PR18:

Schedule 4 - Initial thinking on the approach to calculating the Access Charge Supplement (ACS)

June 2017

This document was first published alongside our consultation on ['Improving incentives on Network Rail and train operators: A consultation on changes to charges and contractual incentives'].

We have reviewed all comments in response to this policy area. We have not yet made any changes to this initial thinking and are considering this position further (and specific proposals) in September 2017.

Policy	**Incentives - Schedule 4**
Policy area	The approach to calculating the Access Charge Supplement (ACS)
Background	Schedule 4 passenger operator compensation is part-funded through the Access Charge Supplement (ACS) which is paid to Network Rail. At present only franchised passenger operators pay ACS in return for full compensation. Open access operators (OAOs) have opted not to pay an ACS and so do not receive full Schedule 4 compensation. ACS is calculated using assumed maintenance and renewals volumes and Schedule 4 unit costs for each asset type and then apportioned pro-rata amongst operators based on historic Schedule 4 compensation payments paid to operators. The total ACS should reflect the amount Network Rail is expected to pay out in Schedule 4 compensation resulting from maintenance and renewals under the liquidated damages regime over the control period.
Which of the PR18 outcomes	Outcome: A network that is available. Description of outcome:

does this charge/incentive deliver against?	• *Taking effective decisions around possessions, mitigating the overall impact of these on end users*.

Problem under consideration with the current charge/incentive

The level of ACS is based on Network Rail's forecast maintenance and renewal (M&R) volumes for each control period. For CP5 this was calculated on the basis of its Strategic Business Plan (SBP) and approved in our Final Determination. However, actual levels of maintenance and renewals are likely to differ from forecast. All other things being equal, lower M&R activity levels mean that Network Rail pays less in Schedule 4 payments than it is funded for. This would be appropriate where lower levels are due to efficiency either in possessions planning or in asset management. However, it may not be appropriate if it is because Network Rail is maintaining the condition of its infrastructure to a lower level than for which it has been funded. Particularly in the latter circumstance, the level of ACS will have been set based on higher forecasts of activity than took place.

Currently there is no mechanism to recalibrate the level of the ACS during a control period and there is a concern that setting the charge based on the SBP has resulted in an ACS higher than appropriate due to, for example, deferral of renewals into CP6.

What is the scale of the issue & who is impacted?

If the ACS is too high then:

- Network Rail is over-funded for Schedule 4.
- Equivalently, franchised passenger train operators will be paying too much into the scheme (although, as franchised passenger operators are held harmless to any change in ACS during their franchise, any impact would be felt directly by franchising authorities). They should also face less disruption due to the lower number of possessions.
- Other operators (such as OAOs) will be less incentivised to join the scheme, and therefore will not benefit from the better allocation of risk that Schedule 4 provides.

In CP5 we have seen significantly less maintenance and renewals activity than forecast. However, in terms of Schedule 4 costs this has been offset by an increase in possessions caused by weather effects and landslips. The nature of weather-related possessions means that they are difficult to forecast.

Options to be considered

Option 0: Do nothing	• Calculate ACS for CP6 based on the SBP
Option 1: Different plan	• Use the delivery plan (which is produced immediately before the start of the control period) rather than the SBP.
Option 2: More frequent recalculation	• More frequent (probably annual) recalculations to adjust the baseline Schedule 4 cost based on the most recent business plan (or potentially for ex-post variations in the volume of renewal and maintenance activity) during the control period.

Option 3: High level adjustment	• Make a high-level adjustment to the total ACS needed (for example on the basis of historical over-recovery) at the start of CP6.
Assessment of options	
Assessment of option 1: Different plan	Potential benefits include: • Increased accuracy of planned volumes, and hence Network Rail's funding, based on an up-to-date plan at the start of the control period. • A more accurate ACS should increase the likelihood of other operators (such as OAOs) choosing to join the scheme. Potential dis-benefits include: • The delivery plan may still not be a reasonable forecast of likely possessions.
Assessment of option 2: More frequent recalculation	Potential benefits include: • Improved accuracy of planned maintenance and renewals volumes, ACS collected, and network Rail's funding, based on a plan that is updated more frequently (or, in the case of ex-post adjustments, is based on actuals). • A more accurate ACS should increase the likelihood of other operators (such as OAOs) choosing to join the scheme. Potential dis-benefits include: • Industry transaction costs associated with developing and applying the mechanistic assessment which could be disproportionate to the scale of the problem.
Assessment of Option 3: High level adjustment)	Potential benefits include: • Some increase in accuracy of planned volumes, and hence Network Rail's funding. • A lower ACS should increase the likelihood of other operators (including OAOs) choosing to join the scheme. Potential dis-benefits include: • There is a risk that the adjustment is not accurate, and therefore will not deliver the benefits set out above or that an adjustment might result in ACS being set too low resulting in an under-funding of Schedule 4. • The solution will have some associated complexity, but small relative to the other options.
Recommendation	• Our initial thinking is that options 1 and 2 might be disproportionate to the problem we are trying to solve. However, we would need to further explore the likelihood of ongoing under-recovery ahead of any decision.
Next Steps • We welcome the views of interested parties on these options, in particular with respect to the scale of the issue we are trying to solve.	

- We will continue to consider the options set out above over the coming months and will set out our findings and detailed proposals in our summer 2017 publication.

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