

Date: 17 July 2014

Item 6: Crossrail Track Access

This paper will be considered in public

1 Summary

- 1.1 The purpose of this paper is to update the Committee on the finalisation of the terms of the Crossrail Supplementary Access Charge (“CSAC”) and its incorporation into the Crossrail Track Access Option (“TAO”).
- 1.2 On 22 September 2008, the Office of Rail Regulation (“ORR”) approved the TAO made between Network Rail (“NR”), and the Secretary of State for Transport (“SoS”). The TAO grants specified access to the national rail network for the operation of Crossrail services for a period of 30 years. The TAO was necessary to underpin the investment made by the Department for Transport (“DfT”) and TfL in the Crossrail project. Without the TAO, DfT and TfL would have had no certainty that Crossrail trains would be able to operate on the national rail network.
- 1.3 Since the operation of Crossrail services is a responsibility of TfL, the Crossrail Sponsors Agreement provides for the novation of the TAO to TfL and, on 30 September 2008, the Board approved the novation of the TAO to TfL. The SoS has also agreed to the novation but it has yet to happen as it was agreed that the terms of the CSAC should be incorporated into the TAO prior to the novation taking place. These terms have now been finalised and the TAO will now be novated from the SoS to TfL.
- 1.4 This paper sets out the process by which the CSAC has been negotiated and the terms that have been agreed.
- 1.5 The long term rights contained in the TAO are drawn down at a later date into Track Access Agreements (“TAA’s”) between the operator and NR. The TAO itself does not set out the detailed form of the TAA, neither does it prescribe the detailed performance regime and incentives that will apply under the future TAA’s.
- 1.6 Under Standing Orders, the authority sought in this paper is reserved to the Board. On 26 March 2014, the Board delegated to the Finance and Policy Committee authority to approve any matter reserved to the Board from 4 July to 23 September 2014. Authority is requested ahead of the meeting of the Board on 24 September 2014 to align with the proposed approval milestones set out in Table 1.
- 1.7 A paper is included on Part 2 of the agenda, which contains exempt supplementary information. The information is exempt by virtue of paragraph 3 of Schedule 12A of the Local Government Act 1972 in that it contains information

relating to the business affairs of TfL. Any discussion of that exempt information must take place after the press and public have been excluded from this meeting.

2 Recommendations

2.1 The Committee is asked to note this paper, the supplementary information on Part 2 of the agenda and, in accordance with authority delegated from the Board, to:

- (a) agree the draft terms of the Crossrail Supplementary Access Charge (“CSAC”) described in this paper and to be documented by way of amendment to the Crossrail Track Access Option (“TAO”) and the first Supplemental Agreement to the TAO (together referred to as the “TAO Agreements”), noting that the TAO Agreements shall be novated to TfL from the Secretary of State for Transport (SoS) as authorised by the Board at its meeting of 30 September 2008 and further noting that there is sufficient financial authority in the TfL Business Plan to cover the estimated cost of £337.2m up to 2022/23 but as the TAO Agreements have a duration beyond the end of the current Business Plan, future Business Plans will need to provide for the remaining years of payment up to 2047/48;**
- (b) approve the amendment of the non-binding regulatory protocol (the “Protocol”) established between Crossrail Limited (“CRL”), Network Rail and the SoS, which governs the delivery of the infrastructure enhancements needed for Crossrail services to operate on the national network, to accommodate changes required as a result of the TAO Agreements;**
- (c) authorise the agreement and execution (whether by deed or otherwise on behalf of TfL or any Subsidiary (as appropriate) of any documentation to be entered into in connection with the completion and implementation of the TAO Agreements and any of the matters referred to in them (including, without limitation, all agreements, deeds, guarantees, indemnities, property or other licences, announcements, notices, contracts, certificates, letters or other documents);**
- (d) authorise TfL Officers and Subsidiaries to finalise the terms of the TAO Agreements, including agreeing any adjustments necessary to secure the approval of the Office of Rail Regulation and to settle the terms of any subsequent variation to the TAO Agreements required to facilitate the extension of Crossrail to Reading;**
- (e) authorise TfL Officers and Subsidiaries to do all such other things as they consider necessary or desirable to facilitate the execution and implementation of the TAO Agreements and the matters referred to in them; and**
- (f) authorise such TfL Officers as may be appointed by the Commissioner, to act on behalf of TfL as Sponsor Representative in relation to TfL’s membership of the Crossrail Sponsor Board, insofar as any decision**

making functions carried out by the Sponsor Board relate to the TAO Agreements, and/or the matters referred to in them.

