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Consultation Response

## High Level Review of Track Access Charges (ORR)

*pteg* Response

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## 1. Terms of Reference

- 1.1. Earlier this year the ORR asked the economic consultancy CEPA to undertake a high level review of track access charges. The purpose of this study was to identify the key issues and options for track access charges in CP5, so that Network Rail is more responsive to the needs of train (passenger and freight) operators, and that it, train operators and others are incentivised to make the best use of existing capacity and develop the network efficiently.
- 1.2. The report identifies and focuses on six short listed options which are:
  - **a regional 'long run incremental cost' (LRIC) approach**, where the variable usage charges would reflect the forward looking costs of providing capacity, including the costs of enhancements, and would be disaggregated across the network. Such an approach would typically mean higher variable usage charges (where there are capacity constraints), but with lower fixed charges;
  - **a regional 'short run incremental cost' (SRIC) approach**, this would be similar to the current approach, however it could mean disaggregating variable usage charges on a regional basis to reflect the differentiated costs across regions;
  - **scarcity charge**, where charges reflect the opportunity cost associated with the use of a path, which prevents another operator from using that path. Such an approach would typically mean higher charges for use of more capacity constrained areas of the network;
  - **cost benefit sharing**, this type of mechanism could allow Network Rail to share a fixed proportion of train operator revenues. Such an approach could incentivise Network Rail to target investment towards projects that would result in higher operator revenue. This approach could be implemented alongside other changes to charges.
  - **a track occupancy charge**, where the focus on charging for network capacity as opposed to track damage. For example, it could be charged per minute rather than per vehicle or train km. Such an approach may result in higher charges for those services which consume capacity on the network for long periods of time; and
  - **an 'average cost' approach**, based on the view of simplification of charges. In this case, variable usage charges would translate to an average charge which would be equivalent for all users across the network. This type of approach could be implemented with or without (or lower) fixed charges, and may reduce or increase individual charges;
- 1.3. Of these six options, CEPA recommended that the first four could offer improvements for the sector. CEPA did not consider that the average cost or the track occupancy charge option would provide benefits or improve the current charging structure. This was largely because of the poor signals that each of these options would send to customers for optimal use and development of the network. CEPA recommends that further detailed work should be carried out to fully evaluate the benefits of any of the options.
- 1.4. The ORR does not have a preferred view on any of these options at this stage, or indeed, whether any changes to track access charges are justified, but will give the CEPA report their full consideration, taking into account stakeholders' views.

## 2. Response to CEPA's recommendations

### Regional SRIC approach

- 2.1. The PTEs agree in principle that improved regional disaggregation of infrastructure costs would lead to an improved incentive structure.
- 2.2. However, it is unclear to what extent it would be possible to achieve this degree of disaggregation based on currently available data or how this would be incorporated into track access charges. We would therefore reserve our future view on this option pending further work by the ORR.

### Regional LRIC approach

- 2.3. The PTEs agree in principle that the inclusion of longer term forward looking costs could be a potentially attractive way to promote and fund necessary infrastructure investment.
- 2.4. However, it is conceivable that such an approach could introduce perverse incentives, for example if it were to encourage Network Rail to allow infrastructure to fall into disrepair in order to justify an increase in access charges. Moreover, it is unclear how long term infrastructure costs would be allocated between different network users.
- 2.5. Should the ORR decide to pursue this option further, the PTEs would be keen to explore with ORR how such framework could fit in with our objective for greater devolution of rail powers. However, we would reserve our future view on this option pending further work.

### Scarcity charge

- 2.6. The PTEs agree that it is reasonable for charges to fairly reflect the full opportunity cost of adding an incremental service to the network.
- 2.7. However, we would argue that this needs to be based on a detailed analysis of the likely performance impacts of a specific service enhancement rather than average network-wide estimates of the opportunity cost per path-km. We have listed some of our concerns in this respect in our letter dated 28<sup>th</sup> April 2008 in response to the 2008 Periodic Review Capacity Charge proposal (attached as an annex to this document). Our key points are summarised below.
- 2.8. The impact on capacity and reliability of a specific service proposal depends on a range of very detailed operational factors which track access charges may not be able to reflect adequately without a very significant increase in complexity.
- 2.9. Moreover, an enhancement can have positive as well as negative effects and this needs to be recognised in any sort of scarcity charge. For example, a proposal to cluster together fast and slow services in place of an alternating service pattern could increase capacity and reliability but potentially result in an overall higher charge. For a scarcity charge to provide the right incentives towards optimal use of capacity it would generally need to reward service proposals which aimed to maximise network performance through careful planning relative to others which represented a high performance risk to the network. However, it is difficult to see how a list of track access charges by region or line type could deal with this scenario in a sensible way.

