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Dear Emily

**Consultation on contractual provisions to implement options for the Capacity Charge in CP5**

Thank you for the opportunity to provide comments on the contractual provisions to implement options for the Capacity Charge in CP5.

Please note that we have only commented on the freight option of 'no negative wash-up' since this is the version that will be implemented in CP5 under the Final Determination.

We note that under the proposals, the wash-up calculations are applied separately to the current billing process and 'overlay' the existing regime. This approach seems appropriate in that it ensures that there is a degree of charging 'at the margin' (albeit at CP4 rates) which is likely to have useful incentive qualities for operators, and is compatible with Network Rail's billing system.

**Wording around freight commodities**

The chief point that we would make is in relation to the freight contract. We consider that there should be three separate wash-up arrangements (for coal and biomass; intermodal; and other traffic). In addition, we believe that ORR's policy, as set out in its Final Determination, is to introduce such an arrangement for freight for CP5. However, the marked-up contract accompanying your consultation defines a single wash-up which is the sum of contributions from coal, intermodal and other. The marked-up contract states that if this sum is negative, the wash-up shall be zero.

However, we do not believe that this is appropriate or as intended by ORR. In particular, this wording appears to mean that if, for example, the wash-up for coal was negative whilst the wash-up for intermodal was positive, the coal and intermodal wash-ups would be permitted to 'cancel out'.

Rather, we consider that a separate wash-up should be defined for each commodity (such that each wash-up becomes zero if the calculation is negative). Network Rail should then charge operators the relevant sum made up of contributions from all three wash-ups (noting that the contribution of one or more wash-ups could be zero). More detail on this is set out in the Annex to this letter.

### **Clarity of contractual provisions**

The formulae set out in the marked-up contract around the wash-up appear to be correct (with the exception of the point raised above around freight commodities). However, since *only* the 'last step' of the mathematics is set out, we are concerned that the proposed contractual wording is less transparent than it could be and risks creating confusion at a later stage. We would be happy to work with ORR to make the approach clearer and more accessible.

### **Other comments**

The remainder of this letter sets out a number of other comments in relation to the three contracts (freight, existing open access and charter).

#### *Freight*

- We note the importance of the baseline term,  $B_{ti}$ , set out in the marked-up contract. We understand that this is to be defined as the difference between the CP5 and CP4 tariffs multiplied by base mileage. The consultation does not make clear when this will be determined and by which party. We believe it is appropriate for Network Rail to calculate this quantity and ORR to provide assurance around the computations. We would welcome ORR setting out the next steps in terms of making this calculation and defining baselines.
- We note that a 'Coal Train' and 'Intermodal Train' in the marked-up contract are defined as trains such that **fifty percent or more** of vehicles on that train contain the relevant commodity. Whilst we recognise that trains with a mixture of intermodal and coal traffic are rare, we note that this definition is ambiguous in the special case in which 50% of the train's vehicles carry coal and 50% carry intermodal. We would suggest the alternative definition for a 'Coal Train' in order to overcome this issue: *means any train in respect of which more than fifty percent of the number of vehicles that make up that train contain electricity supply industry coal, other coal or biomass.*
- We understand the 'Freight Capacity Rate' to be £0.1300 (2012-13 prices, i.e. the CP4 tariff reduced appropriately as set out in the Final Determination) on a weekday and the 'Freight Capacity Charge Wash-up Rate' to be £0.7315 (2012-13 prices, i.e. the Arup-calculated CP5 rate) on a weekday, and ask that

ORR confirms this. We understand the rates for Open Access and Charter services to be defined analogously.

- We assume that the rates appear in the pricelist rather than the contract so that the relevant RPI provisions apply, but would be grateful for ORR confirmation in this regard.

#### *Open Access*

- We note that you are not consulting on the contractual wording for new open access operations or the introduction of new Service Codes for existing open access operators. Whilst we understand the reasons for this, we consider that it will be appropriate to consult on this in the not too distant future in order to provide clarity and certainty to prospective open access operators and open access operators wishing to introduce new Service Codes.
- We note the importance of the baseline term,  $B_{te}$ . We understand that this is to be defined as the difference between the CP5 and CP4 tariffs multiplied by base mileage. The consultation does not make clear when this will be determined and by which party. We believe it is appropriate for Network Rail to calculate this quantity and ORR to provide assurance around the computations. We would welcome ORR setting out the next steps in terms of making this calculation and defining baselines.

#### *Charter*

- The weekend discount has been recorded as 25 per cent rather than 33 per cent in the consultation. We understand that this was a typographical error and ask that this is corrected.
- The weekend term in the formula seems appropriate, but we note that the term 0.25 should be replaced by 0.33 (as per the bullet above).

Please let me know if you would like to discuss any of the above comments.

Yours sincerely

Joel Strange  
**Senior Regulatory Economist**

## Annex

The marked-up contract defines a single wash-up which is the sum of contributions from coal, intermodal and other:

$$KW_t = \sum_i (M_{ti} - B_{ti} - A_{ti}) \left( \frac{T_{ti}}{A_{ti}} \right)$$

The contract states that  $KW_t$  is to be set to zero if the above sum is negative (rather than each of the constituent commodity-level wash-ups being set to zero if the relevant sum is negative).

Under this approach if, for example, the sum for coal was negative whilst the sum for intermodal was positive, the coal and intermodal contributions would 'cancel out'. As such, the commodity differentiation is not as intended, and indeed under the proposed wording, it is not clear that the differentiation by commodity would have any impact on the sums paid through the wash-up.

Rather, we believe that a separate wash-up should be defined for each commodity (such that each wash-up becomes zero if the calculation is negative). Network Rail should then charge operators the relevant sum, made up of contributions from all three wash-ups (noting that the contribution of one or more wash-ups could be zero).

In particular, the following three wash-ups should be defined (note the additional subscript  $i$  on  $KW_{ti}$ ), one for each of the three commodities:

$$KW_{tcoal} = (M_{tcoal} - B_{tcoal} - A_{tcoal}) \left( \frac{T_{tcoal}}{A_{tcoal}} \right)$$

$$KW_{tinter} = (M_{tinter} - B_{tinter} - A_{tinter}) \left( \frac{T_{tinter}}{A_{tinter}} \right)$$

$$KW_{tother} = (M_{tother} - B_{tother} - A_{tother}) \left( \frac{T_{tother}}{A_{tother}} \right)$$

The contract should be clear that these quantities should be set to zero if the sum by commodity is negative.

Then, the amount payable to Network Rail for the relevant train operator should then be:

$$KW_t = KW_{tcoal} + KW_{tinter} + KW_{tother}$$