Responses to the consultation on charges recovering fixed network costs

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PR18 consultation on charges recovering fixed network costs: Pro-forma for responses

This pro-forma is available to those that wish to use it to respond to our consultation. Other forms of response (e.g. letter format) are equally welcome.

Please send your response to pr18@orr.gsi.gov.uk by **30 November 2017**.

Full name	Simon Blake
Job title	General Manager - Rail
Organisation	Aggregate Industries UK Ltd
Email*	
Telephone number*	

*This information will not be published on our website.

Question 2.1: Do you have any views on our proposal to retain the existing freight market segmentation by commodity, and not introduce further market segments for any of the existing commodities?

We are only engaged in the transportation of Construction Materials by rail and as such are only exposed to this market segment. Segmentation by commodity for charging is a rail industry construct which just adds to the complexity of using rail as opposed to simpler alternatives such as road. It introduces some doubt and risk to choosing the rail option. However missing from all calculations is the revenue (variable or fixed) which Network Rail should expend on its own services (infrastructure & maintenance).

Question 2.2: Do you have any views on our proposal to continue allowing Network Rail to levy infrastructure cost charges on freight trains carrying ESI coal, iron ore and spent nuclear fuel? Do you have any views on our proposal to allow Network Rail to levy infrastructure cost charges on trains carrying ESI biomass in CP6?

No, it is not a market in which we operate.

Question 2.3: Do you have any additional evidence around the ability to bear of any of the freight market segments reviewed by our consultants, which you would like to provide us to inform our final decision around which freight market segments are able to bear infrastructure cost charges in CP6?
We would endorse the views of CEPA in their conclusions relating to the Aggregates market. Our choice in transport mode remains extremely price sensitive and we remain heavily exposed to road transport to at least deliver the final mile.

Question 3.1: Do you have any views on the results of the technical analysis undertaken to date on passenger market segmentation (and ability to bear?) Do you have any views around how these emerging findings could inform a passenger market segmentation?
No comment

Question 4.1: Do you have any comments on our proposal to levy any infrastructure cost charges on open access operators as a rate per train mile? Do you think there are any additional considerations we should include in our assessment of the different metric options?
No comment

Question 4.2: Do you have any comments on our proposed approach to varying franchised passenger operators' infrastructure cost charges in response to changes in traffic, on an annual basis. Do you have any comments on the particular approach we have proposed which is based on changes in timetabled traffic, or any of the other options we have considered in our assessment?

No comment

Any other points that you would like to make
The Network Rail Brockley Consulting allocation of fixed costs adds to a poorly informed but nonetheless noisy and unhelpful political dialogue that rail freight is over subsidised relative to other modes. The fixed costs associated with the road network does not suffer from the same level of scrutiny or misconception. In relation to how fixed costs are calculated and their potential for allocation in the Brockley work is a wider debate, however the simple collation, cost avoidance opportunity, contestability and their subsequent allocation based upon unequal opportunity to draw down on access is open to challenge.

Thank you for taking the time to respond.

PR18 consultation on charges recovering fixed network costs: Pro-forma for responses

This pro-forma is available to those that wish to use it to respond to our consultation. Other forms of response (e.g. letter format) are equally welcome.

Please send your response to pr18@orr.gsi.gov.uk by **30 November 2017**.

Full name	Mary Hewitt
Job title	Strategy and Policy Director
Organisation	Arriva plc, its subsidiary Arriva UK Trains Limited and its wholly owned train operating companies (TOCs), Arriva Rail London Limited, Arriva Rail North Limited, Arriva Trains Wales/Trenau Arriva Cymru Limited (ATW), Grand Central Rail Company Limited, The Chiltern Railway Company Limited (CR) and XC Trains Limited (XC). In addition, this response also covers Alliance Rail Holdings Limited and the Great North Western Railway Company Limited. Arriva is a wholly owned subsidiary of Deutsche Bahn AG (DB AG).
Email*	
Telephone number*	

*This information will not be published on our website.

Question 2.1: Do you have any views on our proposal to retain the existing freight market segmentation by commodity, and not introduce further market segments for any of the existing commodities?
No

Question 2.2: Do you have any views on our proposal to continue allowing Network Rail to levy infrastructure cost charges on freight trains carrying ESI coal, iron ore and spent nuclear fuel? Do you have any views on our proposal to allow Network Rail to levy infrastructure cost charges on trains carrying ESI biomass in CP6?

No

Question 2.3: Do you have any additional evidence around the ability to bear of any of the freight market segments reviewed by our consultants, which you would like to provide us to inform our final decision around which freight market segments are able to bear infrastructure cost charges in CP6?
No

Question 3.1: Do you have any views on the results of the technical analysis undertaken to date on passenger market segmentation (and ability to bear?) Do you have any views around how these emerging findings could inform a passenger market segmentation?
Summary This is an area which is incredibly complex, both from a legal and economic perspective. There are many requirements which need to be satisfied – and as detailed later it seems that there is still work which needs to be done to reach a regime that satisfies both market and legal requirements. Whilst we welcome the opportunity to comment on the ORR's initial views on market segmentation and have considered the views of the ORR's consultants, we would also have expected to be consulted upon the ORR's initial views on what the "market can bear" (so that we can make appropriate representations as the ORR develops its thinking). The "market can bear" test – and not just market segmentation – ultimately goes to the heart of the legal and economic requirements for the imposition of a mark-up. We wonder whether this is something which (as the ORR has previously suggested) might be better deferred to a future

point in time after the work necessary to develop a fully satisfactory arrangement has been undertaken.

In our view, activity in this area should focus on addressing of the Competition and Market Authority's investigation into the rail market to enable an increased level of on rail competition on the East Coast Mainline. A significant advantage of this is that any mark-up would naturally be connected with the opening of access for Open Access Operators (OAOs) to the "upstream" market for track access. As we note below, mark-ups and ORR access policy are linked: to seek to impose a mark-up without considering market access would result in discriminatory outcomes. Any developments on the East Coast Main Line could provide an appropriate opportunity to consider both elements together. However, given that the policy will take time to develop, development work should start immediately.

We have a number of significant concerns with the ORR's current proposals outlined in the consultation:

- the ORR's proposal is inconsistent with the judgment of the High Court in the GNER v ORR case;
- in any event, as noted above (and as the ORR has previously outlined) any increased track access charge needs to come with greater access to the upstream "access to infrastructure" market - the two are inextricably linked. Whilst we note that the ORR intends to subsequently consult upon its access policys, the two cannot be seen in isolation. We need to understand how the ORR would intend to ensure that OAOs have greater access to the upstream market, including through detailed proposals to replace or abolish the "Not Primarily Abstractive" test. This needs to be considered in the context of the ORR's recent East Coast decision where the ORR indicated that it has a presumption in favour of rolling over existing access rights into future access contracts, on a network where capacity is already heavily constrained;
- we question whether it is proportionate to be seeking to impose a mark-up on OAOs (representing less than 1% of mileage) when the ORR has indicated that it does not intend to impose a mark-up on charter services (being de minimis – and representing 0.2% of mileage);
- we do not think that the ORR's initial thinking satisfies the legal requirements for the imposition of a mark-up set out in the The Railways (Access, Management and Licensing of Railway Undertakings) Regulations 2016.

Legal precedent: GNER v ORR

The ORR’s proposals do not appear to have addressed the issues identified in the previous legal review of the current arrangements (GNER v ORR, 2006) which concluded that:

> "*Imposing the fixed track charge on open access operators, while holding all the other parts of the picture constant, would not result in a non-discriminatory charging regime for access to the railway infrastructure, but in a regime which was manifestly unfair to open access operators*. (paragraph 75)".
>
> *"it would be contrary to non-discriminatory principles, on which mark-ups may be levied … , if the fixed track access charge was imposed on them. It would be discriminatory because the ORR would be treating two very unlike cases as though they were alike.*"

These conclusions were reached as result of the different market conditions facing Franchised and OAOs in both the “downstream” markets served and in the “upstream market” associated with securing access to the network. These different market conditions include:

- Protections available to Franchised Operators against:
    - Changes in Access Charges as a result of Periodic Reviews
    - Changes in economic indices including RPI
    - Revenue shortfalls in the medium term
    - Costs associated with Government rail consumer policy changes eg Delay/Repay 15, SmartTicketing
- Restrictions placed on OAOs’ Access Rights and service patterns as a result of the ORR’s access policies including the Not Primarily Abstractive test.
- The difficulty in finding capacity on a busy network crowded with highly specified franchise services.
- The length of time it takes to build up the business of an OAO.
- The need to reinvest profits in the business and assets to operate services (which, in the context of the Franchised Operator, does not apply given the investment support through the franchise agreement). In essence, OAO "profits" are not the same as Franchised Operator profits, the latter of which are determined after investment has taken place.

In addition, in GNER v ORR, it was also recognised that OAOs face significant hurdles in terms of staff recruitment and rolling stock access which the franchised operator does not have. Franchised operators essentially take ove an existing business which is fully resourced.

Upstream "access to infrastructure" market

The ORR’s proposal for “*OAOs to contribute an appropriate amount towards fixed costs where they are able to, in exchange for having greater access to the network*” does not seem to address many of the issues faced by existing and new OAO access applications, resulting in the potential for discriminatory treatment. In particualr, there is currently a lack of visibility as to what the ORR intends to do to facilitate “greater access to the network” and whether this will completely address the effect of the different market conditions. We would like to have further discussion with ORR as to how how greater access to the "upstream" track access market might be delivered.

Further, by leaving what it proposes in the area as an open issue, ORR potentially causes significant uncertainty for parties bidding for franchises, i.e. Bidders have no clear picture as to the extent to which they may be exposed to additional competition in the markets served by the franchise. Currently Bidders can take an informed view on this risk by reference to the ORR’s published policy and past decisions. Para 1.17 confirms that the ORR’s work on reviewing the access policy has not yet started – it will therefore be difficult to assess the policy on infrastructure cost charges at this time.

It is also not clear what form any “transitional arrangements” might take. Is ORR referring to a phasing in of any mark-ups or of a phasing in of a changed Access Rights process? Or both? We also question how any transitional arrangements will be levied on "efficient, transparent and non-discriminatory principles" whilst ensuring "the use of infrastructure by market segments which can pay at least the cost that is directly incurred as a result of operating the railway service" is not excluded (as between existing and new OAOs). Further analysis is needs as to how new OAOs serving existing markets will be treated in a fair and non-discriminatory manner, whilst recognising the need to allow a business to build over time.

Finally, we note the recent East Coast decision which indicates that the ORR has a presumption that existing access rights will be rolled over from one access contract to another. In its recent consultation on security of access for HS2 services, the ORR repeats this presumption. In effect, this presumption means that capacity will never be released on the railway from incumbent franchise operators, meaning OAOs will continue to have difficulties in accessing the upstream access to the railway market. This policy would suggest that it would be very difficult for OAOs to obtain greater access to that market, even if OAOs paid higher track access charges. Policy as a whole is a factor which the ORR should take into account in the context of the proposed mark-up.

In summary, our concern here is that there will not be fair competition: OAOs will be paying higher access charges for the same level of access to the "upstream" market. This will not recognise the business of the OAO or allow it to plan its business with a reasonable degree of assurance. It will not respect efficiencies OAOs may make, or ensure that operators serving similar markets are treated in the same way.

Passenger market segments

On this basis, reflecting on the previous High Court ruling, there appear to be at least 3 broad passenger Market Segments:

- Franchised Operators who can be deemed to have the capacity to pay infrastructure cost charges
- OAOs who secure access to the network under a revised ORR access policy which delivers “greater access to the network” who may be able to pay infrastructure cost charges subject to an appropriate market can bear test
- OAOs who secured access to the network under the current ORR access policy who should continue to be deemed as not being able to pay additional charges as no part of their market circumstances has changed since the High Court ruling addressed their position.

Arriva notes and welcomes the decision by ORR to remove the Capacity Charge from the structure of Charges. However, at this stage in the Periodic Review, it is not possible to be certain as to overall level of Charges that will fall to OAOs as the level of variable cost related charges has not be determined.

Specifically, different OAOs are likely to be serving different end user passenger markets with different revenue generating potential. OAOs will also have different restrictions placed on their Access Rights resulting in different access to the total market they are serving. The level of competition will vary by route – and will also change over time.

For example, Grand Central’s West Riding market is distinct from the North East market – how will mark-ups be constructed to operate in a fair and non-discriminatory manner across these different markets? It would seem likely that lumping all OAOs into even 2 Market Segments is likely to result in perverse outcomes. This would suggest that the MCB test will need to be undertaken on individual service patterns.

Serving markets and revenue generation potential – perverse outcomes

The description in para 3.14 and 3.15 of the work being undertaken by the ORR consultants to “develop a passenger market segmentation, by looking at …. Revenue and costs” for all passenger services would suggest that ORR is defining Market Segments on the basis of their ability to pay mark-ups rather than the characteristics of the Market Segments themselves.

In addition, the consideration of the “willingness to pay” of passengers using Intercity rail services seems to be disconnected from the nature of that passenger rail market which appears to meet the ORR’s decription in paragraph 2.11 by being one “where demand is highly elastic and where operators face significant competition from other modes” where ORR has said that it was “able to conclude quickly that the ability to bear mark ups would be low (i.e. zero).”.. The underpinning thinking seems to be to try to assess the extent to which operators could pass on any mark-up to passengers through increased fares. This again touches on the different nature of the market conditions faced by Franchised and OAOs in that, for Franchised Operators the mark-up would be passed on to DfT - an opportunity not available to OAOs. Meanwhile, OAOs would be unable to pass the mark-up onto their passengers as they need to price their tickets in the context of the market price which is broadly set by the dominant Franchised operator.

While the ORR is right in saying in para 3.17 that the “geographic market served” is highly “determinant of ability to bear”, the “practical approach” outlined in para 3.18 to look at “routes as a whole rather than trying to distinguish between peak and off-peak services” fails to take account of the restrictions placed on the Access Rights of OAOs which often significantly restrict access to the peak market. This may be addressed to some degree by defining Market Segments at the level of Service Codes and/or undertaking the MCB test at that level. However, that does not seem to be the ORR's proposed approach.

The observation about “lower than expected surplus values on some routes” is intriguing. We need to see the supporting data to understand what is going on. However, if the analysis has been done at a Service Code level, it seems highly unlikely that competition from OAOs is at the bottom of the issue given the different scale of the Service Codes involved and the even smaller overlap between different the markets they served by the different Service Codes. It seems much more likely that it is driven by the mechanisms by which Revenues and Costs are allocated to Service Codes.

The further observation that “competition might have driven prices down” suggesting “that willingness to pay … is higher than implied by the present level of fares” does not seem to be in line with market research and current experience of passenger and revenue growth on East Coast Mainline station which shows slower growth in revenue and passenger volumes on flows without competition.

Proportionality

If Charter services “do not amount to a material proportion of railway service provision” representing “less than 0.2% of total passenger mileage”, it could be argues that existing OAO services are also de minimis at less than 1% of mileage.

Compliance with 2016 Regulations

We are concerned that the ORR's proposals do not or will not satisfy the legal requirements of the 2016 Regulations. In particular:

- **market can bear**: As noted above, the ORR has not yet put forward its initial views – or given the opportunity for industry parties to comment – on what the market can bear, instead focussing on market segmentation in this consultation. What "the market can bear" is a key element of the test and we will happily engage with ORR and provide evidence to support the development of thinking in this area prior to the ORR finalising its conclusions in this area. We are of the view that OAOs – both existing and new entrants – would not be able to bear additional charges with the current arrangements for access to the "upstream" market in place.
- **exclusion of market segments**: The effect of the imposition of any mark-up must not be to exclude the use of infrastructure by market segments which can pay at least the cost which is directly incurred as a result of operating the railway service, plus a rate of return which the market can bear. This applies to both existing and new OAOs. This clearly links in to what the market can bear – we note that there is a fine balance to be struck in this area as any mark up could have the effect in practice of making services unviable and therefore exclude particular market segments. This is something which we would wish to consider further once the ORR's proposals on what the market can bear become clearer. We would also need to understand how a mark up would be applied in the initial phase where an OAO service is being established versus the more mature phase – whilst at all times ensuring a fair and non-discriminatory approach.
- **productivity increases**: The charges to be imposed must "*respect the productivity increases achieved by applicants*". Further discussion is needed as to how this might be taken into account by the ORR in assessing what the market can bear. As mentioned above, OAOs have a different operational and business model: savings which may be made – such as use of rolling stock or staffing costs – should not simply be taken away through a mark-up. We think that more work needs to be done in assessing how OAO and franchise businesses differ and ensuring that productivity increases achieved by OAOs are respected and do not simply lead to a greater mark up being imposed.
- **efficient, transparent and non-discriminatory principles**: To date, we have not been provided with a set of principles meeting this requirement which can satisfactorily assure us that any mark-up would ensure non-discrimination and efficiency. We question what these might be and would be grateful if these could be articulated as, from what we have seen so far, we are not persuaded that the proposals ensure non-discrimination.
- **"guaranteeing optimum competitiveness"**: The imposition of any mark up must "guarantee optimum competitiveness". Further work is needed to allow the ORR to take a view as to what "optimum competitiveness" might look like in the rail markets. Indeed, there may be differing views of what optimum competitiveness means. However,we think that this should be objectively defined so as to ensure that any proposal for a mark up delivers this situation. We also need to understand how the ORR intends to balance this requirement against its assessment of what the market could, in principle, bear.

Concluding remarks

Given:

- the complexities involved in the relevant analysis;
- the intrinsic link between the "mark up" and ORR policy on the level of access given to the track infrastructure (which the ORR has not yet considered);

- progress to date on considering what the market can in fact bear; and
- inconsistencies with existing case law and the relevant legislation which are unlikely to be addressed in the requisite timescales,

We believe that seeking to impose a "mark up" as part of this periodic review process is likely to raise legal issues which may need further consideration. We think that the ORR should continue to develop the work, which has been done so far in the early stages of the next Control Period, with a view to having a more robust set of proposals should the East Coast Main Line developments recommended by the Competition and Markets Authority's review materialise. This will link charging with access to the "upstream" market and in theory should befairer for all industry parties.

Question 4.1: Do you have any comments on our proposal to levy any infrastructure cost charges on open access operators as a rate per train mile? Do you think there are any additional considerations we should include in our assessment of the different metric options?

Subject to our response to Question 3.1, we would agree with this proposal.

Question 4.2: Do you have any comments on our proposed approach to varying franchised passenger operators' infrastructure cost charges in response to changes in traffic, on an annual basis. Do you have any comments on the particular approach we have proposed which is based on changes in timetabled traffic, or any of the other options we have considered in our assessment?

The use of cost per train mile on an annually assessed level of timetabled traffic may be an appropriate approach to recover mark ups from Franchised Operators. However, the definition of "timetabled traffic" needs to be refined so that it is clear which timetable is being referred to. Ideally, it should be "Base Timetable". In addition, it is essential that this approach is linked to a mechanism to adjust the Network Grant on an annual basis to rebalance any reduction in the level of timetabled traffic so as to address the risk of leaving Network Rail underfunded.

As an alternative, the mark up could be levied on the basis of the Access Rights held by an operator but still subject to the rebalancing requirements detailed above.

Any other points that you would like to make

As the ORR's proposed "Market can bear" test process seems to be based on a "point" assessment measured across a single year, it is not clear how at more developed process would take account of the significant past losses incurred by an Operator associated with the start up on a new service or a significant investment in additional capacity. In addition, it is not clear how foreseeable changes in the market would be addressed in the assessment. Such changes could include major timetable changes which affect the service patters on a route and the introduction of additional services by a competitor. Such changes would have a material effect on the ability to pay of affected Market Segments.

Certainty is required for all businesses - Franchised and OAO. Charges and Access policy should be forecastable over the term of Control Periods and Franchise Contracts as no business can cope with the potential volatility that a lack of certainty in these areas whould present.

On 29th November, DfT published a comprehensive Rail Strategy. A central plank of this Rail Strategy was a desire to see "train and track" working more closely together. As part of the approach to realising this vision, DfT announced that they would be looking to undertake a procurement process to establish an East Coast Partnership comprising the teams delivering the Intercity East Coast Franchise and the London North East Route both working under a combined leadership structure. Clearly, even with this new partnership arrangement in place, there will be a significant number different rail operators serving different markets segments on any one route on the network. In this context, the ORR's proposed approach to setting charges to recover Network Rail's fixed network costs remain broadly valid but may need refinement as the details of DfT's plans emerge.

Bootham Network Solutions Limited

Purpose

This paper comprises comments on the Office of Rail and Road's "PR18 consultation on charges recovering fixed network costs" dated 28th September, 2017.

Introduction

Bootham Network Solutions Limited is a Consultancy offering advice and support to businesses in the rail and freight sectors. Its areas of expertise include:

- Modal shift.
- Business development.
- Bid management.
- Strategy development.
- Operational improvements.

Comments

Bootham Network Solutions Limited welcomes the consultation given the significance of access charges to all parts of the rail industry, and the impact access charges have on decisions taken by operators and customers.

It is emphasised that the comments made in response to this consultation relate only to the principles of recovering fixed network costs, and should not be construed as support for any specific level of cost recovery. Proposed levels of cost recovery should be subject to a separate consultation.

Question 2.1: Do you have any views on our proposal to retain the existing freight market segmentation by commodity, and not introduce further market segments for any of the existing commodities?

No comment.

Question 2.2: Do you have any views on our proposal to continue allowing Network Rail to levy infrastructure cost charges on freight trains carrying ESI coal, iron ore and spent nuclear fuel? Do you have any views on our proposal to allow Network Rail to levy infrastructure cost charges on trains carrying ESI biomass in CP6?

The proposal for continuing to levy FSC on iron ore cannot be supported as it is based on erroneous information provided by the ORR's Consultant, see response to question 2.3 below. Consideration of the application of FSC to iron ore should be delayed until the Market can bear analysis is independently reviewed.

Question 2.3: Do you have any additional evidence around the ability to bear of any of the freight market segments reviewed by our consultants, which you would like to provide us to inform our final decision around which freight market segments are able to bear infrastructure cost charges in CP6?

Market can bear analysis - submitted by Cambridge Economic Policy Associates

8. FSC for Iron Ore

8.2 Analysis

Demand-side market dynamics (the end customer)

In the second bullet the report clams that the construction of HS2 “will require millions of tonnes of steel rail”. This is erroneous. HS2 Stage 1 (London to Birmingham) will require in the order of 55 kTonnes of steel rail. HS2 Limited will be able to make a more accurate forecast of the requirement for steel rail for stage 1, and give an indication of the likely requirement for stages 2a and 2b. It is likely that only rail for stage 1 will be delivered in CP6, with rail for stages 2 a and 2b, if authorised, not required until CP7.

8.3 Conclusions

The author claims “the upcoming significant opportunity presented by HS2” as a justification for continuing with FSC for iron ore. The author has overstated the size of the HS2 opportunity by a factor of 20 (twenty times!), and the likely contribution of FSC to Network Rail in CP6 which results from the HS 2 project by a similar factor. In the light of this fundamental error the conclusions should be subject to a rigorous, independent review based on the realistic estimate of HS2 demand for steel rail in CP6.

Question 3.1: Do you have any views on the results of the technical analysis undertaken to date on passenger market segmentation (and ability to bear)? Do you have any views around how these emerging findings could inform a passenger market segmentation?

No comment.

Question 4.1: Do you have any comments on our proposal to levy any infrastructure cost charges on open access operators as a rate per train mile? Do you think there are any additional considerations we should include in our assessment of the different metric options?

No comment.

Question 4.2: Do you have any comments on our proposed approach to varying franchised passenger operators’ infrastructure cost charges in response to changes in traffic, on an annual basis. Do you have any comments on the particular approach we have proposed, which is based on changes in timetabled traffic, or any of the other options we have considered in our assessment?

No comment.

Chris Polack, CEng
Director
Bootham Network Solutions Limited

30th November, 2017

Submission by the Chartered Institute of Logistics and Transport

to the ORR consultation Changes to charges and contractual incentives

1. The Chartered Institute of Logistics and Transport is a professional institution embracing all transport modes whose members are engaged in the provision of transport services for both passengers and freight, the management of logistics and the supply chain, transport planning, government and administration. Our principal concern is that transport policies and procedures should be effective and efficient, based on objective analysis of the issues and practical experience, and that good practice should be widely disseminated and adopted. The Institute has a number of specialist forums, a nationwide structure of locally based groups and a Public Policies Committee which considers the broad canvass of transport policy. This submission has been prepared by the Institute's Strategic Rail Policy Group.

2. CILT welcomes the opportunity to comment on the proposals by ORR to recover the fixed costs of running the rail network, together with the associated reports by Brockley Consulting for Network Rail and CEPA/Systra for ORR. We believe that the ORR proposals beg some fundamental questions about infrastructure cost drivers and the way these can best be managed and reflected in a charging system. This in turn raises some crucial public policy issues about modal switch, congestion, carbon and the environment.

3. There appear to be two main factors behind the current proposals - the wish to levy 'fairer' infrastructure charges on Open Access Operators (OAOs), who are currently perceived to enjoy an unduly favourable track access charge, and secondly a desire to expose Network Rail to pressure from train operators on the basis that this will drive down infrastructure costs. We outline below our views on these issues and then consider the logic of spreading fixed costs and the potential impact on freight.

