PR23 – Review of Network Rail's access charges

Conclusions on charging framework

20 October 2022

Contents

Executive summary

This document presents our conclusions on how the charging framework for the national rail network should be set for the next control period (CP7).

Access charges are paid by all train operators for use of track and stations owned and operated by Network Rail, the current infrastructure manager. As part of PR23, we have been reviewing this charging framework. We published an initial consultation in July 2021 in which we proposed to retain the existing framework broadly in its current form, while making some incremental changes to ensure it remains fit for purpose in CP7 (particularly in light of the UK Government's rail reform programme). Our further consultation, published in April 2022, presented more detailed proposals for the incremental changes which we were minded to take forward through PR23. It also outlined which aspects of the existing charging structure we considered should be maintained.

Having considered responses to our April 2022 consultation, and further developments since then, we are now confirming which changes we will make to the charging framework for CP7. We have decided to proceed with a limited number of changes which are primarily intended to simplify this framework, and ensure that it remains effective as the planned transition from Network Rail to Great British Railways (GBR) takes place.

Our key decisions for the CP7 charging framework are set out in Table 1 below. Some of these are subject to further review, as we consider it is more appropriate to reach a final view closer to the start of the next control period. We have explained in this document where this applies. We do not intend to revisit our other decisions during the rest of PR23.

We have taken our decisions on the CP7 charging framework based on the existing legal requirements governing access charging, while also ensuring the framework can be applied by GBR as it takes on responsibility for the national rail network. As such, we anticipate that this framework will apply for the duration of CP7. While we refer in this document primarily to Network Rail, our decisions are also relevant for GBR.

However, we recognise there remains some uncertainty around how any transitional arrangements may work as GBR is established, and the timing of this – which we understand is now unlikely to be before the start of CP7. We will work with the Department for Transport (DfT), Transport Scotland and other devolved rail authorities (who will continue to exercise their existing powers and responsibilities in relation to rail), Network Rail, and wider industry, to understand how this may affect the implementation of these charging framework decisions. We expect this work to continue in parallel with the rest of the PR23 programme, and will update industry on relevant developments.

Table 1: Key decisions on CP7 charging framework

Charge		Decision
ICCs	FTAC	• Retain the fixed track access charge (FTAC) for all passenger operators on concession-style agreements, but remove the 'wash-up mechanism'.
	Freight ICC	• Retain the existing market segmentation based on freight commodities. • Retain the infrastructure cost charge (ICC) for: iron ore; spent nuclear fuel; ESI biomass; and ESI coal.
	Open access ICC	• Retain the existing market segmentation which underpins the scope of the ICC for open access services (i.e. interurban and other). • Retain the ICC for interurban services.
Variable charges	VUC	• Retain the existing approach to calculating variable usage charge (VUC) rates – including the cost categories and track damage formulae used. • Maintain the existing phasing-in policy, such that the VUC for freight and charter operators continues to increase (in real terms) to reach full cost reflectivity in the final year of CP7 (subject to review of new cost-reflective VUC rates after the PR23 recalibration stage). • Allow VUC rates to be modified during CP7 if Network Rail / GBR withdraws heavy axle weight capability during CP7.
	Traction electricity (EC4T) charge	• Remove the facility to obtain bespoke EC4T modelled consumption rates for new train services from the start of CP7 (subject to further consideration of how 'generic' consumption rates should be treated in CP7). • Remove the partial fleet metering charging approach (subject to further review later in PR23 of changes in the prospect of take-up of this charging approach). • Remove the loss incentive mechanism used in the EC4T reconciliation process.
	EAUC	• Retain the electrification asset usage charge (EAUC) in its current form.
Station charges	LTC	• Expand the number of station long term charges (LTCs) set using station-specific forecasts, to cover the largest / most complex stations. • Classify new franchised stations (which attract a lower LTC) as 'new' for a fixed five-year term from the date of opening.
Inflation indexation		• Maintain the approach of indexing access charges (and payment rates in other mechanisms) by CPI.

Rest of this document and next steps

Chapters 1 to 4 of this document set out more details on these decisions – including how we have taken account of [responses to our April 2022 consultation]. Our decisions are supported by [impact assessments], which are published alongside this document.

Chapter 5 and Annex 1 of this document provide further details on the remainder of the PR23 charges review. Although this document contains our conclusions on the overall charging *framework* for CP7, the level of each charge will be determined next year following the recalibration of individual charges, and will reflect updated traffic forecasts and Network Rail's overall CP7 funding settlement (as well as the relevant decisions set out in this document). Network Rail leads on the recalibration of most charges, and will shortly be publishing a consultation on this.

While most charges are determined through the recalibration exercise, one exception to this is the ICCs paid by freight and open access operators. This is because the level of these charges takes account of the ability of relevant market segments to bear this charge, which is assessed by ORR. We have outlined our approach to setting these ICCs in this document. We will consult on the proposed level of these charges as part of our Draft Determination, which is currently expected in June 2023.

In the meantime, as explained above, we will continue to monitor the progress of rail reform and the implications for the PR23 charges review, including for the implementation of changes to charging arrangements in operators' track access contracts.

The currently-expected timings of the remaining PR23 milestones are summarised below.

Milestone	Information	Date
Network Rail consultation on recalibration	Network Rail proposals for approach to recalibrating individual charges for CP7 (i.e. the methodologies for calculating charges).	November 2022
ORR Draft Determination	ORR's views on outstanding charging issues (including proposals for level of ICCs) and the conclusions of Network Rail's recalibration exercise.	June 2023
Draft CP7 price lists	Publication of draft price lists for all charges by Network Rail, consistent with ORR Draft Determination.	July 2023
ORR Final Determination	ORR's final view on structure and level of all charges.	October 2023
Review Notices and final CP7 price lists	Publication of Review Notices by ORR, confirming changes to track access contracts for CP7. Publication of final price lists by Network Rail, consistent with Final Determination.	December 2023

Legal consultation on drafting of schedules

Alongside this conclusions document, we have issued a consultation on improvements to the drafting of Schedules 4, 7 and 8 of model access contracts (Schedule 7 relates to track access charges). This consultation invites suggestions for improvements to these schedules in model passenger, freight and charter track access contracts.

The scope of this consultation is limited to changes to improve the existing drafting of these schedules, rather than changes that are required to give effect to our policy decisions set out in this document. A full consultation on updates to model contracts will follow in summer 2023, shortly after our Draft Determination. This will reflect all policy decisions, as well as feedback received through this consultation.

1. Infrastructure cost charges

Summary

All passenger operators on concession-style agreements will continue to pay the fixed track access charge (FTAC). This will be set as an annual charge, based on forecast traffic volumes at the start of CP7, and net of any network grant payments.

For open access operators, we will continue to permit Network Rail / GBR to levy an ICC for interurban services as currently defined (for the purposes of levying this ICC). The level of the ICC is subject to further analysis to be taken forward in the next stage of this review.

For freight operators, we will continue to permit Network Rail / GBR to levy an ICC for services transporting iron ore, spent nuclear fuel, and ESI biomass. We now consider that it would be appropriate to retain the ICC for ESI coal, though we will confirm this decision later in PR23 (pending updated information on forecast volumes for this commodity).

Fixed Track Access Charge (FTAC)

Decision: scope of FTAC

1.1 We will retain the FTAC in CP7 for all passenger operators on concession-style agreements (which form a single market segment, as defined in the Railways (Access, Management and Licensing of Railway Undertakings) Regulations 2016 ("the 2016 Regulations")[1]. The FTAC paid by each operator – which is set net of any network grant payments – will continue to be based on Network Rail's existing fixed cost allocation methodology developed for CP6, subject to some minor changes that Network Rail will consider as part of its recalibration exercise.

Reasoning for decision

1.2 We proposed in our April 2022 consultation to retain the FTAC in CP7. Network Rail supported this approach in its response to our April 2022 consultation. No

[1] Passenger services within the framework of a public service contract. This covers all operators that are commissioned by funders and other devolved rail authorities to provide passenger services, as well as directly operated services (e.g. ScotRail Trains Limited).

other respondents commented directly on this issue or presented any arguments that we had not considered in developing our consultation proposals.

1.3 Our view, based on the reasoning set out in our April 2022 consultation, remains that it is appropriate to retain the FTAC for CP7. We are therefore confirming our decision to maintain this charge.

1.4 As noted in our April 2022 consultation, once GBR is fully established and there is greater clarity over its contractual arrangements for passenger services that it lets and manages, there is likely to be value in reviewing how GBR should recover its fixed costs, within the legislative requirements that apply. This would form part of the next review of charges, to consider further changes beyond CP7.

Decision: FTAC 'wash-up' mechanism

1.5 We will remove the 'wash-up' mechanism currently included in the calculation of operators' FTACs. This will be implemented through a change to Schedule 7 of passenger operators' track access contracts with Network Rail / GBR.

Reasoning for decision

1.6 We said in our April 2022 consultation that we were minded to remove the FTAC wash-up mechanism. This reflected responses to our July 2021 consultation, where respondents broadly supported this proposal.

1.7 No respondent to our April 2022 consultation commented further on this issue. On this basis, and for the reasons set out in our July 2021 consultation, we are confirming our decision to remove this mechanism from the FTAC. This means that operators' FTACs will continue to be set as an annual charge, based on traffic forecasts derived in advance of the start of CP7.

1.8 We have published an impact assessment alongside this document setting out all the factors we have considered, in coming to this decision.

Next steps

1.9 Network Rail is not planning to make any major changes to the fixed cost allocation methodology which underpins the calculation of the FTAC. However, as part of its recalibration exercise, Network Rail is planning to consult on one minor change to simplify the methodology[2]. Network Rail will then publish draft price lists

[2] Network Rail provided an overview of this change in Annex B of its April 2022 consultation response.

in summer 2023, setting out the maximum allocation of FTAC for each operator based on the revised methodology and updated costs / traffic forecasts for CP7.

1.10 We said in our April 2022 consultation that operators' actual FTAC amounts will be net of any network grant payments made by DfT (in England & Wales) and Transport Scotland (in Scotland). Transport for London (TfL) and Merseytravel both emphasised in their consultation responses that the level of network grant can have a major impact on their financial position, through its effect on FTACs. For this reason, Merseytravel said that maintaining the same funding split between CP6 and CP7 would be desirable.