2.2 The following Officers and Subsidiaries shall have delegated authority:

- (a) TfL Officers: the Commissioner, Managing Director Finance, Managing Director Rail and Underground and General Counsel; and**
- (b) Subsidiaries: Subsidiaries of TfL including Transport Trading Limited and any other subsidiary (whether existing presently or to be formed) of Transport Trading Limited and any of the directors of the relevant company shall be authorised to act for and on behalf of that company.**

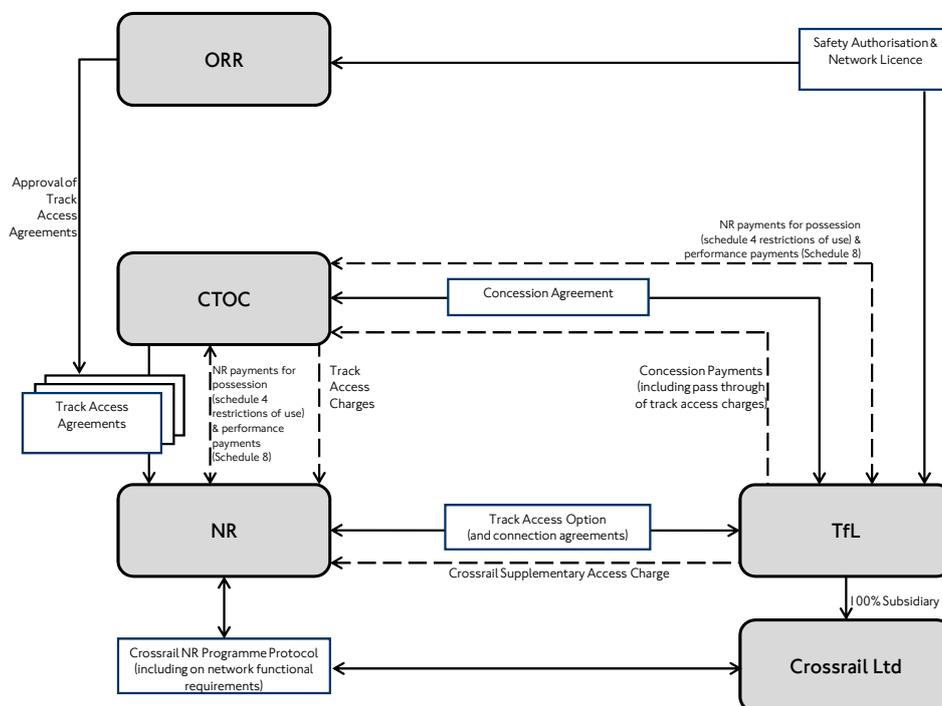
3 Background

Crossrail TAO

- 3.1 On 22 September 2008, the ORR approved the TAO made between NR, as facility owner of the national rail network and the SoS, as access beneficiary. The TAO provides the Option Holder (currently the SoS) firm rights for Crossrail services to be operated on the Network Rail network for a period of 30 years. A process is set out in the TAO for the rights to be drawn down in one, or more, TAA's for the operation of the proposed services.
- 3.2 Since the operation of Crossrail services requires the benefit of the TAO, the Crossrail Sponsors Agreement provided for the novation of the TAO to TfL at Review Point 4 ("RP4", 30 December 2010), when, among other things, TfL's operation of the Crossrail services was confirmed under the Joint Operating Review. Accordingly, the TAO anticipates the novation by the DfT of its rights and obligations under the TAO as Option Holder to TfL. If TfL were not to become Option Holder it would have no contractual rights to require NR to grant its Operator access or to ensure any level of performance by NR in any future TAA.
- 3.3 On 30 September 2008, the Board considered a paper on the suite of agreements ("Crossrail Core Agreements") governing the Crossrail Project including the Sponsors Agreement referenced above and approved the novation of the TAO to TfL. Subject to the ORR's approval, the DfT has also agreed that this should occur but the novation has yet to happen as it was agreed that the terms of the CSAC should be incorporated into the TAO prior to the novation taking place.
- 3.4 These access rights are intended to be used in conjunction with access rights to the Crossrail central section, presently under construction, to enable the Crossrail service operator to provide the Crossrail services envisaged by the Crossrail sponsors, TfL and the DfT (together the "Sponsors"), at the time. Accordingly the TAO does not include rights associated with the recent decision to extend Crossrail to Reading. Following novation of the TAO, TfL will negotiate the appropriate rights with NR direct and a consequent amendment to the TAO will be brought forward in due course.
- 3.5 The TAO does not set out the detailed form of the TAA, which will be in the form approved by the ORR at the time, and neither does it state what track access charges are to be charged or the detailed performance incentives that will apply, as these will reflect the circumstances existing at that time.