4. Taking first the OAO issue, we are in broad agreement that OAOs should pay a track access charge more in line with franchised Train Operating Companies (FTOCs). There is perhaps an argument that OAOs, as small operators with few economies of scale, each competing against a large established TOC, need some assistance and - whilst we might, under certain circumstances, be persuaded of this - the fact that the current OAOs are themselves subsidiaries of large FTOC-owning groups renders the position largely unconvincing.

5. We do not, however, consider that 'levelling the playing field' between FTOCs and OAOs requires a major upheaval of the track access charging system. We believe that the matter could be dealt with relatively simply by charging OAOs the weighted

average track access charge for the sections of the route over which they are competing with the FTOC, but not off that route. Thus, on the ECML, Grand Central would pay a weighted average cost that equated to that paid by VTEC between Kings Cross and Doncaster for Bradford services and between Kings Cross and Northallerton for Sunderland trains, but existing charges beyond these junctions. Similarly, Hull Trains would pay the weighted average rate between Kings Cross and Doncaster (arguably, Heck), but not thence to Hull. It could be argued that, even off the main lines, OAOs compete with other services but, on balance, we consider that the competition issue is largely confined to the market to/from London.

6. Turning to the objective that train operators should exert pressure on Network Rail to improve efficiency, we fully agree that efficiency improvement in NR's operating, maintenance, renewals and enhancement activities is imperative. We believe that there are substantial efficiency reserves available to a competent infrastructure manager, alert to best practice from overseas, and one which is less risk-averse, bureaucratic and centrally-controlled than NR is at present. NR is not exposed to the market pressures that are an everyday reality for TOCs and FOCs, which leads to a lack of urgency and hunger for improvement, and to the prioritisation of process over delivery of tangible results for the benefit of operators and end users.

7. We do not, however, believe that spreading fixed costs to all train miles, even on an ability to pay basis is the way forward. FTOCs are held harmless from changes in track access charges and cannot therefore be expected to expend scarce management resources and an already thin margin when it will have no impact on the bottom line. To challenge infrastructure costs - especially fixed costs - a FTOC would need to equip itself with engineering expertise in civils, signal & telecoms and electrification. Such expertise is in short supply and would be expensive to obtain - without a clear payback there would be no business case for doing so. FOCs, for whom infrastructure cost savings could produce a bottom-line benefit, do not have sufficient influence on the routes over which they run to have a meaningful impact, nor in the current climate, since the collapse of coal, can the FOCs afford to fund the necessary expertise to challenge NR at a granular level.

8. We consider that the best way to challenge NR would be for fixed costs at Route level to be the responsibility of the Prime User of the route - it is not generally difficult to identify the prime user for a route and for devolved Routes with strong Stakeholder Boards, it should be possible to both identify and drive through efficiency improvements. The Prime User would have sufficient interest in tackling the pot of fixed costs and the knowledge to challenge NR's practices and methods. It may be necessary to introduce a meaningful benefit-sharing process for the companies involved and to reflect success (or otherwise) in achieving the desired outcome in the reward packages of key managers involved. The former would go some way to offsetting any costs of engaging engineering expertise and the latter would provide personal motivation to tackle, once and for all, an intractable issue.

9. Irrespective of organisational structure, we believe it is a cardinal principle that a charging system should reflect how costs arise and can be influenced - failure to do

so can produce perverse incentives and unintended consequences. In the current context, we consider that it would be very dangerous to allocate fixed costs as if they were variable - by definition fixed costs vary little, if at all, with changes in volume. That the cessation of a particular activity will result in a reduction in fixed costs is a false premise and adopting it will lead to flawed conclusions. Fixed costs are generally only escapable in the long term or by investment, for which there usually is little or no return, and in some cases not even then.

10. The logical conclusion is that if the UK is to have a rail system there are costs which cannot be avoided - Government policy, reiterated in Vision for Rail as recently as 29th November, is that the UK should have such a system and that, indeed, it should be expanded. In many of the areas where expansion is foreseen, notably in reopening lines or introducing passenger services on freight-only routes, there is little prospect of profit being generated at the operating level, let alone a greater contribution to infrastructure costs.

11. We consider that it follows from this that infrastructure charges should be based on the principle of avoidable costs - that if a service did not exist there would be a demonstrable saving in infrastructure costs. The counter argument - that this fails to extract margin where there is an ability to pay more - is largely spurious in that the margin will be extracted in any event through franchise payments for those (Inter City and outer suburban) TOCs that have the market advantages to generate a surplus. From a UK plc or Treasury perspective, the franchise surplus would be recycled into the fixed costs of having a rail system.

12. We consider this would be much preferable to the alternatives of a higher infrastructure charge per mile, which would act as a disincentive to run more trains and improve customer service, or even a two-part tariff with a fixed element and a lower variable charge per mile - the latter would be cumbersome and would immediately be reflected in the value of franchise bids anyway.

13. We would not wish to lose sight of congestion/capacity charging. Accepting the current inadequacy of appropriate data (delay x time of day x route section) and access billing systems, we consider that ORR should require Network Rail to collect data on delay at a disaggregated level (at least for a pilot) to enable the consequences of congestion to be quantified and, after further consultation with TOC/FOCs, potentially used as part of a cost reflective charging mechanism. We consider that careful consideration of the findings would be essential and that it is not automatically the case that such charges should be reintroduced - we do not wish to see access charging further complicated, potentially hindering the process of running trains to meet customer requirements. We do, however, consider that the corollary of high charges at peak times ought to be lower charges in off-peak hours and particularly at night.

14. We wish to highlight the potential impact of allocating fixed costs on freight - many members of the Institute are involved in Freight and Logistics. It must be recognised that freight trains are crucial parts of many supply chains for major players in the UK

economy. Two statistics demonstrate the point: firstly, 40% of all freight moved in the UK is now consumer goods - mostly imports in containers from the major ports of Felixstowe, Southampton and London Gateway, but also on domestic routes such as the Midlands to Scotland; secondly, approaching 50% of the aggregates used by the construction industry in London are conveyed by rail and even for the outer South East the figure is over 25%.

15. It is fair that freight should be allocated its avoidable costs and that these should be charged on an ability-to-pay basis: we note the proposal to include biomass in to this category in CP6. There is, however, great concern that were other commodities to be included in CP7 or beyond this could act as a brake on private sector investment in wagons and terminals - at the very time when Government wants to see more private sector investment in rail. A possible solution would be for existing operators and end users to be held harmless from such changes for a period sufficient to remove the threat to investment - probably a minimum of 10 years or two Control Periods.

16. It should also be borne in mind that - as CEPA report - outside the current group of commodities deemed able to pay, every tonne moved by rail is won in competition with road hauliers, the infrastructure charges for whom are a small proportion of total costs and which are, by almost every study produced, insufficient to cover their attributable costs, let alone the externalities of accidents, death and injury and environmental impact. Driving freight off rail and onto road would thus generate additional costs for UK plc as well as being contrary to Government policy on modal, shift, carbon and the environment. Unlike passenger, freight is not a zero-sum game and an increase in infrastructure charges will not be offset elsewhere, but will result in real and immediate loss of competitiveness and a transfer of freight to road. Indeed, we would argue that unless and until there are equivalent 'full cost' charging systems for freight on road, they must not be levied for rail freight flows. This is patently a cross-modal issue which the Office of Rail and Road should be well placed to consider.

17. It is worth reflecting that the reason freight access has been charged on an avoidable cost basis for the last 30 years or more is that the railway in the UK and, indeed across Europe, is fundamentally a passenger network on which freight operates, to a greater or lesser extent, at the margin. This is in stark contrast to North America, where the railway exists to move freight and there is a (very) marginal passenger operation. The reasons are not hard to discern - rail is in a strong competitive position with freight in North America because of distance and the inability of road haulage to compete for many flows of traffic. As a result, US railroads are highly profitable and can afford not only to carry the full costs of maintaining and renewing their infrastructure, but to invest in additional capacity on key routes. By comparison, over the much shorter distances that apply in Europe, and particularly the UK, road haulage is a potent competitor and rail cannot extract sufficient margin from the market price to fund fully-allocated infrastructure costs. Any attempt to allocate fixed costs to freight in the UK would unquestionably have disastrous

consequences for the volume of freight moving by rail, with the highly undesirable effects noted above.

18. Finally, we would make the point that - for both passenger and freight - there is an incipient danger of the allocation of fixed costs resulting in a downward spiral. The inescapability of such costs in anything other than the very long term, if then, means that the loss of a business or traffic flow, because it was unable to bear its allocation, would merely result in the remaining flows having to bear a greater share. This could, in turn, result in the loss of further flows and so the industry spirals downward and is ultimately left with a pot of fixed costs being borne by a very small volume of traffic. This danger is exacerbated by the likelihood of flows which are not bearing their allocated fixed costs being portrayed as benefiting from (cross) subsidy - the fact that they are not driving the costs they are being allocated is easily lost in the debate.

19. In conclusion, we do not believe that allocation of fixed costs as proposed is the right way forward and consider that it carries considerable risks of unintended consequences, particularly with regard to freight. We believe that the issues of OAO access charges and Network Rail efficiency can and should be tackled in different ways. We also believe that, as a fundamental principle, charges should reflect real-world cost causation and should not be allocated in an essentially arbitrary manner that does not reflect cost causation, ability to manage the costs, or escapability and which can thus produce perverse and unintended outcomes.

20. The Institute remains happy to contribute its knowledge and experience to the discussion and, in particular, the development of efficient infrastructure management.

Submitted by:
Daniel Parker-Klein
Head of Policy
The Chartered Institute of Logistics and Transport

November 2017

PR18 consultation on charges recovering fixed network costs: Pro-forma for responses

This pro-forma is available to those that wish to use it to respond to our consultation. Other forms of response (e.g. letter format) are equally welcome.

Please send your response to pr18@orr.gsi.gov.uk by **30 November 2017**.

Full name	Gregory March
Job title	Performance & Policy Manager
Organisation	Colas Rail
Email*	
Telephone number*	

*This information will not be published on our website.

Question 2.1: Do you have any views on our proposal to retain the existing freight market segmentation by commodity, and not introduce further market segments for any of the existing commodities?
At this stage we would agree with the proposal to retain the existing freight market segmentation by commodity and support the notion of not introducing further market segments.

Question 2.2: Do you have any views on our proposal to continue allowing Network Rail to levy infrastructure cost charges on freight trains carrying ESI coal, iron ore and spent nuclear fuel? Do you have any views on our proposal to allow Network Rail to levy infrastructure cost charges on trains carrying ESI biomass in CP6?
Regarding ESI coal, whilst it is noted that the 'market can bear' analysis argues that infrastructure cost charge levies are unlikely to have an impact on the volume of ESI coal moved by rail, it could be argued that this is perhaps a somewhat simplistic conclusion. As the analysis notes, the volume of ESI coal moved by rail has significantly reduced over the course of CP5 expedited by Government policy. In many respects, the remaining ESI coal flows tend to be more akin to 'campaign flows', i.e. flows that last for a defined period of time/volume moved rather than regular/indefinite flows. As a result of this for instance, for operators required to lease and maintain coal wagon sets on short term hire to accommodate these flows, costs have invariably increased due to the short term nature of these campaign flows. It is not unreasonable to assume that ESI coal flows during CP6 may continue to follow the trend of 'campaign' flows and as such rail costs associated with haulage of this commodity may increase. In this scenario, the levying of charges could in conjunction with increased haulage costs could by defacto make road haulage of ESI coal more competitive. *Regarding the proposal to begin levying charges against ESI biomass in CP6 we again note the analysis and justification behind the proposal. We would however urge some caution in the*

belief that ESI biomass can bear such a charge. Given the impact Government policy can have on rail freight volumes, as we have seen with ESI coal, should policy result in a move away from ESI biomass, and for example a new form of 'carbon tax' introduced, the cost increases combined with the new levied charge could potentially result in a reduction of ESI biomass volumes moved by rail.

Question 2.3: Do you have any additional evidence around the ability to bear of any of the freight market segments reviewed by our consultants, which you would like to provide us to inform our final decision around which freight market segments are able to bear infrastructure cost charges in CP6?

At this stage we are largely satisfied with the consultants work on the various market segments.

Question 3.1: Do you have any views on the results of the technical analysis undertaken to date on passenger market segmentation (and ability to bear?) Do you have any views around how these emerging findings could inform a passenger market segmentation?

N/A

Question 4.1: Do you have any comments on our proposal to levy any infrastructure cost charges on open access operators as a rate per train mile? Do you think there are any additional considerations we should include in our assessment of the different metric options?

The analysis and justification behind the proposal to levy infrastructure charges on open access operators as a rate per train mile appears to make sense. We would support any proposal that encourages Open Access Operators to make best use of existing allocated capacity so as to avoid encouraging the introduction of additional less efficient services that occupy Network capacity that could otherwise be used by other operators with a greater need for said capacity.

Question 4.2: Do you have any comments on our proposed approach to varying franchised passenger operators' infrastructure cost charges in response to changes in traffic, on an annual basis. Do you have any comments on the particular approach we have proposed which is based on changes in timetabled traffic, or any of the other options we have considered in our assessment?

We would support a proposal that incentivises franchised passenger operators to consider the fixed costs and impact of adding additional services to the Network. Given the introduction of additional services can often impact the availability of capacity for rail freight services, any consideration that promotes the fairest use of Network capacity is to be welcomed. Likewise,

the incentive for Network Rail to add additional franchised passenger services to the Network needs to be met with an equal incentive to do the same for rail freight.

Any other points that you would like to make

Thank you for taking the time to respond.

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PR18
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Richard Clarke
Head of Transport Policy, Access and Regulation

7 December 2017

PR18 consultation on charges recovering fixed network costs

1. This letter contains the response by DB Cargo (UK) Limited ("DB Cargo") to the PR18 consultation document entitled "*PR18 consultation on charges recovering fixed network costs*" issued by Office of Rail and Road ("ORR") on 28 September 2017.

2. DB Cargo is the largest rail freight operator in the UK and is a wholly owned subsidiary of Deutsche Bahn, the second largest mobility and logistics group in the world. DB Cargo operates over 5,000 trains per month in the UK conveying everything from cereals to aggregates, consumer products to biomass and petroleum to steel. DB Cargo employees over 2,200 people, providing freight, infrastructure, rail support and charter passenger services within the UK and freight services to and from continental Europe via the Channel Tunnel.

3. DB Cargo in common with other rail freight operators is a wholly private sector activity receiving no material direct government support in the UK. In this respect, rail freight is different to passenger rail as it has a very different, less direct relationship with Governments, funders and other devolved bodies. In a heavily capital intensive industry, DB Cargo owns and operates its own assets, including depots and rolling stock, and has invested heavily in new locomotives, wagons and facilities over the years since UK privatisation.

General comments

4. DB Cargo understands that this consultation focuses on the continued development of ORR's approach to levying infrastructure cost charges on all operators (subject to a market-can-bear-test) that are aimed at recovering the fixed costs of the network. However, it also understands that the consultation is not intended to set out proposals on the level of any infrastructure cost charges to be levied in CP6.

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5. DB Cargo in considering how all aspects of PR18 will affect DB Cargo's customers, DB Cargo's business and the rail freight sector in general, is applying five "tests" to ensure that the process and outcomes must:

   a. Maintain user and investor confidence.
   b. Respect the open, fair and competitive market.
   c. Not lead to any price shocks.
   d. Only deliver change that is pragmatic and proportionate.
   e. Be subject to timely, holistic impact assessment.

   DB Cargo's responses to the specific questions raised in this consultation will have considered whether or not these "tests" are relevant, and if so, whether or not they have been met.

6. By way of background, DB Cargo has recently responded to Network Rail's related consultation on its proposed methodology for allocating its fixed costs to train operators (a copy is attached as an appendix). In its response, DB Cargo raises significant concerns over the impacts Network Rail's proposed methodology for allocating all of its fixed costs to train operators will have on the rail freight industry. DB Cargo's key messages included the following:

   "*DB Cargo strongly disagrees with the proposed methodology that seeks to allocate total (rather than just avoidable) fixed costs to freight operators given the inability of those operators to influence the reductions of the vast majority (around 84%) of those costs.*"

   "*Allocating a substantial amount of Network Rail's total fixed costs to freight operators [£566m], the majority of which they are not actually responsible for other than as a result of Network Rail's cost allocation model, will cause untold damage to the rail freight industry in DB Cargo's view for very little benefit.*"

   "*Allocating total fixed costs to freight operators, the majority of which do not vary with usage, does not create any focus on the control of those costs. DB Cargo submits that instead, Network Rail should focus its efforts on cost causation and efficiency supported by a robust mechanism to incentivise all train operators to collaborate with Network Rail to facilitate overall cost reductions and improved efficiency rather than just developing methodology that merely allocates responsibility for proportions of a total 'pot' of fixed costs to operators.*"

7. With these key messages in mind, DB Cargo notes the following examples of the objectives and criteria that ORR would expect to use to determine whether Network Rail's cost allocation methodology is suitable for calculating infrastructure cost charges in CP6:

   - operators have good knowledge of costs they are causing (in the short and long-run);

...

- operators understand the basis on which the charge is set and how they can affect it;
- decision makers and funders have good knowledge of costs caused by services in the short and long run;
- promote positive impacts on funders/customers; and
- promote positive wider external impacts.

8. In keeping with the concerns raised in its response to Network Rail's consultation, DB Cargo is not convinced at all that Network Rail's revised fixed cost allocation methodology achieves any of ORR's example objectives and criteria listed above. DB Cargo therefore believes that Network Rail's proposed methodology should not be used by ORR for calculating infrastructure cost charges for CP6 and, instead, that the existing methodology should continue to apply.

9. Furthermore, DB Cargo cannot stress strongly enough that the rail freight industry's main competitor (i.e. the road haulage industry) is not allocated the fixed costs of the road network nor is it considered as receiving a subsidy from the Government for using the road network. DB Cargo is concerned that any infrastructure cost charges levied in CP6 using Network Rail's proposed methodology for the allocation of total fixed costs will widen still further the discrepancy between the two competing modes.

Responses to ORR specific questions

Q2.1 Do you have any views on our proposal to retain the existing freight market segmentation by commodity, and not introduce further market segments for any of the existing commodities?

10. DB Cargo supports ORR's proposal in the consultation document to retain the existing approach to market segmentation without defining any further market segments or sub-segments for any commodity.

Q2.2 Do you have any views on our proposal to continue allowing Network Rail to levy infrastructure cost charges on freight trains carrying ESI coal, iron ore and spent nuclear fuel?

11. DB Cargo accepts that there is no new compelling evidence to change ORR's previous decisions to allow Network Rail to levy infrastructure cost charges on freight trains carrying ESI coal, iron ore and spent nuclear fuel.

12. However, because Network Rail's revised methodology for the allocation of fixed costs apportions a significant level such costs to rail freight, DB Cargo is concerned that if this methodology is adopted, this could lead to a significant increase in the level of infrastructure cost charges in CP6 for these three market segments which in turn could affect their 'ability to pay' those charges. DB Cargo, therefore, considers

...

that the impact of any potential increase in the level of infrastructure cost charges on these three market segments should also be taken into account to ensure that the 'market can bear' test remains appropriate and does not generate a further risk of 'modal shift' of these market segments from rail to other modes.

13. As already stated earlier in this response, DB Cargo considers that the level of any infrastructure cost charges should continue to be based on the avoidable costs of freight rather than on Network Rail's proposed wider revised fixed cost allocation methodology.

Do you have any views on our proposal to allow Network Rail to levy infrastructure cost charges on trains carrying ESI biomass in CP6?

14. DB Cargo disagrees with the proposal to allow Network Rail to levy infrastructure cost charges on trains carrying ESI biomass in CP6. Although ORR mentions in the consultation document that ESI biomass rail freight flows have grown by as much as 133% between 2013/14 and 2016/17, biomass still only makes up around 4% of the electricity generation market which indicates to DB Cargo that it remains an 'emerging market' and, therefore, not yet mature enough for ORR to conclude that it is a market segment that could afford to pay a 'mark-up'.

15. In addition, CEPA in its Freight 'Market-can-Bear' Analysis Report confirms that there are only two UK Power Stations (Drax and Lynemouth) which have committed to biomass on a scale that make rail an option and both remain reliant on CfD (contract for difference) subsidies. Again, this suggests that ESI Biomass conveyed by rail remains an emerging market, particularly as CEPA also confirms a 'levelling off' in the growth in biomass volumes over the past year.

16. Furthermore, even without a 'mark-up' being applied in CP5 to ESI biomass there are no prospects of any further Power Stations converting to using biomass transported by rail. The probability that a 'mark-up' will be applied in CP6 will certainly ensure, in DB Cargo's view, that this situation will not only continue into the future but that volumes being transported to the two existing Power Stations may also reduce.

17. Consequently, the likely effect of implementing infrastructure cost charges on ESI biomass will be a reduction of electricity generation from biomass in favour of potentially non-renewable sources, such as gas. The additional infrastructure cost charges will mostly serve to increase the costs of generation, making biomass a less attractive fuel. Energy providers cannot re-open their support mechanisms with government (CfD or Renewables Obligation) until 2027, so any such increases must either be passed on to customers or absorbed.

18. DB Cargo strongly believes, therefore, that ESI biomass is not a market segment that has the ability to bear a 'mark-up' as it will deter further investment and curtail future growth. Such a 'mark-up' would in effect just become a charge being levied on the basis of the particular circumstances already applying to just two

...

providers who have already invested heavily in this market segment rather than on the basis of the potential of the market segment as a whole.

19. DB Cargo strongly urges ORR to consider its comments made above together with the wider impacts and downstream effects of applying a 'mark-up' on ESI biomass that are set out in section 12 of the CEPA Report before finalising its decision on this matter. These include the potential for reverse modal switch where the impact of a decision to introduce infrastructure cost charges would reduce rail freight volumes and/or deter investment. DB Cargo considers these to be material factors in any decision whether or not a 'mark-up' is applied.

20. Finally, DB Cargo notes that unlike the other three market segments that currently bear a 'mark-up' even CEPA are clearly not fully convinced that a 'mark-up' should be levied on ESI biomass as it states "I .*on balance, we consider (albeit with <u>some caution</u>) that the market is <u>likely</u> to be able to bear a [mark-up]"* (emphasis added).

21. Notwithstanding the above comments, as with the other three commodities likely to be levied infrastructure cost charges, DB Cargo believes that the level of any such charges should continue to be based on the avoidable costs of freight rather than on Network Rail's proposed wider revised fixed cost allocation methodology.

Q2.3 Do you have any additional evidence around the ability to bear of any of the freight market segments reviewed by our consultants, which you would like to provide us to inform our final decision around which freight market segments are able to bear infrastructure cost charges in CP6?

22. DB Cargo agrees with the ORR's proposal that all other market segments should not be levied infrastructure cost charges in CP6. This includes the intermodal market segment which is already at a significant disadvantage when compared against its main competitor, road transport, which, as is mentioned earlier in this response, does not pay any direct costs for the infrastructure it uses (i.e. the national road network).

Q3.1 Do you have any views on the results of the technical analysis undertaken to date on passenger market segmentation (and ability to bear?) Do you have any views around how these emerging findings could inform a passenger market segmentation?

23. As a freight operator, DB Cargo is not best placed to respond on this aspect of the consultation. However, it would be concerned if the proposed passenger market segmentation causes any unintended adverse impacts on rail freight (including freight operators being allocated an increased share of Network Rail's fixed costs).

Q4.1 Do you have any comments on our proposal to levy any infrastructure cost charges on open access operators as a rate per train mile? Do you think there are any additional considerations we should include in our assessment of the different metric options?

24. As a freight operator, DB Cargo is not best placed to respond on this aspect of the consultation. However it would be concerned if the proposals in this area cause any unintended adverse impacts on rail freight (including freight operators being allocated an increased share of Network Rail's fixed costs).

Q4.2 Do you have any comments on our proposed approach to varying franchised passenger operators' infrastructure cost charges in response to changes in traffic, on an annual basis. Do you have any comments on the particular approach we have proposed which is based on changes in timetabled traffic, or any of the other options we have considered in our assessment?

25. Again, as a freight operator, DB Cargo is not best placed to respond on this aspect of the consultation. However it would be concerned if the proposals in this area cause any unintended adverse impacts on rail freight (including freight operators being allocated an increased share of Network Rail's fixed costs).

Concluding remarks

26. For the reasons set out in this consultation response, DB Cargo does not support the proposal to use Network Rail's proposed methodology for allocating all of the fixed costs of the network to operators, rather than solely the avoidable costs as is currently the case in respect of freight. DB Cargo's main competitor the road haulage industry does not pay any direct costs for the infrastructure it uses (i.e. the national road network). So, in proposing to allocate a significant additional proportion of the fixed costs of the rail network to rail freight operators will widen the competitive disadvantage rail freight faces still further as well as perpetuating the perception that rail freight is considered to be subsidised whereas road freight is considered to be a cost.

27. Allocation of fixed costs which do not vary with usage does not create a focus on Network Rail to become more efficient. This is seen by the significant increase in Network Rail costs for CP6 and it will be extremely difficult for a freight operator to truly understand and challenge the makeup of the fixed cost attributed to freight, particularly when such costs would remain even if freight ceased to operate at all on the network.

28. DB Cargo agrees with or accepts many of the proposals in the consultation document concerning the definition of market segments and which market segments could be subject to infrastructure cost charges for CP6. However, it disagrees with ORR's proposal to allow Network Rail to levy infrastructure cost charges on ESI biomass trains and considers that such a proposal will adversely

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affect the ability of this market segment to grow any further and, may, even cause it to contract.

