

Railway Safety Levy Review

April 2008



OFFICE OF RAIL REGULATION



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Contents

Executive Summary	1
1. Introduction	3
Purpose of this document	3
Structure of this document	3
Consultation responses	3
2. Background	5
Safety levy background	5
Operation of the levy	6
Aims of review	6
Review process	7
3. Issues	9
Scope of the levy	9
Definition of turnover	10
Start-up operations	11
Franchise migration and similar situations	11
Thresholds	13
Other issues	13
4. Summary	15
Annex A – List of questions	17

Executive Summary

1. This document is the second stage of our review of the railway safety levy, which came into effect on 1 April 2006.
2. The levy has been broadly welcomed by the industry and no substantial policy changes are proposed (for example, a return to direct charging, which would require legislative change).
3. However, in response to concerns raised, we do propose to introduce a new flat rate charge of £5000 to apply to railway service providers with a reported relevant turnover of between £5 million and £10 million. We also propose to improve our guidance on the levy to ensure clarity around issues such as capital grants and franchise change.
4. Changes arising from this review will not take effect until the 2009-10 levy round – that is from April 2009. The current levy round (2008-09) will not be affected and requests for relevant turnover will be sent to potential levy payers shortly.
5. We welcome your views on the specific questions identified in this document and on any other aspect of the levy arrangements. Please respond by Friday 13 June 2008.

1. Introduction

- 1.1 ORR is funded through a combination of a licence fee and a railway safety levy. The licence fee covers economic regulation activities, whilst health and safety regulation is funded through the safety levy. The total licence fee for 2007-08 was £12.6 million and the total safety levy was £17.5 million.
- 1.2 During the course of the consultation around the introduction of the safety levy, a commitment was made to review the operation of the new arrangements in 2007-08 in the light of two years or so of experience. The purpose of the review would be to identify scope for efficiencies or improvements in the the processes surrounding the levy.

Purpose of this document

- 1.3 This document therefore asks for your feedback on the operation of the new levy system. In particular, we are looking for your views on the relative burden of the process of preparing the annual relevant turnover return (and the effectiveness of our guidance on this). We would also welcome your comments on our treatment of operational issues – particularly around franchise migration and the appropriateness of the various thresholds.

Structure of this document

- 1.4 Chapter 2 deals with the background to the levy, the aims of the review and the review process. Chapter 3 deals with the various issues that we have highlighted for the purposes of this review. These include: scope, definition of turnover, franchise migration and thresholds. Chapter 4 provides a short summary of the document. A list of questions we ask in the text is included at Annex A.

Consultation responses

- 1.5 We invite you to comment on our proposals by 13 June 2008. If possible we would encourage you to respond by email to william.jackson@orr.gsi.gov.uk. However should you prefer, you can also post your comments to:

William Jackson
Business Planning & Corporate Governance

Office of Rail Regulation
One Kemble Street
London
WC2B 4AN

- 1.6 You should indicate clearly if you wish all or part of your response to remain confidential to ORR. Otherwise, we will make it available in our library, publish it on our website and we may quote from it. Where you make a response in confidence, you should attach a summary, excluding the confidential information, which can be treated as above. We may also publish the names of respondents in future documents or on our website, unless a respondent indicates that they wish their name to be withheld.

Question 1: Can we publish your reply?

2. Background

Safety levy background

- 2.1 On 1 April 2006, ORR took over responsibility from the Health and Safety Executive (HSE) for the regulation of health and safety on Great Britain's railways. As part of the transfer, new funding arrangements were developed both to improve on the previous system (which involved inspectors raising individual invoices for chargeable activities) and to reflect the fact that health and safety regulation would now fall to an independent safety and economic regulator.
- 2.2 ORR's health and safety regulation activities are funded by means of the railway safety levy, introduced through the Railway Safety Levy Regulations 2006 (the levy regulations) on 1 April 2006. ORR and the Department for Transport (DfT) consulted widely on the policy proposals and on the draft regulations. The regulations themselves were also subject to a considerable degree of scrutiny during the Parliamentary process which required affirmative resolution in both Houses of Parliament.