1.11 We have been liaising with DfT to understand the network grant funding that will be made available in CP7. We understand that DfT wants to broadly maintain the total level of fixed costs recovered through FTAC, and amend the level of network grant funding to meet Network Rail / GBR's net revenue requirement for CP7. This approach would serve to limit the changes in FTAC payments that are incurred by operators commissioned by TfL, Merseytravel and other devolved rail authorities[3]. We will continue to work with DfT to understand the funding arrangements that are envisaged for CP7; and with Network Rail to understand how any changes in network grant funding are likely to impact individual operator FTACs[4].

1.12 We also said in our April 2022 consultation that we will work with funders to agree the *process* for confirming the terms of network grant arrangements for CP7, with a view to having in place signed deeds of network grant before we take a final decision on the level of FTACs in our Final Determination. This would serve to provide certainty over the level of network grant funding and the terms of the arrangements.

1.13 If this is not possible, one option we are considering for PR23 would be to set the level of FTACs in CP7 price lists *gross* of any network grant funding (i.e. to recover Network Rail / GBR's total net revenue requirement), but also include a clause in operators' track access contracts that would allow FTACs to be reduced if ORR was satisfied that appropriate network grants were put in place before the start of CP7[5]. This would be a change to the process in PR18, where the level of FTACs

[3] Individual operator FTACs also depend on the outputs of Network Rail's fixed cost allocation process for CP7, which will be affected – among other things – by changes in traffic forecasts.

[4] This issue is less relevant to funding arrangements in Scotland, as FTACs are paid by passenger operators who are commissioned or operated by Transport Scotland. However, we will also work with Transport Scotland to understand in more detail what grant funding it intends to make available.

[5] This clause would work in a similar way to the 'grant dilution' arrangements currently set out in Part 3A of Schedule 7 of operators' contracts, but would provide for FTACs to be *reduced* to a level that is net of network grant payments (rather than increased to compensate for any shortfall in network grant funding).

were set in December 2018 based on an assumed level of grant funding that had not been formally confirmed. We intend to consider this issue in our consultation on the Financial Framework for PR23, which we expect to publish in December.

1.14 Under any approach, we will seek to ensure there is transparency over the allocation and funding of Network Rail / GBR's fixed costs in CP7, and in particular the extent to which these costs are recovered through operators' FTAC or direct network grants.

ICC for open access services

Decision: market segmentation

1.15 We will maintain the existing market segmentation of open access services, under which there are two market segments: interurban and other. We will permit Network Rail / GBR to levy an ICC on interurban services.

1.16 The definition of an interurban service would be the same as that defined for CP6, i.e. a service for which:

(a) at least one station served has average entries / exits above 15 million passengers per year, or is within two miles of a station meeting that criterion;

(b) at least one other station served has average entries / exits above 10 million passengers, or is within two miles of a station meeting that criterion; and

(c) two stations meeting these demand thresholds are at least 40 miles apart.

1.17 We note this definition is based on 2018-19 station entry and exit figures (i.e. the last full year before the Coronavirus (COVID-19) pandemic), for ease of comparison with PR18. In finalising the market segmentation for CP7, we may update the definition above to reflect more recent station usage. This may affect the specific thresholds we set, but it would not significantly change the services included in the interurban market segment[6].

1.18 The relief from this charge that is currently in place for existing open access operators (as defined in PR18) would not have any impact in practice on the charges that these operators face. This is because all services approved before

[6] This is because the market-can-bear analysis we have conducted for PR23 is based on forecasts of passenger usage for CP7, so, while the definition is based on 2018-19 figures, it reflects our up-to-date view on the most appropriate segmentation of open access services in CP7. We published a matrix alongside our April 2022 consultation illustrating the full set of routes covered by the interurban segment, as defined above.

PR18 would continue to fall outside of the interurban market segment that we consider can bear an ICC. We will therefore place our relief policy on hold for CP7.

Reasoning for decision

1.19 As part of PR23, we have reviewed the existing market segmentation that underpins the scope of the open access ICC. We commissioned Steer to update the market-can-bear analysis that was originally undertaken in PR18 to establish this charge. Based on this analysis, Steer considered three possible market segmentations of open access services (including the status quo) that would distinguish services that can potentially bear an ICC, from those which cannot[7].

1.20 After considering Steer's analysis, we proposed to maintain the status quo for CP7 (Option 1 in our April 2022 consultation). This was on the basis that the current segmentation continues to broadly identify those types of service which can bear an ICC, and we did not consider that other definitions of an interurban service would deliver a clear improvement on the status quo, especially given the effect of the pandemic on the market in the two years since the start of CP6.

1.21 Responses to this proposal were mixed:

(a) Some respondents – including Arriva and First Rail – supported maintaining this segmentation of services, largely on the grounds that we set out in our April 2022 consultation (and summarised above). However, Arriva outlined some specific concerns with the detailed market-can-bear analysis underpinning this position.

(b) Grand Union Trains (GUT) said we should amend the market segmentation such that only London-based interurban services pay an ICC (i.e. Option 3 in our April 2022 consultation). It said the evidence and its own experience indicate that non-London flows cannot bear an ICC. GUT also said that if the status quo is maintained, ORR should allow itself some discretion on whether to apply the ICC to prospective services that fall within this segment.

(c) DfT said that Option 2 in our April 2022 consultation (which captured more London-based flows) was more likely to balance the requirements of open access operators and taxpayers[8]. Both DfT and Network Rail also suggested

[7] Steer's full report is published on our website.

[8] Option 2 specifically involved restricting the definition of an interurban service to London-based flows, but lowering the existing distance and minimum passenger usage thresholds (to 20 miles and 5 million entries / exits respectively).

deferring a decision on this issue until later in PR23, when the position on passenger demand recovery may be better understood (though Network Rail said that at this stage, it appears a reasonable position to maintain the existing market segmentation).

(d) TfL said that all open access operators should contribute to the recovery of Network Rail's fixed costs.

1.22 We have considered respondents' views on the candidate market segmentations. Arriva and GUT noted that a significant proportion of services captured by Option 1 are marginally profitable or unprofitable. Restricting the definition of interurban to London-based services (i.e. Option 3) would – under the central scenario modelled by Steer – very slightly lower the proportion of services that are marginally profitable, which lowers the risk of including services that are less able to bear an ICC[9]. However, it would also significantly reduce the proportion of the most highly profitable services captured. This would diminish the effectiveness of the overall policy.

1.23 Likewise, DfT noted that Option 2 captures more of the highly profitable services. However, as noted in our April 2022 consultation, this is sensitive to assumptions about how passenger demand recovers from the pandemic; under a 'low growth' demand recovery scenario, Option 1 captures the same proportion of highly profitable services as Option 2 but a lower proportion – and overall number – of marginally profitable services. This reflects the degree of uncertainty over this analysis, and the fact that passenger services profitability is not neatly clustered by geography or journey type, so there is generally a trade-off when expanding the set of services that are defined as interurban.

1.24 GUT said its own business analysis and exploration of potential open access applications suggests that non-London services would not be able to bear an ICC of £4 per train mile. We recognise that London-based flows generally have higher operating surpluses. However, Steer's analysis – which covers the majority of passenger routes on the network – still indicates the presence of profitable flows in non-London parts of the network, as evidenced by the higher proportion of highly profitable services captured under Option 1[10].

[9] We consider the proportion of marginally profitable services to be more relevant than unprofitable services. For unprofitable service codes, i.e. where operating surplus is negative, it is less likely that open access services would be considered over such routes, whether or not an ICC is applied.

[10] Furthermore, GUT's point was in relation to the existing ICC. We still need to set the level of the ICC for CP7, and this will reflect the latest evidence on ability-to-bear for the specific group of interurban services liable for this charge.

1.25 In this context, and recognising also that Steer's analysis is inevitably reliant on forecasts of how passenger demand continues to recover from the pandemic during CP7, our view remains that Option 1 appropriately balances the factors discussed above. We do not consider that there is sufficiently compelling evidence to amend the existing market segmentation.

1.26 With regards to TfL's suggestion that all open access operators should contribute to fixed costs, we consider this would not be consistent with the legal requirements governing the application of mark-ups, which states that they should only be levied on market segments which can bear a mark-up. Our updated market-can-bear analysis indicates that this is only the case for a subset of open access services (i.e. those operating on interurban parts of the network).

1.27 We have considered Arriva's other comments on the market-can-bear analysis:

(a) Arriva said that there is a risk that **station usage figures** include local commuter markets as well as the utilisation of interurban services. While this is likely to be the case, the station usage threshold we have used to define the interurban market segment is derived directly from looking at the services which exhibit high operating surpluses. We do not therefore consider that a higher station usage threshold would be more appropriate.

(b) Arriva noted that most of the **data in Steer's analysis** is based on operators on concession-style agreements. We consider that we have made sufficient adjustments to this data such that it reasonably reflects the position faced by a generic open access operator. However, Steer noted that the cost analysis may reflect some economies of scale that are in practice not applicable to open access operators, which would tend to lead to an overstatement of ability to bear (all other things being equal). This is something we intend to consider when we determine the level of the ICC.

(c) Arriva (and GUT) said a particular difference between open access and other passenger services is that open access operators often operate **shorter trains**, which limits revenue-earning potential. Arriva said one solution to this would be to set the ICC as a rate per *vehicle* (rather than train) mile. We considered in PR18 whether to levy the ICC based on train miles or vehicle miles. We decided that a rate per train mile is the best charging unit, primarily because it would not disincentivise operators from maximising use of network capacity; and more closely reflects the long-run drivers of Network Rail's fixed costs i.e. number of trains. It also allows Network Rail to recover its fixed costs with a higher degree of predictability. For these reasons, our view remains that a rate per train mile is an appropriate charging unit.

(d) Linked to the above point, Arriva said it is disappointing that the analysis still does not explicitly account for variations in profitability between **time of day / day of week**, as this is a key factor influencing profitability and open access operators often serve off-peak markets. As Arriva notes, there are data constraints that make it difficult to reflect this aspect of the analysis. Nevertheless, we recognise this is relevant to the question of ability to bear for a given market segment, and we will consider how to take account of this in setting the level of the ICC.

1.28 Finally, we have considered the other points raised by GUT and DfT, and summarise our position on each of these points below.

(a) On the **use of discretion**: we considered in PR18 whether to exercise discretion in relation to individual decisions about whether a service falls within the interurban market segment. We still consider this is likely to increase uncertainty, create costs associated with lengthened application timescales, and ultimately discourage open access applications. As such, our view remains that an objective market segmentation definition is preferable.

(b) On the **timing of our decision**: we recognise that deferring a decision on the open access market segmentation could allow us to take account of more up-to-date information on likely passenger market dynamics in CP7. However, we consider it unlikely that there will be significantly greater certainty over this by next summer (when we will be publishing our Draft Determination), even if the analysis was updated with more recent information on passenger revenues and costs. We would therefore only revisit this decision if there are major changes in the passenger market during the rest of PR23 that we consider clearly affects the basis for this decision on market segmentation.