Future TAA's

- 3.6 As with any other train operating company, the Operator will be required to negotiate and enter the TAA with Network Rail and pay normal access charges (over and above CSAC) for these sections of the railway. TfL retains a right in the Concession Agreement to direct the Operator in these negotiations if required and, as set out in a paper elsewhere on the agenda, the Operator under the Concession Agreement is strongly incentivised to achieve the highest levels of performance including that of NR with aligned incentives to ensure both parties' optimum contribution to the overall performance of Crossrail passenger train services. The agreement between the Operator and NR will need to support not only high levels of performance on the sections of Crossrail running on the national rail network but also the even more exacting headway measures for the central operating section. Further details of the performance regime applying to the Crossrail Train Operating Concession are included in the separate paper on this subject. In accordance with the Railways Act 1993, the process for agreeing the TAA will be controlled and ultimately approved by the ORR. In order to comply with its statutory duties the ORR has published criteria¹ which specify the basis upon which it will approve any TAA. This includes being satisfied that Network Rail is adequately and continuously incentivised to improve performance, whilst not discriminating between train operating companies.
- 3.7 The contractual matrix between the various parties involved and the relationship between the TAO and TAA is shown below:



The ONW and the Protocol

¹ "Criteria and Procedures for the Approval of Track Access Contracts" published by the Office of Rail Regulation, December 2011.

- 3.8 Attached to the paper considered by the Board on the 30 September 2008 was the Crossrail Information Memorandum, which included a section on the role that NR would play in delivering the infrastructure enhancements needed for Crossrail services to operate on the national network, the so called ONW.
- 3.9 These ONW include a number of significant projects such as electrification of the route between Maidenhead and Airport Junction, major structures at Airport Junction and Acton, new twin track from Plumstead to Abbey Wood and other major works to stations, platforms, signalling and electrification. The Sponsors agreed that these works would be delivered and financed by NR. NR would in turn be remunerated from the farebox revenues generated by Crossrail operations. The cost of the ONW was provisionally estimated at £2.3bn and since TfL was anticipated to be responsible for the operator of Crossrail services, TfL committed under the Sponsors Agreement to paying track access charges sufficient to cover NR's financing of the cost of the ONW (up to a level of £2.3bn).
- 3.10 The Crossrail Information Memorandum went on to describe the intention that the delivery of the ONW be governed under the terms of NR's licence rather than a contractual arrangement, by means of a non-binding regulatory protocol (the "Protocol") to be established between CRL, as client, and NR. The SoS was also made party to the Protocol since government underwrote NR's costs in excess of £2.3bn and exercise certain client functions in that event.
- 3.11 The Protocol contains the On Network Functional Requirements ("ONFR") which translate the high-level Sponsors requirements as defined in the Crossrail Core Agreements into more detailed output related programme functional requirements for the delivery of the ONW. The ONFR include the requirement that the ONW will deliver an operational capability of an average Public Performance Measure ("PPM"), measured as trains arriving within 4m 59s of the scheduled arrival time, of a minimum of 95%. This requirement relates to the capability of the infrastructure provided under the ONW, it does not directly relate to the future TAA's nor does it set a cap on the performance of future Crossrail train services which will be affected not just by NR but also by the performance of the Operator and the rolling stock.
- 3.12 On 24 June 2009, the Board approved CRL entering into the Protocol with NR and the SoS. The Protocol was subsequently established on 27 November 2009.

CSAC

- 3.13 Under the Crossrail funding package, the costs of the ONW are financed by NR and added to NR's Regulatory Asset Base ("RAB"). Approval by the ORR is required to place the costs of the ONW on the RAB and has been granted with effect from the start of the current regulatory control period, 1 April 2014.
- 3.14 While establishing the obligation on TfL to remunerate the cost of the ONW, the Sponsors Agreement does not address in detail how NR will be remunerated for the ONW costs once Crossrail operations commence. The Protocol established the default position that the costs would be placed on the RAB (otherwise NR could not finance the costs up front) but anticipated that more detailed arrangements would be put in place, initially envisaged to be a Facility Charge sufficient to amortise the cost of the ONW.
- 3.15 To facilitate the agreement of detailed remuneration arrangements with NR and the ORR in 2009, TfL and the DfT agreed a Statement of Principles setting out the principles upon which a Facility Charge might be established. From TfL's

standpoint there were five key features that such a Facility Charge required to demonstrate in order to protect TfL's commercial interests. These were:

- (a) the proposed arrangement should be off balance sheet for TfL;
- (b) NR should be remunerated over the full working life of the assets;
- (c) TfL should be compensated for use of the assets by third parties;
- (d) TfL should be protected from regulatory risk where possible; and
- (e) TfL should be protected from inflation risk where possible.

