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Dear Joanna,

IMPROVING FINANCIAL INCENTIVES IN THE RAIL INDUSTRY TO DELIVER BETTER OUTCOMES FOR PASSENGERS, FREIGHT AND TAXPAYERS

On the 3rd December 2015 the Department for Transport (DfT) wrote to Richard Price regarding the ORRs initial consultation on charging in CP6. We are writing to you now as part of our formal response to the DfT letter and the ORR consultation.

1 The letter from the Department for Transport

Open access operators are often criticised for not contributing to the rail network costs. Indeed the DfT states in its letter:

“DfT is concerned about the financial impact, and risk to the franchising system, from open access services which make no contribution towards the fixed costs of the network and abstract revenue from franchised services. We would expect all open access operators to pay at a minimum the full marginal costs of their operations, i.e. including capacity charge, and that any new open access services should make an appropriate contribution towards the fixed costs of the network”

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Directive 2012/34 is concerned with capacity allocation and charging for access to railway infrastructure throughout the European Union. Under this Directive the law identifies that the infrastructure manager must have a charging regime – established by the ORR – which ensures that it is properly financed for the competent and efficient operation, maintenance and renewal of its network.

The Directive also states under Article 29(3) that

“Infrastructure managers shall ensure that the application of the charging scheme results in equivalent and non-discriminatory charges for different railway undertakings that perform services of an equivalent nature in a similar part of the market and that the charges actually applied comply with the rules laid down in the network statement.

Crucially, under Article 32(5) the law also provides that the infrastructure manager’s charges for equivalent use of the infrastructure “must be comparable and comparable services in the same market segment must be subject to the same charges”.

The Case of *GNER v ORR and another 2006* examined the requirement of open access operators to pay the fixed track access charge. This case examined the legal position regarding why open access operators do not pay the fixed track access charge. The standing of this case has not been challenged by the DfT and so remains legally binding in UK law.

This case established “*that there is a critical distinction to be made between the market – the market segment, in fact – in which franchisees and open access operators obtain access to the infrastructure, and the market segment in which they compete for passengers on the same parts of the network.*”¹ In short open access and franchises operate in different market segments. The Directive allows different market segments to be charged differently.

The court also identified that the current fixed charge is not truly cost reflective as it is also used by the government as a conduit for subsidy. The current fixed charge is therefore an “*artificial construct*”² determined by the Government and cannot be paid by open access operators.

¹ Tom Winsor in “Open access operations – charging and competition” – White and Case

² Mr Justice Sullivan GNER v ORR 2006

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In addition under Article 31(2) of the Directive it states that “the *charges for the minimum access package and for access to infrastructure connecting service facilities shall be set at the cost that is directly incurred as a result of operating the train service*”. As the current fixed charge is more than the cost directly incurred, open access cannot pay this.

We note that the reason why open access cannot pay the fixed track access charge is because the government has chosen to pay subsidy via this route. It is therefore blatantly unfair of the DfT to complain that open access does not pay the fixed track access charge when it is of their own making.

For clarity, Alliance and Arriva supports the idea of paying a levy under Article 12 of the Directive (for the support of PSO services). However, open access must then have greater access to the network and must not be restricted under the Moderation of Competition protections that exist. In addition, track access charges must be cost reflective as determined by the Directive.

2: Alliance Rail’s comments on the ORR consultation

We have provided our comments to Chapter 7 of the consultation (which refers to open access) in the attached Appendix A.

Yours sincerely



Ian Yeowart

Appendix A: Consultation response

Chapter 7 Questions	Response
<p>We would welcome comments on how charges might apply to open access in future. In particular, we would welcome comments on:</p>	
<p>Q19. whether open access operators should face charges implemented under the infrastructure costs package;</p>	<p>Under the current regime for granting track access rights, it would be illegal for open access operators to pay the Fixed Track Access Charge (FTAC). This was determined at the High Court in 2006 in the case between GNER and the ORR (and others). The key reason for this is that open access operators are given limited access in the upstream market to compete in the downstream market and have a barrier to market entry in the Not Primarily Abstractive (NPA) test. This test would have to be abandoned before any consideration was given to seeking contributions from open access operators to NR's fixed costs. However, we have previously identified, and discussed with the DfT, other ways in which open access might contribute to costs (see below).</p>
<p>Q20. what forms of adjustments to charges might be appropriate for open access operators, relative to franchised operators;</p>	<p>In the long term, we would expect the vast majority of LDHS services to be operated as commercial services, rather than as a franchised commitment. This may change the upstream market. In that instance, all operators in that [same] market should contribute to fixed costs in the same manner. Until then, one approach that we have advocated is the introduction of a levy on commercial services in order to support Public Service Obligation (PSO) services running over the same route. However, there are two obstacles to this approach. Firstly, as the ORR notes in the consultation document (§159), the DfT has currently chosen not to adopt article 12 of the recast EU Directive 2012/34 which allows such a levy to be charged: without this, or separate legislation, there is no legal basis for the levy. Secondly, there is currently no declared list of PSO services. We cannot assume that all franchised services are PSOs: if they were, no franchise would be bidding a premium to operate them!</p>

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	<p>We agree with the consultation document (§155) that “...the charging framework provides an incentive on funders to prefer franchised passenger operations over similar open access services.” We believe that the development – or at least trial – of a value-based package would help to focus funders’ minds on the value of the services they specify, and therefore the paths that will be used.</p>
<p>Q21. how current incumbent open access operators should be treated; and</p>	<p>As happened between CP4 and CP5, there must be some protection from significant changes in charges for open access operators who have accessed the market via the current process.</p>
<p>Q23. Would you like to see either of the complexity options developed further?</p>	<p>We would welcome the development of a charges calculator. We agree (§175) that this will be of particular value to freight operators, not least because their service patterns are subject to more frequent change. Limiting complexity should not, however, be an end in itself. We therefore do not support the option to introduce complexity as a test. Where appropriate – for example, to provide greater reflection of the true costs through disaggregation – charges may become more complex. In the longer term we believe that value-based charges will provide a more effective, and probably simpler and clearer, way of charging operators for use of the network.</p>
<p>Q24. Are there other options you would like assessed to reduce complexity?</p>	<p>Yes. We would like the ORR to assess a value-based charging package based on ‘standard path’ pricing to be assessed for its suitability, and ability to reduce complexity.</p>
<p>Q25. What costs and benefits would you expect with these complexity options?</p>	<p>We would need further information and a better understanding before giving an opinion.</p>

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