29. Should ORR determine that there will be a significant increase in infrastructure cost charges levied on certain market segments (which DB Cargo hopes will not be the case), DB Cargo would urge ORR to consider the possibility of ‘capping’ or ‘phasing in’ any such charges as it did in CP5 to avoid any ‘overnight’ price shocks.

Yours sincerely,

R Clarke

Richard Clarke
Head of Transport Policy, Access and Regulation

DB

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Richard Clarke
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17 November 2017

NETWORK RAIL'S CONSULTATION ON ITS METHODOLOGY FOR ALLOCATING FIXED COSTS TO TRAIN OPERATORS IN CONTROL PERIOD 6 (CP6)

1. This letter contains the response by DB Cargo (UK) Limited ("DB Cargo") to the CP6 consultation document entitled "*Network Rail's consultation on its methodology for allocating fixed costs to train operators in Control Period 6 (CP6)*" issued by Network Rail on 22 September 2017.

2. DB Cargo is the largest rail freight operator in the UK and is a wholly owned subsidiary of Deutsche Bahn, the second largest mobility and logistics group in the world. DB Cargo operates over 5,000 trains per month in the UK conveying everything from cereals to aggregates, consumer products to biomass and petroleum to steel. DB Cargo employees over 2,200 people, providing freight, infrastructure, rail support and charter passenger services within the UK and freight services to and from continental Europe via the Channel Tunnel.

3. DB Cargo, in common with other rail freight operators, is a wholly private sector activity receiving no material direct government support in the UK. In this respect, unlike passenger rail, rail freight has a very different, less direct relationship with Governments, funders and other devolved bodies. In a heavily capital intensive industry, DB Cargo owns and operates its own assets, including depots and rolling stock, and has invested heavily in new locomotives, wagons and facilities over the years since UK privatisation.

General comments

4. DB Cargo acknowledges that this consultation focuses on Network Rail's proposed methodology for allocating fixed costs to train operators in Control Period 6 ("CP6") and does not cover the potential impact that such fixed cost allocations will have on the level of the fixed charges levied on train operators as a result. However, DB Cargo in considering how all aspects of PR18 will affect DB Cargo's customers, DB Cargo's business and the rail freight sector in general, is applying five "tests" to ensure that the process and outcomes must:

a. Maintain user and investor confidence.
b. Respect the open, fair and competitive market.
c. Not lead to any price shocks.
d. Only deliver change that is pragmatic and proportionate.
e. Be subject to timely, holistic impact assessment.

5. DB Cargo's responses to the specific questions raised in this consultation will have considered whether or not these "tests" are relevant, and if so, whether or not they have been met.

6. DB Cargo acknowledges that this particular consultation document does not directly address the issue of whether or not there may be a 'cap' or a 'phasing in' of any fixed charges levied on freight operators as there was in CP5 as this is a matter for ORR. However, the significant level of fixed costs indicated for allocation to freight operators that was previously allocated to franchised passenger operators, reinforces DB Cargo's concerns in this area.

7. DB Cargo acknowledges the importance of Network Rail wishing to better allocate its fixed costs so that it can develop income requirements for its devolved and virtual routes. However, it is difficult to understand why freight operators as a whole have been allocated 13% of the total fixed costs (after funding adjustment) when they only operate around 6% of the train miles.

8. DB Cargo had considered whether 'weight' would have played an important factor in arriving at such a high allocation given loaded, as opposed to empty, freight services do convey significant tonnages. However, it is clear from paragraph 4.24 of the consultation document that whilst 'weight' is an important factor in driving short run 'wear and tear' costs, the avoidable cost analysis suggests that it plays a relatively small role in driving long run avoidable costs.

9. Consequently, and after noting the contents of paragraph 5.3 of the consultation document, it can only be assumed that such a high cost allocation must have been derived from freight services often using relatively lightly utilised routes. If so, then DB Cargo would consider that allocations to freight operators on that basis would be inherently unfair. This is because both Network Rail and ORR have sought for freight operators to have more flexible access rights, mostly without any right to routing, to enable Network Rail to route freight services onto the 'expensive' lightly used routes to keep them out of the way of higher speed passenger services on the 'cheaper' main lines.

10. For Network Rail to route freight services away from main lines providing additional capacity for passenger trains and then, as a result, allocate a higher proportion of fixed costs than would otherwise be the case, whilst at the same time reducing the fixed cost allocation for passenger operators is of great concern to DB Cargo.

...

11. It is also not equitable in DB Cargo's view to just allocate total fixed costs without giving an opportunity for freight (and indeed other) operators to examine ways in which such allocations of fixed costs can be reduced. The transparent allocation of costs only aids effective decision making where there is clarity on how the allocated costs can be reduced. This aspect does not seem to have been considered in the work carried out to date. There must be a much greater understanding of the ways in which all train operators can help Network Rail reduce its costs reinforced with a robust incentive mechanism to facilitate such help.

12. DB Cargo also notes in the consultation document that whilst freight operators have been allocated the substantial sum of £566m per annum of the total fixed costs (after funding adjustment), only £92m per annum of this figure is avoidable if freight ceased operating on the network. Notwithstanding the adverse implications such a significant allocation may have on the level of charges, it is extremely damaging and unhelpful to the rail freight industry for the figure of £566m per annum to be used externally as the 'cost' of having freight on the network particularly as £474m per annum of that cost would still exist and have to be allocated to other parties under Network Rail's proposed allocation methodology.

13. It should also be recognised that the rail freight industry's main competitor (i.e. the road haulage industry) is not allocated the fixed costs of the road network; nor is it considered as receiving a subsidy from the Government for the provision of that road network. DB Cargo is concerned therefore, that Network Rail's allocation of total fixed costs will create a further imbalance between the two competing modes.

14. For these reasons, DB Cargo submits that Network Rail should focus on the avoidable costs of freight when communicating externally, irrespective of whether it uses the much higher total of £566m per annum for its own internal allocation purposes.

Responses to Network Rail's specific questions

Q1: Do you consider any of the proposals set out in this consultation document are likely to impact the safety of the network?

15. DB Cargo does not believe any of the proposals set out in this consultation will likely impact on the safety of the network.

Q2: Do you agree with our proposals:
a) To use the new methodology developed by Brockley Consulting to allocate our fixed costs to operators in CP6?
b) That these revised cost allocations should form the maximum level of operators fixed cost charges?

16. Given the comments and concerns expressed earlier in this response, DB Cargo disagrees with Network Rail's proposals to use the new methodology developed by

...

Brockley Consulting to allocate total fixed costs to freight operators, particularly as the vast majority of those costs are not 'avoidable'.

17. DB Cargo also disagrees that these revised cost allocations should form the maximum level of operators' fixed cost charges. Beside the fact that it is made clear in the consultation document that decisions on charges are a matter for ORR, in order for such revised cost allocations to form the maximum level of operators' fixed cost charges, such allocations would have to have been made on the basis of efficient, transparent and non-discriminatory principles whilst guaranteeing optimum competitiveness, in particular in respect of rail market segments (i.e. in accordance with the relevant access charging principles set out in the Railways (Access, Management and Licensing of Railway Undertakings) Regulations 2016). DB Cargo remains to be convinced that Network Rail's revised fixed cost allocations meet these principles.

Q3: Do you agree with the revised methodology developed by Brockley Consulting for allocating income to train operators when calculating their fixed cost allocations?

18. Without prejudice to its views on the allocation of total fixed costs to freight operators expressed in this response, DB Cargo notes that the revised methodology does not appear to take into account the income received by Network Rail from freight operators through the freight-only line charge and the freight specific charges. Presumably, if stage one of the process allocates total costs, then stage 2 should deduct total revenue?

19. In addition, in respect of freight operators, Network Rail's proposals in this respect do not allocate income to freight operators as the figures are aggregated and reported at a rail freight industry level instead.

Q4: Do you have any comments on the overall change in cost allocations shown in Table 12, above?

20. DB Cargo notes that Table 12 in the consultation document shows an increase in the fixed costs attributable (or should this say allocated?) to freight operators from £0 to £566m per annum and also notes Network Rail's reiteration that this amount is a cost allocation and it is for ORR to decide how much of this is reflected in charges to freight operators. DB Cargo also notes Network Rail's subsequent argument that in any case the £566m (and £92m avoidable cost) per annum allocation is still far lower than the £1.6 billion per annum of productivity gains that rail freight is estimated to deliver for UK businesses.

21. However, the £1.6bn per annum of productivity gains figure is incorrect. The Rail Delivery Group's "Freight Britain" document from which the figure has been quoted, makes clear that the £1.6bn per annum also includes road externalities of £0.5bn per annum making the actual productivity gains more than 25% lower at £1.1bn per annum. DB Cargo understands that this figure is now being revisited and could

...

become even lower as a result. Therefore, it only needs the £566m of total fixed costs per annum allocated to freight to increase once CP6 cost assumptions are used, for the balance between the two figures to become substantially closer, thereby calling into question Network Rail's mitigating argument outlined above.

22. This is another strong reason in DB Cargo's view that only the avoidable fixed costs should be allocated to freight operators and not the remainder which would still be incurred by Network Rail whether or not freight operates on the network. The damage that will be done to the rail freight industry both politically and publically by allocating fixed costs to freight that do not change with volume (i.e. £474m per annum and therefore for which freight operators are not ultimately responsible) is very concerning indeed.

Q5: Do you agree that we should be transparent about which train operators are responsible for our fixed costs?

23. DB Cargo disagrees that Network Rail should be transparent about which train operators are responsible for its fixed costs on the basis of the allocations set out in the consultation document. This is because that by focusing on total fixed costs, Network Rail's proposed cost allocations do not provide transparency of which train operators are actually responsible for its fixed costs. By way of example, in the consultation document freight has been allocated (i.e. is deemed by Network Rail to be 'responsible' for) £566m per annum of fixed costs yet it is admitted that £474m per annum of those costs would remain if no freight was operated.

24. DB Cargo therefore wishes to understand how freight operators can be made 'responsible' for costs that would still remain whether or not they continue to operate on the network. It is also the case that in respect of freight, the fixed costs are not proposed to be allocated at a train operator level in any case and are instead aggregated at on a rail freight industry level basis.

25. Furthermore, it is acknowledged in paragraph 6.2 of the consultation document that where a market segment (e.g. freight services carrying certain commodities) cannot afford to pay all of the fixed costs attributable to it, Network Rail considers that this should be explicitly recognised in the form of a transparent grant from funders to Network Rail. DB Cargo questions how the proposed methodology will increase transparency when the allocation of costs has not been carried out on a 'market segment' basis. The freight fixed costs, for example, have been allocated on a 'rail freight industry level' basis and not by market segment therefore not allowing fixed costs to be efficiently allocated to those market segments that ORR deems can afford to pay a 'mark-up'.

26. DB Cargo also notes that the adjustments made between DfT and Transport Scotland funded franchises also distort the transparency of allocating fixed costs to those train operators Network Rail has deemed are responsible for them.

...

27. Had Network Rail instead proposed as to whether it should be transparent about which train operators are responsible for its fixed avoidable costs on the basis of the allocations set out in the consultation document (for freight £92m per annum), then DB Cargo may have expressed a different view.

Q6: Do you agree with our proposal to retain a simple approach to adjusting FTACs for franchise re-mappings but based on train miles, rather than vehicle miles?

28. As a freight operator, DB Cargo is not best placed to offer a definitive view on this question which appears to be is aimed at franchised passenger operators. However, DB Cargo would not support the change if as a consequence, the change of metric resulted in further fixed costs being allocated to freight operators.

Concluding remarks

29. For the reasons set out in this consultation response, DB Cargo strongly disagrees with the proposed methodology that seeks to allocate total (rather than just avoidable) fixed costs to freight operators given the inability of those operators to influence the reductions of the vast majority (around 84%) of those costs.

30. Allocating a substantial amount of Network Rail's total fixed costs to freight operators, the majority of which they are not actually responsible for other than as a result of Network Rail's cost allocation model, will cause untold damage to the rail freight industry in DB Cargo's view for very little benefit.

31. Finally, allocating total fixed costs to freight operators, the majority of which do not vary with usage, does not create any focus on the control of those costs. DB Cargo submits that instead, Network Rail should focus its efforts on cost causation and efficiency supported by a robust mechanism to incentivise all train operators to collaborate with Network Rail to facilitate overall cost reductions and improved efficiency rather than just developing methodology that merely allocates responsibility for proportions of a total 'pot' of fixed costs to operators.

Yours sincerely,

R Clarke

Richard Clarke
Head of Transport Policy, Access and Regulation

Department for Transport

Phil West
DEPARTMENT FOR TRANSPORT

Web Site: www.dft.gov.uk

8 March 2018

Chris Hemsley
Deputy Director of Railway Markets and Economics and Period Review 2018 Programme Director
Office of Rail and Road

By email

Re: ORR's consultation on charges for recovering fixed network costs

Thank you for the opportunity to respond to the ORR's consultation on charges for recovering the fixed costs of the network. We are grateful to you for allowing us additional time to respond to the consultation. This has been crucial in considering the impacts of the proposals given the number of potential changes.

I would also like to take this opportunity to thank you for the ORR's positive and open engagement with the Department on your proposals. This is a very complex and technical area and it is important that whatever comes out of it is practicable. Particularly in relation to how the charging framework, and Network Rail's (NR) implementation of it, fits with the contracts that franchising authorities have with their operators. Your constructive engagement has been vital in helping us form a view and we look forward to continuing this dialogue as we continue through the Periodic Review process.

Overall approach

We welcome the ORR's overall principles for greater cost reflectivity and for all operators to make an appropriate contribution towards the fixed costs of the network. We also recognise that in order to deliver an efficient network that is used to its full potential for the benefit of passengers and freight shippers, NR must have the right incentives when deciding whether to add traffic. This must be balanced against potential impacts on performance and resilience of adding traffic, considerations that franchising authorities also take into account, working with NR, when specifying services.

We are pleased that you are taking forward charging reform for open access. As you know, we strongly agree with the Competition and Markets Authority (CMA) that having robust protection for taxpayers in place is critical before open access can play a significantly expanded role. This is particularly the case in the next few years given constraints on public spending. In addition, given recent trends in operational performance, which appear to be at least partly related to the degree of congestion on the network, it is critical that we take into account performance impacts before making any decisions to fill gaps in the timetable where network capacity is already heavily utilised.

In the longer term, as the CMA recommended, there may be greater opportunities for open access to deliver more services once charging reform and our proposed public service obligation (PSO) levy are in place. We will be publishing our response to the levy consultation shortly.

It is, though, important to be clear that franchising will continue to be the main way we deliver services even in the longer term given the success it has had in delivering growth, performance, safety and customer satisfaction. Government is a substantial funder of the railway and determines the vast majority of services which run on the network on behalf of passengers and taxpayers. In doing this we balance the different objectives, and social and economic outcomes that citizens want to see from the railway to ensure it benefits everyone.

It is therefore absolutely right that Government, working in partnership between the public and private sectors, retains sufficient control over services and fares, as well as operator profits, through the franchising system. Although not captured by charges, we think it is also important to recognise that funders in particular take account of much more than just the financial costs of running the railway. We consider the economic and social impacts that services and connectivity deliver for passengers and communities. This will remain an important part of the railway given its role in facilitating opportunities for people.

In the remainder of this response, we consider the various areas of your consultation and NR's own consultation on cost allocation, setting out our views on each of them. But we thought it would be useful to summarise our understanding of the proposals to provide the context for our views.

In summary, there appear to be four different, but related, changes being considered in the two consultations. The first is a change to the underlying methodology for allocating costs to operators. This is the subject of NR's consultation and the work of Brockley Consulting. It would affect all types of passenger and freight operators, and ultimately funders. It will be for the ORR to determine whether to implement this in Control Period 6.

The second is levying infrastructure cost charges on all types of passenger operators – including open access operators who are not currently subject to them – where they are able to pay. This would be subject to the proposed market can bear (MCB) test for passenger operators.

The third change is introducing a degree of 'variability' to infrastructure cost charges for franchised passenger operators, whilst retaining the existing lump sum fixed track access charging approach for the majority of fixed charges.

And finally, you are proposing to update the market can bear (MCB) analysis for the freight market and levy fixed charges on trains carrying biomass for the electricity supply industry (ESI biomass) in CP6.

Each of these is important in its own right and in principle we support all of the changes and want to work with the ORR and industry towards them. However, it is important that all of these proposals work in practice and that the industry works together to consider them in greater detail over the next few months. We would not want to see changes introduced where this creates a level of disruption that is not balanced by a corresponding benefit for end users. We are therefore pleased that the ORR intends to use its assessment framework which will help with this consideration.

We would welcome the opportunity to discuss each of these areas further once you have considered our response.

Network Rail's work on allocating fixed costs

As we set out in our response to *Network Rail's consultation on its methodology for allocating fixed costs to train operators in Control Period 6* we are supportive of the principle of transparency for the underlying costs of the railway. However, it is important that if you make changes to the methodology, and ultimately if this is reflected in the level of charges for operators (subject to a market can bear test), then the benefits to passengers and freight shippers must significantly outweigh the costs of doing so. It is not yet clear to us that this is the case and we would welcome more evidence before we can fully support the change in practice.

It will also be important to consider the implications for different funders of the railway and the operators with which they have contracted. There are a range of models with different cost-sharing and funding mechanisms and a significant change in the way costs are allocated, which if incorporated into charges, are likely to have unanticipated impacts. We welcome the ORR's willingness to discuss this issue with funders to inform its decisions.

Design of infrastructure cost charges for passenger services

As you set out, the main outcomes that you want to achieve through the introduction of infrastructure cost charges, and of franchised passenger operators fixed cost charges, is to improve the incentives on NR, operators and funders to use the network more efficiently, as well as the potential to improve competition between passenger services. These objectives are important for delivering the most efficient use of the network and better outcomes for passengers and end users.

We understand that you are considering the potential impacts on NR from the greater volatility in income that the proposed changes in charges may introduce, particularly in light of your decision to remove the capacity charge. Given that the fixed costs of the network will remain irrespective of (marginal) changes in traffic it is important that NR are able to manage the potential volatility. We would clearly be concerned if NR ended up with a shortfall in income due to the introduction of this proposal. As the grant we have made available for Control Period 6 has a fixed ceiling, a shortfall in income will mean de-scoping of work on the network so that costs match the reduced income. This would be detrimental to end users and the wider economy.

We would welcome a further discussion with you and NR to consider how we can make sure that the proposals meet their intended objectives and do not introduce unnecessary funding risks.

Subject to a satisfactory conclusion to your consideration of the impacts on NR, we support this proposal and consider that an approach based on train miles is most appropriate.

The Passenger market can bear test

As you know, charging reform and the introduction of a PSO levy were two of the pre-conditions that the CMA recommended for facilitating a greater role for open access. In his July Guidance to the ORR, the Secretary of State for Transport stated that he considers that a pre-condition for an increase in open access is that all operators make an appropriate contribution to the costs of the network. We are therefore pleased that you are taking forward proposals to reform track access charges and we support these. However, we recognise that access charging reform is likely to be only one of the steps necessary to facilitate a greater level of open access competition and we look forward to discussing the ORR's overall approach to access over the coming months.

It is important, as the industry has stressed at the Rail Delivery Group PR18 working groups, that an increased contribution by operators is considered alongside changes to your access policy. Higher charges – where they appropriately offset the financial impacts on Government and our ability to provide vital social services and make investment in the network – should come with greater access to the network. Albeit, that franchising will remain the main vehicle through which passengers' needs are met, and that we consider open access operators should target communities less well served by the franchise system and delivering innovation in the market.

Clearly it is also crucial that the other impacts of new services continue to be evaluated as it is not just the financial impacts that are important. Performance, resilience, capacity, innovation, economic benefits and the overall affordability of the railway remain critical considerations to delivering benefits for passengers from open access.

We very much support the development of the market can bear (MCB) test for passenger services. It is important, indeed it is a legislative requirement, that operators are only required to pay more than their marginal cost of using the network where they are able to. Establishing a MCB test that strikes the right balance between encouraging innovative open access services which serve communities not well served by the franchising system, and ensuring that, where they can, open access operators pay an appropriate contribution to the costs of the network is critically important. Both for protecting government's continued investment in the railway, and ultimately for the passenger.

The initial work by CEPA on segmenting the market and estimating what the markets can bear is a good start to this work. Whilst we understand that there are always data limitations with this sort of analysis, we would like to see it continue to develop over the next few months, as well as over the next control period. Clearly we want to avoid spurious accuracy, but further segmentation, particularly by time of day, would be good to aim for as part of Periodic Review 2023.

The impacts on operators already running on the network must be considered very carefully as you have noted. This is something we also highlighted in our consultation on the PSO levy. We would not want to see these successful operations priced off the network by inappropriate increases in (total) charges. This is obviously influenced by what happens to variable track access charges as well as those for recovering fixed costs. As you have recognised, at CP5 rates, these operators can pay at least the existing capacity charge and may be able to pay more in certain markets.

For new operators, or those who apply for greater access we would expect these to pay the full open access rate that a particular market is determined to bear. This is the basis on which they would enter the market. It should be open to review (at each periodic review) to consider whether the operators are able to make a higher contribution, or if market conditions have changed such that they can no longer pay the original rate. This, however, should not shield inefficient operators from market pressures – we want an efficient and well performing railway delivering for passengers and end users.

We recognise that establishing a new service, particularly to new destinations, is not an easy process and takes time to develop a customer base. Therefore it may be appropriate to include some transitional arrangements to support these services. We would not wish to see the level of charges as being a barrier to establishing services to new communities – albeit there needs to be safeguards in the not primarily abstractive test if operators were to target more lucrative routes with these genuinely new routes treated purely as a balancing item.

Finally, we also recognise that the outcome of our PSO levy consultation is an important part of the overall access and charging package. As noted above, we intend to publish our response shortly and are thankful to all consultees who provided responses, including the industry, the ORR and CMA.

Freight charges

As you will know, as set out in his Guidance to ORR, the Secretary of State wishes ORR to have particular regard to the objectives set out in the Government's Rail Freight Strategy (2016). In particular, for 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 possible. More generally, he wishes ORR to take all appropriate steps to support the growth and development of the rail freight sector.

We are supportive of rail freight and consider the sector to be playing a vital part in reducing UK emissions, as each tonne of freight transported by rail reduces carbon emissions by 76 per cent compared to road. We are clear that the affordability of freight charges is an essential factor in realising these benefits, and that the rail freight industry requires clarity and certainty to plan their businesses for the future.

We expect ORR to carefully consider whether levying fixed charges on trains carrying ESI biomass would negatively impact on the commercial sustainability of the rail freight sector, and whether this would lead to modal shift from rail to road. In light of the above, we are supportive of ORR undertaking further analysis into the operating costs of the ESI biomass market segment. In particular, we would be interested to know the commercial impact of an additional charge on rail freight operators and their customers.

Electricity for Traction

As you may be aware, we are also in the process of exploring the impact of NR's revised TAC assumption in relation to a material forecast increase in Electric Current for Traction (EC4T) costs. We need to understand how this change in assumption impacts the department's franchising model before we can agree to this particular expenditure/income assumption in the plan. We will be in touch again when we have a clearer position on this.

Concluding remarks

As noted above, we would very much welcome further discussion on this important issue. Getting the incentives for NR and operators right through the charging framework is a key part of delivering an efficient railway which works for end users. As is creating the right circumstances for open access competition which appropriately maintains government's ability to deliver vital social services and continue to invest in the network.

Whilst we support the principles you are trying to achieve through the proposals, it is likely to need further thinking and discussion around the practical and real world implications of introducing some of them. This is particularly the case given the commercial position of the rail freight market, and the potential impacts on both funders and franchising authorities.

Yours Sincerely

Phil West

Phil West
Director, Rail Strategy, Security & One Railway

PR18 consultation on charges recovering fixed network costs: Pro-forma for responses

This pro-forma is available to those that wish to use it to respond to our consultation. Other forms of response (e.g. letter format) are equally welcome.

Please send your response to pr18@orr.gsi.gov.uk by **30 November 2017**.

Full name	Russell Evans
Job title	Policy & Planning Director
Organisation	First Rail
Email*	
Telephone number*	

*This information will not be published on our website.

Introduction

Thank you for the opportunity to respond to this consultation. This response is made by FirstGroup on behalf of our Rail Division and its train operating companies: Great Western Railway; TransPennine Express; Hull Trains; East Coast Trains Ltd; and South Western Railway (which is a joint venture between FirstGroup and MTR).

FirstGroup is a core member of the working groups established by the Rail Delivery Group (RDG) in relation to the PR18 process, which has spent time reviewing this consultation and debating feedback. We have contributed to and are supportive of RDG's response to this consultation. Notwithstanding our position on the RDG response, we would like to provide further clarificatory commentary, which is set out in this response.

We would request that the ORR considers our letter of 10th March 2017 (Response to ORR's Consultation on Improving Incentives) as there are pertinent and related points, for example in relation to the ability to bear test.

Question 2.1: Do you have any views on our proposal to retain the existing freight market segmentation by commodity, and not introduce further market segments for any of the existing commodities?

No.