- 3.16 Subsequently, TfL dropped the final point since all of NR's revenues are protected against inflation as a matter of regulatory policy and since TfL itself has a natural hedge against inflation in respect of fare box revenue. These features would require the Facility Charge to be expressed on a 50 year basis with a fixed interest rate and incorporating a rebate mechanism for third party use of the ONW assets. In addition the scale of the transaction far exceeded the level for which the Facility Charge mechanism had been envisaged (private third party schemes in £tens of millions amortised over 5-20 years). Consequently, neither the agreement of NR nor support of the ORR for a Facility Charge on this basis was forthcoming.
- 3.17 TfL therefore developed and proposed an alternative approach which preserved the principles summarised above. The key to this alternative approach is establishing a nexus between the grant of access rights by NR and its receipt of revenue, rather than merely remunerating it for construction of infrastructure.
- 3.18 Although TfL set out the detail of this approach in March 2012, it has been necessary first to obtain the support of the DfT and subsequently the agreement of NR and finally the endorsement of the ORR to the approach. The last of these proved most time consuming since the ORR was reluctant to accept an approach outside the existing regulatory framework. The proposed alternative is the CSAC, payable by the beneficiary of the Crossrail TAO. This charge will be supplementary (i.e. additional) to the normal access charges payable by the operator of Crossrail services. The key elements of the CSAC are outlined in Sections 4 and 5 of this paper.
- 3.19 The obligation to pay and the mechanism for calculating the CSAC will be incorporated into the TAO by amending the existing document. As the SoS is currently the beneficiary of the TAO, it will need to be novated to TfL to allow it to take on the liability for the payment of the CSAC in addition to allowing TfL to benefit from the access rights provided by it. Since the beneficiary of the access is liable to pay the CSAC, if TfL ceases to be the beneficiary of the access, TfL will no longer be liable to pay the cost of the ONW.
- 3.20 At its meeting on 27 February 2014, the Sponsor Board agreed the terms of the CSAC and subsequently the final drafts of the TAO Agreements have been agreed. Therefore, the Sponsors now propose bringing forward, in agreement with NR, amendments to the TAO to incorporate the arrangements for the CSAC and consequential amendments to the TAO, which shall be contained in a supplemental agreement to the TAO ("First Supplemental Agreement"). Subject to the ORR's approval, the incorporation of the CSAC into the TAO will occur in parallel to novation of the TAO to TfL.

4 Basis of CSAC

- 4.1 The Protocol already provides for costs incurred by NR in delivering the ONW (including any incentive amounts or risk share) to be logged to the RAB. Additionally, the ONW have been included by the SoS in the High Level Output Specification for Control Period 5.
- 4.2 This means that the remuneration of NR's investment in the ONW will be reflected in the determination by the ORR of NR's Total Revenue Requirement for each Control Period, in line with the ORR's policy for RAB-financed Government schemes in exactly the same way as for any other such scheme including any underwriting or guaranteeing of funding by the DfT.
- 4.3 Liability for the CSAC will be held directly by TfL as Option Holder under the TAO, rather than passing to the contracted operator, and will be independent of whether the rights available under the TAO are actually drawn down.
- 4.4 The Crossrail operator, under the terms of its TAA, will still be liable (in addition to the CSAC payable by TfL) for fixed and variable access charges on an equivalent basis to those levied on other passenger train operators, as established by the ORR at each periodic review. These charges will recover an appropriate proportion of NR's overall operations, maintenance and renewals costs reflecting the normal operation of Crossrail services over the national rail network.