Aims of the levy

- 2.3 ORR's stated¹ policy objectives for the levy were to introduce a funding system which:
- was part of a framework that encouraged effective engagement on safety and economic matters;
 - was fair and transparent;
 - was broadly cost reflective;
 - was cost effective (keeping the administrative burden to a minimum);
 - avoided any significant windfall gains or losses;
 - was consistent with ORR's independence;

¹ *Licence fees/safety levy – conclusions* - Office of Rail Regulation, London, November 2005

- was compatible with DfT regulations implementing EU rail directives; and
- was stable over time, facilitating forward planning.

Operation of the levy

- 2.4 As part of our annual planning process, we calculate the total resource required to fund our health and safety regulation activities for the coming year. Stakeholders are consulted on the planning priorities. At the beginning of the year (normally in April) we then write out to all potential levy payers requesting details of their relevant turnover for the year just ended. Potential levy payers have at least two months to provide the information requested and we will be available to deal with any queries on request.
- 2.5 Once all the required details have been received, we calculate the individual levy payments due with the amount payable varying in proportion to turnover. We then publish our determination notice as required under regulation 3(4) of levy regulations, and issue invoices.

Aims of review

- 2.6 The aim of this review is to obtain feedback from levy-payers on the operation of the system in practice. This will allow us to identify any amendments required to ensure the process is robust and remains so over the coming years.
- 2.7 We would therefore welcome your views on your experience with the levy system. We have suggested (in section three below) a number of issues you might like to consider. These should not however be regarded as constraining and we would welcome your comments on any aspects of the system.
- 2.8 For clarity, we should however confirm that we do not envisage a significant *policy* change (for example, a return to direct charging). Neither do we expect to change the current licence fee arrangements, which entail Network Rail meeting the full costs of economic regulation through the licence fee.

Review process

Pre-consultation stage

- 2.9 On 23 November 2007 we wrote to major industry stakeholder groups asking for initial views on the operation of the railway safety levy. Letters were sent to:
- Network Rail Infrastructure Limited;
 - The Association of Passenger Train Operating Companies (ATOC);
 - London Underground Limited;
 - Transport for London;
 - The Rail Freight Group;
 - The Confederation of Passenger Transport UK (CPT); and
 - The Heritage Rail Association.
- 2.10 This was well into the second levy round and seemed to be the right time to gather feedback on the process. The intention of this “pre-consultation” exercise was to bring out any major issues ahead of the main consultation so that these could be addressed as part of that main exercise. Respondents were offered the opportunity to put forward their views at a meeting as well in writing and one body, CPT, took this up. The meeting was held on 5 February 2008.
- 2.11 Written responses were received from four of the recipients.
- 2.12 *Network Rail* – Network Rail anticipated a gradual reduction in the regulatory costs as ORR becomes ever more efficient. Network Rail experienced no significant administrative burden as relevant turnover information was already provided to ORR as part of the regulatory accounts requirements.
- 2.13 *Heritage Rail Association* - The Heritage Rail Association did not want to see any change to the existing arrangements.
- 2.14 *ATOC* – The association consulted a number of members and reported no difficulties with the operation of the levy, nor any suggestion of undue administrative burden.

- 2.15 *CPT* – CPT noted that light rail, tramway operators had had no offsetting reduction in licence fees and that costs were much higher than under the previous direct charging regime. CPT also noted that different contractual arrangements mean that it was not always readily apparent how the railway service provider should identify relevant turnover.

Consultation

- 2.16 This document launches the main phase of the consultation. Copies have been sent to all the 2007-08 levy payers as well as to the major stakeholder groups and other industry parties.
- 2.17 Responses are requested by 13 June 2008 and these will inform our final conclusions on the review, which we expect to publish in the summer.

Implementation of changes

- 2.18 Amendments to the administrative processes surrounding the levy can be implemented through revised guidance. However, any more fundamental changes would require amending legislation (with corresponding timescales). For this reason, any changes arising from this review will not come into effect until 1 April 2009 at the earliest – and we will produce revised guidance if appropriate, for the 2009-10 levy round. For clarity, this means that the 2008-09 levy round will be administered on the basis of the existing arrangements and requests for relevant turnover will be sent to potential levy payers shortly.

