

**PTE sponsored increments and
decrements of train services:
Workshop on the implications for
Network Rail's CP4 regulatory regime**

ORR, 20 July 2007

Introduction and purpose of meeting

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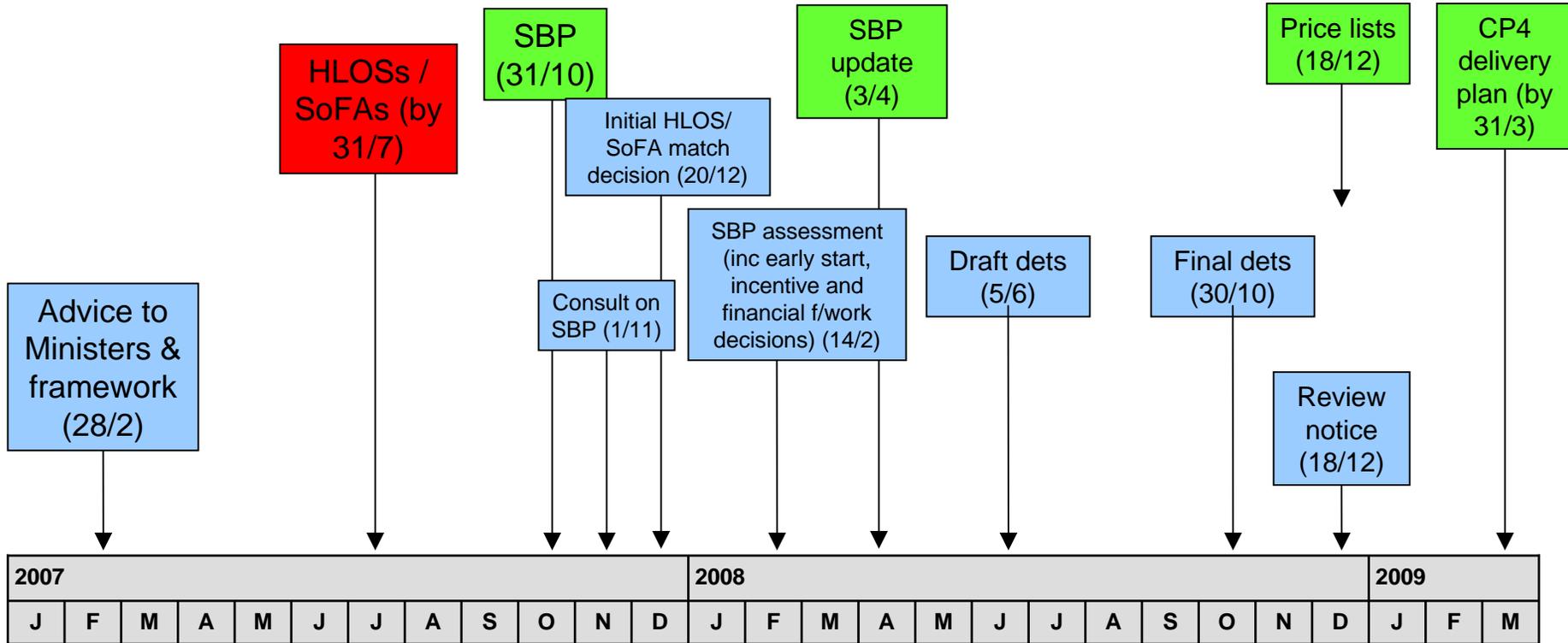
Agenda

- Introduction (Paul McMahon) (5 mins)
- Background and examples of increments and decrements (Iain Morgan) (30 mins)
- Cost identification (including a presentation from Network Rail) (40 mins)
- Break
- Mechanisms for transferring costs (Iain Morgan) (25 mins)
- Relationship with other legal arrangements (Iain Morgan) (25 mins)
- Other issues and next steps
- Lunch

Periodic review 2008

- Sets Network Rail's outputs, revenue requirement and access charges for CP4 (1 April 2009 – 31 March 2014)
- Includes work to develop structure of charges
- Network Rail developing charges proposals consistent with our charging objectives and guidance and subject to our audit and approval
- We are examining mechanism for possible changes to the fixed charge to reflect PTE sponsored increments/decrements
 - at the same time as developing the methodology for determining how the fixed charge would be allocated between franchised passenger operators

PR08 timeline



Colour coding: ORR (Blue), Network Rail (Green), DfT/TS (Red)

Purpose of meeting

- Originally intended to consult initially by letter
- However, today's workshop should allow us to:
 - Discuss possible examples of increments and decrements rather than reviewing in the abstract
 - Test out the implications of these examples on:
 - Network Rail cost changes
 - How relevant cost increase or decrease might be transferred to PTE
 - Interaction with other legal arrangements
 - Other issues e.g. the level of the materiality threshold
 - We will use the outcome of our discussion in preparing a formal consultation

Background and examples of increments and decrements

Iain Morgan
Senior Economist

Background (1)