- 2.10. In our 2008 letter, we pointed to the specific example of the Walsall line where the addition of extra services to what was originally a very tightly diagrammed line led to reliability improvements by creating a considerable performance buffer through increased turnaround times. Yet, a typical capacity charge would actually lead to an increase in the payments to Network Rail.
- 2.11. Ultimately, it is the PTEs' view that track access charges are not a replacement for good network planning. Regardless of the incentive structure put in place it is largely beyond the scope or ability of individual franchisees to identify their individual behaviour which would collectively maximise network capacity. It would be easy to demonstrate that two separate operators acting in their individual best interest would not necessarily come up with the optimum allocation of capacity.

### **Cost Benefit Sharing**

- 2.12. While it is difficult to make a judgement on the practical implications of this proposal without some more detailed analysis the PTEs would find this approach potentially appealing in the context of greater devolution of powers and responsibilities to PTEs. In particular, we feel that such a system could provide much more effective incentives towards investment and greater revenue generation by PTEs.
- 2.13. However, we have significant concerns over the likelihood that a cost benefit sharing arrangement between Network Rail and Train Operating Companies could lead to investment in favour of the most profitable services in detriment of more heavily subsidised routes regardless of wider socio-economic benefits.

### **Charges based on average cost and track occupancy**

- 2.14. The PTEs broadly agree with CEPA's assessment that these two options provide very poor signals to the industry. Track occupancy introduces a perverse incentive against increases in operating speed by Network Rail whereas average cost does not reflect true variability in costs and charges by different types of operation and therefore provides a very weak incentive towards more efficient behaviour.

## **3. The need for more fundamental changes**

- 3.1. Although the PTEs understand the ORR's objective to devise a charging structure that produces the most effective incentives towards efficient behaviour, we feel that in the current franchising system track access charges play a very limited role in either Network Rail's investment decisions or TOC behaviour.
- 3.2. In the kind of railway that the PTEs envisage increasingly complex charging structures are not necessarily what we need to help us achieve our policy objectives. Our view is that greater simplicity and transparency in the way the railways are funded is paramount in allowing the stakeholders involved to be able to make the decisions that best meet wider policy objectives.
- 3.3. We would therefore argue that the current track access charging system needs a substantial overhaul in order to achieve the objective of greater simplicity and in order to reflect the wider benefits of service changes.
- 3.4. There is a case for arguing that the level of service across the rail network should be specified by a strategic planning body (such as the DfT) better placed to factor in the

complex range of variables necessary for determining the optimum level of infrastructure provision. The majority of the costs associated with providing this level of service (essentially corresponding to the current fixed charges) could be directly provided by government to Network Rail. Given that franchised services are largely specified prior to tendering, fixed charges essentially play no role in TOC's decision making. Doing away with fixed charges would therefore significantly simplify current funding flows without significantly changing the structure of incentives faced by operators.

- 3.5. In this context, the allocation and use of capacity would be driven solely by the timetable planning process, underpinned by Route Utilisation Strategies (RUS) and a clear process for prioritising the use of capacity based on wider policy objectives. The significance of capacity/scarcity charges in providing incentives to operators would therefore be much more limited.
- 3.6. In this context, all operators would still pay variable access charges (possibly based on the SRIC approach above), reflecting their wear and tear, and electricity charges (if relevant).
- 3.7. Our proposal would not preclude the use of a LRIC approach to fund investment in the network over and above the base specification.
- 3.8. The PTEs recognise that this simpler approach removes some of the price signals to Network Rail that fixed charges currently provide. However, it would replace them with a much more comprehensive approach to the assessment of rail services, better able to take on board wider policy objectives.