3. Issues

Scope of the levy

3.1 Section 43A(1) of the Health and Safety at Work etc Act 1974 (H&SWA) provides for the Secretary of State to make regulations requiring “persons who provide railway services” to pay the safety levy. Section 43A(9) provides that a person provides railway services if he “manages or controls, or participates in managing or controlling a transport system” which falls within paragraph 1(3) of Schedule 3 to the Railways Act 2005. In essence this means:

- passenger train operating companies (franchised and non-franchised);
- freight operating companies;
- infrastructure managers (including Network Rail);
- heritage railways; and
- light rail tramways.

Those outside the scope include infrastructure contractors and vehicle manufacturers/testers. Whilst these entities provide essential services, they do not manage or control “transport systems” within the meaning of the H&SWA.

3.2 Whilst the distinction is reasonably clear in respect of the mainline railway, we recognise that this is not always the case for the light rail/tramways sector, where services may be provided under a variety of different arrangements. In these cases the scope issue is essential in identifying the railway service provider who is liable to pay the levy.

3.3 Taking the Nottingham Express Transit (NET) as an example, a 30.5-year concession to build and operate Line One was awarded to Arrow Light Rail Limited a company owned by six members of a consortium: Transdev, Nottingham City Transport, Bombardier, Carillion, Galaxy and Innisfree. Arrow in turn contracted construction and operation back to the consortium partners: Bombardier built the trams, Carillion built the infrastructure, and the

tramway is operated and maintained by the Nottingham Tram Consortium which is owned by Transdev and Nottingham City Transport. In this situation it is the *Nottingham Tram Consortium* that provides the railway services and hence pays the levy based on turnover received.

Question 2 – Do you have any comments on the scope of the levy or the identification of the railway service provider?

Definition of turnover

3.4 The levy is currently calculated on the basis of relevant turnover for the previous financial year (that is the year from 1 April to 31 March). Relevant turnover is defined in the regulations as “turnover of the railway service provider derived from the provision of relevant services in Great Britain during a financial year after the deduction of trade discounts, value added tax, and other taxes directly related to turnover”. Relevant services means services provided in the course of managing or controlling or participating in the management or control of a transport system falling within paragraph 1(3) of Schedule 3 to the Railways Act 2005. This includes

- fares paid in respect of railway passenger services;
- fees paid in respect of services for the carriage of goods by railway and revenue from charges to customers other than passengers;
- income from access charges to third parties in respect of network, station and light maintenance depots; and
- other sources of revenue support (including grant and subsidy).

3.5 On the last point, the levy regulations specify that relevant turnover includes turnover derived from “aid granted by a public sector operator as defined in section 25 of the Railways Act 1993, if the aid facilitates or promotes the provision of relevant services by the railway service provider”. The intention behind this provision was to ensure that the operating subsidies granted to franchised train operating companies (TOCs) were included in the calculation relevant turnover.

3.6 We recognise however, that this has caused some concern in the light rail sector where capital grants from scheme promoters or other bodies often feature as the principal source of funding for major infrastructure projects such as new lines. In these cases we believe that the relevant turnover return

should *not* include the total amount granted. Turnover should be calculated in accordance with the appropriate accounting standards. Accounting standards generally require a capital grant to be recognised as income over the life of the physical asset to which it relates. So, if a railway service provider receives a capital grant of £100 million to fund the construction of a new line and associated infrastructure, with an asset life of 50 years, the relevant turnover figure for the grant would be £2 million (assuming straight line depreciation) and not £100 million.

- 3.7 It is also important to stress that for start-up operations where the railway service provider has yet to run any services, the relevant turnover will be “nil” as the railway service provider has yet to engage in “managing or controlling or participating in the management or control of a transport system” as laid down in the levy regulations.

Question 3 – Do you have any comments on the definition and calculation of relevant turnover?

Start-up operations

- 3.8 For start-up operations no levy will be payable in the first year of operation. In the second year of operation, the levy will be calculated according to turnover, as above and in the third year of operation the levy will reach its stable level or “norm”.
- 3.9 For example, if a new freight operating company commences operations on 1 June 2008, no levy will be payable for 2008-09. For 2009-10 the relevant turnover will be the amount raised in 2008-09 (which will be 10/12 of the expected norm, i.e. the total turnover for the ten months from June 2008 to March 2009). For 2010-11, the relevant turnover figure will reach the expected norm, i.e. the full year figure for 2009-10.