- Scope – PTEs, TfL, potentially other local funders in future
- July 2004 Future of Rail White Paper
 - PTE increments - 'the additional cost of that service including any additional infrastructure costs and compensated to other operators, will be calculated by Network Rail and reviewed by ORR
 - 'Similar process would apply with any PTE proposed reductions to services, to ensure that all network and cost effects had been properly taken into account'.
- July 2006 policy statement
- Key aim – to facilitate PTEs in decision making but to also consider the appropriate balance between cost reflectiveness and simplicity in the structure of charges

Background (2)

- Key questions
 - What indicative information can be made available to PTEs from start of CP4
 - How might costs be identified in individual cases
 - How should any change in costs be transmitted to PTEs
- Our investment framework already provides basis for negotiating third party enhancements to the capability, capacity and/or functionality of the network (increments)
- Therefore most of our focus today will be on decrements
- Some examples are set down on next slide – they may or may not be savings to Network Rail
- CP2/3 fixed track access charge - fixed

Example decrements (1)

- Removal of PTE sponsored services from a route enabling the route capability to be reduced but still maintained at a lower level e.g. as a diversion for other services (where there was CP4 renewals plans and where renewals were not planned until CP5)
- Removal of PTE sponsored services leaving the route with no services operating on it
- Removal of PTE sponsored hourly services from route with, or without, specified renewals programme in CP4
- Mixed passenger/freight line with planned renewals activity in CP4 where the passenger service is halved, or where it is removed

Example decrements (2)

- Removal of station stops used partly or only by PTE sponsored services
- Halving of PTE stops at a particular station where renewals were planned within CP4
- Shortening of train services from 8 car to 4 car trains using stations where renewals was planned for CP4
- Change all PTE sponsored services on a route from electric to diesel powered leaving electrification equipment no longer used
- Reduction in PTE sponsored services that produces significant performance improvements across that part of the network

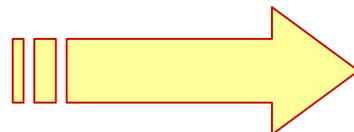
**Increments & Decrements –
Network Rail thoughts
Presentation to ORR Workshop 20
July 2007**

The issues

- Could changes in service specification by PTEs (and others?) lead to recalculations of the fixed charge?
- If yes, what methodology should be adopted?
- These questions need to be considered in the context of the structure of charges
- Therefore we will briefly:
 - re-cap the structure of charges and our ongoing consultation
 - set out Network Rail's proposed way forward
 - consider some case-specific examples

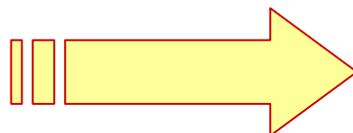
Charges context

Variable usage charges



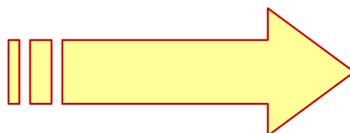
Recover wear and tear of extra trains

Other variable charges



Traction electricity.
Capacity charge

Fixed charges



Recovery of all residual costs after taking into account other sources of income and government grant.

Proposed approach (i)

- We distinguish between four categories:
 - Minor changes in traffic
 - Change in franchise-mapping
 - Enhancement
 - Decrement due to significant drop in traffic
- The last of these is likely to be of most interest to the audience today

Proposed approach (ii)

- Minor change in traffic
 - Variable usage charges are modelled on 5-10% changes in usage for existing capability
 - For decreases in traffic, we have adopted a threshold of 15% changes in usage
 - For increases in traffic, we have adopted a threshold based on whether there is a step change needed in maintenance and renewal (and therefore increased capability requirement)
- Change in franchise mapping
 - One-off update to reallocate fixed charges between operators
 - Could also apply to long-term access options
- Enhancement (including change in traffic leading to increased capability requirement)
 - Dealt with under the *Policy Framework for Investments*

Proposed approach (iii)

- Decrement due to significant drop in traffic:
 - Believe that case-by-case analysis is most appropriate – will examine cases leading to greater than 15% decrease in usage
 - Approach would use ICM as one input and address issues around:
 - o Detailed cost structure of the asset under question and any ‘step-changes’ in cost
 - o Time-periods over which costs may become avoidable
 - o Other impacts and interaction with re-opener provisions
 - Local validation / calculation will also be critical
 - Clarity of process will be needed to ensure that PTEs gain benefit

Analysing decrements – process steps

Step	Questions / issues
Identify total costs of relevant line / line section	Use ICM modelled approach, including the fixed track-access charges calculator
Seek local validation of costs	Test whether the ICM model assumptions are robust for the local segment identified
Fully understand the service change being considered and its implications	Permanent or non-permanent? Is the line to be closed or to be maintained to a lower standard? Provision for possible future use and/or for other modes?
Treatment of amortisation	Actual cash spend on renewals vs smoothed annual allowance?
Time period of analysis?	Period over which fixed charge is paid, when do costs become avoidable?