<u>Treatment of existing operators</u>

1.29 In our April 2022 consultation, we also invited views on whether we should maintain relief from any increase in charges as a result of the open access ICC, for existing operators (as defined in our PR18 final determination). Respondents had mixed views on this. Some respondents were in favour of maintaining this relief largely on the grounds that existing operators' business cases were based on the charging framework in place at the time of their access rights being granted, while other respondents said that all operators who can contribute to Network Rail's fixed costs should do so.

1.30 As set out in paragraph 1.18, this question would not have any impact on charges paid in CP7. We have therefore decided to place our existing relief policy on hold for CP7. We will reconsider this policy as part of the next periodic review, if the evidence at that time suggests that we should amend the market segmentation that underpins the scope of this charge (or there are other factors that affect the position), such that this issue becomes relevant.

1.31 For the avoidance of doubt, if an existing operator proposes significant variations to existing services, and that service meets the interurban definition set out above, it would be subject to an ICC. The definition of a significant variation (also known as a 'substantial modification') is explained in Chapter 4 of our March 2019 conclusions document for implementing the open access ICC.

Decision: phase-in arrangements for ICC

1.32 We will maintain the existing phase-in arrangements for new interurban services that are currently in place (as set out in Table 2.2 of our April 2022 consultation).

Reasoning for decision

1.33 DfT was the only respondent to explicitly comment on phase-in arrangements for new interurban services. It said a four-year phase-in profile to the full ICC would be more appropriate than the current five-year profile.

1.34 We do not consider that DfT has provided sufficient reasons to change the current arrangements. The phase-in profile is intended to reflect that new entrants generally do not expect to be very profitable in the early years of operation, and face higher risks than existing entrants. We consider that these factors remain relevant and that new entrants still face greater uncertainty over their business, particularly in light of the impact of the pandemic on passenger demand during CP6. As such, we do not consider the phase-in period should be shortened.

Next steps

1.35 This document sets out our provisional conclusions on the open access market segmentation for CP7. We will only review these positions if there are major changes in passenger market dynamics during the rest of PR23 that we consider we consider clearly affects the basis for these positions.

1.36 The next phase of this work involves reviewing the *level* of the ICC for interurban services. We set out some considerations in our April 2022 consultation that are relevant to this. A few respondents also provided some views on this. In particular:

(a) First Rail said it envisaged the ICC being frozen or reduced in CP7 (given the effect of the pandemic on passenger services).

(b) GUT said a differential ICC should be considered to reflect smaller markets and smaller train size on a case-by-case basis.

1.37 We will undertake this work in parallel with Network Rail's recalibration exercise over the rest of 2022 and early 2023. As set out in our April 2022 consultation, we expect the starting point for this will work will be Steer's updated analysis of operating surplus for interurban routes[11]. However, while Steer's analysis is likely to provide a broad indication of an ICC that can be borne, average operating surplus does not directly determine operators' ability to bear. We will therefore consider additional factors which may affect ability to bear[12].

1.38 We will also have regard to the fixed costs that are allocated to operators under Network Rail's fixed cost allocation methodology. We consider it would not be appropriate for open access operators to pay an ICC which exceeds their total traffic-avoidable fixed cost allocation. In its response, Network Rail included an indicative comparison which shows that the current ICC is below the avoidable fixed cost allocation (on an equivalent basis) for similar interurban services. Before finalising any ICC for CP7, we will ensure this remains the case.

1.39 We will set out specific proposals for the open access ICC in our Draft Determination.

1.40 We do not intend to differentiate the ICC faced by different interurban services. We consider, in light of our market segmentation exercise, that the services we define as interurban can broadly bear an ICC, and we will set the ICC to reflect the characteristics of this group of services. Setting different ICCs for specific operators would increase the uncertainty faced by prospective operators over the charges they would face. It could also require us to undertake a bespoke market-

[11] As noted by First, this forecasts operating surplus across GB passenger services to be lower on average at the start of CP7 than when we previously assessed the market in PR18.

[12] For instance, in PR18, we undertook some case studies of specific interurban service flows which considered variation in operating surpluses within these services (e.g. by time of day).

can-bear exercise for each prospective application, to inform the "not primarily abstractive" test that informs each access decision.

ICC for freight services

Decision: market segmentation

1.41 We will retain the existing market segmentation of freight services, based on commodities carried.

Reasoning for decision

1.42 We said in our April 2022 consultation that we did not consider there is a clear case for amending the definition of existing freight market segments (or for defining sub-segments of existing market segments). Respondents to our April 2022 consultation strongly supported this position, on the basis that the existing segmentation is well-established, practicable and continues to reflect major differences in ability to bear mark-ups on freight traffic.

Decision: commodities eligible to pay an ICC

1.43 We will continue to allow Network Rail / GBR to levy an ICC on services carrying iron ore; spent nuclear fuel; and electricity supply industry (ESI) biomass. We are also minded to retain the ICC for ESI coal, though we will confirm this decision later in PR23, pending updated information on forecast volumes for this commodity. These decisions are consistent with our April 2022 consultation position, except for ESI coal.

Reasoning for decision

1.44 We said in our April 2022 consultation that the available evidence indicates that the commodities which currently pay ICCs can continue to bear a mark-up. This position was informed by a review of these freight markets by CEPA, which focused on market developments since our last review for PR18.

1.45 We did not consider there was sufficient evidence to indicate that other freight commodities could bear a mark-up in CP7. However, CEPA did recommend continuing to monitor the development of the domestic waste market segment during CP7, to understand ability to bear for this segment in more detail.

1.46 Respondents who commented on these proposals broadly agreed that it was appropriate to continue to permit the existing set of freight ICCs to be levied in

CP7. Freightliner and Rail Partners said we should consider the proportionality of these charges, given the low revenues raised, and noted that we have proposed removing the ICC for ESI coal on these grounds. Rail Freight Group (RFG) said it supports the general principle of removing charges when situations arise, but said we should consider whether the potential perception issues from making coal transport cheaper would be outweighed by the benefits of removing this ICC.

1.47 We recognise that the existing revenues generated from freight ICCs are relatively low. However, as a general principle, we consider it is important that all network users contribute to the long-run costs that they impose on the network, where they can do so. This supports the objective of efficient network use, as well as our duty to have regard to the funds available to the Secretary of State. Furthermore, we expect overall freight ICC revenues to be significantly higher by the end of CP6 as the biomass ICC is fully phased-in – and this could increase further over time depending on market conditions (particularly for biomass and spent nuclear fuel, where volumes have changed in recent years). Removing freight ICCs would imply recovering these fixed costs from passenger operators through FTACs, which would ultimately increase the industry's overall reliance on public funding.

1.48 In respect of the ICC for ESI coal, we considered in our April 2022 consultation that the specific circumstances of this commodity – namely that volumes were declining, partly in light of a Government commitment to end the use of coal in energy production by 2024 – created a much stronger case to remove the ICC than for other commodities. Since then, developments in energy markets indicate that the use of coal in energy production may persist beyond the first year of CP7[13]. We also recognise RFG's view that removing a charge for coal transport could be seen to run counter to environmental objectives (even though the sensitivity of this commodity to ICCs is in practice very low, so we would not expect the removal of the ICC to have a significant impact on rail freight volumes).

1.49 In light of this, we are now minded to also maintain the ICC for ESI coal for CP7. However, we will continue to keep this under review until Network Rail has developed freight forecasts for its Strategic Business Plans, and we will take a final decision on the basis of this updated information later on in PR23.

1.50 Finally, TfL said that all freight services should contribute to the fixed costs of network operation. We disagree with this approach, for the same reasons outlined in paragraph 1.26 above.

[13] For example, Drax announced in July 2022 a six-month extension to its coal operations.

Next steps

1.51 We are confirming in this document the scope of ICCs paid by freight services in CP7. As explained above, we will take a final decision on whether to maintain the ESI coal ICC following a further review of forecast volumes later in PR23.

1.52 In the longer-term, as noted in our April 2022 consultation, we intend to continue monitoring the development of the domestic waste market segment during CP7, to understand ability to bear for this segment in more detail. Volumes of domestic waste moved by rail have continued to grow in recent years, and the updated modelling work undertaken by MDS Transmodal indicates that some existing flows of this commodity may be relatively captive to rail. We therefore intend to improve our understanding of the different types of flow within this commodity, to inform any future assessment of the freight market beyond CP7[14].

Level of ICCs in CP7

1.53 In our April 2022 consultation, we sought views from industry about the most appropriate approach to setting the *level* of freight ICCs in CP7. Freight operators, RFG and Rail Partners supported taking a similar approach to setting these ICCs as we did in PR18, whereby ICCs were set to maintain the overall level of total charges in line with the CP5 exit levels (on average). On the other hand, Network Rail said we should set the level of ICCs for all freight commodities on the basis of market-can-bear assessments[15]. Network Rail also provided some information on how current ICCs compare to the effective rate per kgtm implied by the fixed costs allocated to each freight commodity. This showed that:

(a) ICCs for ESI biomass and iron ore recover a relatively small proportion of the total traffic-avoidable fixed costs allocated to these commodities (reflecting that these commodities cannot bear their ‘full’ allocation of fixed costs)[16].

(b) The ICC for spent nuclear fuel recovers a *greater* proportion of costs than its total traffic-avoidable fixed cost allocation. This is not consistent with our approach to setting ICCs in PR18, under which the total traffic-avoidable

[14] Network Rail is currently considering potential improvements to the reporting of volumes for different freight commodities. This may provide an opportunity to disaggregate domestic waste data at a more granular level, in any future assessment.

[15] TfL said these ICCs should reflect the share of fixed costs allocated to operators under Network Rail’s fixed cost allocation methodology. For the reasons in paragraph 1.26, we do not consider this approach would be consistent with the relevant legal requirements.

[16] These proportions were between 15% and 20%. Network Rail did not present figures for ESI coal, given that we had proposed to remove this ICC in our April 2022 consultation.

fixed cost allocation (i.e. excluding any fixed costs that are identified as non-avoidable) set the upper bound for each service's ICC.

1.54 We have considered the approach to setting these ICCs for CP7, taking account of stakeholder views as well as CEPA's review of freight markets. For:

(a) **ESI coal and iron ore**, the relatively low volumes of these commodities mean the revenues raised by these ICCs are low (less than £1 million per year). Furthermore, CEPA did not find any evidence that indicates these commodities could bear higher charges in the medium term. We therefore consider that it would be proportionate to set these charges to broadly maintain the overall level of track access charges (excluding any EC4T payments) for these segments between CP6 and CP7, as we did in PR18.

