Pedro Abrantes
Head of Analysis and Rail Economics

OFFICE OF RAIL AND ROAD

22 November 2018

Peter Swattridge
Head of Regulatory Economics
Network Rail

Dear Peter,

Approval of the recalibration of track access charges for CP6

1. This letter provides our formal approval of Network Rail's methodology for recalibrating the track access charges below for CP6, in response to your requests of the 9 and 16 November 2018.

Variable Usage Charge (VUC)

2. We concluded in June 2017[1], following our December 2016 consultation on charges and contractual incentives[2], that the current structure of the VUC will be retained for CP6. The PR18 recalibration of the VUC has therefore primarily involved the charge being updated to reflect factors such as changes to Network Rail's costs and patterns of traffic on the network.

3. We note that, in July 2017[3], you consulted on a number of minor methodological changes to the charging methodology and on a revised assessment of excludable costs under the Commission Implementing Regulation (EU) 2015/909[4]. You also gave stakeholders the opportunity to identify any potential inaccuracies in the draft VUC price list published in July 2018.

4. We note also that an independent audit of the VUC calculation model was carried out by Arup and that Network Rail has also completed its own proportionate assurance of subsequent changes necessary to reflect decisions outlined in our

[1] *Charges and contractual incentives – consultation conclusions*, ORR, June 2017. This may be accessed here.
[2] *Consultation on changes to charges and contractual incentives*, ORR, December 2016. This may be accessed here.
[3] *Network Rail's consultation on variable charges and station charges in Control Period 6 (CP6)*, Network Rail, July 2017. This may be accessed here.
[4] *Commission Implementing Regulation (EU) 2015/909 of 12 June 2015 on the modalities for the calculation of the cost that is directly incurred as a result of operating the train service*. This may be accessed here.

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final determination (notably, the application of our VUC capping/phasing-in policy).

5. Having reviewed both the methodology and the assurance processes applied to the recalibration of the VUC, we approve the VUC price list for use in CP6.

Electrification Asset Usage Charge (EAUC)

6. In your request, you proposed to recalibrate the CP6 EAUC rates using the same methodology as in CP5 but based on the latest forecasts of traffic volumes.

7. We note that operators and other stakeholders have had the opportunity to review and challenge the recalibration of the EAUC through your engagement with the Traction Electricity Steering Group (TESG) and through your published consultation[3] and conclusions[5] documents, including your July 2018 email to stakeholders providing further clarifications on the EAUC recalibration methodology. In your letter, you state that no party has objected to the proposed EAUC recalibration approach.

8. Moreover, we note that Steer independently audited the EAUC recalibration and has confirmed that it has no outstanding concerns with the analysis.

9. Having reviewed both the methodology and the assurance processes applied to the recalibration of the EAUC, we approve your proposed EAUC price list for use in CP6.

Electric Current for Traction charge (EC4T)

10. In your letter you requested, among others, that we approve the removal of the meter tolerance factor from the Traction Electricity Rules. This is something we had previously sought views on in our July 2018 consultation[6] on changes to track access contracts.

11. We note that, in July 2017, you consulted[3] on the methodologies you proposed to apply in CP6 to:

- the recalibration of the Distribution System Loss Factors (DSLF) used for billing metered services in all the Electricity Supply Tariff Areas (ESTA) ; and

[5] Network Rail's conclusions on variable and station charges in Control Period 6 (CP6), Network Rail, May 2018. This may be accessed here.
[6] Implementing PR18: consultation on changes to access contracts, ORR, July 2018. This may be accessed here

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- the recalibration of regenerative braking discounts for non-metered electrified services.

12. In the same consultation[3], you also proposed to:

- remove the power factor correction from the Traction Electricity Rules in order to reduce the administrative burden on metered train operators; and
- introduce default modelled consumption rates for electrified passenger services, equal to the current highest consumption rate for electric multiple units and loco-hauled passenger services respectively[7] .

13. We note that operators and other stakeholders have had the opportunity to review and challenge the above proposed EC4T changes through your engagement with the Traction Electricity Steering Group (TESG) and through your published consultations[3] and conclusions[5] documents. In your letter, you state that no party has objected to any of those changes.

14. Moreover, we note that Steer independently audited the DSLFs and regenerative breaking discounts' recalibration and it has confirmed that it has no outstanding concerns with the analysis.

15. In light of the above, and having reviewed both the methodology and the assurance processes applied to the recalibration of the DSLFs and the regenerative breaking discount rates, we approve, for use in CP6 :

- your recalibrated DSLFs and regenerative breaking discount rate
- the EC4T price list including the default modelled consumption rate; and
- the removal of both the power factor correction and the meter tolerance factor from the Traction Electricity Rules.

Fixed Track Access Charges (FTACs)

16. We note that in your September 2017 consultation[8] you proposed using a new methodology, developed by Network Rail and Brockley Consulting, for allocating

[7] Your rationale for this proposal was to provide Network Rail with a robust contractual basis for billing modelled services whilst waiting for a modelled consumption rate to be consented to or determined by ORR.

[8] *Network Rail's consultation on its methodology for allocating fixed costs to train operators in Control Period 6 (CP6)*, Network Rail, September 2017. This may be accessed here.

