of the information, we will take full account of your explanation, but cannot give an assurance that confidentiality can be maintained in all circumstances. An automatic confidentiality disclaimer generated by your IT system will not, of itself, be regarded as binding on ORR.

70. We will process your personal data in accordance with the Data Protection Act (DPA) and in the majority of circumstances this will mean that your personal data will not be disclosed to third parties.



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Annex – Heathrow Spur Charging Framework

1. Definitions

In this Charging Framework, unless the context otherwise requires:

“**HAL**” means Heathrow Airport Limited;

“**Heathrow Spur**” means the 8.6km of railway infrastructure that is owned by HAL which links Heathrow Airport to the Great Western Main Line. For the avoidance of doubt, the Heathrow Spur comprises the railway infrastructure from the tunnel portal to the tunnel end wall at Heathrow Airport terminal 4 and Heathrow Airport terminal 5 stations;

“**Historical Long-Term Costs**” means all costs relating to the construction of the Heathrow Spur incurred prior to the coming into force of this Charging Framework; and

“**Regulations**” means (i) the Railways Infrastructure (Access and Management) Regulations 2005, as amended; or (ii) any instrument made for the purpose of implementing Directive 2012/34/EU of the European Parliament and of the Council of 21st November 2012 establishing a single European railway area (recast) which revokes the Railways Infrastructure (Access and Management) Regulations 2005.

2. Introduction

2.1. Any charges levied by HAL on train operators for track access to the Heathrow Spur and for such other services as are referred to in Schedule 2 of the Regulations, including station access, shall be determined by HAL pursuant to this Charging Framework and the Regulations.

2.2. HAL shall ensure that any track access or station access agreement entered into with a train operator relating to access to the Heathrow Spur contains provisions to give effect to the principles set out in the Regulations to which each of HAL and the other parties to such agreements shall be contractually bound.

3. Access charges

3.1. Subject to paragraph 3.2, access charges may include any charge permitted by the Regulations.

3.2. Access charges may not include any charge purporting to comply with the exception set out in paragraph 3 of Schedule 3 to the Regulations in respect of the Historical Long-Term Costs.