(b) **Spent nuclear fuel**, we consider that the ICC should be set to recover the total traffic-avoidable fixed costs that are allocated to services transporting this commodity (but no more than this)[17]. This means that spent nuclear fuel services would not contribute to the recovery of Network Rail / GBR's non-avoidable fixed costs, which would align the charge with the existing approach to setting ICCs, under which these fixed costs form the upper bound for each service's ICC. This would likely result in the ICC falling in CP7, relative to CP6, though the precise impact depends on Network Rail's recalibration exercise.

(c) **ESI biomass**, CEPA considered that the position of the biomass market in the short to medium term is likely to be particularly strong, evidenced by continued investments in rail capacity. This ICC also raises significantly higher revenues, given the higher volumes of biomass traffic, than other commodities which pay ICCs[18]. On balance, we consider that it would be appropriate to revisit the evidence underpinning the level of this ICC. This will ensure that it continues to be set at an appropriate level, based on an updated view of ability to bear.

1.55 The main evidence base underpinning the existing biomass ICC is a study of relative biomass transport costs undertaken by MDS Transmodal as part of our

[17] Given CEPA's view that this commodity continues to exhibit a high ability to bear, we consider that an ICC set at this level would be consistent with the relevant legal requirements.

[18] Once the ICC is fully-phased in by the final year of CP6, we estimate this ICC will raise around £3 million per year in revenues – more than the other ICCs combined.

PR18 charges review. We will review and, if necessary, refresh the assumptions underpinning this study before considering the implications for the level of the ICC.

1.56 We will then set out proposals on the specific level of ICCs in our Draft Determination.

2. Variable charges

Summary

We are confirming our decision to retain the existing approach to setting the variable usage charge (VUC). This includes retaining the existing phasing-in policy for VUC rates paid by freight and charter operators (as set in PR18), subject to a further review later in PR23. We will not make any changes to the cost categories or the underlying track damage formulae used to calculate VUC rates. However, we will allow VUC rates to be modified during CP7 if Network Rail / GBR withdraws heavy axle weight (HAW) capability.

For the traction electricity (EC4T) charge, we remain minded to remove modelled consumption rates for new train services from the beginning of CP7, to incentivise take-up of on-train metering. However, we intend to consider further how 'generic' modelled consumption rates should be treated. We also intend to simplify this charge by removing the loss incentive mechanism and the partial fleet metering charging approach.

We will keep the electrification asset usage charge (EAUC) unchanged, beyond recalibration.

Variable Usage Charge (VUC)

Decision: cost categories included within VUC calculation

2.1 We will not make any changes to the cost categories included within the VUC.

Reasoning for decision

2.2 As part of PR23, we have reviewed the findings of some work that Network Rail undertook in PR18[19], to ensure that all costs included in the VUC comply with the definition of a directly incurred cost as set out in the 2016 Regulations and the Commission Implementing Regulation EU 2015/909[20]. We confirmed in our April 2022 consultation that we were content that all the cost categories that are

[19] See Appendix 2 of Network Rail's conclusions on variable charges and station charges in CP6.

[20] The Commission Implementing Regulation (EU 2015/909) is a retained EU regulation which sets out further detail on what qualifies as directly incurred costs.

currently included comply with the legislation, and that we did not intend to make any changes to the cost categories included within the VUC calculation.

2.3 Apart from DfT, who stated that it supported maintaining the existing cost categories that are used to calculate VUC rates, we have not received any specific comments or additional evidence from stakeholders to consider. We will not therefore make any further changes to the VUC cost categories for PR23.

2.4 We note that Network Rail has since identified some discrepancies in the way in which some indirect costs were removed from the VUC calculation in PR18 to comply with the Implementing Regulation. These do not affect our view on the treatment of individual cost categories, as they instead relate to how this assessment was applied. However, they do affect the proportion of costs that are recovered through the VUC. Network Rail will set out further detail on this in its recalibration consultation, including a broad indication of the magnitude of the impact of addressing these discrepancies for CP7.

Decision: track damage formula

2.5 We will not make any changes to the underlying track damage formulae used to calculate VUC rates.

Reasoning for decision

2.6 In our April 2022 consultation, we noted that Serco (on behalf of RSSB) has been conducting a review of some aspects of the Vehicle Track Interaction Strategic model (VTISM), which underpins the calculation of VUC rates. This work identified four development areas where Serco considered there is potential scope for technical refinements to the VTISM methodology. These refinements have the potential to affect both: (i) the overall proportion of Network Rail's track-related costs recovered through the VUC; and (ii) the formula which estimates the relative vertical track damage impacts caused by different vehicle types.

2.7 We said that we would continue to engage with RSSB, Network Rail and the rest of industry on this work as it progresses. However, given the timing of this work, we did not consider that it would be proportionate or feasible to revise the vertical track damage formula that is used to allocate variable usage costs to vehicles, based on their characteristics, to set individual VUC rates for CP7. We proposed to commence early work with Network Rail and industry during CP7 to develop a new vertical track damage formula and understand the implications for VUC rates. This would inform the next review of this charge, to set the VUC beyond CP7.

2.8 All respondents who commented on this issue agreed that it is too late in the PR23 process to update the vertical track damage formula, on the basis that there is unlikely to be enough time for sufficient stakeholder engagement on the issue and to implement any revisions. Respondents also noted that updating the formula would create uncertainty and instability for operators[21]. Network Rail, RFG and Govia Thameslink supported our proposal to revisit this issue early in the next control period[22]. As such, we will proceed on this basis for PR23. This will provide greater certainty for freight operators over their charges, and allows us to properly consider new evidence on track wear-and-tear impacts while the existing VUC phasing-in policy (discussed below) is fully implemented.

2.9 We note that Freightliner and Rail Partners opposed any revisions to VTISM that would impact the VUC – including in relation to the proportion of track-related costs recovered through the VUC – for the same reasons as outlined above. We have engaged further with Network Rail on this point since April 2022. We understand that the refinements to VTISM planned by Network Rail are not primarily driven by the outputs of Serco's review, and are unlikely to have a significant impact on VUC rates, which draw on a range of inputs (of which VTISM is only one). We consider that – unlike a change to the track damage formula – these refinements are consistent with the normal process of improving modelling accuracy in each periodic review. We therefore support these minor changes being made for PR23.

Decision: VUC phasing-in policy

2.10 We remain minded to retain the existing VUC phasing-in policy as set in PR18, such that the VUC for freight and charter operators continues to increase (in real terms) at a uniform rate to reach full cost reflectivity in the final year of CP7.

2.11 However, we will keep this policy under review until after the PR23 recalibration stage, which we expect to conclude in summer 2023. If the recalibration exercise results in significant changes in cost-reflective VUC rates at the end of CP7, we would review our position at that stage.

[21] Some respondents disagreed with the statement we made in our consultation that the existing phasing-in policy would serve to mitigate the impact of any changes in (uncapped) VUC rates that result from a change to the VUC methodology, as fully cost reflective rates will be paid by the end of CP7 (or, in the case of some commodities such as intermodal, before then).

[22] Northern Trains said it would welcome further consultation on Serco's findings when they are released, and DB Cargo said it would like to understand the updates in more detail.

Reasoning for decision

2.12 We said in our April 2022 consultation that we were minded to retain the existing VUC phasing-in policy set in PR18. This followed a mixed response from stakeholders to our July 2021 consultation. Several stakeholders (including DfT and Network Rail) supported this proposal, but most freight industry respondents did not support the proposal. Freight industry respondents said that fully unwinding VUC caps would be inconsistent with governments' environmental and rail freight growth objectives, as it could deter modal shift from road to rail.

2.13 In our April 2022 consultation, we reiterated our view that the existing policy is consistent with governments' aspirations in respect of the environment and rail freight growth, as set out in the Plan for Rail, and supports longer-term stability and predictability in charges for freight operators. We also explained that any caps must be time-limited to comply with the existing legal requirements governing charges that recover directly incurred costs.

2.14 Five stakeholders provided further comments on this proposal in response to our April 2022 consultation. DfT and Network Rail reiterated their support for our position. DfT said this reflects the UK Government's aim to support the freight industry to maximise its economic and environmental benefits, and to support the opportunities provided by charter services. However, Transport Scotland, Freightliner and GB Railfreight reiterated concerns that this would be inconsistent with governments' environmental and rail freight growth objectives. Freightliner said it would be preferable to pause further phasing-in of VUC increases, though it welcomed our intention to keep the policy under review in PR23.

2.15 We have previously considered these points raised. We consider that our existing VUC phasing-in policy, set in PR18, took account of the full range of our relevant Section 4 duties and is intended to support rail sector stability (consistent with these duties), while remaining compliant with the existing legal legislation. In their responses to our consultations, stakeholders have not presented any new evidence which we consider challenges this view[23]. For these reasons, we intend to continue with the existing phasing-in policy as set in PR18.

[23] Transport Scotland noted the findings of the study that we commissioned by MDS Transmodal to assess the likely impacts on rail freight volumes of unwinding VUC caps. Transport Scotland said these impacts do not appear to be compatible with Government objectives to increase rail freight. However, as noted in our April 2022 consultation, these impacts remain broadly in line with the expected impacts when we set this policy in PR18. In any case, for the reasons explained above, we consider that caps on VUC rates must be time-limited to comply with existing legal requirements.

2.16 However, as we stated in our April 2022 consultation, we will keep this decision under review until after the PR23 recalibration stage, which we expect to conclude in summer 2023. If the recalibration exercise results in significant changes in cost-reflective VUC rates at the end of CP7, we would review our position at that stage.

2.17 We will also review and determine the precise rate of growth in VUC rates to be applied over CP7. Factors that might influence this include Network Rail / GBR's underlying maintenance and renewals costs in CP7 as well as the overall level of charges faced by operators in the round.

Decision: heavy axle weight

2.18 We will allow Network Rail to amend the VUC guidance for CP7 to include a clause which stipulates that a new VUC rate should be calculated for existing vehicle types that are downgraded to a lower than heavy axle weight (HAW) route availability (RA)[24], following a decision by Network Rail / GBR that it is necessary to withdraw HAW access rights during CP7.

