

RDG PR18 working group

Note of meeting held on 10 October 2016 at RDG's offices

Attendees: Bill Davidson (RDG); Richard Evans (RDG); James Mackay (RDG) (by phone); Stuart Freer (Southeastern); Nigel Jones (DB Cargo); Russell Evans (FirstGroup); Jonathan Cooper (Arriva); Phil Dawson (Virgin Trains East Coast); Lindsay Durham (Freightliner); Maggie Simpson (Rail Freight Group) (by phone); Ben Worley (Network Rail); Peter Swatridge (Network Rail); Mark Thompson (DfT); Rob Whittleston (DfT); Chris Hemsley (ORR); Deren Olgun (ORR); Joel Moffat (ORR)

Apologies/not present: Richard Mclean (Arriva); Lanita Masi (East Midlands Trains); Chantal Pagram (Go-Ahead); Lee Shuttlewood (SWT)

Rail incentives and enabling sustainable competition

1. DfT presented slides on their emerging thinking on options to improve incentives in the rail industry and enable sustainable competition.

Enabling sustainable competition – PSO levy

2. DfT began by explaining that their work on enabling sustainable competition in the rail industry came out of the recommendations made by the Competition and Market Authority (CMA) in their report on 'Competition in passenger rail services in Great Britain', published in March 2016.
3. The focus in this meeting was on the CMA's recommendation to introduce a public services obligation (PSO) levy
4. DfT presented their objectives for the levy and their initial thoughts on how it might work in practice.
5. DfT commented that it would not intend to set the PSO levy at a level that made efficient open access services unprofitable. To achieve this, some test would need to be applied.
6. In terms of timings DfT is intending to consult on the principles of the levy and their high level options in December 2016. The aim is to implement the levy in time for the start of CP6, but as it will likely need primary legislation it is possible that it may be implemented after the start of CP6.
7. The group raised several points for DfT to consider when designing the levy, including:

- It needs to be carefully considered who the levy would apply to. The current plan is for it to apply to all open access rights granted after Budget 2016. This would mean that operators would have to factor in the levy to any open access applications they are currently making, or planning to make, which is difficult given that the exact structure of the levy is unclear at this time.
- The premiums franchised operators pay to run profitable services are intended to recover the costs of providing unprofitable services. Therefore to avoid DfT over recovering the costs of unprofitable services changes would also need to be made to the franchise system.
- One of the high level options for the levy that will be included in the consultation is a rate of return levy. The group commented that this option may be difficult to implement as it could be hard to accurately prove what profits open access operators make. It was suggested that setting the level of the levy based on revenue rather than profit may be more appropriate.
- Another high level option discussed was basing the levy on premium/subsidy payments. The group questioned whether or not setting the levy in this manner would be legal.

Rail incentives

8. The group agreed that the current incentives for operators and Network Rail could be improved and better aligned. DfT are currently developing options to address this issue and they presented their objectives and principles for their options.
9. DfT have begun to develop options that relate to three general themes; alliancing to better join-up track and train; Variable Usage Charge (VUC) exposure; and bespoke funds for infrastructure efficiency improvements. The focus in this meeting was on alliancing and VUC exposure.
10. On alliancing DfT are considering mandating a contractual risk/reward mechanism between Network Rail and operators, which could be in the form of a deep alliance. The group discussed possible reasons why alliancing in the past has not been very effective. In addition it was raised that when developing any new options in relation to alliancing the objectives of alliancing need to be established and that the objectives are likely to vary across the network.
11. Linked to alliancing, the group also discussed possible reasons why REBS had not been as successful as it was hoped. The group suggested one reason was that the baselines used in REBS were not correct. There was support from amongst the group for a revised and simplified version of REBS that would use a baseline that is agreed with operators as part of the normal business planning cycle, rather than being set by ORR.

12. In terms of the VUC DfT are considering making franchised operators at least partially exposed to changes to the VUC and making it easier for operators to retain the benefit of a lower VUC rate over the duration of a franchise. DfT explained that one of the objectives of this option would be to incentivise operators to improve their rolling stock and work with Network Rail to reduce network costs. The group commented that there also needs to be consistency across control periods as the VUC already provides incentives for operators to improve their rolling stock.
13. On rail incentives the group also commented that it is important to align operators' franchise targets with the Network Rail's regulatory output targets for CP6.

ORR update on PR18

14. ORR provided the group with an update on PR18.
15. ORR will be publishing several documents before the end of the year and is currently going through internal clearance processes for these documents.
16. The documents that will be published before the end of the year include:
 - Summary of responses to the initial consultation document and priorities going forward
 - Draft guidance on strategic business plans (SBPs), for consultation
 - Consultation on the potential regulatory framework for the system operator
 - Charges and incentives consultation
 - Consultation on the financial framework

ORR impact assessments

17. ORR explained its approach to assessing options for improving charges and incentives. This included talking through the outcomes, objectives and criteria that will be used in the impact assessments to assess options against the status quo.
18. ORR explained that the outcomes are based on what ORR wants to achieve in PR18 and the objectives and criteria have been informed by ORR's statutory duties, RDG's review of charges and discussions with industry. It was suggested that ORR produce a document showing where their objectives and criteria match those used in the RDG review of charges and where and why they are different in some instances.
19. The group commented that there is not a lot in ORR's objectives and criteria on passenger and freight customer impacts. It was suggested that this could be addressed by moving the general objectives and criteria, which includes criteria on

passenger and freight customer impacts, to the front of the list when the objectives and criteria are presented externally.

ORR update on the capacity charge

20. ORR is currently considering three options for the capacity charge, these are:
- i) Remove the current capacity charge and instead adjust Schedule 8 benchmarks to account for traffic growth
 - ii) Remove existing capacity charge and recover more through mark-ups
 - iii) Remove wash-ups and caps to expose all operators to the full capacity charge
21. The group were keen to see more details on options ii) and iii).

Future meetings and suggested topics

22. This group is due to meet three more times before the end of 2016; 27 October, 14 November; and 5 December.
23. The items suggested to discuss on 27 October included:
- RDG update on Schedule 4 and 8 working group
 - ORR update on SBP guidance
 - ORR update on PR18 financial framework
 - Network Rail update on REBS
24. The items suggested to discuss on 14 November 2016 included:
- Network Rail update on fixed cost allocation research.