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PR18: ORR Structure of Charges Review
Office of Rail and Road,
One Kemble Street,
London,
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4th March 2016

Dear Sir/Madam,

PR18: Review of Network Charges and how they can improve efficiency

This letter sets out TfL's responses to the questions raised in the ORR's consultation on how charges can improve efficiency. TfL is content for its responses to be published and shared with third parties.

1. How much does Network Rail's structure of charges matter today?

The structure of charges is important as it incentivises operator behavior. It is important that the structure provides the right incentives to the industry to reduce costs and improve efficiency.

2. What issues could a new structure address?

A new structure could potentially provide more transparency concerning those costs that are currently fixed, such as the Fixed Track Access Charge. This could help the industry to understand the source of these costs better, supporting benchmarking and cost reduction activity as well as providing better information on the long term costs of upgrades. It is important that any new structure achieves a reduction in overall cost over time, compared to the status quo.

3. Can you provide examples of behaviours that would change within your organisation or elsewhere in the rail industry with an improved structure of charges?

Providing greater granularity and transparency of fixed costs would make it easier for TfL to challenge these and work jointly with Network Rail to secure better, more efficient management of the rail network, particularly in the context of understanding the long term cost of network upgrades.

4. **Are the high-level gaps (in Figure 4) a good starting point for developing solutions? Would you have expected to see any other high-level gaps and, if so, what are they?**

TfL considers that the key gap identified is cost reflectivity. A better understanding of cost is key to enabling this to be addressed over time, enabling operators and funders to act as better informed clients of Network Rail.

The point raised under complexity is important. Changes to the charging structure at the start of a new Control Period do create uncertainty and the potential for additional costs. It is important that any parties (including funders outside central government) who lose out financially are compensated for their losses.

The value of the capacity and competition gaps are more questionable. It is the role of the charging system to accurately reflect the cost of network operations rather than to determine decisions on capacity allocation which should be made with reference to a much broader range of criteria, including the value of different train services.

5. **Do the assessment criteria accurately reflect the main factors we should consider for assessing the impact of options?**

The assessment criteria stated are broad and reflect the main factors that need to be considered. It is important that the financial impact of changes to funders outside central government is considered as part of the “wider external impacts” criterion.

6. **To what extent does the use of scenarios, in the form of the RDG ‘states of the world’, help to understand the likely effectiveness of future charging structures?**

Scenario testing has the potential to form a useful part of the overall analysis.

7. **To what extent do the packages of options represent the key strategic choices available to improve the existing charging structure?**

The packages of options available do represent the strategic choices available.

8. **Would you expect the infrastructure costs package to deliver more (or fewer) benefits than the value-based capacity package at this stage and, if so, why?**

From TfL’s perspective the Infrastructure costs package would deliver some benefits, because it would improve the understanding of currently fixed costs and has the potential to drive greater efficiency and cost reductions. The changes proposed under this package could lead to significant adjustments in the funding required to support operators. Funders must be compensated for any losses they incur as a result of any changes to the methodology for calculating fixed costs.

The value based capacity package is much less useful because it does not focus on actual costs; indeed it could result in the creation of perverse incentives whereby additional high value services are not provided because of their high cost.

9. What are you views on the proposal to prioritise further development of the infrastructure costs package?

TfL agrees that the prioritisation of the infrastructure costs package is appropriate. This package has the greatest value out of those proposed, in TfL's opinion.

10. What costs and benefits do you see with the infrastructure costs package? Do you think our draft impact assessment is missing any significant impacts or has misrepresented any impacts?

TfL notes that the list of fixed charges quoted in the consultation documentation does not include the Network Grant, although it is displayed in Figure 6. This needs to be included in any assessment made of fixed costs. TfL assumes that it is the ORR's intention to do this, potentially by incorporating all or part of the Network Grant into the Fixed Track Access Charge. TfL would welcome clarification of this point.

The key benefit of this package is the opportunity it provides for greater transparency of Network Rail's costs; this has the potential to drive greater efficiency and cost reduction if the data is used proactively by operators and funders. The main cost is associated with the disaggregation of the data to a greater degree of granularity to support the process and the subsequent analysis to turn this into charges.

As mentioned previously the impact of changes on funders outside central government requires careful consideration and mitigation. At present more than 60% of Network Rail's income is paid through the Network Grant so it represents a very significant financial flow within the rail industry. In the context of London Overground the value of the Network Grant was £45 million in 2013/14. Any revision to charges must therefore ensure that funders such as TfL are properly compensated for changes that affect all flows related to the Network Grant or other fixed charges on an annual basis, otherwise such changes may have a significant adverse effect on the ability of funders to invest in the transport network.