Question 2.2: Do you have any views on our proposal to continue allowing Network Rail to levy infrastructure cost charges on freight trains carrying ESI coal, iron ore and spent nuclear fuel? Do you have any views on our proposal to allow Network Rail to levy infrastructure cost charges on trains carrying ESI biomass in CP6?
No.

Question 2.3: Do you have any additional evidence around the ability to bear of any of the freight market segments reviewed by our consultants, which you would like to provide us to inform our final decision around which freight market segments are able to bear infrastructure cost charges in CP6?
No.

Question 3.1: Do you have any views on the results of the technical analysis undertaken to date on passenger market segmentation (and ability to bear?) Do you have any views around how these emerging findings could inform a passenger market segmentation?
There are two elements to our response to this question. The first deals with market segmentation and the ORR's commentary around access to the Network and the second is on the ability to bear test and work to date in that area (including specifically the results of the analysis undertaken by ORR's consultants. Taking each of these in turn: **Market Segmentation** The ORR seems to have determined that there are only two segments within the passenger market. Whilst we can understand the distinction between franchised and open access operators (OAO) at a macro level, this simple distinction seems to ignore the different nature of service groups both within operators and between OAOs. We also note that the ORR has stated that the consultation implies that the policy of recovering fixed-costs from all operators *"has the potential to improve competition between passenger services over the longer-term…because it would allow [Open Access Operators] to contribute an appropriate amount towards fixed costs where they are able to, in exchange for having greater access to the network"*.

Not only does the consultation not set out how the framework would change it also misses the point that if a new OAO was able to have greater access to the market than existing OAOs (including those that have had rights granted but are not yet operating) in exchange for a greater contribution then this creates a separate and distinct type of passenger operator.

This would imply that there are at least three segments:

- OAOs who have been granted restricted access to the market, secured through the current ORR access policy, and who are therefore not able to contribute anymore towards Network Rail's costs than they already do;
- Franchised operators who have the capacity to contribute towards Network Rail's costs (i.e. because their ability to bear is in essence identified at the time of bidding for the franchise, through the requirements of the franchise and once the franchise is established, then the franchisee is held neutral to changes to charges through the franchise agreement mechanisms.); and
- OAOs who are granted access based on a new but as yet undefined access policy in exchange for a larger contribution towards Network Rail's costs.

Notwithstanding the fact that the ORR has in effect identified a further market segment through this consultation, we are very concerned that the ORR has left open what a new access framework would be and how it would operate. This has created uncertainty for prospective operators, particularly those bidding for franchises. Prospective bidders are essentially facing an unquantified risk of competition as there is now no clear policy on how OAOs may enter the market. Whilst in practice this is likely to mean significant risk premia being built into bids, resulting in a worse outcome for Government, ultimately it could mean that companies chose not to bid.

The uncertainty created is also concerning for prospective OAOs or for those that already have access to the network who have established business plans based on the current known framework.

Our conclusion on this had been that ORR should consider a holistic review of charging and access. This is a significant and complex piece of work, which as we have already described has implications across the passenger sector and therefore we need to ensure it has the time and appropriate resource dedicated to it. However, we also note that the Department for Transport (DfT) published its rail strategy "Connecting People; a strategic vision for rail" on 29th November, which states:

"The ORR is developing proposals to ensure open access operators make an appropriate contribution to network costs. We believe that open access rights should not be granted where they would have a significant negative impact on the performance of existing services, nor where the service would have the effect of primarily abstracting value from franchised services without serving new markets."

Given this development, and the fact that there are no firm proposals from the ORR within the consultation, we would request that a further statement on the approach to granting access for non-franchised passenger operators for Control Period 6 is made as soon as is practicable.

Returning to the specific question of segmentation. We note that the approach taken for freight is to define markets based on commodities as competing operators all face similar market conditions. This is not the case for OAOs who provide services to very different and often unique markets that would not otherwise be served and who do so on the basis of having had rights granted on a restricted basis. It is therefore reasonable to conclude that OAOs should not be treated as one market segment and that in fact it may be worth considering these markets at a more granular level such as individual service groups.

We are also concerned that the ORR seems to suggest that if there was to be an increase in charges paid by OAOs that these would be passed on to passengers. We do not agree that this is a realistic hypothesis as: (1) regulated fares, which OAOs accept on their services, preclude this; and (2) this would undermine the competitive position of an operator and be a demonstration of the inability to bear.

Ability to Bear & Passenger Analysis

The ORR states that OAOs do not currently contribute to Network Rail's fixed costs. This is not the case. All OAOs currently pay Capacity Charge, which is a mark-up on the path that is being operated. It is also worth noting that OAOs are effectively paying for more than short run variable costs, as it is an increased charge on existing traffic levels with no difference in performance on either party.

In terms of the actual detailed analysis undertaken on existing OAOs contained within the report "Market-can-bear analysis: Passenger Services", we have already provided some specific feedback to ORR on the calculations concerning Hull Trains. We would like to take this opportunity to reiterate what we have said, which was as follows:

"We have undertaken analysis of the data that has been used by your consultants to derive the numbers in the table below and can concur that we reach a similar result. We are therefore content that the result is accurate, based on the data used. Having said that, we still have significant concerns surrounding the publication of this report and the impact that it may have on the market without adequate context and explanation. We are also concerned that in the previous version the consultants appeared to draw conclusions, based on this very narrow and simplistic approach, which we do not feel are appropriate.

As explained previously both in writing, at [industry meetings]… this is a very sensitive subject matter with wide ranging implications and therefore needs to be treated appropriately by ORR. [We] would therefore like to reiterate the points that we have already made in relation to this report and the associated consultation to be treated as caveats to our acknowledgment of the accuracy of the results, based on the data used, below:

- *The consultancy work is focused only on one year of data*
- *No account is taken of the long term business plans submitted by OAOs as part of their application for rights, which are crucial in demonstrating to ORR the viability of the proposed business*
- *No reference is made to actual profit and loss or company accounts*
- *No account is taken of the profitability of the associated business over the long term (links to business plan) given that OAOs tend to operate at a loss for a number of years post-commencement and that profitability is therefore not solely an annual consideration*
- *That existing OAOs (including those with TAAs in place but not yet operating) were granted rights to operate based on the current access framework having passed a Not Primarily Abstractive test which in effect restricts access to the market and protects franchised operators"*

Finally, we would also like to remind the ORR that OAOs already contribute to Network Rail's fixed costs through the Capacity Charge. This level of payment is one that all existing OAOs and those that have access rights in place but are not yet operating (i.e. East Coast Trains Ltd),

can demonstrably afford to bear. This is proven because they are either already paying this level of charge (e.g. in the case of Hull Trains) or they have been granted access to the Network on the basis of a business plan that contained that level of payment to Network Rail, because those were the prevailing conditions on which the application was made.

Question 4.1: Do you have any comments on our proposal to levy any infrastructure cost charges on open access operators as a rate per train mile? Do you think there are any additional considerations we should include in our assessment of the different metric options?
In principle, we are content that the proposal to levy any infrastructure cost charges on OAOs on the basis of a rate per train mile. This ensures a fair and appropriate level of payment for the volume of services operated and continues to provide an incentive to Network Rail in terms of additional services.

Question 4.2: Do you have any comments on our proposed approach to varying franchised passenger operators' infrastructure cost charges in response to changes in traffic, on an annual basis. Do you have any comments on the particular approach we have proposed which is based on changes in timetabled traffic, or any of the other options we have considered in our assessment?
In principle we support the preferred option put forward by ORR for charges to franchised operators, whereby an annual charge is adjusted based on timetabled traffic. This is appropriate as it accurately reflects the planned use of the network and should encourage Network Rail to support growth in traffic to meet demand. ORR will need, however, to be careful to ensure that it does not inadvertently create an incentive for Network Rail to discriminate in favour of traffic that incurs higher unit rates than when faced with competing requests for additional traffic on the same route which has a lower rate. We do recognise that Network Rail would be unlikely to act on such an incentive, as the process for granting access to its network takes into account many other factors, and that a number of safeguards, not least the fact that Network Rail are not permitted to make economic decisions between two competing applicants, are in place to ensure that fair access to the network is maintained. Equally there needs to be consideration of the situation in which there are decrements in the level of service as this could leave Network Rail underfunded.

Any other points that you would like to make
Finally we would add that it is important to consider the impact of changes in levels of service within market segments. This is pertinent in terms of the ORR's approach on ability to bear as it is based on one-year rather than spread across a longer period of operations. We would like to understand how the new approach will deal with the situation where operators invest to

provide incremental capacity or incur additional start up costs. We would also want to understand how material future timetable changes within market segments would be addressed in the assessment of which segments can bear costs. Such changes could increase the competition to an established OAO resulting in an impact on the ability to bear costs.

Thank you for taking the time to respond.

PR18 consultation on charges recovering fixed network costs: Pro-forma for responses

This pro-forma is available to those that wish to use it to respond to our consultation. Other forms of response (e.g. letter format) are equally welcome.

Please send your response to pr18@orr.gsi.gov.uk by **30 November 2017**.

Full name	Chris MacRae
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Organisation	Freight Transport Association
Email*	
Telephone number*	

*This information will not be published on our website.

Question 2.1: Do you have any views on our proposal to retain the existing freight market segmentation by commodity, and not introduce further market segments for any of the existing commodities?
We welcome the decision not to extend segmentation to other market sectors or commodities. However, and in line with our previous policy approach, we do not in principle support the segmenting of markets on the basis of those that can bear mark-ups and those that cannot. Doing this sends the wrong signals to existing, and as importantly, potential new users that reliance on rail will be exploited in charging on the basis of pricing elasticity and inelasticity of demand. Apart from sending the wrong signals we are not sure that such policy is even technically correct as experience with our aggregate shipper members indicates that traffics that are currently on rail are not necessarily there indefinitely and changes in rail charges will change the thresholds of cost balances with road freight and more freight will move to road instead. Also, in global markets with global sourcing and selling, changes in input or export costs affected by rail freight charges can affect decisions on locations of manufacturing plants and consequentially investment decisions on their continuation or otherwise.

Question 2.2: Do you have any views on our proposal to continue allowing Network Rail to levy infrastructure cost charges on freight trains carrying ESI coal, iron ore and spent nuclear fuel? Do you have any views on our proposal to allow Network Rail to levy infrastructure cost charges on trains carrying ESI biomass in CP6?
The background to our policy stance on this is outlined in our answer to the previous question. For the reasons stated above we do not think that it is right to segmentally charge extra to sectors because of their deemed inelasticity of demand, nor to extend this to new sectors.

Question 2.3: Do you have any additional evidence around the ability to bear of any of the freight market segments reviewed by our consultants, which you would like to provide us to inform our final decision around which freight market segments are able to bear infrastructure cost charges in CP6?
Anecdotal evidence from previous reviews showed that increasing charges on ESI Coal traffic effectively put Scottish produced coal and that imported via Scottish ports at a competitive disadvantage in the English Power generation supply market given the longer flows and hence charges than coal imported via Immingham. At the time one Scottish coal producer went out of business and Scottish Government concern was such that a meeting on the Scottish aspects of that charges review was held at Buchanan House in Glasgow with Scottish Government officials attending.

Question 3.1: Do you have any views on the results of the technical analysis undertaken to date on passenger market segmentation (and ability to bear?) Do you have any views around how these emerging findings could inform a passenger market segmentation?
As this is not a freight question we have no comment.

Question 4.1: Do you have any comments on our proposal to levy any infrastructure cost charges on open access operators as a rate per train mile? Do you think there are any additional considerations we should include in our assessment of the different metric options?
As this is not a freight question we have no comment.

Question 4.2: Do you have any comments on our proposed approach to varying franchised passenger operators' infrastructure cost charges in response to changes in traffic, on an annual basis. Do you have any comments on the particular approach we have proposed which is based on changes in timetabled traffic, or any of the other options we have considered in our assessment?
As this is not a freight question we have no comment.

Any other points that you would like to make
In relation to the Network Rail Brockley Consulting work a key point that we would like to make is that the fixed road network costs are not allocated in the same way to users. Rail is always considered as subsidised whereas the road network is considered as a cost. There needs to be equitable treatment between rail and road. The biggest point is that this is an allocation of fixed costs which do not vary with usage and therefore do not create any focus on cost control. We would like to see a focus on cost causation and efficiency rather than allocating costs that Network Rail state won't change anyway. There is no transparency of the costs per section and no transparency of assumed usage data. So we have to take a leap of faith that data is correct.

Thank you for taking the time to respond.

Office of Rail and Road PR18 Consultation

Consultation on charges recovering fixed network costs

Response from Freightliner Group

November 2017

INTRODUCTION

This is the response of Freightliner Group Limited encompassing its subsidiaries Freightliner Limited and Freightliner Heavy Haul Limited to the Office of Rail and Road's (ORR) consultation on charges recovering fixed network costs.

PERIODIC REVIEW PRIORITIES

Freightliner's priorities for the Periodic Review 2018 are:

- A continued emphasis on improving safety
- A stable, national and simple charging and incentives framework, which does not increase the overall level of net costs borne by freight operators
- Reducing overall industry unit costs and delivering efficiency
- A greater focus on optimisation of capacity and careful balancing of passenger and freight needs by the System Operator
- Delivery of value for money outputs through a long term programme of infrastructure
- A customer focused ethic throughout Network Rail and a supplier who wants our business to be successful

EXECUTIVE SUMMARY

- Freightliner supports the ORR's conclusions on the market-can-bear analysis for freight services.
- Freightliner supports the simplification of the mark-up to one charge – the Freight Specific Charge.
- It is not clear in the consultation what the process will be for setting the levels of the Freight Specific Charge.
- Freightliner supports work to increase the understanding of causes of costs to sectors and recognises that such information would be helpful to support future decisions about use of the network.
- Network Rail's proposed approach for allocating fixed costs to operators in CP6 does not appear to align with the aims stated by ORR in this regard.
- Allocating costs to freight that do not vary by activity creates the perception that it is freight driving the costs and would be completely out of scale with the ability of any commodity group to bear.
- There are already misconceptions about the cost causation of freight on the network. Unless all decision-maker stakeholders have and retain perfect knowledge of the methodology there is likely to be a medium to longer-term adverse assumption about what freight costs.
- Freightliner instead supports the allocation of avoidable costs to different traffic types.
- Allocating avoidable costs provides a better indication of cost causation better and will support management action to reduce costs.
- The allocation of avoidable costs will help improve decision making. For example there may be opportunities to rationalise infrastructure following the decline of ESI coal, and an

understanding over how the consolidation of assets will impact on fixed costs will aid decision making. This will only work at an avoidable cost level – such decision making cannot be influenced by considering costs that do not vary by traffic.

Calculating Infrastructure Costs

Network Rail has carried out a consultation on its proposed new methodology for allocating the fixed costs of the rail network. Freightliner does not support this proposed methodology and lays out reasons below why it does not appear to meet the ORR's stated objectives and criteria and is therefore not appropriate as a basis to set the level of charges.

The allocation of costs, including common costs that do not vary with activity, has resulted in an extraordinarily high allocation of costs to freight. As only a small proportion of the allocated charges are avoidable the proposed allocation methodology will not allow cost causation to be accurately identified, nor will it facilitate better decision-making.

As a result Freightliner does not agree that Network Rail's cost allocation exercise should directly influence the level of fixed cost charges. To do so risks conflating the principle of this exercise, devising a methodology for allocating fixed costs with an ORR policy decision, on the ability of a market to bear a mark-up.

Consideration is needed as to whether using Network rail's allocation approach as a basis for charges is compliant with the "Railways (access, management and licensing of railway undertakings) regulations 2016". The Regulations prescribe that to obtain full recovery of the costs incurred, Network Rail can levy mark-ups, but that these must be on the "basis of efficient, transparent and non-discriminatory principles".

Freightliner notes that there is no discussion in the Network Rail consultation over whether the costs allocated to operators are considered to be at an efficient level, nor is there any transparency in the make-up of the costs within the 3,100 sections and the assumed train miles by operator. Without this information, it is difficult to consider that this cost allocation as being compliant with the legislation.

It is also noted that the scale of fixed costs proposed to be allocated to freight would be completely out of scale with the ability of any commodity group to bear and the current charges levied, which total circa £2m.

We comment below on why the Network Rail proposal does not appear to align to the ORR objectives and assessment criteria for considering different options around charges:

- **Operators have good knowledge of costs they are causing (in the short and long-run)**

One of the key priorities for the rail industry should be to understand cost causation better. At a time when rail industry costs are increasing, Freightliner strongly believes that understanding cost drivers should be the priority, rather than devoting considerable industry time and resource on a greater focus to allocating fixed costs to different users.

If the allocation of costs were a mechanism to identify cost causation, which in turn would support management action to reduce costs this would be a worthwhile step to achieve an important outcome. It is difficult to understand the benefits of the allocation of common costs and costs that do not vary with activity, without any focus on opportunities for cost reduction.

Freightliner questions whether the proposed methodology actually allows cost causation to be accurately identified. The identification of avoidable costs, which Network Rail state accounts for 18% of the fixed costs, is a clear indication of causation and we are supportive of these avoidable costs being allocated to different traffic types. However, it is difficult to understand the rationale for allocating costs that cannot be avoided and will not vary as a result of changes of activity, as that will not give any insight into causation.

It is crucial that the industry understands what drives costs higher and lower, in order to be able to put in place actions to manage costs. This should take priority over devising methods to allocate costs between operators, or geographically.

- **Decision makers and funders have good knowledge of costs caused by services in the short and long run**

We do not support the principle of fixed and common costs being allocated to the freight sector. These costs will not vary with different traffic levels and would remain in a scenario where no freight traffic at all operated. As a result these are not costs that are driven by activity, and not costs that will change should traffic patterns change, in the short or the long term.

Even with a very careful narrative, it is highly likely that by allocating such costs to the freight sector, it could be perceived that it is freight driving the costs even though they cannot be escaped if traffic patterns were to change.

There are already misconceptions about the cost causation of freight on the network. Unless all stakeholders have and retain perfect knowledge of the methodology we believe that there is a high risk that adverse decisions could be made on a misunderstanding of freight cost causation.

The fixed costs of the UK road network are not allocated to different sectors of road users. The proposals by Network Rail to allocate fixed costs to each sector will create an uneven playing field between modes. An unfortunate consequence will be that rail freight will be considered as "subsidised" whilst there is no parallel process at all that considers the long term or fixed costs of the road freight network or to allocate those fixed costs to different road users. This will create an unbalanced picture between the modes. The consequence of this could be to distort the case for future investment between the modes on the basis of unequal information.

- **Promote positive impacts on funders/customers**

A stated benefit of the proposed methodology is to inform over the "level of a transparent grant from funders to Network Rail" where a market segment cannot pay all the costs allocated to it. This can only be considered a benefit when the costs allocated to that segment are avoidable costs. A market segment should not be considered to be in receipt of a grant where the costs are not driven by that traffic, but are shared costs that would be borne by the infrastructure manager without that traffic operating.

There is concern that, despite any accompanying narrative, funders, both public and private will be put off from investing in rail freight as they will perceive that the sector is subsidised, and not sustainable to invest in.

- **Promote positive wider external impacts**

As rail freight operators are competing directly with HGVs on a daily basis, we believe that there is a severe risk that imbalance in the level of scrutiny between road and rail – i.e. rail disaggregates cost causation to individual sections and road makes no attempt to do similar. This can lead to a distorted picture when comparing the modes, which could lead to ill-informed decision making. Network Rail's proposal to allocate fixed costs to the rail freight sector is exacerbating this situation, and will potentially undermine policies that would secure the wider positive external benefits that rail freight brings to the UK through reduced congestion, improved safety, reduced emissions and carbon and increased productivity.

Design of Infrastructure Cost Charges

Freightliner supports the ORR decision to simplify the cost structure for freight operators and merge the Freight Only Line Charge and the Freight Specific Charge to one charge. This aligns with the structure of “mark-ups” laid out in the Railways (access, management and licensing of railway undertakings) regulations 2016.

Market-can-bear analysis for freight services

Freightliner welcomes the stable approach to assessing what commodity markets can bear a mark-up in line with the Railways (access, management and licensing of railway undertakings) regulations 2016. Predictability such as this is very important to private sector businesses to support future development and investment plans.

We strongly support the proposal to retain the existing approach to market segmentation based on commodities carried. In particular we welcome the decision not to further disaggregate commodity sectors by geography, as this would make the rail product even more complex for customers. Freight operators already work extremely hard to try and simplify the rail product for our customers, as we are competing with road where the network is free at the point of use and simple to understand.

Furthermore we strongly welcome the clear consideration that has been given to the intense competition from other modes that many freight segments face and therefore the continued inability of those segments to be able to bear infrastructure cost charges.

We note the intention to undertake a proportionate update of the market can bear test to assess whether the ability to bear has materially changed in any of the market segments defined. It is unclear in the consultation documentation how or when these next steps - to define the level of Freight Specific Charge for the defined markets - will be undertaken. It would be helpful if these next steps and the expected timelines could be laid out.

Biomass

Freightliner does not currently operate in this market and so does not have visibility of the market economics required to understand its ability to bear a mark-up, although we note that its possible inclusion was flagged during the Periodic Review 2013 process. Freightliner is aware that other operators have raised broader concerns about the decision being made on the basis of historic investment, leading to this traffic now being perceived as captive.

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29 November 2017

PR18 consultation on charges recovering fixed network costs

Thank you for the opportunity to comment on this consultation. GB Railfreight (GBRf) would like to provide a response on a question by question basis but will start with a general summary:

GBRf objects to any additional charges being levied on rail freight to recover fixed network costs. To date, GBRf have seen little or no real detailed work being carried out to attempt to understand why the rail network is so expensive and in some cases, offers such little value for money. If the industry is serious about supporting rail freight, and the obvious economic and environmental benefits that it offers, we would not be faced with such uncertainty of both the level of variable charging increasing and now the allocation of fixed costs. We probably do not need to share with you the tight financial situation that many operators face annually. To be clear, GBRf will, at every opportunity, seek to defend the interests of both ours and our customers' businesses for the benefit of the sustainability of freight on rail.

It is rare to read through an industry consultation and see such immediate reference to rail freight from the outset of the document. Often, GBRf observe that freight is mentioned as an afterthought in industry consultations but, in this case, it appears that freight is very much a focal point, perhaps more so than the franchise operators whom invest very little in the network and often find themselves in revenue support. This greatly concerns us.

Whilst GBRf offer a response to the questions posed as part of this consultation, perhaps it is worth dwelling on what efficiency or innovation Network Rail (NR) have offered during CP5 and why certain strategic decisions have seen:

a) Network maintenance and renewals decisions become a 'toss-up' between what work should be carried out.
b) Major investment projects delivered late and over-budget, with the benefits of said projects very rarely delivered or realised.
c) A holistic acceptance that devolution will be the answer to the complete inability to operate the network efficiently.
d) The fixed cost of the network continue to grow with seemingly a major level of overspend on HQ fixed costs at NR, as well significant spend on contractors who deliver work that is later aborted.

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e) An obsession with network performance at the detriment of a clear strategy for asset performance.

GBRf fail to understand why a business such as ours - that has made enormous strides in becoming more efficient to drive our marginal profitability - is increasingly threatened because a Non-departmental public body is essentially passing through their inefficiencies to us. If the Office of Rail and Road (ORR) could demonstrate how NR was becoming progressively more efficient, yet fixed network costs were still increasing, then GBRf would be more amenable to a mark-up in charging. This is not the case and we are not.

Question 2.1: Do you have any views on our proposal to retain the existing freight market segmentation by commodity, and not introduce further market segments for any of the existing commodities?

GBRf does not see the need to introduce further market segments or any level of additional complication.

Question 2.2: Do you have any views on our proposal to continue allowing Network Rail to levy infrastructure cost charges on freight trains carrying ESI coal, iron ore and spent nuclear fuel? Do you have any views on our proposal to allow Network Rail to levy infrastructure cost charges on trains carrying ESI biomass in CP6?

ESI Coal

ESI Coal traffic has run on the network for many decades and helped form the building blocks of revenue-generation for the rail freight industry, particularly the growth of GBRf in the last decade. We appear to be at the point now where many in government and the wider transport industry are keen see its total removal from the network. Thus, we have seen, and will no doubt see further, a dramatic increase in charges applied to this commodity. Nonetheless, there are Power Stations that have invested in Flue-Gas Desulphurisation, and other innovative solutions to ensure a cleaner burn, and will generate energy from coal until at least 2023 – that is only based on existing government policy, which could change several times by then. GBRf would like to see the current level of Freight Specific Charging fixed at the current levels and increased no further – save for an annual RPI uplift. With no real viable alternative to rail, the cost of running Coal has become almost unsustainable, several years before we expect coal generation to cease.

GBRf assert that the CP5 analysis for ESI Coal charging was probably erroneous and a flawed strategy. The expectation that there would be an uplift in income to recover the cost of running coal services on the network was most likely offset by the reduction in service volumes. The increase in charging only added to the reduction in demand and did not in fact offer any additional income to Network Rail. Increased charging only serves to push towards the use of alternative fuels as generation from coal becomes more expensive. The same applies to levying this charge on Biomass, which will be discussed below, where an increase in rail costs adds to the overall increase in energy generation costs.

