



Department for Transport

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John Larkinson
Director, Railway Markets and Consumers
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By email

Variable usage charge in CP6

Further to the helpful discussions through the Joint Steering Group and between our teams, I wanted to write to you to provide a view on the Department's position in relation to Network Rail's recovery of the variable usage charge (or VUC) in CP6. This follows initial discussions, which have indicated the potential for the variable usage charge to increase considerably in CP6 as a result of Network Rail's costs increasing and the efficiency saving anticipated in PR13 having not been realised. We hope that setting out our view, as funder and shareholder, will help to enable ORR's Board to make a decision as part of the draft determination.

Freight

We support the principle of cost reflective charging to enable better incentives between Network Rail and operators using the network and recognise the VUC is important in helping to deliver a more efficient network. We also recognise freight operators concerns that certainty and stability is important in planning future business. We believe that this is important to provide certainty to freight industry and welcome the decision taken not to reform this charge as part of PR18, recognising the calibration process underway, and particularly welcome your previous, important, conclusion that capping or phasing of the charge is permitted in certain circumstances.

As you will be aware, the Secretary of State's Guidance to ORR in July 2017¹ makes it clear that he wishes ORR to have regard to the objectives set out in the Government's Rail Freight Strategy (2016).² One of the themes identified in the strategy relates to the need for certainty and stability of charges. The Guidance also states that the Secretary of State "*particularly wishes ORR to have regard to the affordability of freight charges and to ensure that the rail freight industry has sufficient clarity and certainty about the costs that they will face in CP6 as soon as*

¹ Secretary of State's Guidance to ORR, July 2017

https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/629698/guidance-to-the-office-of-rail-and-road.pdf

² DfT Rail Freight Strategy, 2016,

https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/552492/rail-freight-strategy.pdf

possible. More generally, he wishes ORR to take all appropriate steps to support the growth and development of the rail freight sector.” As you will be aware, Government supports modal shift from road to rail, supporting a growing, vibrant freight sector; stability for rail freight sector is key to ensuring that barriers to growth are removed to enable rail freight to achieve its potential.

This is particularly important at the current time in the light of external impacts on the sector. We note the ORR’s recent UK rail financials publication which shows that the rail freight sector is making an overall loss; it is therefore likely that any significant change to the level of charges will have an impact on overall industry profitability. We also recognise the impact the decline of coal has had on freight operators financial position and that they are in a period of recovery from the market changes.

It is within this context that in relation to the scale of VUC charging, we would support the proposed approach as set out in Network Rail’s Freight and National Passenger Operator Route Strategic Business Plan, to keep the overall level of charges at the same level (in real terms) as at the end of CP5. We recognise that ORR has taken the decision to remove the coal spillage charge and the capacity charge for CP6. **We would therefore support capping charges in real terms, to the full extent consistent with the legal framework, at the current end of CP5 level (i.e. uncapped end CP5 rates) in order to provide rail freight operators and investors with certainty about the level of this charge for the next control period.** As funder and shareholder, we are satisfied that this is consistent with the assumptions we made in the Statement of Funds Available.

We note that Network Rail will need to recover its costs and recognise that capping of charges at end CP5 levels will need to be time limited. It is our view that the specific and particular circumstances of the rail industry need to be taken into account to ensure operators do not face a steep increase in charges; therefore we would support revisiting this issue as part of a future periodic review, once further information is available about Network Rail’s cost and efficiency in CP6.

More generally, we note that ORR has yet to carry out its post-efficient levels of spend to be used in final calculations. Therefore in the interest of ensuring industry has certainty, and to prevent any steps which would impact on investor confidence, we would support ORR and Network Rail in delaying publication of price lists until decisions have been taken a decision on capping of charges.

We note that you have further decisions in relation to the recovery of fixed costs and the market can bear test and we have provided a response separately in relation to this issue. We would however urge you to continue to consider the implication of overall charges on the freight sector as you make decisions about Network Rail’s recovery of charges.

Passenger Operators

Consistent with the position in PR13, we continue to consider that capping or phasing of charges would not be appropriate for either franchised or open access operators. However, we recognise that an increase in the VUC for open access

operators will need to be factored into the assessment of how much fixed track access charges they can bear.

However, we consider that capping would be appropriate for the **charter trains** industry. This reflects that the charter industry provides significant additional benefits, both to customers and to the economy, which could be lost to users in the event of considerable increases in the VUC. **We would support capping charges in real terms in CP6, in order to provide charter operators with certainty about the level of this charge for the next control period.** As funder and shareholder, we are satisfied that this is consistent with the assumptions we made in the Statement of Funds Available, particularly in their light of their limited use of the network.

Concluding remarks

We hope that this helpfully sets out the Department's position. Consistent with the open and positive engagement we have enjoyed with the ORR throughout PR18, we would be very happy to further discuss any of the issues in this letter.

Yours Sincerely

A handwritten signature in black ink that reads "Phil West". The signature is written in a cursive, slightly slanted style.

Phil West
Director, Rail Strategy, Security & One Railway