2.19 For the avoidance of doubt, this change will only protect operators from the risk of *unanticipated* withdrawals of HAW availability. It will not be possible to recalculate a VUC rate during CP7 if an operator decides not to use their HAW access rights as agreed between Network Rail and operators at the beginning of CP7; or if Network Rail made clear in advance of determining CP7 price lists that a specific route will have HAW capability withdrawn on a specific date during CP7.

Reasoning for decision

2.20 In their responses to our July 2021 consultation, DB Cargo and Freightliner suggested that the VUC guidance should be reviewed, in order to allow a new VUC rate to be calculated if Network Rail / GBR considers it necessary to remove HAW capability during a control period. In our April 2022 consultation we said we considered this would be an appropriate change to make, as in such circumstances it would not be reasonable for operators to bear the risk of Network Rail / GBR making unanticipated changes in HAW access rights.

2.21 Respondents – including both funders – were broadly supportive of the proposal, noting that the change would avoid over-recovery of costs from Network Rail / GBR in the event of changes to RA. Rail Partners and GB Railfreight agreed that the administrative costs of this change would likely be outweighed by the benefits it would create. Freightliner said that the change may incentivise Network Rail to

[24] Route availability (RA) is a measure of the axle load that the network infrastructure can safely bear.

avoid downgrading the infrastructure. Network Rail also supported the proposal in the event there is an unanticipated requirement to downgrade RA to lower than HAW, in so far as the downgrade has a direct effect on characteristics.

2.22 However, several respondents, including RFG and DB Cargo, stressed the importance of maintaining HAW capability and said that the potential to revise VUC rates should not be seen as an alternative to providing the capability. We agree with this view, and we will continue to work with Network Rail and funders on this aspect of its network capability. Furthermore, as noted by Freightliner, we consider that this policy should if anything strengthen Network Rail / GBR's incentives not to remove HAW capability.

2.23 The current VUC guidance specifies the steps that must be followed when a new VUC rate is introduced. This includes that Network Rail and the operator must seek ORR's consent to the new VUC rate being applied, as well as Network Rail's publication of the new VUC rate consented to by ORR on its website. This process will continue to be followed in the implementation of this policy.

Next steps

2.24 Network Rail will shortly publish a consultation on its recalibration of the VUC (along with other charges). It will then set out revised VUC rates as part of its draft price lists, which are expected in summer 2023. This will take account of feedback to its consultation, as well as incorporating our proposals for the precise rate of growth in freight and charter VUC rates to be applied over CP7 (which we plan to set out in our Draft Determination).

2.25 Network Rail will also update the existing VUC guidance. This will reflect our decision in respect of modifying VUC rates if Network Rail considers it necessary to withdraw HAW capability, as set out above. We expect this to be made available to the industry in advance of the start of CP7.

2.26 In the longer-term, Network Rail will also begin planning the work needed to review the track damage formula that is used to determine VUC rates for individual vehicles, taking account of Serco's study. We expect this work to formally start early in CP7, i.e. once PR23 has been completed, and will involve input from wider industry.

Traction Electricity (EC4T) Charge

Decision: modelled consumption rates

2.27 We remain minded to remove the facility for new train services to obtain ‘bespoke’ modelled consumption rates from the beginning of CP7, as a way of being billed for EC4T. For the purpose of this policy, a new train service would be defined as in our April 2022 consultation, i.e. any service that uses vehicles that are brand new to the industry, or existing vehicles that require a new modelled consumption rate (for example because their operator moves them to a new service code). This means there would be no provision to apply for, and have approved, a new modelled rate from the start of CP7.

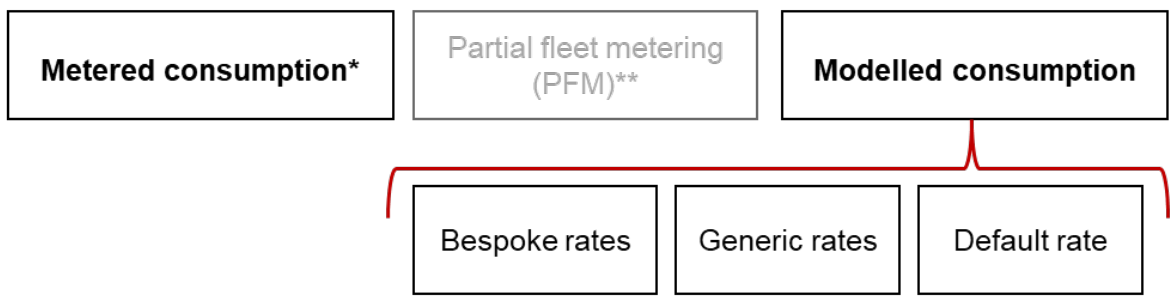
2.28 This is primarily intended to incentivise greater take-up of on-train metering (OTM). However, the effectiveness of this policy in achieving this aim is likely to be affected by the treatment of ‘generic’ consumption rates in CP7. Network Rail has suggested in its response to our April 2022 consultation that these rates should also be removed for CP7, for both new and existing train services, and it will consult further on this specific change as part of its recalibration consultation.

2.29 We intend to consider further whether there should be any changes to the availability of generic rates in CP7, taking account of responses to Network Rail’s consultation. We will then set out a full view on this in our Draft Determination.

Reasoning for decision

2.30 The EC4T charge is calculated based on one of the following three approaches: (a) metered consumption (based on readings taken from meters on trains); (b) modelled consumption (based on estimated consumption, subject to an end of year volume reconciliation exercise); or (c) partial fleet metering, or PFM (which extrapolates metered consumption from metered trains to estimate consumption for un-metered trains).

Figure 2.1: Summary of EC4T charging approaches



**Once a service opts into metered consumption, it can only be charged using that approach.*
***PFM is offered under the Traction Electricity Rules, but no operator has opted into this charging approach.*

2.31 Modelled consumption can itself be estimated using one of the following types of consumption rates: (a) 'bespoke' rates; (b) generic rates; (c) default rates. These are described in more detail in Table 2.1 below.

Table 2.1: Traction electricity modelled consumption rates

Modelled rate	Description	Applies to
'Bespoke' rates	A set of estimated consumption rates for a given vehicle type on a specific train service code, i.e. operating on a particular part of the network.	Passenger / freight operators of electrified services who have applied for a bespoke rate(s).
Generic rates	A set of estimated consumption rates for a given vehicle type operating anywhere on the network.	Any passenger / freight operator of electrified services which uses the relevant vehicle type.
Default rate	A single set of rates for passenger services – equal to the highest rates on the modelled rates list – which is primarily to allow for traction electricity to be billed while waiting for a bespoke modelled rate to be approved, or for OTM to be set up.	Passenger operators of electrified services. (A default rate is not currently available for freight traction.)

The traction electricity modelled consumption rates list for CP6 is published on Network Rail's website.

2.32 In our April 2022 consultation, we proposed to remove the possibility for new train services to be given new bespoke modelled rates. For the purposes of this proposal, we defined "new train services" as any service that uses vehicles that are brand new to the industry, or existing vehicles that require a new modelled consumption rate.

2.33 We received a mixed response to this proposal. Arriva, First Group, Govia Thameslink and Network Rail fully supported the proposal. Network Rail further suggested that we should consider removing the existing 'generic' consumption rates from the traction electricity modelled consumption list, to further simplify this charge and strengthen incentives to take up OTM.

2.34 DB Cargo, Freightliner, Southeastern, and Rail Partners supported the removal of modelled consumption rates for services introduced in CP7 using new rolling stock, but not for old rolling stock. Other respondents did not support the proposal. They raised the following concerns:

(a) the availability of new modelled rates provides an alternative when meters cannot function properly, including in cases of teething problems with commissioning and setting up the metering interface;

(b) some older freight trains are technically unable to be fitted with meters;

(c) the proposal would remove freight operators’ capability to introduce new services at short notice, in response to changes in customer demand;

(d) meter fitment may not be cost effective particularly in areas with few operators, and a high proportion of existing metered trains; and

(e) the proposal could lead freight operators to increase the use of diesel traction or deter modal shift to rail, which would be inconsistent with governments’ environmental objectives.

2.35 We have reviewed our April 2022 proposal, taking account of the points raised by respondents. Our view remains that there are clear benefits to the use of metered consumption of EC4T. This is the most cost-reflective and accurate charging approach for traction electricity. We also consider that it strengthens operators’ incentives to optimise their traction electricity consumption on the network, as they pay the actual cost of their energy consumption[25]. In doing so, this can improve the overall efficiency and environmental sustainability of the rail network, which is a key priority for governments and wider industry.

2.36 Greater use of metered consumption would also help to simplify the administration of the EC4T charge. Billing for EC4T using modelled consumption involves an end-of-year volume reconciliation exercise, which can be complex and time-consuming, and often involves large wash-up payments between Network Rail and operators. We are also aware that some operators choose to participate in this, despite having OTM capability. Over time, moving the network towards full metering should help to reduce the scale and complexity of this exercise, and limit any perverse consequences that may result from operators ‘self-selecting’ into a billing approach which is based on estimated rather than actual consumption.

2.37 Furthermore, OTM provides information about the specific amount of energy required to power electric trains. As such, it can improve Network Rail’s overall picture of where and how traction energy is being consumed across network. This could help it to identify factors that affect energy efficiency (e.g. if very high meter readings were recorded over a particular portion of track), which may in turn inform future improvements to electrified parts of the network.

2.38 At the same time, we recognised in our April 2022 consultation there are some costs involved in changing EC4T billing approaches. This is why our proposal applied only to new train services introduced from the start of CP7, with existing

[25] In contrast, modelled consumption is based on estimated rates and, despite the volume reconciliation exercise, provides for a less direct link between usage of traction electricity and EC4T payments.

train services being able to continue being billed using bespoke modelled consumption rates. This would allow operators to manage the impacts of this change more easily, as it would only apply where a new train service code is required (rather than to their entire fleet of services).

2.39 Against this context, we have considered respondents' specific points in relation to the implications of this proposal. We firstly consider the treatment of bespoke modelled rates, which was the focus of our April 2022 consultation. We then consider the implications for, and interplay with, use of generic and default rates.

<u>Bespoke modelled rates</u>

Technical issues with OTM for new and existing rolling stock

2.40 We expect that some new services introduced during CP7 would use new rolling stock. We understand that all new rolling stock comes fitted with on-board meters. Moreover, we are aware that meters go through extensive quality assurance processes, and we have not yet seen any evidence that they are either inaccurate or difficult to use. We consider that the teething problems that may occur in the process of setting up the metering interface are a normal part of adopting a new technology and should be addressed by industry, rather than abandoning the use of meters just because modelled consumption rates are an available alternative.