Biomass

The proposal to commence levying a charge on Biomass is incredibly disappointing to GBRf, particularly given the level of commitment and investment we have injected into this commodity, which in truth pales in comparison to end-user investment levels. The introduction of additional charges only serves to offer greater uncertainty for the long-term sustainability of Biomass. The end user investment in Biomass loading and discharge facilities for rail served traffic flows has been phenomenal, and has translated into a very positive news story for rail freight. The increase in services across the trans-pennine route and very shortly in the North East has been a real area of additional revenue uplift for the rail freight market following the downturn in coal volumes. Certainly, other commodities have helped to close this gap but from GBRf's perspective, our biomass contracts are worth approximately £13m per annum and are a key foundation of building our annual budgets.

The most worrying element of levying further infrastructure cost charges to rail freight commodities is the assumption that these charges can just be passed through to users of rail freight – our customers. We do not believe that the ORR have made any tangible attempt to understand the contractual agreements that FOCs are signed up to with our customers. The market can bear tests will not actually predict the reality of the flow of money, it is simply a high-level indicator taken at a certain point in time. These uplifted charges will tear a substantial proportion of profitability out of our customer contracts if, and most likely when, we are unable to pass the costs through.

In addition to our contracts becoming less profitable, and in some scenarios not profitable whatsoever, you are potentially starting to distort the commercial differentiators between operators. The FOCs do not have 'off-the-shelf' contracts with our end users, they are negotiated terms and conditions. Has ORR considered how any impact in charging may reduce further demand? The fact remains that the driver for any FOC to run rail freight services is to make money, if our profits are reduced then the risk is that we are pushed to deliver greater margins by selling our assets to more profitable services.

We are additionally concerned by the lack of consideration that the rail freight market has seemingly shifted towards investment in track-friendly rolling stock to reduce track 'wear and tear' – which is the basis of the variable charging. This is particularly true for biomass hopper wagons. Whilst this investment is a positive step for the rail freight market, the incentive to do this was financially trivial. The value of the investment in these assets, many of which operate on biomass flows, is in danger of becoming offset by the proposition to apply the Freight Specific Charge.

GBRf believe that by importing a charging levy onto Biomass you are eroding the advantage that this commodity currently has over road haulage, whilst trying to maintain that it is a rail-captive market. It is not impossible to develop a haulage solution using trucks rather than trains from Port to Terminal. This opportunity is further supported by the fact that that modern hybrid willow and poplar trees, which can be harvested at peak performance on a three-yearly basis, can offer a locally sourced alternative to importing from North America. Whilst GBRf appreciate that a modal shift may still be some way off, the impact of transportation costs will likely lower the demand for biomass and increase the demand for alternative energy, such as gas.

The theories that are presented throughout the consultation do not mirror the reality of trying to operate a profitable rail freight company in U.K. GBRf will only continue to grow profitably if the following can be assured:

1. Long term charging certainty
2. Sustainability of existing rail contracts based on the ability to guarantee our access to the network
3. Potential for further rail freight growth by identifying latent network capacity
4. Investment linked to incentives

The ORR, more specifically the Rail division, should be offering greater certainty, incentives and opportunities to the rail freight market. This proposal appears to find another way to tax what are moderately successful markets to extract margins from haulage contracts to pass through to fund an overpriced, poor value-for-money railway network. GBRf note the reference in the DfT guidance to the ORR where it is very clear that the government support our position on the needed for affordability, certainty and growth:

"The secretary of state 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 possible. More generally, he wishes the ORR to take all appropriate steps to support the growth and development of the rail freight sector." [Para 21]

In 2016 the Network Rail Chief Executive was very clear that about the demand to embrace private investment in the network to help fund the growing railway. In the case of Biomass, this investment has been substantial. Overpricing and uncertainty of charges will only risk a scenario where the industry is left with once-valuable stranded assets, the investment in which is never fully realised, but the costs for which sit within company finances for many years to come.

GBRf continues as a business to seek to grow our biomass service offering and have built up, to date, a high-level of confidence in the long-term certainty that this offers GBRf – we are fearful that elements within this consultation document appear to put at risk this level of confidence and certainty that we currently enjoy. With this at risk, it will be challenging for GBRf to continue to make recruitment and training decisions specific to our Biomass haulage contract if it is not supported by a long term, sustainable government position on supporting Biomass.

Finally, GBRf are still unclear that the ORR really has an appreciation of both the benefits and costs of Biomass by rail. We do not believe that you have truly grasped the actual costs of running a biomass facility therefore we do not think that an accurate charging model can really apply. GBRf consider that a further Control Period without additionally charging Biomass services will offer a more accurate picture. The perversity of the policy on biomass is that the at one stage the market was subsided by Contracts for Difference (CFD's) that were offered to aid the economic drive for an investment in switching from Coal to Biomass, yet now it is being proposed that increased charging should be levied through the freight operators. GBRf would like to understand how the ORR are intending to fairly incorporate this into a strategy that supports sustainable rail freight growth? Given the extent of the investment made by not just generators, but also ports, GBRf fail to see the link between the inelasticity of the demand for rail in the biomass market and its profitability – particularly that the inelasticity determines that the market can bear the increased costs.

<u>Other commodities</u>

GBRf welcome the fact that both NR and ORR are not proposing to form any arguments that would see further charges applied to any other commodities that are not yet mentioned in this consultation.

Question 2.3: Do you have any additional evidence around the ability to bear of any of the freight market segments reviewed by our consultants, which you would like to provide us to inform our final decision around which freight market segments are able to bear infrastructure cost charges in CP6?

The additional evidence has likely been referred to in Question 2.2. To reconfirm, the most salient of these are:

1. A lack of understanding of freight contracts and the ability for FOCs to absorb any mark-up or pass through.
2. No clear understanding of the actual costs of biomass generation and thus an inability to develop a fair and reasonable charging model.
3. A diminishing confidence in the ability for ORR to accurately understand the profitability of rail freight haulage in U.K.

Question 3.1: Do you have any views on the results of the technical analysis undertaken to date on passenger market segmentation (and ability to bear)? Do you have any views around how these emerging findings could inform a passenger market segmentation?

None.

Question 4.1: Do you have any comments on our proposal to levy any infrastructure cost charges on open access operators as a rate per train mile? Do you think there are any additional considerations we should include in our assessment of the different metric options?

GBRf considers that levying infrastructure cost charges at a rate per train mile for Open Access Operators (OAOs) is fair and will hopefully incentivise efficient passenger services. The main point is that OAOs must consider the additional fixed costs of adding new traffic. Empty seats need to be filled and train length needs to be determined by the required usage. If a longer train is necessary to make a service more efficient, then charging should not be constructed to exclude that ability. GBRf will heavily object to additional services being added to the network when in fact longer services could be a better option. The exact same argument applies for freight services that aim to run longer, heavier services as opposed to a greater quantum of services – such services should be rewarded with a financial incentive to operate in a way that makes best use of capacity.

Question 4.2: Do you have any comments on our proposed approach to varying franchised passenger operators' infrastructure cost charges in response to changes in traffic, on an annual basis. Do you have any comments on the particular approach we have proposed, which is based on changes in timetabled traffic, or any of the other options we have considered in our assessment?

It is our view that it is important for passenger services to only operate if it is necessary. If there is a way of incentivising Franchised TOCs to reduce the number of trains run by varying infrastructure cost charges on an annual basis, then it may well highlight how pointless it is to run several sparsely populated trains per hour as opposed to a reduced quantum of services and higher load factors (more passengers on the train). This would free up capacity for all users and potentially offer greater opportunities for variable track access income by running more services over the infrastructure per hour. GBRf feel that the most suitable option will be the one that offers the greatest transparency and data to help determine value for money for network users. There is the opportunity here to reduce the short run fixed marginal costs. NR are incentivised to add traffic to the network, not just passenger services. GBRf are sure that a fine balance needs to be struck between the income received from operating services, and the short-run marginal costs that are paid by these services operating.

GBRf would expect that any reduction in passenger services running would see an actual reduction in cost, not a reallocation of costs passed elsewhere throughout the industry. We are alarmed by the position to incentivise TOCs to run more services to boost income, certainly in some areas of the country. Instead, GBRf would like to see passenger operators pay a far higher cost for operating services that offer very little return at the farebox. The freight industry has collectively worked hard to remove unused freight and deliver latent capacity. The same should be applied to TOCs. Therefore, we believe any option should incorporate this point.

Finally, we do not want any changes to charges or draft prices to be shared publicly until all operators have been consulted with, or at the very least, had an opportunity to review. GBRf will want to challenge these and are aware that in the assessment of OAOs profitability there was some dubiety in the results. We will want to test the accuracy of this.

We would like to highlight the following points that you can find on the ORR website that are pertinent considering this consultation. GBRf are not convinced that the freight-specific elements of this consultation fully align with your strategic objectives:

ORR's ambitions for the freight sector are grounded in our strategic objectives :-

• *'support a better service for customers' – use our powers to hold the industry to account for performance and standards of service across the railway network,*
• *'secure value for money from the railway, for users and funders' – strengthen incentives for the increased use of railway capacity, and more cost-effective investment in the network,*
• *'promote an increasingly dynamic and commercially sustainable sector' – support sustainable economic growth by promoting innovation and efficient long-term investment across the rail industry through the appropriate development of effective markets and regulatory intervention*

GBRf would be very keen to further engage with ORR and NR on this matter, in collaboration with key industry partners whose involvement is critical. If you have any further questions please feel free to contact me.

Yours Sincerely,

Carl Kent
Head of Strategy & Innovation
GB Railfreight

cc. John Smith
Duncan Clark

PR18 consultation on charges recovering fixed network costs: Pro-forma for responses

This pro-forma is available to those that wish to use it to respond to our consultation. Other forms of response (e.g. letter format) are equally welcome.

Please send your response to pr18@orr.gsi.gov.uk by **30 November 2017**.

Full name	Charlie Hodgson
Job title	Managing Director, Rail Development
Organisation	Go-Ahead Group
Email*	
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*This information will not be published on our website.

Govia is one of the leading rail operators in the UK and is a joint venture between the Go-Ahead Group (65%) and Keolis (35%). Govia has experience running complex and challenging rail operations; currently running three major rail franchises: GTR, Southeastern and London Midland. Govia is the UK's busiest rail operator, currently providing around 35% of all passenger journeys. As a key provider of rail services, we welcome the opportunity to respond to the ORR's consultation regarding the 2018 periodic review.

This response represents the views of the three Govia-owned Train Operating Companies as well as Go-Ahead Group plc.

Question 2.1: Do you have any views on our proposal to retain the existing freight market segmentation by commodity, and not introduce further market segments for any of the existing commodities?
Go-Ahead Group is not currently affected by freight charges and it would therefore not be appropriate for us to comment on this particular proposal. However, as a general principle, where it is evident that the market can bear it, we fully support the levying of fixed costs on freight in the interest of fair and consistent charging.

Question 2.2: Do you have any views on our proposal to continue allowing Network Rail to levy infrastructure cost charges on freight trains carrying ESI coal, iron ore and spent nuclear fuel? Do you have any views on our proposal to allow Network Rail to levy infrastructure cost charges on trains carrying ESI biomass in CP6?
Go-Ahead Group is not currently affected by freight charges and it would therefore not be appropriate for us to comment on this particular proposal.

Question 2.3: Do you have any additional evidence around the ability to bear of any of the freight market segments reviewed by our consultants, which you would like to provide us to inform our final decision around which freight market segments are able to bear infrastructure cost charges in CP6?
Go-Ahead Group is not currently affected by freight charges and it would therefore not be appropriate for us to comment on this particular proposal.

Question 3.1: Do you have any views on the results of the technical analysis undertaken to date on passenger market segmentation (and ability to bear?) Do you have any views around how these emerging findings could inform a passenger market segmentation?
As the passenger services report was not published until later (16 November) we have only had limited time to consider the analysis presented. Our initial observation is that there is still much more work to be done and it is perhaps unlikely that there will be sufficient time to implement the changes at the start of CP6, especially given the implications for Government/funders. We agree with the concerns raised in the RDG response regarding the suggestion that the next opportunity to comment on proposals would be in response to the ORR's Draft Determination in Summer 2018. We would like to resolve the likely position for CP6 at an earlier stage in the process. In terms of the analysis, using a single year's worth of data is perhaps not sufficient to make an informed view. We would suggest that for future analysis, multiple years' worth of data should be used to reach a more accurate conclusion. It was unclear in the report, for cross-country type services, where the overall revenue per service is more evenly distributed across a number of shorter journeys rather than end-to-end journeys, for which leg of the journey would the MCB for this type of service be assumed to apply? The approach would perhaps need to be more granular in order to be accurate. The report suggests that services are substitutable and a charge could deter the operation of certain trains, however for franchised operators this is rarely an option. Timetables are tightly specified and franchised operators often have limited flexibility to alter these. Similarly, the report suggests operators can alter fares and pass on charges to farepayers; this may be the case for long-distance operators however for our operations we are restricted by regulated fares. We agree with the concerns raised in the RDG response regarding the risk that Network Rail could be left underfunded as a result of annual adjustments to charges. Network Rail's fixed costs do not vary with small changes in traffic levels, therefore if it receives less income to fund these fixed costs, it would need to make efficiencies elsewhere which may be detrimental to the quality of service. Similarly, there is a risk for franchised operators, if TOCs are expected to pick up the incremental cost of additional services, this limits the opportunity to add services in the same way as it currently does with HS1 where incremental charges are prohibitive.

Question 4.1: Do you have any comments on our proposal to levy any infrastructure cost charges on open access operators as a rate per train mile? Do you think there are any additional considerations we should include in our assessment of the different metric options?
We agree with the proposal to levy charges on Open Access Operators (OAOs) as a rate per train mile as this is consistent with the arrangements for franchised operators. We support the principle of a fair and consistent charging method and believe that OAOs should be exposed to the same cost elements as franchised operators. It is important, however, that any revision to the ORR's policy on the NPA rule must be properly consulted as this remains a concern.

Question 4.2: Do you have any comments on our proposed approach to varying franchised passenger operators' infrastructure cost charges in response to changes in traffic, on an annual basis. Do you have any comments on the particular approach we have proposed which is based on changes in timetabled traffic, or any of the other options we have considered in our assessment?
In effect, this makes fixed track access another variable charge, which would be a more accurate reflection of the costs incurred. We can see the benefit in incentivising Network Rail to increase network usage, however it would create uncertainty for both operators and Network Rail on the level of charges/income within a Control Period. There is also a risk that this limits a train operator's ability to introduce additional services due to the incremental cost; in the same way as it currently does on the HS1 network where incremental charges are prohibitive. Of the options presented, the proposal to base charges on timetabled traffic seems the most sensible, however we have concerns regarding the practicality of varying infrastructure cost charges on an annual basis. Experience has shown that Network Rail does not have the capability to effectively manage variations in charges for Control Periods, let alone on an annual basis. In the case of an annual recalibration, the first six months of every year could be spent agreeing the revised charges with Network Rail; this would create a significant administrative burden on both sides. We also have concerns regarding the assumption that TOCs will be held harmless through Franchise Agreements, we agree that this is how it should work as per the contract, however following experience with the DfT on previous recalibrations, we know that this is not necessarily how it works in practice. Greater clarity on how this would work in practice needs to be provided before we would be able to make an informed decision.

Thank you for taking the time to respond.

PR18 consultation on charges recovering fixed network costs: Pro-forma for responses

This pro-forma is available to those that wish to use it to respond to our consultation. Other forms of response (e.g. letter format) are equally welcome.

Please send your response to pr18@orr.gsi.gov.uk by **30 November 2017**.

Full name	Ian James Dexter Leigh
Job title	Finance Director
Organisation	Heritage Railway Association
Email*	
Telephone number*	

*This information will not be published on our website.

Question 2.1: Do you have any views on our proposal to retain the existing freight market segmentation by commodity, and not introduce further market segments for any of the existing commodities?
No

Question 2.2: Do you have any views on our proposal to continue allowing Network Rail to levy infrastructure cost charges on freight trains carrying ESI coal, iron ore and spent nuclear fuel? Do you have any views on our proposal to allow Network Rail to levy infrastructure cost charges on trains carrying ESI biomass in CP6?
No

Question 2.3: Do you have any additional evidence around the ability to bear of any of the freight market segments reviewed by our consultants, which you would like to provide us to inform our final decision around which freight market segments are able to bear infrastructure cost charges in CP6?
No

Question 3.1: Do you have any views on the results of the technical analysis undertaken to date on passenger market segmentation (and ability to bear?) Do you have any views around how these emerging findings could inform a passenger market segmentation?
The analysis has started to show up the complexities of segmenting the market. We think this is only the beginning of the work, for a fully functional segmentation model there is a lot more work to do. We welcome the decision to exclude charter train operators from this proposal and we are grateful that the ORR has taken our concerns on board. What we are not clear on is what the ORR is trying to achieve with market segmentation. For the franchised operators they will be protected by the franchise agreement with the DfT so the only operators this work will really make any difference to are the Open Access Operators (OAOs). Is the idea to raise more industry revenue by making the OAOs charge passengers more for tickets and the consultants are working the demand elasticity to achieve that? Or do the ORR simply wish to set the charges to maximum to what the consultants think the OAOs can pay out of their profits? Or leave the OAOs cost neutral compared to today with the capacity charge? This is the crucial point we believe the ORR should be clear on. We have concerns that the ticketing system on the national network is already far too complex. In addition, that the cost of "any time" tickets in particular is a powerful disincentive for passengers to use rail to visit our members premises. So, we don't want to see the costs of the charge passed straight on to passengers as we view this as depressing demand. We are also wondering why the ORR feels the need to interfere with the market with some sort of capacity pricing? Whilst the not primarily abstractive test remains in place it is highly unlikely that open access operators will be able to emerge to compete generally with the franchised operators. If this test was abolished would the charge act as a dis-incentive to run trains as an OAO as the profitability could be reduced by this charge. Is the idea to encourage only high value use of the network? If this is the case, then surely on mixed traffic routes the logic would see the stopping services squeezed out with their low value local fares in favour of Intercity type services? Or on lines with very limited capacity by virtue of being single track and limited signalling, would the charge favour all year-round services? We are also concerned that the charge will act a barrier to entry to the market and discourage our members from expanding their use of the national network. As if the market segmentation imposes a high charge to start on the basis of the incumbent operator revenue the same will apply for an OAO without a customer base to pay this charge. Then we have concerns that the work by the consultants will aim for a level of unachievable perfection, rather than being about right the charge will be absolutely wrong. We understand that for consistency all operators should be priced for the use of the infrastructure in the same way. But we believe the markets are highly fragmented, and no matter how hard the consultants work and sophisticated the analysis is, it is will miss out some factors. For example, the analysis does not include multiple use trains, which could be "commuter" for part of the journey and "leisure" for another part. Leisure use can apply on a largely commuter route such as C2C. Or the reverse applies there is a lot of a commuting from Swindon to London which could otherwise be Intercity. So, any segments proposed will probably be a compromise anyway. Plus, we didn't see any mention of revenue allocation of inter available tickets through ORCATS, or how season ticket discounts for bulk purchase distort the market. Therefore, we would propose a simplified decision tree as to pricing be developed as an approximation of all the factors. If this proposal is implemented at all.

We note the comments about the granularity of current service codes, we would be opposed to any suggestion that the number of train service codes increase to assist in market segmentation. There are already many codes in use and having them correct is already a major challenge for all the train planning staff involved. We believe an increase in codes would significantly increase errors.

We are still concerned that our members trains may be disproportionally affected by the market can bear tests as they are simple operations so working out the elasticity is relatively easy. Our members are pricing their tickets, so they strike a balance between well loaded trains and profits. The money generated less the various access charges is helping our members to sustain their business and pay for capacity improvements. We would not wish to see these profits being used to provide what to Network Rail will be trivial sums but could make a major impact on our members bottom line. We would also like to remind the ORR that our members services run on a seasonal basis. There are many days when our members don't use the national network so any charge applied to our members would have to take this into account. So, we urge the ORR to exclude Heritage Operators from the charge.

Question 4.1: Do you have any comments on our proposal to levy any infrastructure cost charges on open access operators as a rate per train mile? Do you think there are any additional considerations we should include in our assessment of the different metric options?

We prefer by train mile, it is simple multiply the train miles by the rate.

Using vehicle miles could incentive our members to reduce train formations to reduce costs.

We are against using passenger numbers, as we view this as complex to obtain and would open the door to contractual disputes between our members and Network Rail. The consultation states that passenger numbers would be determined on each train using LENNON data. This would mean that our members would have the additional expense of purchasing / leasing and operating LENNON ticketing equipment for any journey on the national network. Or they would have to passenger count each train which then would have to be entered in a billing system manually. This could lead to inaccuracies in billing and frankly an incentive to understate numbers.

Question 4.2: Do you have any comments on our proposed approach to varying franchised passenger operators' infrastructure cost charges in response to changes in traffic, on an annual basis. Do you have any comments on the particular approach we have proposed which is based on changes in timetabled traffic, or any of the other options we have considered in our assessment?

As noted in previous consultations we wish to see an adequately funded Network Rail that is able to maintain and renew the network to improve the network and keep it TSR free as much as possible. So, we are against any method of funding Network Rail that leads to large swings in their income if there is not a corresponding change in the amount of maintenance and renewals required.

Any other points that you would like to make
No

Thank you for taking the time to respond.

PR18 consultation on charges recovering fixed network costs

On Behalf of the Institute for Transport Studies, University of Leeds
Professor Chris Nash
Professor Andrew Smith
Dr Phill Wheat

15 November 2017

Currently track access charges in Britain comprise a variable charge based on an estimate of short run marginal cost (wear and tear and congestion) and a fixed charge for passenger franchisees to contribute towards fixed cost. Only for a small number of freight commodities is there a mark up on the variable charge, designed to contribute towards recovery of freight avoidable costs

It is proposed that new mark ups (or infrastructure charges) will replace capacity charges for all services and fixed charges for passenger franchisees. They will be capped at allocated total cost, either using the existing methodology or the new methodology proposed by Network Rail, and be subject to an 'ability to pay' test.

For freight, this is essentially a continuation of the current approach, so if the 'ability to pay' test is applied in the same way, it should not make much difference, although it is noted that it is now proposed to apply mark-ups to biomass, as well as coal, iron ore and nuclear waste, and that the allocated cost ceiling will be greater for freight than now, as some fixed costs will be allocated to freight as well as avoidable costs. Were this to lead to a higher mark-up on freight, it would potentially encourage a transfer at the margin of some freight to road, even though the evidence is that heavy goods vehicles are on average paying less than marginal social cost so such a transfer would be inefficient (DfT, 2009).

For passenger, however, this is a new approach. ORR regards difference between revenue and cost of running a particular train as indicating scope for mark-ups, and sees these as possible for inter-city passenger services and long distance commuter trains to London.

It is proposed to abolish the capacity charge.

It appears that there are primarily two reasons underpinning the desire to make a change to the current basis for track access charges:

1. It is envisaged that open-access operators will play a greater role in the provision of inter-city services in future and thus the current approach in which open-access operators only pay the variable track access charge is not sustainable. In particular, to the extent that profitable aspects of current inter-city franchises are subsequently provided by open-access operators, the profit on those services will accrue to operators (or be competed away) and will no longer be available to government to help pay the fixed costs of the infrastructure and to subsidise socially necessary services.
2. It is considered that train operators have little incentive to work with Network Rail to reduce fixed infrastructure costs because either they do not contribute towards fixed costs (except as noted above in some cases for freight operators) or, in the case of franchisees, their

finances are held neutral to changes in track access charges for the full period of their franchises.

The major disadvantage of a mark-up is that it may price traffic off the network which is able to cover its marginal social cost, thus compromising economic efficiency and limiting the incentives for sensible development of services. We do not consider that it is desirable for decisions about variations in traffic at the margin to be based on variable charges that include a large mark-up and thus greatly exceed short run marginal cost.

As against this, it must be accepted that franchisees have to provide the services specified in their franchise agreement, so in this case the variable charge will have no effect (unless franchising authorities actually regard it as part of the cost of specifying a particular level of service). It is in the case of open access operators, services offered by franchisees in excess of the required service specification and freight operations where the increased variable charge may influence service levels.

Secondly, an "ability to pay test" is proposed. Provided that this is applied at a very disaggregate level regarding route and time of day, this will ensure that services will not be withdrawn if they at least cover their marginal cost. However, it does not appear that this degree of differentiation will be possible, given that ORR appears to accept that Network Rail cannot disaggregate charges below service code level or by time of day. So a mark-up that can be paid by the more profitable services in the timetable may still lead to withdrawal of less profitable services.

We believe that it is a mistake to remove the capacity charge. At least in principle this charge raises revenue in a way that gives correct incentives in terms of service levels. The current charge does have serious shortcomings, in particular a lack of differentiation by time of day. We do not think that ORR should accept as a long term position that Network Rail cannot differentiate charges by time of day, and would urge them to require Network Rail to bring forward costed proposals with a timetable for overcoming this constraint.

If mark-ups could also be differentiated by time of day, then the problems the current proposals will cause could be much reduced. Nevertheless, we believe there could be benefit in exploring whether a continuation of charging according to a two part tariff could be a better alternative.

Firstly, if the fixed part of the tariff reflected the avoidable fixed costs of that operator's services as a whole, then this would reflect those costs that the operator could influence, and provide important information about the incremental cost of different sets of services in a way that an approach based on an arbitrary allocation of joint costs (as is the case both with the existing and proposed new allocation of fixed costs by Network Rail) does not. Avoidable costs would of course respond to changes in service levels, but cannot readily be reflected in a tariff for individual trains since the avoidable cost of any one train depends on what other trains are running in the service.