Question 4 – Do you have any comments on the application of the levy to start-up operations?

Franchise migration and similar situations

- 3.10 We also recognise the need for further clarity around franchise migration and other similar situations (for example, where a concession changes hands). During 2007-08 there were a number of such changes and these gave rise to

questions on the proper apportionment of the safety levy. ORR's position on these is as set out below.

Franchise changes hands during the previous year

- 3.11 Where an operation has changed hands during the previous financial year (i.e. the year in respect of which relevant turnover is calculated) the current operator will be required to provide turnover data for *the whole* of the previous year, obtaining the necessary information from the previous operator.

Franchise changes hands during the current financial year

- 3.12 Where the operation changes hands during the current financial year (i.e. the year in respect of which the safety levy is payable) the current incumbent *at the time the invoice is issued* will be required to pay for the whole year and to reclaim the appropriate amount from the preceding or (as the case may be) succeeding operator. The examples below illustrate how this would work in practice.

Example one

- 3.13 Where a franchise changes hands from franchisee A to franchisee B on 1 July and the invoice is issued on 1 August, franchisee B will be required to meet the whole of the year's levy payment. Our expectation however would be that franchisee B would wish to obtain from franchisee A an undertaking to reimburse the appropriate proportion (in this case 3/12) of the levy.

Example two

- 3.14 Similarly, where the invoice is issued on 1 August and a concession is due to change hands from concessionaire A to concessionaire B on 1 November, concessionaire A will be required to meet the whole of the year's levy payment although again the expectation would be that concessionaire A would wish to secure a commitment from concessionaire B to reimburse concessionaire A for the appropriate proportion of the year's levy – in this case 5/12.

Question 5 – Do you have any comments on the treatment of franchise migration or similar changes?

Thresholds

- 3.15 A key objective underpinning the safety levy was to ensure that transaction costs were reduced to a minimum consistent with focused and effective health and safety regulation. We were also keen to ensure that the levy did not impose a disproportionate burden on the smaller operations notably in the heritage and light rail sectors. To that end there are two key thresholds: firstly, those railway service providers whose relevant turnover is less than £1 million do not pay a levy; and secondly, those railway service providers whose relevant turnover is between £1 million and £5 million pay a flat rate levy of £1000.
- 3.16 We do not propose to amend these thresholds at present. However, in response to concerns raised by the CPT, we propose to introduce a further flat rate, £5000, for those railway service providers whose relevant turnover is between £5 million and £10 million.
- 3.17 As the levy is based on an apportionment of costs, the introduction of a new flat rate will impact on all the levy payers. However, based on the unadjusted figures for the 2007-08 levy payments, our analysis is that the new flat rate band will generate only marginal changes (we estimate an average increase of £150 for levy payers as a whole). At the same time, we believe (again on the basis of the turnover figures underpinning the 2007-08 levy round) that the new threshold will bring two of the seven light rail/tramway operators into a flat rate payment.

Question 6 – Do you have any comments on the proposed threshold arrangements?

Other issues

- 3.18 This document identifies the key issues that emerged from the pre-consultation stage. You may however, wish to raise other issues and we would welcome any other comments you may have.

Question 7 – Do you wish to comment on any other aspects of the safety levy arrangements?

4. Summary

- 4.1 Feedback received from our stakeholders suggests that the railway safety levy is working well and that the objectives set out in the November 2005 conclusions document (see paragraph 2.3 above) are for the most part being achieved. We do however recognise that there may be scope for further improvements in particular for greater clarity in terms of the guidance we provide.
- 4.2 We would therefore be grateful for comments from consultees to be received by 13 June 2008 on the seven questions set out in the document and listed at **Annex A**.

Annex A – List of questions

Question 1: Can we publish your reply?

Question 2: Do you have any comments on the scope of the levy or the identification of the railway service provider?

Question 3: Do you have any comments on the definition and calculation of relevant turnover?

Question 4: Do you have any comments on the application of the levy to start-up operations?

Question 5: Do you have any comments on the treatment of franchise migration or similar changes?

Question 6: Do you have any comments on the proposed threshold arrangements?

Question 7: Do you wish to comment on any other aspects of the safety levy arrangements?