2.41 Regarding existing rolling stock, we asked train operators to share with us information regarding the size of their fleet that cannot be fitted with meters, and the reasons this would be the case. The information we received suggests there are no major barriers that would prohibit existing rolling stock which is already being used on Network Rail's network to be fitted with meters.

2.42 As noted in our April 2022 consultation (and explained further below), in the event of any delays to setting up metered billing processes, operators would not be prevented by this policy from using traction electricity on the network, as they could be temporarily billed for EC4T consumption using a default or a generic modelled consumption rate while waiting for metered consumption to be set up[26].

[26] We discuss the availability of these rates for different types of operator in more detail below.

Flexibility to respond to changes in demand

2.43 We have considered whether this proposal would affect the ability of operators to respond to customers' demand by introducing new services at short notice, as suggested by some freight respondents.

2.44 Firstly, we note that applying for and approving new modelled rates can itself often take time. To the extent that there are longer lead times associated with opting into metered consumption, a new freight service could be billed using generic consumption rates while waiting for metered billing processes to be set up. Once this is done, Network Rail would use metered consumption data to recharge these journeys (up to a limit of 12 months from the introduction of a new service)[27].

2.45 We consider that this should allow sufficient flexibility in circumstances where a new train service is introduced at short notice, while at the same providing an incentive to set up OTM processes as soon as reasonably practicable.

Use of other traction modes

2.46 We have considered the possibility that this proposal may increase or prolong the use of diesel traction (or other transport modes), by prohibiting electric traction or making it more costly to switch to this traction mode. We consider the risk of this outcome to be very low. We have explained above why we do not consider there are barriers which prohibit new services having OTM capability. Although we recognise that introducing a new service using older electric rolling stock would incur some incremental costs in fitting a meter, we consider this is unlikely to affect the decision about which traction mode to deploy. This is because:

(a) firstly, there is a separate cost to operators in obtaining a bespoke modelled rate, which we understand from Network Rail is around £12,000. This reduces the risk that, by removing the facility to obtain a new modelled rate, this *specific proposal* will deter the use of electric traction (or use of rail).

(b) the use of diesel traction involves additional incremental costs that would offset any incremental costs associated with OTM. For instance, diesel locomotives are generally heavier and therefore liable for a higher VUC rate.

[27] We also note that data on applications for new modelled consumption rates for the last three years, i.e. since the beginning of CP6, indicates that there were no applications for new freight rates in this period. This indicates that freight operators can respond to customer demand without having to apply for a new modelled consumption rate.

They are also slower than electric locomotives, which could result in higher staff costs (e.g. driver salaries);

(c) greater reliance on diesel traction would run counter to operators' longer-term corporate objectives to support more environmentally friendly network use.

2.47 We recognise that freight operators have changed traction type in the recent past, most notably in response to rising traction electricity prices. However, we consider the circumstances prompting that action are materially different to those being considered here, as the magnitude of these changes in EC4T prices was significantly larger than the incremental cost of retrofitting a meter[28] – particularly when considering that OTM is largely a one-off rather than an ongoing cost[29].

2.48 Furthermore, freight operators have emphasised that the move to diesel traction was a temporary response to energy price changes, rather than a longer-term move away from electric traction, and that they remain committed to improving the environmental impact of their operations (which we consider would be supported by metering).

Generic and default consumption rates

2.49 We have considered Network Rail's suggestion of also removing generic consumption rates for CP7. The traction electricity modelled consumption rates list shows that bespoke modelled consumption rates can be much higher or lower than an equivalent generic consumption rate for the same vehicle type. This reflects that bespoke rates are more cost-reflective than generic rates, as their calculation takes account of more factors likely to affect energy consumption, including the geographical characteristics of the area where the service operates. On average, bespoke modelled consumption rates are higher than generic rates.

2.50 This indicates that a policy of removing the facility to obtain new bespoke modelled rates would more effectively provide operators with an incentive to adopt OTM if we also removed the availability of generic consumption rates in CP7. This is because it could otherwise lead operators to instead adopt an existing generic consumption rate, rather than opting into OTM. This would mitigate the intended benefits of this proposal. It could also inadvertently lead to a *less* cost-reflective

[28] We have previously estimated the cost of an on-train meter to be around £12,000 for AC train-sets and £24,000 for DC train-sets.

[29] Moving to diesel traction could also create additional administrative and logistical issues. For example, the fact that diesel trains are slower may affect timetables and availability of network paths, and (by extension) the timely fulfilment of operators' delivery contracts. It may also require new arrangements for maintenance and stabling facilities.

charging regime if more services are billed using generic rather than bespoke modelled rates.

2.51 However, removing generic consumption rates would have broader implications for operators of electrified services. In particular:

(a) We understand that a significant number of **passenger services** are currently billed for EC4T consumption using a generic consumption rate. As such, if generic rates were removed from the traction electricity modelled consumption list, these services would have to adopt a new billing approach for CP7. The feasibility of this, both for operators and Network Rail, would depend on several factors, including (i) the degree to which these services already have OTM capability (but have not yet opted into metered consumption); and (ii) operators' plans to meet contractual requirements to use metered consumption as soon as reasonably practicable[30].

(b) As there is currently no *default* consumption rate available to **freight services**, alternative arrangements would need to be put in place to ensure that freight services could be billed for EC4T consumption while waiting to set up metered consumption e.g. the introduction of an equivalent default rate.

2.52 These issues would need to be considered further before any decision is made about the ongoing availability of generic consumption rates for CP7, for both passenger and freight services. Network Rail has been considering in more detail how the removal of generic rates would work (including the points noted above), and has agreed that it would be worthwhile to consult further on this potential change as part of its recalibration consultation.

<u>Overall view</u>

2.53 In summary, we do not consider that the points raised by respondents preclude us taking forward the proposal to remove new bespoke modelled rates from the start of CP7 for all new train services as defined in our April 2022 consultation, i.e. those using both old and new rolling stock. For the reasons explained above, we consider that operators are technically able to use on-train meters (or install them where necessary); any additional costs would be limited only to the introduction of new services; and the risks of any drawbacks (in terms of responding to consumer demand or switching traction type) are low. This is set against the benefits

[30] Specifically, operators who currently hold concession-style agreements with DfT, as this is a condition of these agreements.

associated with greater OTM that this policy could deliver, as set out in our previous consultations, and summarised above.

2.54 However, as also noted above, we recognise that the benefits delivered by this policy could end up being quite small in practice, particularly if new services are able to use a generic consumption rate in CP7. To ensure that we are providing the most effective incentives to move to metered consumption, we therefore consider there is value in giving further consideration to the feasibility and impacts of also removing generic consumption rates for CP7. Network Rail will consult on this issue, and we welcome industry providing views on the likely implications of extending the policy to generic rates.

2.55 We then intend to set out a final proposal on this issue in our Draft Determination, taking account of responses to Network Rail's consultation and its conclusions. Alongside this, we will publish a full impact assessment on the overall package of changes to modelled consumption rates for CP7.

Decision: PFM charging approach

2.56 We remain minded to remove PFM. This is one of the three approaches that is currently available to calculate the EC4T charge (although no operator has opted-in to this approach since it was introduced). This means that EC4T charges in CP7 would be calculated using either metered or modelled consumption.

2.57 However, we will keep this decision under review until later in PR23, taking account of whether there has been any take-up of PFM during the rest of CP6, and if there has been any change in the prospect of its potential use in the future.

Reasoning for decision

2.58 We said in our April 2022 consultation that we were minded to remove PFM as a charging option. This reflected responses to our July 2021 consultation, where all respondents who commented on this issue supported our proposal, on the basis that PFM appears to be complex but of little value to operators, given that no operator has chosen to use it since its introduction in PR13. We also did not consider that removing PFM would discourage the use of full OTM, as we are not aware of any evidence suggesting that it has had any influence on train operators' incentives to take up OTM.

2.59 Apart from DfT, who reiterated its support for our proposal to remove PFM, no other respondent to our April 2022 consultation commented further on this issue.

For the reasons summarised above, we are therefore minded to proceed with this proposal (subject to taking a final decision later on in PR23 as explained above).

2.60 We have published an impact assessment alongside this document setting out all the factors we have considered, in coming to this decision.

Decision: loss incentive mechanism

2.61 We will remove the loss incentive mechanism from the EC4T volume wash-up. This will be implemented through a change to the volume reconciliation formula in Section 18 of the Traction Electricity Rules (TERs), such that Network Rail / GBR is not allocated a proportion of wash-up volumes to reflect transmission losses.

Reasoning for decision

2.62 We said in our April 2022 consultation that we were minded to remove the loss incentive mechanism from the EC4T volume wash-up. This reflected that this mechanism has not been effective in meeting its intended objective of incentivising Network Rail to reduce transmission losses, and has actually increased the overall level of operators' EC4T payments. We said that we do not consider it would be proportionate to try to redesign this mechanism, mainly due to the errors in modelled consumption estimates and distribution system loss factors (DSLF) which are not practically possible to fully eliminate[31]. Moreover, removing this mechanism would simplify the calculation of EC4T payments.

2.63 This position also reflected responses to our July 2021 consultation, where most respondents agreed with this proposal. However, some respondents said that Network Rail should, where possible, be incentivised to reduce transmission losses. We agree that this is an important issue, particularly in light of the high energy costs facing industry. For the reasons set out above, we do not consider that retaining or redesigning this loss incentive mechanism would effectively support this aim. However, as we move to fully metered consumption and errors in EC4T consumption recordings are reduced, this could in future allow us to design a mechanism that is more effective in incentivising Network Rail / GBR to reduce transmission losses.

2.64 No respondent to our April 2022 consultation commented further on this issue. For the reasons summarised above, we are confirming our decision to remove the loss

[31] At each periodic review, we have worked with Network Rail to recalibrate the DSLFs. Network Rail has recalibrated DSLFs again for CP7 and will include this in its recalibration consultation. However, as these estimates are derived from an engineering model, we do not expect them to be fully accurate.

incentive mechanism from the EC4T volume wash-up in CP7. We have published a full impact assessment alongside this document setting out all the factors we have considered, in coming to this decision.

Next steps

2.65 As noted in paragraph 2.57, we will continue to monitor PFM take-up during the rest of PR23. We will also consider the outcome of Network Rail's recalibration consultation in respect of the availability of generic consumption rates in CP7. We will confirm our provisional decision on both issues in our Draft Determination.

2.66 In the meantime, we will consider the changes to the TERs, and to Schedule 7 of operators' track access contracts, that are necessary to implement these decisions on the EC4T charge. We expect to consult on the form of those changes next summer, shortly after our Draft Determination (see Section 5 for more details).