It is appreciated that, certainly whilst they remain small, open access operators may not cause any avoidable fixed costs on key routes and thus on the basis of such a charge would still not contribute towards fixed costs. However, they could be charged a fixed charge reflecting the estimated revenue abstraction from the franchisee (and thus the reduced contribution to fixed costs paid by the franchisee indirectly through the premium paid for the franchise). Such a charge has been proposed for the situation where one operator has running rights over the infrastructure of another in the US (Baumol, 1983) as giving correct incentives as new entry would be determined by the positive advantages of the new operation rather than simply on its ability to abstract revenue from the current operator. Again, the charge would need to be highly differentiating, varying with the level of service provided by the open access operator, and it could not readily be expressed as a tariff per train kilometre (as in earlier proposals by DfT for a PSO levy) since the level of abstraction by an individual train depends on what other trains are running in the service.

If these charges still did not raise sufficient revenue to finance Network Rail given the level of Network Grant, the fixed charges could be raised further using an allocation of joint costs on a prime user basis. For most rail infrastructure it is not hard to determine the prime user, although it is accepted that this may have a degree of arbitrariness in some cases, and this problem may grow if open access operators expand. Again, a charge levied on a prime user basis does reflect costs the operator can really influence, and convey useful information to decision takers in a way an allocation of joint costs does not.

We accept that what we are proposing would be more complex to implement than the current proposals, so if its advantages in terms of better incentive effects were small then it might not be worthwhile. Also the avoidable cost approach is not straightforward when there are several operators on a route; it would have to be decided whether services of different operators should notionally be removed hierarchically and if so what the hierarchy should be. Nevertheless, ORR has in the past commissioned research into the avoidable cost approach (AEA, 2005), and we believe this research should be resumed.

References

Baumol, W.J., 1983. Some subtle issues in railroad deregulation. International Journal of Transport Economics 10, 341–355.

Department for Transport (2009) Mode Shift Benefit Values: Technical Report

AEA Technology (2005). *Recovery of Fixed Costs – Final Report.* A report for the Office of Rail Regulation

PR18 consultation on charges recovering fixed network costs: Pro-forma for responses

This pro-forma is available to those that wish to use it to respond to our consultation. Other forms of response (e.g. letter format) are equally welcome.

Please send your response to pr18@orr.gsi.gov.uk by **30 November 2017**.

Full name	David Jones
Job title	Rail Development Manager
Organisation	Merseytravel (on behalf of the Liverpool City Region)
Email*	
Telephone number*	

*This information will not be published on our website.

Question 2.1: Do you have any views on our proposal to retain the existing freight market segmentation by commodity, and not introduce further market segments for any of the existing commodities?
There appears to be no reason to change the current market segmentation.

Question 2.2: Do you have any views on our proposal to continue allowing Network Rail to levy infrastructure cost charges on freight trains carrying ESI coal, iron ore and spent nuclear fuel? Do you have any views on our proposal to allow Network Rail to levy infrastructure cost charges on trains carrying ESI biomass in CP6?
We would suggest that there should be no increases in charges without compelling evidence. The issue of coal being potentially price sensitive would also suggest that it may be worth eliminating these charges. While Biomass charges are being reviewed we would be concerned at the potential impact of this. Roads are already congested and increasing the number of vehicles transporting materials by road can only have a negative effect on the air quality with potential knock on impacts on people's health. The key issue here, which we believe is being missed, is not whether the market can bear a charge but what would be the benefits from reducing existing charges and potentially increasing the use of rail by freight. While there would be a cost for this as capacity would have to be provided the potential benefits through a healthier population do not appear to have been assessed. We believe this is a piece of work which needs to be done and the ORR, with responsibility for both road and rail, is ideally placed to undertake it.

Question 2.3: Do you have any additional evidence around the ability to bear of any of the freight market segments reviewed by our consultants, which you would like to provide us to inform our final decision around which freight market segments are able to bear infrastructure cost charges in CP6?
We do not, at this time, have evidence to support charging the freight sector an element of fixed costs.

Question 3.1: Do you have any views on the results of the technical analysis undertaken to date on passenger market segmentation (and ability to bear?) Do you have any views around how these emerging findings could inform a passenger market segmentation?
We have no specific views on the technical analysis undertaken on passenger market segmentation. However we do have concerns about the rationale behind this work. Fixed costs should be allocated in line with the services which cause the costs to exist. Thus an 11 car Pendelino will almost certainly cause more costs than a 2 car Class 150 service and costs should be allocated accordingly. We appreciate that much of this will be picked up through variable costs but some, such as enhanced signalling needed for high speed services, would fall likely fall under fixed costs.

Question 4.1: Do you have any comments on our proposal to levy any infrastructure cost charges on open access operators as a rate per train mile? Do you think there are any additional considerations we should include in our assessment of the different metric options?
We believe that train miles is to coarse a measure to fully assess the correct level of charging. Passenger kilometres would be accurate but would seem to penalise the operator for successfully attracting passengers and it may be difficult to obtain the information needed to assess the charge. Whilst noting the points made about vehicle miles we believe this is the correct measure. Operators are unlikely to change the length of trains to avoid the charge. They should be aware of the charge prior to operating their service and will have entered into an agreement with a rolling stock company to provide specific trains.

Question 4.2: Do you have any comments on our proposed approach to varying franchised passenger operators' infrastructure cost charges in response to changes in traffic, on an annual basis. Do you have any comments on the particular approach we have proposed which is based on changes in timetabled traffic, or any of the other options we have considered in our assessment?
We have no comments on this process but are surprised that it would have such an impact. Our experience is that franchise operators are required to deliver a specific level of service which only varies through franchise requirements such as the improved services northern are currently implementing. The costs that would flow from these changes would need to be known by the operator as part of the bidding process.

Any other points that you would like to make
No.

Thank you for taking the time to respond.

Network Rail's response to ORR's 2018 Periodic Review (PR18) consultation on charges recovering fixed network costs

30 November 2017

1 Executive summary

Network Rail welcomes the opportunity to respond to ORR's 2018 Periodic Review (PR18) consultation on charges to recover fixed network costs in Control Period 6 (CP6). We respond to each of the consultation questions in the detail of this response. However, first we summarise our position in relation to what we consider to be the key issues.

Franchised passenger operators' charges

In principle, we support being financially incentivised to accommodate additional trains on the network. As set out in response to ORR's December 2016 consultation on charges and incentives, we consider that the incentives that we currently face to grow traffic on the network could be improved. This will be particularly true in CP6, in light of ORR's decision to remove the Capacity Charge. Without the additional income that we currently receive from the Capacity Charge, we will be financially worse off when we run additional trains on the network. This is because, on expectation, we incur increased Schedule 8 costs as the network becomes busier.

However, we continue to be concerned that ORR's proposal, which is to change franchised passenger operators' fixed charges so that the amount of income that we receive varies depending on traffic levels, is too vague for us to form a definitive view. We also consider that ORR's proposals have the potential to expose us to additional financial risk in CP6. Our initial modelling of potential FTAC levels in CP6 indicates a potential increase from around £500m per annum to approximately £650m-£850m per annum. Therefore, if traffic levels were consistently just 1% per annum below forecast levels, this could result in us receiving around c. £30m-£45m less income over CP6.

It is important to remember that, like other network businesses, our fixed costs do not vary with small changes in traffic levels. Therefore, if we receive less income to fund these fixed costs in CP6 we would have to reduce activity and outputs in other areas such as renewals, which would be likely to impact network sustainability. This would be a disappointing outcome, given the importance that many stakeholders have placed on Network Rail significantly increasing its renewals activity in CP6.

Therefore, if ORR implements this sort of proposal ideally it would be asymmetric with the downside risk that we face being limited, reflecting our very limited ability to reduce our fixed costs if traffic levels fall. We believe that a good way to do this would be to:

- **Use a 'business as usual' traffic growth forecast which we have a reasonable expectation of outperforming**. We consider that the use of a 'business as usual' traffic growth forecast is supported by the latest statistical release published by ORR[1], which indicates that the number of passenger journeys by rail have fallen for the first time since 2009/10. If this reduction in passenger numbers persists, over time it could translate into fewer passenger train journeys.

- **Limiting our exposure to a relatively small proportion of our fixed cost base**. One option would be to set the overall level of CP6 fixed charges, which depend on traffic levels, at a

[1] Source: ORR Passenger Rail Usage 2017/18 Q1 statistical release available at: http://orr.gov.uk/statistics/published-stats/statistical-releases.

similar level in aggregate to current Capacity Charges which are due to be removed (i.e. £400m-£500m per annum). This should not result in a significant increase in our network-wide exposure to financial risk in CP6 (although there would be no direct link between income recovered through these new fixed charges and our Schedule 8 costs which the Capacity Charge is designed to recover). Our initial modelling suggests, however, that the total CP6 FTAC could be as much as twice Capacity Charges in CP5. This is because of different levels of grant in CP6 compared with CP5. ORR's proposals could, therefore, expose us to double the financial risk that we currently face from variations in traffic levels. We have very limited ability to absorb risk in CP6, due to the way that we are now funded. This emphasises the need to base any new fixed charges on a 'business as usual' traffic growth forecast which would limit the financial risk that we face, but also provide a financial incentive for us to accommodate additional trains on the network.

We also suggest that ORR discusses its proposal with Governments to confirm that this potential change to the charging structure is affordable and works within Governments' Statements of Funds Available. Any change in franchised passenger operators' fixed charges could be a direct pass through to funders under the terms of operators' franchise agreements. In this situation, Governments would either have to provide the rail industry with additional funding in order to support ORR's proposal, or reduce its funding to the industry elsewhere. In order for this proposal to provide us with a real financial incentive to add traffic to the network, it is important that we actually receive more money overall in CP6 if we outperform the original traffic assumption.

Finally, if ORR decides to implement its proposals we consider that it should do so in a way that is simple and readily understandable. Otherwise, we fear that the intended incentives on train operators and Network Rail will be significantly dulled, rendering the new charge an additional complexity which yields limited benefits.

Freight operators' charges

We support ORR's proposal to continue to levy freight charges designed to recover our fixed costs at commodity level. We also support ORR's proposal to continue levying these charges on ESI coal traffic and spent nuclear fuel traffic.

It is, of course, vital that ORR's evidence as to whether a commodity can afford to pay a contribution towards our fixed costs is robust. If charges were levied on commodities inappropriately this could result in rail freight traffic switching to road, which could have an adverse environmental and societal impact (e.g. increased pollution levels and congestion). We are, therefore, keen to ensure that ORR's evidence that suggests iron ore and ESI biomass traffic can afford to pay a contribution towards our fixed costs is robust. We note, for example, the apparent fragility of the GB iron and steel sector. We also note the fact that biomass receives Government grants, which could make ORR's assessment more complex.

Open Access passenger operators' charges

We support ORR's proposal that Open Access operators pay fixed cost charges, where they can afford to do so. However, it is important that ORR's analysis in this area is robust. We are very aware that Open Access operators' business models are potentially quite sensitive to small increases in costs.

We also support ORR’s proposal to levy these charges on a £/train miles basis, subject to the billing constraints set out in the detail of this response. However, we consider that ORR should be clear as soon as reasonably possible in relation to how its access policy would change if Open Access operators were to pay fixed cost charges.

2 Responses to ORR's consultation questions

Question 2.1: Do you have any views on our proposal to retain the existing freight market segmentation by commodity, and not introduce further market segments for any of the existing commodities?

We support ORR's proposal to retain the current approach to analysing the freight market, which segments it based on the commodity being transported. We also support ORR's proposal not to create additional market segments by further disaggregating existing freight commodity types (e.g. splitting intermodal traffic into multiple markets segments based on journey length).

We currently levy fixed charges on freight operators at commodity level. Therefore, ORR's proposal to retain this approach for CP6 would mean that we do not have to make any changes to our billing system in order implement ORR's charging policy in this area. We consider this to be a significant benefit of ORR's proposal, given modifications to our billing system can take a significant amount of time to implement and be expensive relative to the value of freight charges designed to recover fixed costs (c. £1m in 2016/17).

We also consider that the current market segments are sufficiently granular to capture the ability of different freight flows to pay charges designed to recover some of our fixed costs.

Question 2.2: Do you have any views on our proposal to continue allowing Network Rail to levy infrastructure cost charges on freight trains carrying ESI coal, iron ore and spent nuclear fuel? Do you have any views on our proposal to allow Network Rail to levy infrastructure cost charges on trains carrying ESI biomass in CP6?

We support ORR's proposal to continue to allow us to levy charges designed to recover some of our fixed costs on freight trains carrying ESI coal and spent nuclear fuel.

It is, of course, vital that ORR's evidence as to whether a commodity can afford to pay a contribution towards our fixed costs is robust. If charges were levied on commodities inappropriately this could result in rail freight traffic switching to road, which could have an adverse environmental and societal impact (e.g. increased pollution levels and congestion). We are, therefore, keen to ensure that ORR's evidence that suggests iron ore and ESI biomass traffic can afford to pay a contribution towards our fixed costs is robust. We note, for example, the apparent fragility of the GB iron and steel sector. We also note the fact that biomass receives Government grants, which could make ORR's assessment more complex.

Consistent with our September 2017 consultation on the methodology for allocating our fixed costs to train operators in CP6, we suggest that the maximum level of any freight charges designed to recover our fixed costs should be based on the new cost allocation developed by Brockley Consulting. As we also propose in our September consultation on fixed costs, we consider that where freight services cannot afford to pay for all of the fixed costs attributable to them, if possible this should be made transparent as part of the grant to us from funders in CP6.

We suggest that as soon as reasonably possible ORR provides freight operators with an indication of the overall level of charges that it considers the relevant commodities would be able to bear in CP6. We consider that this would help operators to plan their businesses. We recognise that the level of variable charges in CP6 is not yet certain, and that the level of these charges could have a knock-on impact on the level of charges designed to recover our fixed costs. However, we consider that it is should still be possible for ORR to express a view on the overall level of charges (i.e. total fixed and variable charges) that it considers freight commodities can afford to pay in CP6. For example, whether freight trains carrying spent nuclear fuel could afford to pay higher or lower total charges than they are currently paying in CP5.

Question 2.3: Do you have any additional evidence around the ability to bear of any of the freight market segments reviewed by our consultants, which you would like to provide us to inform our final decision around which freight market segments are able to bear infrastructure cost charges in CP6?

We consider that an additional piece of relevant evidence which ORR should consider when setting the level of freight charges designed to recover our fixed costs is ORR's decision to discontinue the Capacity Charge for CP6.

Given freight operators are already paying these charges in CP5, this indicates that they should be able to bear the financial value that they are currently paying for these charges in the form of a charge designed to recover our fixed costs in CP6, assuming no other changes to the level of track access charges.

Question 3.1: Do you have any views on the results of the technical analysis undertaken to date on passenger market segmentation (and ability to bear?) Do you have any views around how these emerging findings could inform a passenger market segmentation?

As ORR acknowledges in its consultation, it does not yet have a fully developed market segmentation proposal. Therefore, it is not really possible for us to say at this stage whether we support it or not.

We appreciate the challenges (e.g. data limitations) associated with analysing the passenger services market. However, CEPA/Systra are clear that its analysis only demonstrates 'proof of concept' and that further work is likely to be required before implementing any changes to charges in CP6. We are concerned that ORR may not have sufficient time to carry out this additional work, and consult stakeholders on the detail of its proposals, ahead of its Final Determination.

In order to help stakeholders plan their businesses, we suggest that ORR sets out its position on the following areas as soon as reasonably possible:

- The different market segments which it considers comprise the passenger services market;

- The extent to which it considers that each of these market segments is capable of paying charges designed to recover some of our fixed costs;

- The level of granularity at which it plans to calculate operators' charges (e.g. operator-level, service group-level or service code-level);

- Whether for franchised passenger operators the level of incremental charges will be based on CEPA/Systra style analysis, or whether this analysis will only inform the level of charges paid by open access operators; and

- The impact on ORR's access policy (including the application of the NPA test) where Open Access operators pay charges designed to recover our fixed costs.

We are also very mindful that for Open Access operators, the findings of the CEPA/Systra analysis could significantly affect their business models. Therefore, it is important that this analysis is robust.

We note that Open Access operators will no longer pay Capacity Charges in CP6. Therefore, we agree with CEPA/Systra that CP5 Capacity Charges represent the minimum level of fixed cost charges that existing open access operators could afford in CP6, assuming no other changes to the level of charges.

We also consider that the findings by CEPA/Systra that major intercity and long-distance commuter routes generate the largest operating surplus, and that this surplus is lower on routes where there is competition, on the face of it appears reasonable. However, we note that this is very complicated to accurately assess.

ORR notes in its consultation that operating surplus might not be the right indicator of whether a group of train services can afford to pay charges designed to recover our fixed costs. Instead, it suggests that the willingness of passengers to pay higher fares on certain routes may be a better measure. We agree that there could be merit in exploring this area further. However, we are concerned that ORR may not have sufficient time to do so prior to its Final Determination. Particularly, if ORR wishes to undertake a review of the entire passenger services market in order to understand how passengers' willingness to pay higher fares varies across different routes. We also question the ability of train operators to pass increases in their costs onto passengers because many fares are price regulated through franchise contracts.

We also consider that ORR's CP6 charging policy should not create a perverse financial incentive to unduly financially favour one passenger service over another. For example, it should not create a situation where one operator on a particular section of route pays charges designed to recover our fixed costs and another does not (or pays charges set at very different levels). In this situation there would appear to be a financial incentive to favour services run by the operator that pays fixed charges (or the higher fixed charges), even though both operators could impose similar costs on our network and/or generate a similar level of benefits to society. However, in reality we would be unlikely to act on such an incentive, as the process for granting access to the network takes into account many other factors, and there are a number of safeguards in place to ensure that fair access to the network is maintained.

Consistent with our September 2017 consultation on the methodology for allocating our fixed costs to train operators in CP6, we suggest that the maximum level of any operators' charges designed to recover some of our fixed costs should be based on the new cost allocation developed by Brockley Consulting. As we also proposed in our September consultation on fixed costs, we consider that if Open Access passenger services cannot afford to pay for all of the fixed costs attributable to them, if possible this should be made transparent as part of the grant to us from funders in CP6.

Question 4.1: Do you have any comments on our proposal to levy any infrastructure cost charges on Open Access operators as a rate per train mile? Do you think there are any additional considerations we should include in our assessment of the different metric options?

We support ORR's proposal to levy charges designed to recover our fixed costs on Open Access operators on a £ per train mile basis, subject to any charges being levelled at either operator, Service Group or Service Code level (Service Code is the lowest level of granularity at which our billing system currently operates). Our cost allocation work found that train length was not a material driver of our fixed costs. Therefore, we consider train miles to be a more appropriate metric for charging operators than vehicle miles. Our billing system would not be able to accommodate the other potential option set out in ORR's consultation, which involved levying charges based on passenger miles.

If ORR plans to use our cost allocation work to inform the level of any new charge on Open Access operators designed to recover our fixed costs, we suggest that ORR is mindful of the fact that in this work we only allocate costs to Service Groups, not Service Codes.

We recommend that ORR continues to work closely with us in this area, and discusses its emerging charging policy, in order to make sure that we are able to implement any changes to the charging structure in our billing system prior to the start of CP6. This will be particularly important, given that ORR is not planning to express a view on whether Open Access operators can afford to pay charges designed to recover our fixed costs (i.e. whether a new charge should be introduced) until its Draft Determination.

Question 4.2: Do you have any comments on our proposed approach to varying franchised passenger operators' infrastructure cost charges in response to changes in traffic, on an annual basis. Do you have any comments on the particular approach we have proposed which is based on changes in timetabled traffic, or any of the other options we have considered in our assessment?

In principle, we support being financially incentivised to accommodate additional trains on the network. As set out in response to ORR's December 2016 consultation on charges and incentives, we consider that the incentives that we currently face to grow traffic on the network could be improved. This will be particularly true in CP6, in light of ORR's decision to remove the Capacity Charge. Without the additional income that we currently receive from the Capacity Charge, we will be financially worse off when we run additional trains on the network. This is because, on expectation, we incur increased Schedule 8 costs as the network becomes busier.

However, we continue to be concerned that ORR's proposal, which is to change franchised passenger operators' fixed charges so that the amount of income that we receive varies depending on traffic levels, is too vague for us to form a definitive view. We also consider that ORR's proposals have the potential to expose us to additional financial risk in CP6. Our initial modelling of potential FTAC levels in CP6 indicates a potential increase from around £500m per annum to approximately £650m-£850m per annum. Therefore, if traffic levels were consistently just 1% per annum below forecast levels, this could result in us receiving around c. £30m-£45m less income over CP6.

It is important to remember that, like other network businesses, our fixed costs do not vary with small changes in traffic levels. Therefore, if we receive less income to fund these fixed costs in CP6 we would have to reduce activity and outputs in other areas such as renewals, which would be likely to impact network sustainability. This would be a disappointing outcome, given the importance that many stakeholders have placed on Network Rail significantly increasing its renewals activity in CP6.

We also note that our recent cost allocation work indicates that the vast majority (c. 70%) of our fixed costs would continue to be incurred in the long-run even at minimal traffic levels (i.e. one train per day). We consider that in no circumstances should the amount of income that we receive to fund these long-run fixed costs depend on traffic volumes given they are not related to traffic levels, even in the very long-run.

If ORR implements this sort of proposal ideally it would be asymmetric with the downside risk that we face being limited, reflecting our very limited ability to reduce our fixed costs if traffic levels fall. We believe that a good way to do this would be to:

- **Use a 'business as usual' traffic growth forecast which we have a reasonable expectation of outperforming**. We consider that the use of a 'business as usual' traffic growth forecast is supported by the latest statistical release published by ORR[2], which indicates that the number of passenger journeys by rail have fallen for the first time since 2009/10 (passenger journeys fell by 2.7% in the first quarter of 2017/18). If this reduction in passenger numbers persists, over time it could translate into fewer passenger train journeys. It could also be the case that in CP6 passenger train operators are less likely to add new services, particularly over and above their franchise specifications, if track access charge payments in relation to these services increase.

- **Limiting our exposure to a relatively small proportion of our fixed cost base**. One option would be to set the overall level of CP6 fixed charges, which depend on traffic levels, at a

[2] Source: ORR Passenger Rail Usage 2017/18 Q1 statistical release available at: http://orr.gov.uk/statistics/published-stats/statistical-releases.

similar level in aggregate to current Capacity Charges which are due to be removed (i.e. £400m-£500m per annum). This should not result in a significant increase in our network-wide exposure to financial risk in CP6 (although there would be no direct link between income recovered through these new fixed charges and our Schedule 8 costs which the Capacity Charge is designed to recover). Our initial modelling suggests, however, that the total CP6 FTAC could be as much as twice Capacity Charges in CP5. This is because of different levels of grant in CP6 compared with CP5. ORR's proposals could, therefore, expose us to double the financial risk that we currently face from variations in traffic levels. We have very limited ability to absorb risk in CP6, due to the way that we are now funded. This emphasises the need to base any new fixed charges on a 'business as usual' traffic growth forecast which would limit the financial risk that we face, but also provide a financial incentive for us to accommodate additional trains on the network.

We suggest that ORR discusses its proposal with Governments to confirm that this potential change to the charging structure is affordable and works within Governments' Statements of Funds Available. Any change in franchised passenger operators' fixed charges could be a direct pass through to funders under the terms of operators' franchise agreements. In this situation, Governments would either have to provide the rail industry with additional funding in order to support ORR's proposal, or reduce its funding to the industry elsewhere. In order for this proposal to provide us with a real financial incentive to add traffic to the network, it is important that we actually receive more money overall in CP6 if we outperform the original traffic assumption.

If ORR decides to implement its proposals we consider that it should do so in a way that is simple and readily understandable. Otherwise, we fear that the intended incentives on train operators and Network Rail will be significantly dulled, rendering the new charge an additional complexity which yields limited benefits.

We also note the link between this proposed change to fixed charges and the current Volume Incentive mechanism, which is designed to encourage us to add traffic to the network. We will set out our position in relation to the Volume Incentive in more detail as part of our response to ORR's Volume Incentive working paper. However, in summary, we consider that the Volume Incentive should be removed for CP6 and that ORR's proposed change to fixed charges could provide us with a stronger financial incentive to add traffic to the network.

ORR's proposal to base charges on timetabled traffic levels

In principle, we support ORR's proposal to base adjustments to operators FTACs on timetabled traffic levels, rather than outturn traffic levels (i.e. including cancelled train services). As ORR notes in its consultation, this should in theory reduce the volatility of our income because there should be a smaller variance between forecast traffic and timetabled traffic levels, than forecast traffic and outturn traffic levels.

However, in order to base charges on timetabled traffic, it is imperative that the data system used to convert the timetable into annual train miles is robust. If the data system is not robust it could actually increase our income volatility, rather than reduce it. As ORR notes in its consultation, timetabled data from our NETRAFF system shows significant year-on-year fluctuations. We do not consider this system to be sufficiently robust for setting our income or operators' charges.

We will continue to explore the potential to use other data systems in order to robustly translate the timetable into train miles. However, if this is not possible, an alternative option could be to apply an evidence-based percentage uplift to the outturn traffic levels recorded in our billing system in order to adjust for cancelled services.

Any other points that you would like to make?