Analysing decrements - issues by cost category

Cost category	Issues / treatment
Direct costs	Avoidable, subject to specific local validation. Initial stage using unit rates from ICM.
Route specific enhancements	Similar in principle to direct costs. In practice seems unlikely that decrements would be specified for parts of the network with specific enhancements.
Allocated overheads	Overheads are unlikely to be avoidable. However, this will depend on the nature of the local cost relationships, so case-by-case assessment is necessary.
Regulatory Asset Base	Based on actual renewals avoided in the remainder of the CP during which the decrement is proposed. Detailed case-by-case assessment analysing work-banks.

Case-study analysis – possible impacts by cost category

	Possible treatment	
Examples	Reduction in services	Cessation of all services
1a. Branch line with dedicated signal box	Unlikely to be any saving	Avoided signaller costs
1b. Branch line signalled from local control centre	No saving	Unlikely to be any avoided costs
2. S&C located at entrance to branch line	Unless significant, the decrease is unlikely to trigger a change in asset strategy	Possible eventual saving of maintenance and any planned renewal for Control Period, depending on identified future use
3. Plain line	Possible saving in the event that the number of tracks could be reduced	Possible saving depending on future use
4. Other line-side opex / maintenance (cleaning, tree pruning etc)	Unlikely to be any saving	Minimal savings in the short to medium term as activities driven by time rather than number of services run
5. Structures	Unlikely to be any saving	Possible long-term saving if there is closure

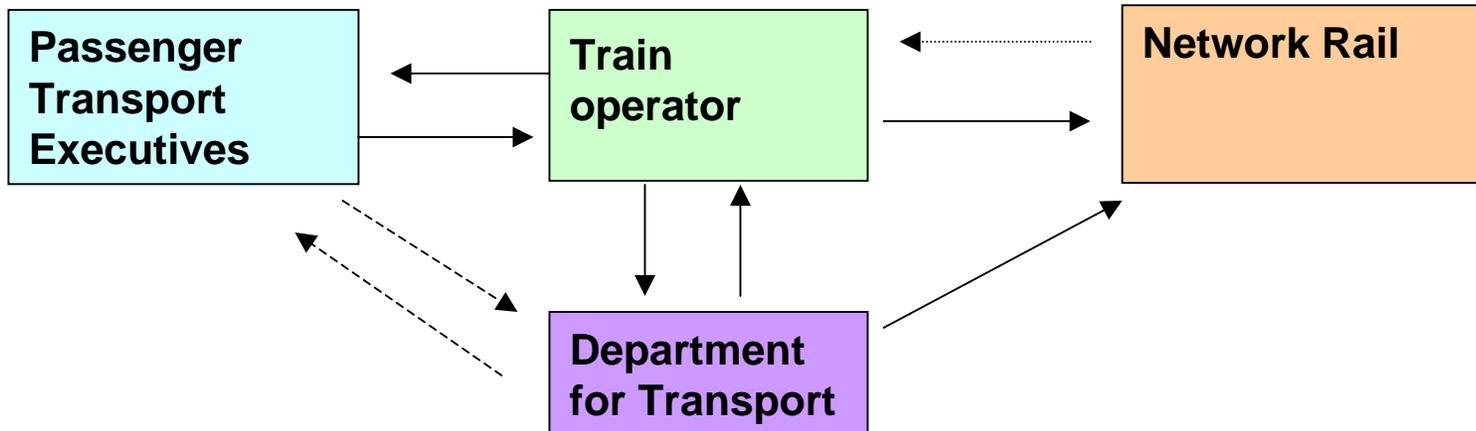
Mechanisms for transferring costs and interaction with other legal arrangements

Iain Morgan

Senior Economist



Industry structure for transferring costs



Options for transferring costs

- Alter the level of the fixed track access charge (disaggregated to PTE level) in Part 2 of Schedule 7
- Have an additional track access charge (either positive or negative) as an additional permitted charge in Part 5 of Schedule 7
- Network Change provisions in Part G of the Network Code
- Part J – changes to access rights
 - J2 – voluntary surrender or adjustment to access rights by a train operator
- Other arrangement
- Preference for changes to the track access charges in Schedule 7 because of greater transparency and cost reflectivity

Interactions with other legal arrangements

- Changes likely to trigger franchise change procedures
- May therefore need some arrangement between DfT and PTEs rather than simply use the PTE/TOC arrangement
- Some decrements would be network modifications and
 - Follow the procedures set out in s22 – 45 Railways Act 2005
 - Appraise proposals against objective criteria

Other issues and next steps

Iain Morgan
Senior Economist

Other issues

- Level of materiality threshold
- Timing of any changes to Network Rail's regulatory asset base

Next steps

- Follow up today's workshop with consultation letter setting out main issues
- Incorporate approach into our criteria and procedures document for the approval of passenger track access contracts
- Establish mechanism in PR08
- But examine cases as they arise through s22s