11. To what extent do you think the benefits of this package can be realised through more information, rather than through the use of charges?

The benefits of this package can be realised to an extent through the provision of more information. This would certainly provide operators and funders with greater opportunities to benchmark and challenge Network Rail's costs.

12. What are your views on the proposal not to prioritise the further development of charging options based on the value of capacity?

TfL considers that this proposal has no value and could prove detrimental, for the reasons outlined below. TfL considers that it should not be developed any further.

13. What costs and benefits do you see with the value-based capacity package? Do you think our draft impact assessment is missing any significant impacts, or has misrepresented any impacts?

TfL does not consider that there are significant benefits to the value based capacity package. Charges should be levied to cover the costs of network operation. Questions relating to the financial and economic value of rail services should be addressed through the capacity allocation process. Mechanisms already exist to enable this through the Network Code, for example. Basing costs on the value of train services will result in high value services attracting higher charges, creating a disincentive to expand these services which would have detrimental economic and financial effects.

14. Would you expect a better understanding of costs to be an essential precursor to value-based charges?

A better understanding of fixed costs would be the key benefit of the review proposed. TfL considers that a value based capacity package is unlikely to deliver any significant benefits.

15. To what extent do you think the benefits of this package can be realised through more information alone, without passing that into charges?

Methods already exist to evaluate the economic and financial value of train paths across a variety of parameters, as expressed in WebTAG and the Passenger Demand Forecasting Handbook. Efforts to improve the understanding of the value of train services should be focused on the ongoing programme to refine and update this guidance; a separate workstream is not required.

16. What options would you expect to see in a long list of improvements to Network Rail's short-run variable charges?

Consideration should be given to withdrawing the Route Efficiency Benefits Sharing (REBS) mechanism and the Volume Incentive, as neither of these measures have had a significant impact on Network Rail's behaviour or performance in TfL's opinion. TfL considers that greater efficiency and network capacity could more readily be achieved through a better understanding of Network Rail's fixed costs across the industry and the application of challenges from operators and funders to reduce these, as proposed elsewhere within the consultation documentation.

17. What options do you see as a priority for this package?

Refer to the response to question 16 above.

18. What costs and benefits do you see with this package?

TfL considers that there is relatively little value in a further review of the short run variable charges, except for REBS and the Volume Incentive as discussed in the response to question 16. The variable charges have all been analysed previously in depth so it is unlikely that they are providing incorrect price signals. Any changes are only likely to make the charging process more complex by disaggregating the charges to a greater extent which would be undesirable, particularly when reducing complexity is an objective of the review.

Changes to the balance between fixed and variable costs within the overall industry cost model also require careful consideration, as these could create perverse incentives to reduce service volumes at a time when these need to increase to address crowding and customer expectations.

19.a Whether open access operators should face charges implemented under the infrastructure costs package;

TfL has no comment to make in response to this question.

19.b What forms of adjustments to charges might be appropriate for open access operators, relative to franchised operators; and

TfL has no comment to make in response to this question.

19.c How current incumbent open access operators should be treated.

TfL has no comment to make in response to this question.

20. Would you like to see either of these options developed further?

TfL agrees that a charges calculator would be useful, to give operators a consistent and convenient method of calculating the costs associated with new services. Minimising the complexity of charges is also a worthwhile goal and should be considered by the review, for example in the context of changes to short run variable charges.

21. Are there other options you would like assessed to reduce complexity?

TfL has no comment to make in response to this question.

22. What costs and benefits would you expect with these options?

Refer to the response given to question 20 above.

23. Do you have any views on options for implementing a new structure and what would be the impacts of these options?

It is critical that funders outside central government are compensated for the impact of changes to the charging structure, given the scale of these flows which were worth more than £50 million during 2013/14 on the London Overground network alone. Monetary flows such as the Network Grant which is currently paid by DfT directly to Network Rail should instead be used to compensate funders and/or operators for any increased fixed charges they face, giving time for the businesses affected to adjust to the change, and also to use the disaggregated cost data to commence a dialogue with Network Rail to enable greater efficiency in future.

Funders outside central government and operators should be given a greater formal role in setting future access charges that affect them if they are required to take direct responsibility for a greater proportion of the funding supplied to the rail industry.

Yours sincerely,

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