5 Calculation of CSAC

- 5.1 Although, as described above, the CSAC will take the accounting form of an operating charge in respect of access, it will be calculated as if it were a capital financing charge along the lines of a Facility Charge as described in the Investment Framework published by the ORR, with certain adjustments outlined below.
- 5.2 The capital sum upon which the calculation is based will be the "Adjusted Cumulative NR Programme Costs" which incorporates adjustments for indexation, the application of the incentive/risk share arrangements, and any costs cash funded by CRL, but excludes renewals save as specifically provided for in the Protocol, reduced to take account of:
 - (a) the reduced RAB indexation of NR's Programme Costs prior to and during CP5 associated with CRL's interim cash funding of those costs;
 - (b) any costs in excess of the DfT Intervention Amount (which, as set out in the Protocol, will be the responsibility of the DfT);
 - (c) an adjustment, agreed between the Sponsors, reflecting the proportion of the capital cost of the ONW assets which they consider benefit other network users. This adjustment will be 11.2 per cent of the Adjusted Cumulative NR Programme Cost, being representative of the benefit of the ONWs to non-Crossrail services as a proportion of total services including Crossrail; and
 - (d) an adjustment of £19.3m reflecting additional costs to the ONW due to the acceleration of elements of the works to meet the requirements of other projects This value having been calculated by NR and agreed by the Sponsors.

- 5.3 In respect of these adjustments, item (a) above reduces the value that will have been logged to the RAB when the CSAC becomes payable; it therefore reduces the element of NR's Total Revenue Requirement relating to the return on the RAB as well as the CSAC. Items (c) and (d) reflect costs that will be logged to the RAB but will be outside the CSAC; therefore, NR's remuneration for these items will be paid through FTACs/Network Grant in the same way as for any other HLOS enhancement. Under the terms of the Protocol, any costs falling within item (b) above may either be funded directly by the DfT or remunerated through the RAB in the normal way (outside the CSAC).
- 5.4 The CSAC will be calculated from this capital sum with the following characteristics:
- (a) the profile of CSAC payments will be the same as a level annuity expressed in real terms;
 - (b) the 'rate of return' for this calculation will be the prevailing Regulatory Cost of Debt for each Control Period as established by the ORR at each Periodic Review (3 per cent real in CP5); and
 - (c) the total number of periods for the calculation will be 50 years, to reflect an assessment of the average economic life of the assets, (although the charge will be payable only for 30 years, commencing at the Transition Date as defined in the Protocol and corresponding to the duration of the TAO).
- 5.5 The basis for the calculation of the CSAC will be defined in the TAO for its entire duration. The quantum of the charge will change over time to reflect changes in the Regulatory Cost of Debt, and the impact of price inflation assessed in line with the arrangements for indexation, both as established by the ORR at each Periodic Review.
- 5.6 After the 30 year period of the TAO, TfL's access rights and its liability to pay the CSAC will expire. Whether a further TAO is agreed, with or without the liability to pay the remaining 20 year period of the charge, will be a matter of policy and regulation prevailing at that time.

6 Form of Agreements

- 6.1 The following documents have been drafted or amended in order to incorporate the CSAC in the TAO and to novate the TAO to TfL:
- (a) **Amended TAO.** The existing TAO contains a blank charging schedule. The amended TAO incorporates a charging schedule which obliges the Option Holder to pay the CSAC and sets out the basis of the calculation. Some consequential amendments are also made to the TAO;
 - (b) **First Supplemental Agreement to the TAO.** The First Supplemental Agreement will give effect to the amended TAO;
 - (c) **Novation Agreement.** The Novation Agreement effects novation of the TAO from the SoS to TfL; and
 - (d) **NR Programme Protocol Version 8.0.** There are a few consequential amendments required to the Protocol, notably to recognise that remuneration arrangements for NR's investment in the ONWs have been agreed.

7 Programme

7.1 The remaining key milestones are outlined in the table below. All internal NR and DfT approvals necessary to enable execution of the TAO Agreements, with the exception of the Sponsor Board endorsement, have already been obtained.

Table 1

Milestone	Responsibility	Date
Sponsor Board endorsement (made subject to TfL approval)	Sponsors	16 July 2014
TfL approval (by the Finance and Policy Committee under delegated authority from TfL Board)	TfL	17 July 2014
Sponsor Board endorsement	Sponsors	17 July 2014
Formal submission to the ORR with supporting documentation	NR	18 July 2014
Following review, the ORR to:- i. Approve the First Supplemental Agreement ii. Approve the novation of the TAO iii. Provide letter of non-objection in relation to the amended Protocol	ORR	18 August 2014
Execution of:- i. First Supplemental Agreement ii. Novation Agreement iii. Amended Protocol through signing of execution letter	Sponsors, NR, CRL	1 September 2014

List of appendices to this report:

Exempt supplemental information is included in a paper on Part 2 of the agenda.

List of Background Papers:

None

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