2.67 We will also continue liaising with funders and wider industry in relation to the impact of higher electricity prices. Although variations in these prices are not controllable by Network Rail, as prices are set by the electricity market, we recognise that this can significantly affect train operators' (and their commissioning authorities') use of electric traction on the network. We held a workshop over the summer to clarify operators' options in respect of locking-in EC4T prices for a duration of time (or not locking in), which may help operators to manage their costs (particularly for freight). We will also continue to monitor Network Rail's procurement of traction electricity on behalf of train operators, as set out in Section 19 of the TERs, to ensure that it implements a procurement strategy as effectively as possible[32].

Electrification Asset Usage Charge (EAUC)

Decision: structure of EAUC

2.68 We will retain the EAUC in its current form.

Reasoning for decision

2.69 We said in our April 2022 consultation that we were minded to make no changes to the EAUC in PR23, beyond recalibration. This reflected responses to our July 2021 consultation where most respondents supported our proposal, largely on

[32] In the longer-term, as explained above, we consider that moving the network towards full metering will help to promote more efficient use of traction electricity.

proportionality grounds. Apart from DfT, who reiterated its support for this proposal, no other respondent to our April 2022 consultation commented further on this issue. We are now confirming our decision to make no changes to the structure of this charge through PR23.

Next steps

2.70 Network Rail will recalibrate the EAUC along with other variable charges, and will set out revised rates as part of its draft price lists in summer 2023.

Charter slot charge

2.71 In addition to other variable charges, charter operators pay a slot charge to Network Rail. The purpose of this charge is to recover Network Rail's costs for activities undertaken specifically for charter services for which it is not otherwise funded (e.g. bespoke gauging activities).

2.72 There is currently a single slot charge for diesel / electrified services, levied at a flat rate per journey. There is a separate slot charge for steam-driven services, which varies depending on the length of the journey (with journeys that are defined as exceeding 250 miles attracting a higher charge per journey)[33].

2.73 We have not proposed to make any changes to the slot charge through PR23. As part of its recalibration of charges, Network Rail is considering combining the slot charges for steam services into a single uniform rate for all journey lengths. We understand this is primarily because Network Rail has changed the way that it undertakes gauging activities, such that the costs of these activities are now less closely driven by journey length.

2.74 In principle, we consider that would be an appropriate change to make and would simplify the billing process for charter operators, while having a very small impact on the overall amount paid. We will consider the outputs of Network Rail's recalibration exercise – including views from industry – in deciding whether to confirm this change to the charter slot charge next summer.

[33] Additionally, there is another charter slot charge for repeat business journeys.

3. Station charges

Summary

We are confirming our decision to make two small changes to how the long-term charge (LTC) is set for some of the largest stations, as well as for new stations that open during a control period. Network Rail will implement these changes as part of its recalibration of station LTCs.

We will continue to review and approve the management fee element of the qualifying expenditure (QX) charge for managed stations. Network Rail will submit its proposal in respect of this fee later in PR23. The fixed element of this charge will continue to be agreed by Network Rail and passenger operators.

Station Long Term Charge (LTC)

Decision: definition of a large / complex station

3.1 The station LTC for 32 large / complex stations will be calculated using station-specific expenditure forecasts in CP7, with the remainder of station LTCs calculated using a 'category-averaging' approach that is currently used to calculate franchised station LTCs. This was 'Option B' in our April 2022 consultation.

3.2 The full list of large / complex stations is set out in Table 3.1 below. As shown in Table 3.1, this change slightly increases the number of station LTCs that are calculated using station-specific forecasts. It also means the LTC for one station – Guildford – would move from a station-specific to a category-averaging approach.

Reasoning for decision

3.3 In our April 2022 consultation, we said that we are minded to pursue our proposal to align the calculation of the largest franchised stations with the methodology currently used to calculate managed station LTCs, i.e. based on station-specific expenditure forecasts. We consulted on two possible definitions of a large / complex station (with a preference for option B)[34]:

[34] The stations covered by these definitions are set out in Table 4.1 of our April 2022 consultation.

(a) **Option A**: The six busiest stations in each of Network Rail's five regions, measured by passenger usage (i.e. 30 stations in total); and

(b) **Option B**: Option A, adjusted to take account of the different distributions of station sizes between regions, such that slightly more stations in the Southern region are included, and slightly fewer stations in the Scotland and Wales & Western regions are included.

3.4 Most respondents who commented on this proposal favoured basing the LTC calculation methodology on station size, rather than managed or franchised station status (as is currently the case). Southeastern noted that this could increase the administrative burden on operators. As the options considered only involve a modest revision to the number of station LTCs being calculated using station-specific expenditure, and this will increase the level of transparency over maintenance, repair and renewal (MRR) costs at these stations, we consider this is a proportionate change[35].

3.5 Of the two definitions of a large / complex station, most respondents agreed that Option B was the more appropriate definition. Network Rail said Option A is marginally preferable since it better addresses the distorting effect of larger franchised stations on LTCs of smaller franchised stations. In practice, as shown in our April 2022 consultation, the two definitions are very similar – and Option B still ensures the largest stations in each region would be removed from the expenditure forecasts that are used to set franchised station LTCs. On balance, we therefore remain of the view that Option B is the more suitable definition to use.

3.6 Nexus and TfL noted the potential financial implications of this proposal. TfL said that it needs to understand these implications in more detail before it can comment further[36]. In principle, this change should increase the overall cost-reflectivity of Network Rail's station charges, which should improve the information that these charges provide to operators and lead to more efficient network use. It will also improve transparency over Network Rail's costs at its largest stations[37], which, in the longer-term, we would expect to drive greater scrutiny over cost efficiency. As

[35] Arriva said this would still leave most station LTCs being calculated using a category-averaging approach, while MTR suggested expanding the number of stations defined as large / complex. We considered this in our April 2022 consultation. For the reasons set out there, we remain of the view that the definition of large / complex under Option B strikes an appropriate balance between cost-reflectivity and simplicity.

[36] We considered Nexus' views on the impact of this proposal in paragraph 4.26 of our April 2022 consultation.

[37] The existing LTCs for the existing franchised stations included in Option B are significantly different in a way that is unlikely to reflect differences in MRR costs. For instance, the LTC for Vauxhall is around four times less than the LTC for Gatwick Airport.

such, our view remains that this proposal would constitute an improvement to the station charging framework.

3.7 Notwithstanding this, as part of our full impact assessment of this proposed change, we have considered the likely financial impacts on operators (and their rail authorities). For the reasons set out in this assessment, we expect these impacts on train operators and their rail authorities are likely to be moderate.

3.8 Nevertheless, we will work closely with Network Rail during the recalibration of LTCs, and will review this proposal as part of our Draft Determination if the overall impact of this change on specific parts of industry is significantly different to that set out in our impact assessment.

Table 3.1: List of large / complex stations for station LTC

Currently a managed station and classified as large / complex	Currently a franchised station and classified as large / complex	Currently a managed station but NOT classified as large / complex
Birmingham New Street Bristol Temple Meads Clapham Junction Edinburgh Waverley Glasgow Central (High) Leeds City Liverpool Lime Street London Bridge London Cannon Street London Charing Cross London Euston London King's Cross London Liverpool Street London Paddington London St. Pancras London Victoria London Waterloo Manchester Piccadilly Reading	Brighton Cardiff Central East Croydon Gatwick Airport Glasgow Central (Low) Glasgow Queen Street (Low) Glasgow Queen Street (High) Highbury and Islington Liverpool Central London Marylebone Stratford Vauxhall Wimbledon	Guildford
19	**13**	1

Glasgow Central High / Low level and Glasgow Queen Street High / Low level are classed as separate stations by Network Rail – hence the total number of large/complex stations is 32 rather than 30.

Decision: calculation of LTC for new stations

3.9 The operational property element of station LTCs for stations that have opened during CP6 – and those that open during CP7 – will be set at 10% of that for equivalent existing stations, for a fixed five-year period from the date of opening.

Reasoning for decision

3.10 Currently, Network Rail sets the operational property element of the station LTC at 10% of forecast expenditure levels for existing stations in the same route and station category, until the end of the control period in which the station opened.

3.11 We proposed in our April 2022 consultation that the operational property element of LTCs should be set in this way for a fixed five-year period (regardless of when in the control period it opened). This reflected responses to our July 2021 consultation, where respondents broadly supported this proposal. We also clarified some aspects of how this would work – in particular, that it would apply to stations that open during CP6, as well as those which open during CP7.

3.12 Only Transport Scotland and Northern Trains opposed this proposal. Transport Scotland said this approach would make some stations unaffordable to operate. We disagree with this. As explained in our April 2022 consultation, the lower LTCs charged for use of new stations reflect Network Rail's own analysis that new stations initially incur lower maintenance and renewal costs than existing stations. Furthermore, LTCs for existing stations would be adjusted so that in aggregate the total revenue from franchised station LTCs continues to recover total forecast expenditure for those stations[38].

3.13 We also disagree with Northern Trains that this approach could impact operators unfairly. We consider that it ensures LTCs for new franchised stations are calculated on a consistent basis, and are not dependent on the timing of a periodic review. We have published an impact assessment alongside this document setting out all the factors we have considered, in coming to this decision. This sets out the specific impacts on operators in more detail[39].

3.14 Southeastern requested clarity on when the fixed five-year period (for the lower operational property charge) begins. For the avoidance of doubt, this will begin on the date which the first train carrying fare-paying passengers stops at the station, i.e. the date on which the station opens to the public.

[38] We also note that this proposal was specifically prompted by a concern raised by Transport Scotland towards the end of PR18 that some stations would incur a lower LTC for a shorter timeframe than others. See our January 2020 letter approving LTCs for new franchised stations in CP6.

[39] Merseytravel said the LTC for more complex new stations will need to be calculated separately. As noted above, we consider that for PR23 it remains proportionate to calculate LTCs based on station-specific forecasts only for the largest / most complex stations.

Next steps

3.15 Network Rail will shortly consult on its recalibration of station charges, taking account of our decisions on the station LTC that are set out above. We understand this consultation will also cover how Network Rail intends to adapt the category-average approach used to calculate remaining franchised station LTCs, to reflect its regional (rather than route-based) structure.

3.16 In advance of CP7, Network Rail also intends to publish additional guidance on the revised calculation methodologies for station LTCs, to aid industry's understanding of this charge.