In its consultation ORR states that because charter services are not captured in industry data systems CEPA/Systra did not consider whether this segment of the market could afford to make a contribution towards our fixed costs. ORR notes that due to lack of data availability, analysis of this market segment would be very complex and potentially disproportionate to the size of the market.

Network Rail is supportive of the charter train sector and the benefits that it delivers for passengers and local communities. However, we also consider that it is important that ORR carries out is market can bear analysis in a non-discriminatory way. Therefore, we do not believe that the charter sector should be exempt from ORR's affordability analysis. Particularly, given there are some small segments of the freight market (e.g. iron ore) which ORR has analysed and concluded should pay charges designed to recover our fixed costs.

It may be the case that ORR analyses the charter sector and concludes that it cannot afford to pay charges designed to recover our fixed costs. However, this decision should be based on market analysis, rather than be assumed. If ORR requires additional information (e.g. traffic data) in order to inform its market analysis, we would be happy to provide this, where possible.

Rail Delivery Group

Response to

ORR's PR18 consultation on charges recovering fixed network costs

Date: 30 November 2017

Rail Delivery Group response to

ORR's PR18 consultation on charges recovering fixed network costs

Organisation: Rail Delivery Group

Address: 200 Aldersgate Street, London EC1A 4HD

Business representative organisation

Introduction: The Rail Delivery Group (RDG) was established in May 2011. It brings together Network Rail and passenger and freight train operating companies to lead and enable improvements in the railway. The purpose of the RDG is to enable Network Rail and passenger and freight train operating companies to succeed by delivering better services for their customers. Ultimately this benefits taxpayers and the economy. We aim to meet the needs of:

- Our Members, by enabling them to deliver better outcomes for customers and the country;
- Government and regulators, by developing strategy, informing policy and confronting difficult decisions on choices, and
- Rail and non-rail users, by improving customer experience and building public trust

For enquiries regarding this consultation response, please contact:

Tom Wood

Rail Delivery Group [redacted]

2nd Floor, 200 Aldersgate Street

London EC1A 4HD

Introduction

1. This document outlines the key points from our members in response to the ORR's PR18 consultation on charges recovering fixed network costs. RDG welcomes the opportunity to respond to this consultation and is pleased to support many of the proposals set out by the ORR.

2. We would welcome the opportunity to engage further with the ORR and we would be pleased to discuss this response, including next steps.

3. Given its publication on 29 November, we will be considering the Department of Transport's strategic vision for rail in detail and, if necessary, will provide a further response to the ORR on this consultation.

4. We are content for this response to be published on the ORR website.

Passenger services

Interactions between the charging regime and the track access framework

5. RDG has stated in previous responses that it supports an approach to fixed-cost charging that ensures that the ORR is agnostic to decisions about granting franchise or open access rights on the network by creating an environment of revenue neutrality. Further, RDG acknowledges that one potential way to improve industry outcomes is by introducing more competition but that before implementing changes to this end, it is important to consider whether it will lead to the best possible outcomes and whether the benefits of such a change would significantly outweigh the costs.

6. The consultation indicates that a policy of recovering fixed-cost charges from all operators "*has the potential to improve competition between passenger services over the longer-term…because it would allow* [Open Access Operators] *to contribute an appropriate amount towards fixed costs where they are able to, in exchange for having greater access to the network*". However, the consultation does not detail how the access framework will change, or potential options for change.

7. RDG considers that that reform of the 'charging' and 'access' sides of this equation should not be looked at in isolation from each other. Rather, it would be preferable for the ORR to take a holistic approach to its review of this matter, considering both aspects concurrently. RDG considers that it is challenging to give a view on proposed changes to the charging arrangements without also having an understanding of how the access framework may change.

8. The current position, whereby the ORR has indicated that the access framework will change to allow Open Access Operators (OAOs) a greater level of access without providing additional clarity around this, creates uncertainty for prospective franchise bidders around the level of competition that they might face within the life of the franchise in question. There is a very real chance that this will impact upon bidding behaviour. For example, this may mean that prospective bidders build a greater risk premium into their bids, or elect not to bid at all.

9. For this reason, we would welcome early clarification from the ORR on how it intends to take this work forward. Similarly, additional clarity would be welcomed around how any change to charging arrangements or the track access regime would apply to existing OAOs which entered into track access contracts with Network Rail under the current access and charging frameworks.

10. RDG had anticipated that the ORRs' work on proposals for the recovery of fixed-cost charges from passenger operators would be at a more advanced stage by this point. Earlier this year, the ORR indicated that this consultation would include "*a proposal … on which passenger market segments should be subject to mark-up charges*" (See Charges and contractual incentives – consultation conclusions, 29 June 2017). Instead, the report prepared by the ORR's consultants' presents itself as a 'proof of concept'. RDG observes that neither that report nor the ORR consultation contain a firm proposal for how the market segments should be defined or on which segments may be able to bear an additional charge.

11. RDG has a concern with the suggestion that the next opportunity to comment on proposals in this area would be in response to the ORR's Draft Determination in Summer 2018, and would have a strong preference for seeking to resolve the likely position for CP6 at an earlier stage in the process.

12. More broadly, the reform of the access and charging arrangements envisaged by the ORR is an important and complex project, with far-reaching implications and the potential to impact upon railway funding, franchising and other areas. It is essential that, as an industry, we give ourselves sufficient time to get this right, for the benefit of passengers and taxpayers. RDG considers it unlikely that there is sufficient time remaining in the PR18 timetable to reach a satisfactory conclusion and allow implementation at the start of CP6.

13. In summary:

    - reform of the access and charging arrangements should be considered together as a single project;

    - given the complexities and potential implications, there is unlikely to be sufficient time in PR18 to complete this work in time for implementation at the start of CP6;

    - RDG would welcome early clarity from the ORR around the envisaged scope of work in relation to reform of the access framework, timescales and how this might affect existing OAOs.

Design of infrastructure cost charges for franchised passenger operators

14. With regards to the proposed design of charges to recover fixed costs from franchised TOCs, the ORR has proposed that charges are adjusted on an annual basis to reflect changes in timetabled traffic. In principle, RDG supports Network Rail being financially incentivised to accommodate additional trains on the network, particularly given ORR's decision to remove the Capacity Charge in CP6. Without additional income to replace the Capacity Charge, Network Rail will be financially worse off when it runs additional trains because, on expectation, it incurs increased Schedule 8 costs as the network becomes busier.

15. The consultation document suggests that infrastructure cost charges could be levied using rates per unit of traffic that could be different for each franchised passenger operator. If this suggestion were to be implemented in CP6, the ORR would need to be careful to ensure that it does not inadvertently create a financial incentive for Network Rail to discriminate in favour of traffic that incurs higher unit rates than when faced with competing requests for additional traffic on the same route. Although, we recognise that Network Rail would be unlikely to act on such an incentive, as the process for granting access to its network takes into account many other factors, and that a number of safeguards are in place to ensure that fair access to the network is maintained.

16. RDG also considers that the guiding principle must be to ensure that Network Rail is not left underfunded for its activities as a result of annual adjustments to charges. Like other

network businesses, Network Rail's fixed costs do not vary with small changes in traffic levels. Therefore, if it receives less income to fund these fixed costs in CP6 it would have to reduce activity and outputs in other areas, which would be an unsatisfactory outcome for the industry, with adverse impacts on customers.

17. One way to mitigate the potential financial risk that this proposal could introduce for Network Rail would be to base charges on a 'business as usual' traffic forecast, which it has a reasonable expectation of outperforming. An alternative option would be to adjust the network grant on an annual basis to make up for any shortfall in Network Rail's income arising from a reduction in timetabled traffic. However, this may be challenging to implement in reality.

Other comments on the charging proposals

18. Though we recognise that the ORR's consultant's report is presented as a 'proof of concept', we consider that basing an assessment of operating surpluses on a single year's worth of data is inappropriate and may yield an incorrect conclusion. We would suggest to the ORR that this assessment (as and when used in conducting the final market-can-bear assessment) should be based on multiple years' worth of data.

19. Additionally, we would suggest that the ORR needs to be clear how future changes (such as timetable changes or the introduction of competing services) within market segments would impact upon the assessment of which segments can bear fixed cost mark ups.

Freight services

20. We accept the ORR's proposal to retain the existing freight market segmentation by commodity, and agree that it is sensible not to introduce further market segments.

21. It is, of course, vital that the ORR's evidence as to whether each commodity can afford to pay a contribution towards Network Rail's fixed costs is robust. If charges were levied on commodities inappropriately this could result in rail freight traffic switching to road, which would have an adverse environmental and societal impact (e.g. increased pollution levels and congestion).

22. The ability of rail freight operators to pass increased costs through to end-user customers should not be taken as a given and the ORR should ensure that any proposal to levy charges in more market segments (such as biomass) is based on sound evidence on the expected customer response to such a change. The extent to which this point has been considered by the ORR in relation to the biomass proposal is unclear.

23. In addition, we agree with the ORR's consultants that there are wider considerations which the ORR should take into account in determining the commodities that can bear an additional charge, such as whether it is appropriate to take a decision which could be seen as penalising investment in railway infrastructure. In the case of the biomass proposal, it is largely unclear from the ORR's consultation how it has taken these wider contextual considerations into account and how it has sought to balance the full range of its statutory duties in arriving at this proposal.

24. Before extending infrastructure charges to additional freight commodities, we believe that the ORR should provide a full assessment of the impact that such a change would have on the industry and in relation to the policies of other government departments (eg BEIS).

Changes to Charges and Contractual Incentives

Response from Rail Freight Group

November 2017

1. Rail Freight Group (RFG) is pleased to respond to the consultation on changes to charges and contractual incentives. No part of this response is confidential.

2. RFG is the representative body for rail freight in the UK, and we campaign for a greater use of rail freight, to deliver environmental and economic benefits for the UK. We have around 120 member companies including train operators, end customers, ports and terminal operators, suppliers including locomotive and wagon companies and support services.

General Comments

3. We recognise the desire of Network Rail and ORR to increase transparency of charges, and to levy additional charges where this can be done legally and without adverse impact on the rail freight market. However, in low margin businesses even modest increases in charges can impact on the viability of operating, so ORR must set a high bar for assessing increases, and take into account the overall envelope of charges that an operator or customer is exposed too.

4. Given this, we are pleased that the ORR has concluded that for significant parts of the rail freight industry including intermodal and construction, a mark-up cannot be charged. This is particularly welcome.

5. We also note that ORR proposes no change to the principle that a mark-up should be charged for coal, iron ore and spent nuclear fuel. In principle, we have no objection to this continuation, but this is subject to the level of the mark-up, and the overall charge, remaining affordable.

6. We are concerned with the proposals to introduce a levy on biomass transport, which has the potential to reduce the volume of such traffic on the network, impacting on the business of rail freight operators and rail linked ports. Our specific points are below.

7. We have responded separately to Network Rail's consultation on the allocation of fixed costs, where we are concerned over some aspects regarding the allocation of common costs to freight, the scale of that allocation and the potential for perverse incentives.

8. We note that the Network Rail work will inform the level of mark-up which could be charged and are therefore particularly concerned that the level of additional charge could be very significant for some traffics, if ORR decide to charge in full. We believe the charge should be limited to the avoidable cost, as in CP5. This must be clarified urgently, as there could be very significant impacts, including on

coal, iron ore and nuclear as well as on biomass if the full assessed allocation is the basis of the mark up.

9. We note the criteria in para 1.9, relating to the allocation and thus potential charging of fixed costs. We see little in Network Rail's allocation which serves to increase understanding of where costs are caused, and what the freight sector can do to help reduce costs. Equally, we can see little which serves to provide positive outcomes for customers, aside from those sectors where the decision has been not to levy an additional charge. ORR should be clear that this consultation relates to the possibility of increasing charges within the prevailing legal framework, rather than to any incentive effect.

Comments on Specific Proposals

Question 2.1: Do you have any views on our proposal to retain the existing freight market segmentation by commodity, and not introduce further market segments for any of the existing commodities?

10. We support this conclusion.

Question 2.2: Do you have any views on our proposal to continue allowing Network Rail to levy infrastructure cost charges on freight trains carrying ESI coal, iron ore and spent nuclear fuel?

11. Pragmatically, we agree that there is no evidence to change the previous decision and to remove the mark up from these commodities.

12. However, the Network Rail fixed cost work has allocated a significant part of common costs to freight. Using this as the basis of the mark-up could lead to a significant increase in costs for these commodities, and the impact of a significant rise should be assessed. This might be particularly important for iron ore given the recent difficulties in the UK steel industry and the reliance of Network Rail on these producers for the supply of rail.

13. As such we believe that the level of mark- up should be limited to the avoidable costs, or retained at the same level as in CP5 for these commodities.

Do you have any views on our proposal to allow Network Rail to levy infrastructure cost charges on trains carrying ESI biomass in CP6?

14. We do not support the introduction of a new charge, which is likely to lead to reduced volumes of freight moved and potential growth. This charge acts to penalise a very small number of players in the market, all of whom have invested significantly in rail infrastructure, and is likely to reduce the electricity generation from biomass in favour of potentially non-renewable sources such as gas.

15. We recognise that ORR's policies and the prevailing legislation, do not require consideration of downstream effects and are focussed on the potential for reverse modal switch. However, where the impact of a decision would reduce rail freight volumes, or deter investment in rail, then we would consider these to be

material factors which should be taken into account.

16. We recognise that, whilst there are some opportunities for local substitution, the carriage of ESI biomass to Drax and Lynemouth will generally be by rail to meet environmental requirements. An increase in rail costs will therefore mostly serve to increase the costs of generation, making biomass a less attractive fuel. The generators cannot re-open their support mechanisms with Government (be they CfD or Renewables Obligation) until 2027, so any increase must be passed onto customers, or absorbed.

17. Given the nature of the electricity market, increases in the cost of biomass generation will tend to make it less favourable than other modes, such as gas, and will therefore reduce the amount of biomass needed, and hence rail freight volumes. So an increase in charges can reduce rail freight even if it does not cause modal shift. We accept that there are many factors affecting the generation mix, but transport costs will impact.

18. We are also concerned that the charge targets a sector which is relatively new to rail and one where there has been significant third party investment. We dispute the argument that businesses should have taken the CP5 review as an indication of intent for CP6, particularly as many of the investment decisions by Drax were already in place by the CP5 review.

19. In an environment where third party investment is being encouraged, a policy which 'rewards' investors with increased charges is perverse. Of course, businesses will expect some change over time but to use the investment itself as a justification for increasing charge is at best unfortunate.

20. The proposed decision impacts on a small number of companies, Drax, Lynemouth, Port of Liverpool, ABP Immingham and GBRailFreight, as well as having implications for wagon manufacturers and lessors. We would expect, given the small market, that ORR will have met with each in turn to understand any specific impacts, and to take decisions which support continued use of rail freight.

21. As with other commodities, the level of the mark-up should be linked to the avoidable costs, and not common cost allocation.

PR18 consultation on charges recovering fixed network costs: Pro-forma for responses

This pro-forma is available to those that wish to use it to respond to our consultation. Other forms of response (e.g. letter format) are equally welcome.

Please send your response to pr18@orr.gsi.gov.uk by **30 November 2017**.

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*This information will not be published on our website.

Question 2.1: Do you have any views on our proposal to retain the existing freight market segmentation by commodity, and not introduce further market segments for any of the existing commodities?

A general answer, and one that impinges on 2.2 and 2.3 – as for passenger access charges – the full cost should be calculated.

I appreciate that the current approach is a “market can bear” approach but this does not necessarily take into account full social and environmental benefits.

Question 2.2: Do you have any views on our proposal to continue allowing Network Rail to levy infrastructure cost charges on freight trains carrying ESI coal, iron ore and spent nuclear fuel? Do you have any views on our proposal to allow Network Rail to levy infrastructure cost charges on trains carrying ESI biomass in CP6?

IF a commodity causes increased costs then logically these should be recovered.

Question 2.3: Do you have any additional evidence around the ability to bear of any of the freight market segments reviewed by our consultants, which you would like to provide us to inform our final decision around which freight market segments are able to bear infrastructure cost charges in CP6?
Should intangible benefits not be fully considered in any analysis?

Question 3.1: Do you have any views on the results of the technical analysis undertaken to date on passenger market segmentation (and ability to bear?) Do you have any views around how these emerging findings could inform a passenger market segmentation?
Below are my views on this analysis which take into account many of the issues and distortions in the UK rail market. I have to say that the overall conclusions reached are supported by observation. It is good that the top level adjusted data analysis reaches conclusions that are observable. The overall results clearly indicate that UK rail could generate more revenue for investment by charging realistic access charges. Tax payers would have to give less support / tax revenues could be used to invest. My opinions below are just, that but they are based on years of observation and some research of available data. I have highlighted areas where I believe further simple desk top research could be done to arrive at supportable fixed cost access charges. There is abundant data available. Firstly I believe that full fixed costs (maybe including annual worth costs of new, additional or enhanced infrastructure) should be calculated for all services at normal capacity – that is full utilisation allowing for existing or more freight paths. This is needed for whatever politically desired regime is in play. Of course ‘normal’ needs definition but is not simply cramming the system. The digital railway can help with maximising sensible use of the network but is not a panacea – there still need to be reliable and resilient parallel tracks. Little or no mention is made of the other revenue stream that rail brings – intangible benefits. These are large amounts for freight and commuter lines. For example less pollution with the resultant lower health costs from fewer lorries on the roads and London would barely function without rail. The knowledge of the full cost per train mile can be the base for segment analysis. But if a charging regime is to be moved forward the immediate need for analysis is for intercity routes - as broadly defined below.

Segment analysis should be carried out for –

1 Freight

2 Intercity - this includes stopping mainline trains, cross country etc. These are all intercity - the passengers are not so different.

3 Commuter

4 Rural (or another suitable word)

This classification would simplify analysis. Commuter and rural passenger traffic are special cases and need PSO or local area support. Freight ought to have support – related to the considerable intangible benefits.

For commuter traffic there is very limited scope for competition. Commuter routes would be best run by a body like TfL or on a management charge basis as for some franchises. However a known fixed cost charge per train mile is essential for economic planning.

Untangling the sectors

But how to untangle long distance commuters from intercity? Treat them as intercity for that is what the trains are. How to untangle the use of track?

For London – treat the fast lines as intercity and slow as commuter for an agreed distance from the termini. eg From Liverpool Street up and down slow lines to Shenfield – commuter. Fast lines intercity. Hertford lines commuter.

For other conurbations identify the radial lines which are used for the first x miles predominantly by commuter trains. The intercity trains could pay a market rate for access – supporting the commuting line funders.

Probably too simplistic, but stopping trains are just that – serving commuter areas.

Having established the segments: intercity, commuter and rural there is the question of geographical segmentation. I see no reason to analyse on the basis of geography. There are inevitably more commuters, trains and routes out of London and Birmingham and Manchester etc. There are intercity routes between cities, across the country – and note not all intercity passengers go to London!

North, East, South (to a much lesser degree) and West of London there are rural lines – geography classifies them thus.

Separating commuter from intercity passengers in combined franchises

Presumably at the time of tendering for a combined franchise the fixed access costs are diligently calculated. However reasonable they might be at the outset visibility of whether one segment supports another is lost. There is data that could reveal this. Ideally there should not be combined franchises.

The state railway – the cause of distortions

A state railway is what we have under the guise of a privatised railway – the franchises are awarded as monopolies and there is little competition.

There is a hint that the market can bear levels could be set based on what is observed under today's flawed regime. Set neither on a willing to pay basis, nor ability to paybasis. Maybe it is a what they will have to pay basis? Is it correct that a 10 mile trip in the south east should cost more than a trip in another part of the country? Should a PSO cost not be a political imposition in the name of equality and taking account of the bigger, longer term economic picture that politicians take?

Distorted fare structures

The analysis does attempt to adjust for the franchise regime we have in the UK. However it maybe does not fully appreciate that the present fare structures and practices have become institutionalised. They would not be the practices under a more open regime – or a traditional state regime.

Likely revenue streams are seriously affected by the fixed term, basically fixed access costs, franchise TOCs. This leads to a major revenue driver being to run more trains at marginal cost and sell seats likewise – as long as the revenue covers the variable costs then £1 cash surplus on a nil capital investment gives an infinite return.

A study of fares on any route reveals huge discrepancies. Many fares cannot be 'economical'.

The problem has two causes.

1 The fixation with the DfT demand for a state railway style timetable. As I noted in another paper "rail travel is not a human right", Rail travel is underappreciated – a huge market to be won but not through central planning.

2 The franchise term, basically fixed, access charge. Where they are free to the TOCs approach franchises as a bus or low cost airline operator might – they do not have to look to the long term – dedicated to provide for the long term with a full service on a specific route. There is no real driver for sustainability – if you lose a franchise then you can get back into buses. The yield management systems adopted are thus more suited to an airline than rail. There is a strong possibility that many TOCs could increase revenue by cutting out the very low

priced, last minute advance tickets. A fair average fare should yield more. A study comparing Deutsche Bahn's approach to the UK approach would be revealing. I hope that among these opinions and comments there may be some of use in moving the fixed cost charging regime forward in a practical manner.

Question 4.1: Do you have any comments on our proposal to levy any infrastructure cost charges on open access operators as a rate per train mile? Do you think there are any additional considerations we should include in our assessment of the different metric options?
A rate per train mile is straightforward – as in 3.1 Categorising markets and what the of the full cost recovery rate should be is the problem.

Question 4.2: Do you have any comments on our proposed approach to varying franchised passenger operators' infrastructure cost charges in response to changes in traffic, on an annual basis. Do you have any comments on the particular approach we have proposed which is based on changes in timetabled traffic, or any of the other options we have considered in our assessment?
As long as we have the economics and accounting of the existing franchise regime then annual adjustments are justified.

Any other points that you would like to make

Thank you for taking the time to respond.

PR18 consultation on charges recovering fixed network costs: Pro-forma for responses

This pro-forma is available to those that wish to use it to respond to our consultation. Other forms of response (e.g. letter format) are equally welcome.

Please send your response to pr18@orr.gsi.gov.uk by **30 November 2017**.

Full name	Phil Dawson
Job title	Regulation & Track Access Manager
Organisation	Stagecoach Rail and Virgin Rail Group
Email*	[redacted]
Telephone number*	

*This information will not be published on our website.

Question 2.1: Do you have any views on our proposal to retain the existing freight market segmentation by commodity, and not introduce further market segments for any of the existing commodities?
No comment.

Question 2.2: Do you have any views on our proposal to continue allowing Network Rail to levy infrastructure cost charges on freight trains carrying ESI coal, iron ore and spent nuclear fuel? Do you have any views on our proposal to allow Network Rail to levy infrastructure cost charges on trains carrying ESI biomass in CP6?
No comment.

Question 2.3: Do you have any additional evidence around the ability to bear of any of the freight market segments reviewed by our consultants, which you would like to provide us to inform our final decision around which freight market segments are able to bear infrastructure cost charges in CP6?
No comment.

Question 3.1: Do you have any views on the results of the technical analysis undertaken to date on passenger market segmentation (and ability to bear?) Do you have any views around how these emerging findings could inform a passenger market segmentation?
We are broadly supportive of the approach and the concept of an "intercity service" as a market segment (although this needs to be clearly defined – would it be any flow into London or would it be split by track sections? Perhaps ORR could clarify this). However, ignoring the difference between a peak and off peak intercity train is a fundamental weakness of the approach taken. Peak train revenues are materially higher than off peak train revenues and therefore ignoring this fact will result in artificially low MCB test results. That said, we agree with the CEPA/SYSTRA view that mark-ups could be "easily borne" from OAO on major intercity routes. We strongly believe that there is an Intercity passenger market that can be segmented for the purposes of a MCB test for infrastructure cost charges.

Question 4.1: Do you have any comments on our proposal to levy any infrastructure cost charges on open access operators as a rate per train mile? Do you think there are any additional considerations we should include in our assessment of the different metric options?
We believe ORR's views[i] of levying lump-sum fixed charges are fundamentally flawed. OAO will not give up access rights or train paths in advance of the start of the control period and it is highly improbably that OAO would exit the market – given the profit levels declared in statutory accounts. Given the actual level of infrastructure charges that will end up being levied, even if OAO exited the rail market (highly improbable) we don't accept this would have any material impact on Network Rail's funding. We would support the approach preferred by ORR for franchised passenger operators – based on timetabled traffic, updated for each timetable period. This would send the clearest price signals to all parties and be the most equitable solution. Our overriding view is that both OAO and Franchised Operators operating in the same market segment must be treated in the same way. Should ORR determine that a rate per unit of traffic is the best way forward, we believe that the "rate per train mile" is the best option. It would have the further benefit of acting as an incentive to make better use of track capacity (longer trains) rather than running more frequent shorter trains using up scare track capacity. The overriding concern is that however the charges are levied, it must be levied on a consistent basis. To do otherwise could lead to some perverse behaviours. For example, if a Franchised Operator is charged on a fixed planned timetable basis but OAO on a rate per train mile basis, it would be in NR's commercial interests to favour running more OAO services in disruption and planned engineering works than a franchised operator. This would be totally unacceptable.

Question 4.2: Do you have any comments on our proposed approach to varying franchised passenger operators' infrastructure cost charges in response to changes in traffic, on an annual basis. Do you have any comments on the particular approach we have proposed which is based on changes in timetabled traffic, or any of the other options we have considered in our assessment?

We would support the proposed approach based on changes to traffic but we believe it should be for each timetable change rather than annually. As discussed in our response to 4.1. above, the charge must be levied on the same basis for OAO and Franchised Operators.