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fixed costs and variable and third party income to operators in CP6, including for the purpose of setting access charges.

17. In your May 2018 conclusions document[9] you revised your original proposal to exclude non-avoidable costs.

18. In June 2018, we consulted on using your revised May 2018 methodology in the recalibration of fixed track access charges (FTACs)[10]. We concluded in October 2018[11] that your revised May 2018 methodology should be used for the recalibration of FTACs.

19. Stakeholders have had the opportunity to review and challenge the new cost allocation methodology through both of our consultations and we note that you revised the original proposal in your May 2018 conclusions document in response to stakeholder feedback.

20. Moreover, we note that Steer independently audited the recalibration of FTACs and that it has confirmed it has no outstanding concerns with the analysis. In addition, we note that since the Steer audit was completed before the publication of our PR18 final determination, you have carried out detailed internal checks to confirm any decisions in the final determination that affect the calculation of FTAC have been correctly reflected in the FTAC model, including the model for the new cost allocation methodology. We note that there are no concerns that need to be addressed following these internal checks.

21. Thus, in light of the above, and having reviewed both the recalibration methodology and the Steer audit report, we approve the recalibrated FTAC price list for use in CP6.

Managed and franchised stations long term charge (LTC)

22. We note that in your July 2017 consultation[3] you proposed new methodologies for the recalibration of the long-term charge (LTC) for managed and franchised

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[9] *Network Rail's conclusions on its methodology for allocating fixed costs to train operators in Control Period 6 (CP6)*, Network Rail, May 2018. This may be accessed here.

[10] *2018 periodic review draft determination: Supplementary document – Charges and incentives: Infrastructure cost charges consultation*, Office of Rail and Road, June 2018. This may be accessed here.

[11] *2018 periodic review final determination: Supplementary document – Charges and incentives: Infrastructure cost charges conclusions,* Office of Rail and Road, October 2018. This may be accessed here.

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stations. And in your May 2018 conclusions document[5] you made further refinements to your proposed methodologies. In the case of franchised stations, the proposed refinements were:

- to allocate route-level annual average franchised station operational property maintenance, repair and renewal (MRR) expenditure on the basis of long-run renewals, as opposed to depreciation. The rationale being that, relative to depreciation rates, long-run renewal estimates are likely to be a better reflection of long-run MRR expenditure; and
- to allocate route-level MRR expenditure to individual franchised stations using an average long-term annual renewal estimate for each combination of route and station category. This refinement was to address an issue identified with using the Operational Property Asset System (OPAS) to allocate MRR expenditure at an individual franchised station level.

23. For managed stations, the only proposed refinement was to calculate the LTC on a station-by-station basis, as opposed to allocating route-level forecasts of MRR expenditure to managed stations. The purpose of this refinement was to make the LTC for managed stations more cost reflective.

24. Following the publication of your conclusions document you presented the proposed refinements to industry in a Rail Delivery Group (RDG) PR18 Working Group meeting and published the slides you presented in the meeting on your website[12]. We note that you also engaged with the operators that raised concerns in their response to our draft determination.

25. In your letter, you state no party objected to your proposed methodology in response to your May 2018 conclusions or following the presentation to the RDG PR18 Working Group meeting. You have also confirmed that the issues raised by operators in response to our draft determination have now been addressed.

26. Moreover, we note that Steer independently audited the recalibration of the LTC for managed and franchised stations and that it has confirmed it has no outstanding concerns with the analysis. In addition, we note that Network Rail has undertaken assurance work on the OPAS for its use in the calculation of the

[12] *CP6 Station long term charge calculation – June 2018 Update*, Network Rail, June 2018. This may be accessed here.

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LTC for managed stations, and that, following minor amendments, you have confidence in the data used.

27. Thus, in light of the above, and having reviewed both the methodology and the Steer audit report, we approve the recalibrated LTC price lists for managed and franchised stations for use in CP6.

Schedule 4 Access Charge Supplement (ACS)

28. We note that you discussed your proposed methodology for recalibrating the Schedule 4 ACS with the Schedule 4 and 8 Working Group at several meetings over the period between February and May 2018. Through this process, operators and stakeholders had the opportunity to discuss and challenge your proposed methodology. We note operators and stakeholders raised a number of concerns about your methodology on which ORR was asked to adjudicate. Although we decided not to require Network Rail to change its proposed methodology for CP6, in part because of the limited time available, we made a number of recommendations about how Network Rail should work with industry to develop its ACS methodology over the next Periodic Review to address the areas of concern raised.

29. Moreover, we note that Steer independently audited the recalibration of the Schedule 4 ACS and that it has confirmed it has no outstanding concerns with the analysis.

30. In addition, we note that since the Steer audit was completed before the publication of our PR18 final determination, you have carried out further detailed internal checks to confirm any decisions in the final determination that affect the calculation of Schedule 4 ACS have been correctly reflected in the ACS model. We have no outstanding concerns following these checks.

31. Thus, in light of the above, and having reviewed both the methodology and the Steer audit report, we approve the recalibrated Schedule 4 ACS for use in CP6.

Yours sincerely,

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