Qualifying Expenditure (QX)

3.17 The QX charge allows station facility owners to recover the day-to-day running costs of providing shared services and amenities at stations. It is made up of a 'fixed' element, recovering direct costs such as station staff, cleaning and refuse collection costs, and a 'management fee' element which recovers overhead costs and allows for a reasonable profit. Only the management fee element at managed stations is regulated by ORR[40].

3.18 We said in our April 2022 consultation that the fixed element of the QX charge at managed stations will continue to be agreed between Network Rail and passenger operators, instead of becoming a regulated charge. Since April, Network Rail has consulted with operators on a proposal to adopt a simplified approach to the determination of the QX charge for CP7. This would involve both the fixed and management fee elements of this charge being indexed by inflation and implemented without additional recalibration in CP7.

3.19 We welcome the industry engagement that has been undertaken so far. Should this proposal receive the necessary endorsement from train operators, this should allow the fixed element of QX charges to be set in a timely fashion in advance of the start of CP7. In the meantime, we encourage Network Rail to continue publishing the total QX amount for each of its managed stations on its website, on an annual basis.

3.20 We will continue to approve the management fee element of the QX charge for managed stations (which is regulated). We will consider this in more detail when Network Rail submits its proposal for the management fee element later in PR23.

[40] This reflects the terms of the Station Access Conditions (Annex 2).

4. Inflation indexation

Summary

We will retain the Consumer Price Index (CPI) as the general inflation index for updating access charges (and payment rates in other mechanisms where we set the method of indexation) in CP7.

4.1 In PR18, we changed our method of inflation indexation for access charges (and payment rates in other mechanisms where we set the method of indexation[41]) from the Retail Price Index (RPI) to the Consumer Price Index (CPI). We also considered using a slightly different measure of general inflation to CPI, known as CPIH, which includes owner-occupiers' housing costs. We decided against this, but said we would review the use of CPI over CPIH in our next periodic review.

4.2 Having reviewed the merits of changing the inflation index, we proposed in our July 2021 consultation to retain CPI as the general inflation index for updating Network Rail's access charges and other payment rates in CP7. We said in our April 2022 consultation that we were minded to proceed with this for PR23.

4.3 In response to our April 2022 consultation, a few respondents commented further on inflation. Southeastern asked if there is scope to set a standalone indexation rate that would help to control the on-going impacts of inflation, while Northern Trains said fuel / electricity charges / rebates should be linked to energy price changes. Merseytravel said it did not support the proposal for track access costs to be increased by inflation, and that revised costs should take account of the objective for the rail industry to reduce costs over CP7.

4.4 With regards to Southeastern and Merseytravel's comments, the level of access charges will reflect the efficiency savings that we consider to be achievable during CP7 – taking account of the specific input price inflation that Network Rail faces. This is determined through our assessment of Network Rail's OMR costs, which feeds into the recalibration of charges. The annual increase in charges over the course of CP7, to reflect general inflation, is then applied over and above these

[41] These include Schedule 4 and Schedule 8 payment rates.

charges. We consider this is the best way to reflect inflation risks faced by Network Rail, and the degree to which it can manage these risks.

4.5 With regards to Northern Trains' comment, EC4T charges are not indexed by inflation in the same way as other charges, as they depend on several factors that can vary during a control period.

4.6 In light of the above, we are confirming our decision to update Network Rail / GBR's access charges (and payment rates in other mechanisms where we set the method of indexation) by inflation in CP7, and to use CPI as the general inflation index for this. Price lists will be updated annually during CP7 on this basis.

5. Next steps and implementation

5.1 This chapter provides some further details on the next stages of the PR23 charges review, including how our decisions for the overall charging framework will be implemented in advance of the start of CP7.

5.2 A timetable for the rest of the PR23 charges review is set out in Annex 1.

Recalibration phase

5.3 Network Rail will shortly publish a consultation on the recalibration of access charges for CP7. This consultation will cover the methodology and calculation of individual charges. We will continue to engage with Network Rail on specific recalibration points, particularly where they have the potential to materially affect the level of any charges.

5.4 Network Rail will consider the responses to its recalibration consultation and publish a conclusions document, confirming how it intends to calculate CP7 charges (including where there are any significant changes to the calculation methodologies). Network Rail will then work to produce a draft price list in summer 2023, following our Draft Determination, setting out a full set of new prices for individual track access and station charges for year 1 of CP7.

5.5 In parallel with Network Rail's recalibration exercise, we will also undertake further work to consider ability to bear for the market segments that we consider can bear an ICC in CP7[42]. This will inform the level of ICCs paid by operators that serve these market segments. We will consult on the proposed level of these charges as part of our Draft Determination.

Determining and approving charges

5.6 We will review and approve Network Rail's charges during autumn 2023. This stage of the review will ensure that Network Rail has correctly implemented the recalibration methodologies, as well as our provisional decisions on the charging framework, in deriving price lists. It will also seek to ensure that the calculations are accurate, though the focus will be on identifying any major issues and ensuring Network Rail's own quality assurance processes have been followed.

[42] We have set out our approach to how we will do this for relevant market segments in Chapter 1.

5.7 We envisage that this process will also involve the wider rail industry, to ensure an appropriate level of scrutiny, and we will set out further details of how this process will work nearer the time.

5.8 Following this, we expect that Network Rail will publish final price lists in December 2023, consistent with the decisions made as part of our PR23 Final Determination.

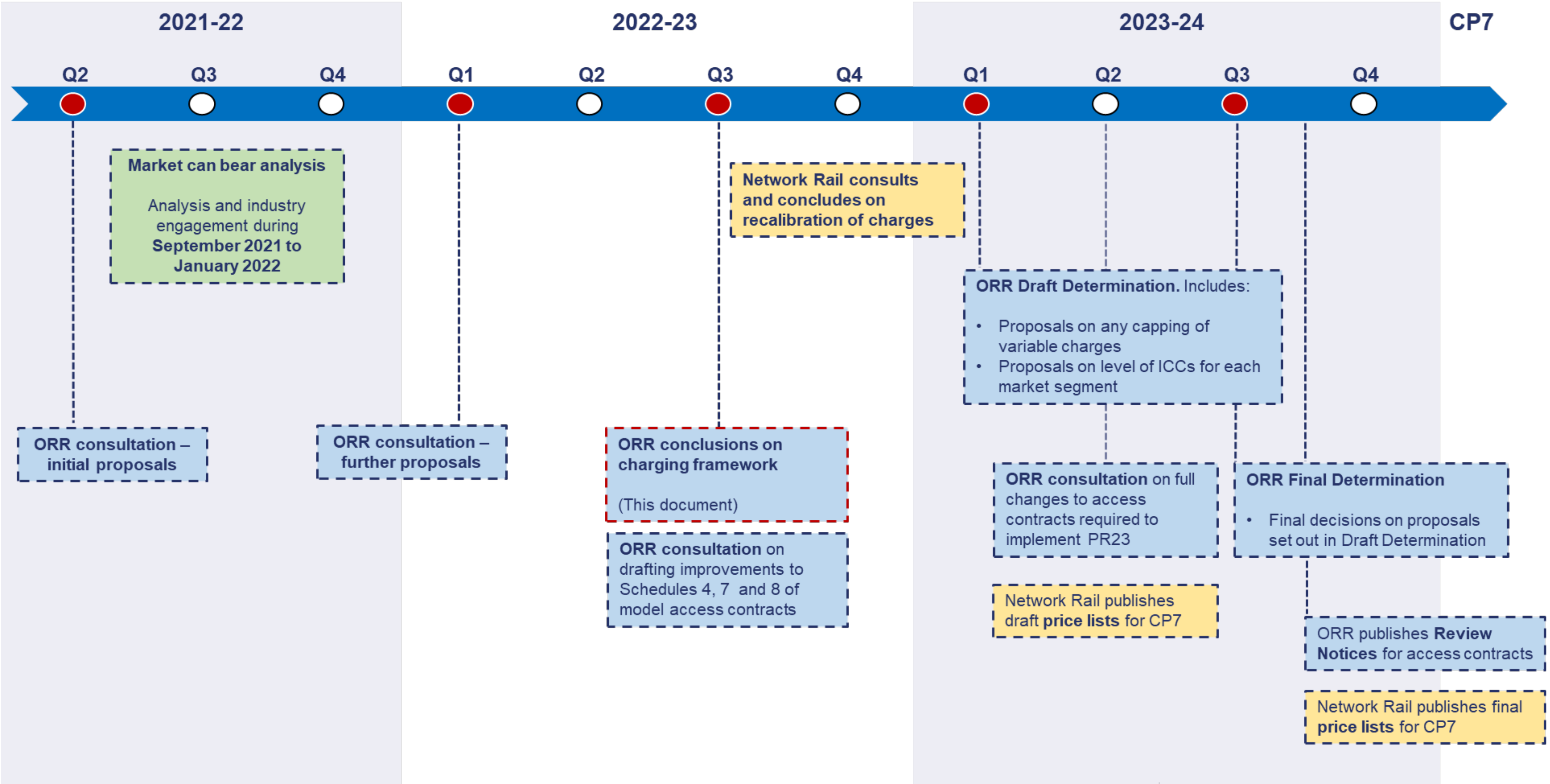
Implementing changes to contracts

5.9 To implement some of the decisions set out in this document, we will need to make changes to operators' track access contracts (and, in the case of EC4T, changes to the TERs). We expect to consult on the form of these changes next summer, shortly after our Draft Determination[43]. This will give stakeholders an opportunity to inform the final wording that will be implemented in revised track and station access contracts from 1 April 2024.

5.10 We will then publish Review Notices setting out the full set of detailed changes that will be applied to affected contracts. We envisage that Review Notices would be published alongside Network Rail's final price lists in December 2023, which is consistent with the process followed in PR18 when Review Notices were issued three months before the start of the next control period. This will allow sufficient time for train operators to review the Notices in advance of the start of CP7, and (if necessary) raise any issues before their new contracts come into effect.

[43] As noted in our Executive Summary, we are consulting alongside this document on *drafting improvements* to Schedules 4, 7 and 8 of model contracts. The feedback received as part of this consultation will feed into our full consultation on changes to contracts next summer.

Annex 1: PR23 charges review timeline



This shows the currently-expected timings for milestones. Some dates may be subject to change.

Annex 2: Impact assessments

We have produced proportionate impact assessments for each of the changes to the CP7 access charging framework that we are confirming in this document. These assessments support the decisions that we have taken, and are published as a separate annex.

We intend to publish impact assessments on the decisions in this document that are subject to further review during the rest of PR23 (e.g. on VUC phasing-in, and on EC4T modelled rates) alongside our Draft Determination.

This publication is available at orr.gov.uk

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