The benefit of this approach will mean that Network Rail will also be incentivised to deliver Capacity Enhancements on time (or early) – if the trains aren't included in the base timetable, they will not receive the access charge income.

Any other points that you would like to make

The CEPA analysis regarding the current capacity charge was of particular note – three operators in the same market segment paying significantly different rates. Both OAO receive up to 50% of their revenue through ORCATS from inter-available tickets that are priced at a level to recover fixed charges and premiums – further evidence that the market can certainly bear mark-ups – the passenger is already paying for them, it's just that the OAO are currently able to keep the money as a "super profit".

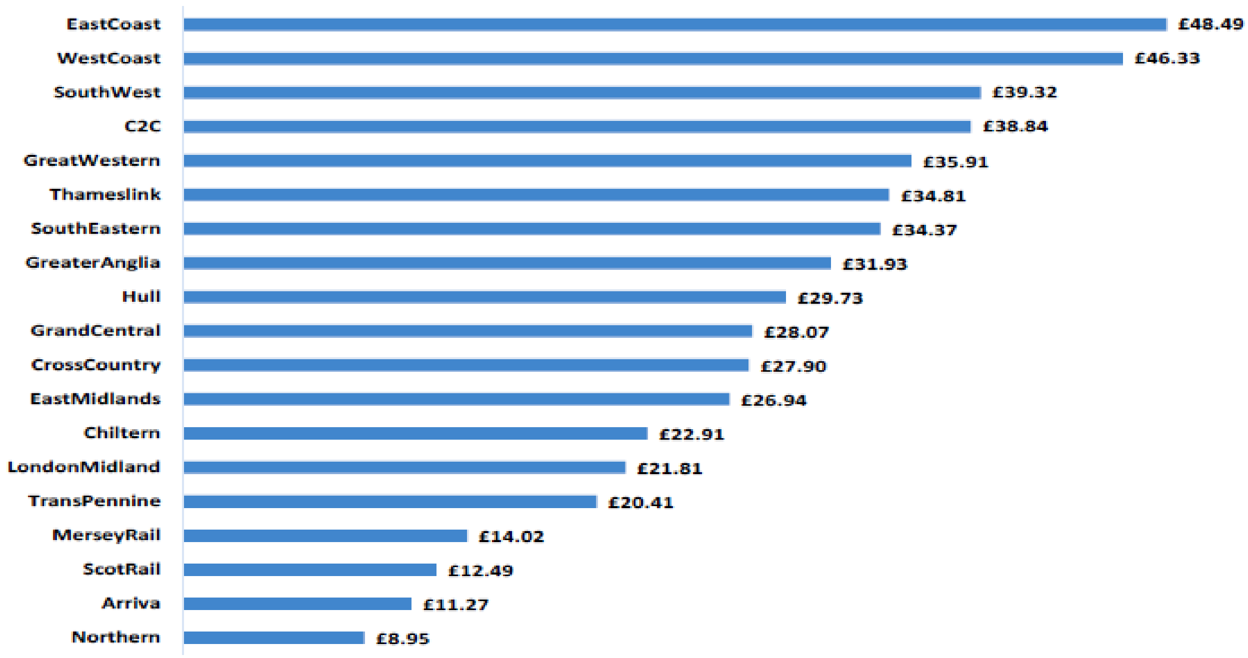
Table 2.1: Open Access Operators' average capacity charge per train mile

Operator	Average capacity charge per train mile (2015-16)
Grand Central Trains	£0.51
Hull Trains	£0.47
East Coast Trains (for context)	£2.64

Sources: CEPA calculation based on ORR data of amounts paid and MOIRA mileage estimates – i.e. timetabled mileage.

We also note Figure 4.1 from the CEPA report:

Figure 4.1: Passenger revenue per train mile – TOC level



This would suggest that OAO could bear significant mark-ups. During PR13, ORR accepted OAO's arguments that they could not bear the proposed Capacity Charge rates originally proposed – this analysis does not support this argument.

Thank you for taking the time to respond.

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[i] PR18: Infrastructure cost charges – Draft impact assessment of units of traffic for levying infrastructure cost charges on open access operators (September 2017)

PR18 consultation on charges recovering fixed network costs: Pro-forma for responses

This pro-forma is available to those that wish to use it to respond to our consultation. Other forms of response (e.g. letter format) are equally welcome.

Please send your response to pr18@orr.gsi.gov.uk by **30 November 2017**.

Full name	Robert Fickling
Job title	Rail Strategy Manager
Organisation	Transport for Greater Manchester
Email*	
Telephone number*	

*This information will not be published on our website.

Question 2.1: Do you have any views on our proposal to retain the existing freight market segmentation by commodity, and not introduce further market segments for any of the existing commodities?
TfGM does not hold a particular view of this subject, however we would not want to see the current freight market, which is extremely competitive and currently running at low profit margins, hampered by any change. Our attached letter in response to the Network Rail consultation of Fixed Track Access Charges is attached for further information.

Question 2.2: Do you have any views on our proposal to continue allowing Network Rail to levy infrastructure cost charges on freight trains carrying ESI coal, iron ore and spent nuclear fuel? Do you have any views on our proposal to allow Network Rail to levy infrastructure cost charges on trains carrying ESI biomass in CP6?
TfGM does not hold a particular view of this subject, however we would not want to see the current freight market, which is extremely competitive and currently running at low profit margins, hampered by any change. Our attached letter in response to the Network Rail consultation of Fixed Track Access Charges is attached for further information.

Question 2.3: Do you have any additional evidence around the ability to bear of any of the freight market segments reviewed by our consultants, which you would like to provide us to inform our final decision around which freight market segments are able to bear infrastructure cost charges in CP6?
TfGM does not hold any such evidence.

Question 3.1: Do you have any views on the results of the technical analysis undertaken to date on passenger market segmentation (and ability to bear?) Do you have any views around how these emerging findings could inform a passenger market segmentation?
We would want it to be noted that revenue yields on services in the TfGM area can range between very low to levels similar to those in the south east of England, and as such the ability of the Market to Bear any increased cost allocation could lead to major disbenefits to local rail users which we would not support. Any segmentation needs to be cognisant of this variability of demand, and draw upon recent research demand research showing passenger's willingness to pay before any such fixed charging allocation is considered. Again, our attached letter in response to the Network Rail consultation of Fixed Track Access Charges is attached for further information.

Question 4.1: Do you have any comments on our proposal to levy any infrastructure cost charges on open access operators as a rate per train mile? Do you think there are any additional considerations we should include in our assessment of the different metric options?
We believe that applying charges to open access operators on the same basis as franchised operators would form the most transparent process. However, as explained in our attached letter to Network Rail, we question the rational for applying a Fixed Charge at all. Instead a universal track access charge alone applicable to any operator (franchised or open access) expressed in terms of vehicle miles (by type of vehicle) a much fairer manner of appointing network usage costs.

Question 4.2: Do you have any comments on our proposed approach to varying franchised passenger operators' infrastructure cost charges in response to changes in traffic, on an annual basis. Do you have any comments on the particular approach we have proposed which is

based on changes in timetabled traffic, or any of the other options we have considered in our assessment?
We repeat our comments from Question 41 that only charging variable access fees would avoid the issue of taking into account changes in timetabled services. Detailed are contained in the attached letter to this response.

Any other points that you would like to make
The clear complexity in trying to allocate fixed track access costs exposes the problems in achieving a fair and equitable system, without passing large amounts of costs from the long distance operators to the regional operators and freight. We do not wish to see any increase in subsidy requirement allocated to the regional operators, and struggle to understand the need to do so. As mentioned in our attached letter if the rail network were to be treated as an open network with all costs covered by direct public grant, and then only a usage charge made the issues of charging open access operators fairly would be removed.

Thank you for taking the time to respond.

Transport for Greater Manchester

2 Piccadilly Place
Manchester M1 3BG

0161 244 1000
www.tfgm.com

Ben Worley

17th November 2017

Dear Sir / Madam,

Network Rail's consultation on its methodology for allocating fixed costs to train operators in Control Period 6 (CP6)

Thank you for offering us the opportunity to comment on your proposed methodology for allocating fixed costs to train operators in CP6, and this letter constitutes Transport for Greater Manchester's response. Transport for Greater Manchester is the transport executive for the Greater Manchester Combined Authority (GMCA) and we deliver the transport policies set by the Greater Manchester Mayor and GMCA. The GMCA constitutes ten Districts including Bolton, Bury, Manchester, Oldham, Rochdale, Salford, Stockport, Tameside, Trafford and Wigan. This response captures the strategic requirements of the entire GMCA area.

1. Introduction

While we recognise the need for adequate funding to ensure the upkeep and maintenance of the rail network in a fair and transparent way, we have concerns that the proposed change to the methodology creates unnecessary complexity for very little tangible gain. The changes in cost allocations either have the potential for undesirable consequences to operators whose costs will increase, or, if the operators are protected from changes, it will render the approach irrelevant.

Although Transport for Greater Manchester do not operate trains, we do have an interest in ensuring that the railway is able to provide passenger services to meet the needs of our residents, employees and visitors, as well as freight services that meet our economic requirements. These services need to be provided at a fair cost so that they are competitive with other modes and will ensure rail contributes to the wider transport needs of Greater Manchester.

In principle we agree with the need to treat all operators fairly so that they all have a proportionate share of the cost of the network, however, we are concerned that the methodology stated will penalise some operators and could have a detrimental impact on the economics of railway operations. Of particular concern to us is the significant cost increase proposed for the freight operators and the Northern franchise, both of these are covered in more detail below (sections 2 and 3) and it is for these reasons that we do not support the proposal. However, we recognise that the disproportional allocation using the existing system is also not the right solution, but rather than adding further economic complexity, leading to additional cost to the industry, we feel the whole approach to rail funding, including fixed and variable costs should be reviewed. We describe this in more detail in section 4 below.

2. Impact on Freight Operators

We are concerned about the impact the changed methodology has on freight. The consultation document suggests the allocated costs will rise from £0 to £566m (based on PR13 costs). This level of increase is unlikely to be affordable to the freight operators and the marginal costs of rail freight means that there is little scope for rail to absorb additional costs, potentially putting rail freight at risk.

We do recognise that the cost allocations are not the same as the charges that will be applied, as these will be subject to a Market Can Bear (MCB) test. However, we are aware that separate ORR analysis suggests only four sectors can absorb additional costs; these being Coal (Electric Supply Industry), Iron ore, Biomass and Nuclear Waste. Of these, Coal is in decline as a result of Government energy policies and the other three are not forecast to see the required growth. The areas of rail freight which are forecasting growth (particularly intermodal and aggregates) are much more susceptible to competition from other modes. Therefore, any increase in the cost of rail freight provision is likely to see a switch back to less sustainable modes with a resultant loss of wider benefits (e.g. environment and highway congestion).

We are fully supportive of rail freight and would seek to encourage greater adoption. Rail freight is widely recognised as being a more sustainable mode of transport than road freight and we fully support the use of rail for transferring freight where this is practicable. As such, we are opposed to any unnecessary (or artificial) increase in the cost of rail freight compared to other modes. As we have stated elsewhere in this response, the road freight market is not directly liable for the fixed cost of the highway network and this provides it with an unfair cost advantage.

3. Impact on Northern

We are concerned that the overall impact of operators' fixed cost allocations with the revised methodology will have a significant impact on Northern, increasing allocations from £263m to £394m (based on PR13 values). Northern already has one of the highest cost per passenger subsidy of any operator and considerable effort has been made to reduce this in recent years, through encouraging growth and efficiency of operation. That progress could be undermined by the methodology set out here. While we understand that the franchise agreements protect operators from changes to costs during periodic reviews and that a MCB test would be applied, the perception of this cost allocation undermines the case for investment.

We consider that the methodology developed by Brockley Consulting to allocate the fixed costs further shifts these costs in a disproportionate way to regional and rural rail operations. The UTG (Urban Transport Group) report, "A Heavy Load to Bear, towards a fairer allocation of rail industry costs for regional rail"[1], demonstrates that regional operators are already overburdened with costs in comparison to other sectors such as freight and long-distance services.

The approach suggested here is in contrast to allocations of cost in many European railways, where the prime user principle approach is used, such that shared costs are allocated to the most profitable operations (or put differently, those most able to bear the costs). The decrease in cost allocations for the major Intercity operators (particularly Intercity East Coast and Intercity West Coast) will risk artificially improving the profitability of these services in a way that could lead to windfall profits leaving the industry, whilst loading costs on to regional rail services in a way that could be used to justify future reductions in the extent and scale of regional rail services.

The fact that the level of change for some operators (such as Great Western and London Midland identified in paragraph 5.6) are only modest because of the portfolio of service types, ignores the damage to the economics of individual services. Stakeholders making the case for additional regional services will be facing additional cost allocations and cannot rely on cross-subsidy of the intercity operations to provide a balanced cost.

Previous research by UTG has shown that regional trains cause up to twenty times less damage to the network than inter-city trains and have considerably cheaper

[1] http://www.urbantransportgroup.org/system/files/general-docs/A%20heavy%20load%20to%20bear_July%202014_FINAL.pdf

infrastructure requirements. Because of this, the current methodology already appears to overstate the cost of regional railways.

4. The approach to fixed track access charges

It is recognised in the consultation document that the Fixed Track Access Costs (FTAC) allocated to the franchised passenger operators has a simple methodology. While we recognise that this limits the level of detail that is available, the fact that calculation is simple means that it does not create unnecessary resource requirements from the rail industry to calculate and manage. However, a move away from this to a more complex system risks incurring unnecessary additional administrative costs.

There is an argument that fixed charges should be abolished altogether given that other transport networks, such as the roads, do not charge a fixed access charge to access the network. An alternative approach would be for Central Government to provide a network maintenance payment, in similar fashion to how roads are funded. This would mean that trains on a specific track would only need to cover the cost of wear and tear through a Variable Charge, but would not be expected to cover major works to the track (e.g. as a result of flooding or a landslip), in the same way that motorists do not have to directly cover these costs. For this to work, it is likely that the variable costs would need to be increased to cover a greater proportion of the overall network costs, but this can be calculated in a fair and transparent way, with the overall network grant ensuring that the network is available as per legislative requirements.

Such an approach would deliver a number of benefits to the rail industry, including those which the revised methodology is trying to address. These are:

- All operators (including open access and freight) pay a fair amount which is proportionate to the cost of their operation. This means that open access operations are also contributing to overall network costs on an equal basis with the franchised operators;
- It would reduce the complexity of calculating the fixed cost allocation for each operator. This is likely to reduce the overall costs of administering the network;

- It would remove the risk of funding shortfalls if there was a substantial reduction in operations (e.g. a significant downturn in rail freight traffic or the loss of an open access operator);
- It makes the final funding package more transparent as it removes the need for the MCB test and subsequent Government grants to cover the funding shortfall to Network Rail. It also reduces the complexity associated with franchise operators being protected from changes in cost allocation as part of their contracts with the funding bodies; and
- It is more straightforward to identify the costs of new services or increases in frequencies to organisations which are sponsoring these or preparing Business Cases. This should also be supported by a fairer allocation of variable costs which do not penalise regional services which we have identified earlier in our response.

It is noticeable that in the 2016/17 financial year, only £392m of fixed cost funding came through FTACs, with the remaining £4,380m being grant income from Government in lieu of access charges, effectively 6.7%.

5. Long term impact

The MCB test and the protection that franchises are afforded through their franchise agreements to protect them from period review changes should protect passengers from any immediate impact. However, when franchises are renewed, this protection could be lost and the revised methodology is likely to impact on bidders approach to costs and subsidy / premium. For rural and low use railways, this could easily become a serious barriers to justifying the improvements that are urgently required and may artificially restrict the ambition of both bidders and funding bodies.

We also consider that some of the assertions in the proposed methodology do not entirely reflect the economics of railway operation.

- On page 20 of the consultation document it states that “while the weight of trains is an important factor in driving our short run ‘wear and tear’ costs, the avoidable cost analysis suggests that weight plays a relatively small role in driving long run avoidable costs.

  We would challenge this assertion as there is a clear correlation between the size and scale of infrastructure necessary to cater for heavy trains compared to lightweight local passenger trains. There have been studies which suggest that where rural lines are only used by lightweight sprinter trains (or equivalent) it is possible to reduce the infrastructure costs. Similarly, there are a number of routes where sprinter differential speeds are in place to reflect the lightweight nature of these trains and allow them to operate more quickly than other services. There would be a cost in bringing the infrastructure up to a standard to allow the faster speeds to apply to all services.

The focus of costs in this document is on track and earthworks and does not take account of infrastructure and complexity of the track layout. Generally, it is the need to cater for high levels of demand and a mix of service types which drives the need for complex infrastructure and signalling capability, which has additional cost compared to a low use line. For example, many of the lowest use rural lines operate as a single line siding with no intermediate signalling away from the junction with the rest of the network.[2]

6. Transparent Grant

We agree that it is important to be transparent about fixed costs. However, it is important that this transparency is built on a realistic and undisputable set of assumptions. As we have stated earlier, we do not believe that the revised methodology provides a justifiable set of assumptions, especially for regional services, which will undermine any information made transparent.

Finally, paragraph 6.2 suggests that where a particular market cannot afford the fixed charge allocated to it, there should be use of a transparent additional grant to cover this inability to bear the true costs. We support in principal transparency of approach. However, we do not want such visibility of any grant aid to lead to a susceptible to financial cuts of particular services or market segments without the wider rail services implications considered, and in particular the knock-on impact to any remaining operators on the network.

I hope that you find the above responses constructive and would ask that you keep us informed of progress with any changes to the fixed access charge allocations, and the results of this consultation.

Yours Sincerely,

AJ Whe

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[2] Examples include Blackpool South line; Windermere – Oxenholme.

Amanda White
Head of Rail
Transport for Greater Manchester
2 Piccadilly Place, Manchester, M1 3BG

PR18 consultation on charges recovering fixed network costs: Pro-forma for responses

This pro-forma is available to those that wish to use it to respond to our consultation. Other forms of response (e.g. letter format) are equally welcome.

Please send your response to pr18@orr.gsi.gov.uk by **30 November 2017**.

Full name	Carol Smales
Job title	Rail Development Manager
Organisation	Transport for London
Email*	
Telephone number*	

*This information will not be published on our website.

Question 2.1: Do you have any views on our proposal to retain the existing freight market segmentation by commodity, and not introduce further market segments for any of the existing commodities?
TfL is content with the existing market segmentation.

Question 2.2: Do you have any views on our proposal to continue allowing Network Rail to levy infrastructure cost charges on freight trains carrying ESI coal, iron ore and spent nuclear fuel? Do you have any views on our proposal to allow Network Rail to levy infrastructure cost charges on trains carrying ESI biomass in CP6?
TfL is content with the proposal to levy infrastructure cost charges on freight trains carrying ESI coal, iron ore, spent nuclear fuel and ESI biomass.

Question 2.3: Do you have any additional evidence around the ability to bear of any of the freight market segments reviewed by our consultants, which you would like to provide us to inform our final decision around which freight market segments are able to bear infrastructure cost charges in CP6?
See 2.2

Question 3.1: Do you have any views on the results of the technical analysis undertaken to date on passenger market segmentation (and ability to bear?) Do you have any views around how these emerging findings could inform a passenger market segmentation?
TfL has no comments on the market segmentation analysis.

Question 4.1: Do you have any comments on our proposal to levy any infrastructure cost charges on open access operators as a rate per train mile? Do you think there are any additional considerations we should include in our assessment of the different metric options?
As we said in our response to Network Rail's consultation on allocation of fixed costs, infrastructure cost charges should be allocated on a per vehicle mile basis rather than per train mile. This would not impose additional costs of attribution on NR and would lead to a fairer cost allocation.

Question 4.2: Do you have any comments on our proposed approach to varying franchised passenger operators' infrastructure cost charges in response to changes in traffic, on an annual basis. Do you have any comments on the particular approach we have proposed which is based on changes in timetabled traffic, or any of the other options we have considered in our assessment?

TfL is content with the proposal to vary infrastructure cost charges in response to timetabled traffic. This is a better option than varying in response to actual traffic which could provide operators with perverse incentives to cancel trains.

Any other points that you would like to make
TfL has no further comments to make.

Thank you for taking the time to respond.

Ken Skates AC/AM
Ysgrifennydd y Cabinet dros yr Economi a Thrafnidiaeth
Cabinet Secretary for Economy and Transport

Llywodraeth Cymru
Welsh Government

Ein cyf/Our ref: MA-P/KS/4339/17

Stephen Glaister
Chair – Office of Rail and Road

05 December 2017

Dear Stephen,

I welcome the opportunity to respond to the ORR's consultation on changes to charges and contractual incentives.

During Control Period 6, the Welsh Government will be responsible for the funding and management of the Wales and Borders franchise. Track access charges account for over one quarter of Arriva Trains Wales' total expenditure and are, therefore, a significant cost to the Wales and Border franchise, which is already heavily subsidised. Clearly, the way in which costs are allocated and raised through fixed tack access charges is of significant relevance to the financial viability of the franchise.

There is a general need for greater transparency and understanding around Network Rail's costs and charges - a better understanding of fixed costs could potentially improve industry decision making, as well as supporting a more equitable split of costs against impacts.
While the proposed changes have some merit, they raise a number of concerns which could potentially worsen the viability of some passenger services in the future.

Although the UK Government has provided a high level commitment to reasonably protect the Welsh Government against any future increases in track access charges, details of what this would mean in practice have not yet been agreed. Importantly, the UK Government has not confirmed whether the protection would be limited to cost increases applying to a set of services being operated at a point in time when any changes are made - or whether the protection would also apply to additional costs incurred as a result of operating any additional services which the Welsh Government might choose to specify in the future.

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It is vitally important that any changes in this area do not adversely affect the affordability or economic case for any additional services to be operated under the Wales and Borders franchise and I would like the ORR to develop appropriate mechanisms to ensure that industry processes facilitate and monitor this commitment.

Network Rail's proposed approach is likely to tilt the allocation of costs away from already profitable inter-city lines towards more rural subsidy-dependent, lightly-trafficked, services. Smaller, regional trains, on low density areas of the network, are already allocated many elements of fixed track access charges, including central support costs, at the same rate as inter-city trains on congested parts of the network. Furthermore, there is no recognition within the current charging structure of differences in the quality of infrastructure - for example line speeds, signalling capabilities, or resilience. These factors should be the focus of any changes to be made to the allocation of fixed costs.

It is clear that the currently proposed approach to allocating charges has real potential to bring challenges to the operation of some of our more rural routes, which provide vital connectivity for communities in Wales. We would like to understand the implications of the proposals on the costs of operating the current franchise and the likely costs of introducing new services - both on lines where the Wales and Borders franchisee is the only operator, and on lines where other services operate in addition to Wales and Borders services. We would like the ORR to work with the Welsh Government and Transport for Wales to clarify the specific implications of proposed changes to the costs of the Wales and Border franchise.

Turning to freight, the Welsh Government is committed to supporting and encouraging opportunities for goods to be transported using more environmentally sustainable methods - including by rail. Freight train operators are highly exposed to changes in track access charges and it is important for the charging regime to provide stability and continuity for the freight industry.

It will be important for my officials to be closely engaged in deliberations following this consultation.

Yours sincerely,

Ken Skates AC/AM
Ysgrifennydd y Cabinet dros yr Economi a Thrafnidiaeth
Cabinet Secretary for Economy and Transport

Response from West Midlands Rail

I am responding to the consultation on options for recovering fixed network costs on behalf of West Midlands Rail (WMR) – the devolved body overseeing local rail services in the West Midlands.

WMR has a strong interest in charges as we are actively developing proposals for enhancing local rail services in the West Midlands, along with having longer term aspirations for greater devolved powers for subsequent rail franchises.

WMR notes that the Market-can-bear analysis suggests that inter-city and long distance commuter services appear to have the ability to bear a higher proportion of infrastructure cost charges. We would certainly support the view that local short-distance urban and rural/regional services struggle to cover even their direct operating costs currently and will therefore be dependent on public sector subsidy for the foreseeable future. Any additional costs placed on these services could therefore have negative consequences on the ability for devolved bodies such as WMR to support rail services at a time of major growth and investment going into the network.

For the West Midlands franchise, there are services that fit within both the long-distance commuter and regional/urban market segments. There are also examples of a single trains covering multiple services groups and service codes (e.g. New Street – Northampton – Euston services) and there is therefore the potential for a single train to have different treatments with respect to charging depending on what leg of the journey it is on. Any market segmentation will need to recognise these complexities.

While WMR awaits more details of the proposed structure of charging in the draft determination, the potential for levying fixed access charges through a mileage based charge for some services and not for others would appear to add additional complexity to the overall charging framework, especially if Network Grant continues in its current form. There is also the likelihood that on a specific section of route (e.g. between Birmingham and Coventry), some services will have charges levied using one approach, while others will have a different approach. Any potential impacts of this will need to be understood before agreeing the wider charging structure.

WMR would also like to support the wider concerns that Urban Transport Group (previously PTE Group) has raised regarding the allocation of costs to regional/urban service in its “A heavy load to bear” report:

http://www.urbantransportgroup.org/system/files/general-docs/A%20heavy%20load%20to%20bear_July%202014_FINAL.pdf

WMR looks forward to seeing the draft determination in due course.

Peter Sargant

Head of Rail Development, West Midlands Rail