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BY EMAIL

See annex A for distribution list

Dear Colleague

Consultation on the policy on variable usage charges for modified vehicles

Background and purpose

1. The purpose of this letter is to consult you on our proposed policy on how operators should benefit from the savings in track costs brought about by vehicle modification, both in Network Rail control period 4 (CP4) and in control period 5 (CP5)¹.
2. The variable usage charge is designed to recover Network Rail's operating, maintenance and renewals costs that vary with traffic. For CP4 the variable usage charge was determined for each vehicle type (or vehicle/commodity mix for freight) based on a network wide calculation of variable cost, which is allocated between vehicles with reference to relative damage caused to the network.
3. The charge was set to provide signals to operators, and their suppliers and funders, for the efficient use and development of vehicles and the infrastructure, subject to other policy objectives and constraints.
4. We are pleased that some train operators are taking the initiative to modify the vehicles being used on the network in order to reduce infrastructure costs, and we wish to ensure that they benefit from reducing Network Rail's costs through an appropriate reduction in the variable usage charge.
5. The industry is working collaboratively in order to develop a policy and charging regime for modification of vehicles to minimise their track wear, and we participate in cross industry meetings on this subject (attended by Network Rail, ATOC, RoSCos and ORR). We note that the Vehicle/Track System Interface Committee has helped guide the development of variable usage charges and has provided technical reviews of Network Rail's proposals for changes to this charge, particularly in relation to the use of wheel profiles and primary suspension yaw stiffness as mitigants to rolling contact fatigue.

¹ CP4 is 2009-14, and CP5 is 2014-19.

Treatment in CP4

6. We would expect operators to benefit from the vehicle modifications through reductions in their variable usage charge, which in turn reflect the reductions in Network Rail's costs due to the modification.

7. The charges for unmodified vehicles do not change for CP4 under this process, though all vehicle charges will be reviewed as part of the 2013 periodic review (PR13) for CP5.

8. Amending a variable usage charge to take into account modifications to an existing vehicle requires a supplement to the track usage price list published at the periodic review. The process for effecting a supplement to the track usage price list is set out in Paragraph 9 in Part 2 of Schedule 7 of the model track access contract². Under this process the parties may agree the supplement or, if they cannot agree, may refer the matter to an arbitrator for determination under the Access Dispute Resolution Rules. In each case, the supplement requires ORR's consent in order to become effective.

9. We would expect the variable usage charge for the modified vehicle to be calculated using the same methodology, as applied in the charging model used in the 2008 periodic review (PR08) or an extension to the methodology, that is used to calculate all variable usage charges.

10. We understand that there may be some instances where the change to the variable usage charge estimated using the PR08 charging model is considered by both Network Rail and operators to be a substantial underestimate of the cost savings, and that this discrepancy undermines the operator's business case for modifying the vehicles.

11. In such cases, we propose that we will still be prepared to consent to an alternative charge for the modified vehicle which seeks to take account of such an underestimate, provided that:

- a. it is agreed by the operator and Network Rail;
- b. the reduction in charge for the modified vehicle is calculated using the same overarching principles that underpin the PR08 charging model, so that they are derived from changes to track wear and tear costs;

² See <http://www.rail-reg.gov.uk/server/show/nav.202>; or <http://www.rail-reg.gov.uk/server/show/nav.2006> for passenger or freight respectively.

- c. the evidence provided is objective, transparent and well founded. This may include evidence based on expert judgement, provided that the process for establishing the expert judgement is set out, the experts involved are identified, and differences between their judgement and model outputs are explained; and
- d. the associated reduction in charges calculated can be applied in a way that does not result in undue discrimination (we do not anticipate this to be a problem, but need to be reassured of this, and would be interested in consultees' views).³

12. We are happy to discuss specific examples with Network Rail and with operators.

Treatment in CP5

13. For CP5, we will ensure that the difference in track access charges between the modified and unmodified vehicle continues to reflect the difference in cost for track damage. We propose to commit to preserving or increasing this differential in absolute terms in CP5 irrespective of other changes in policy with regards to track access charges. For example, if the differential for price between the modified and unmodified vehicle in CP4 is 5 pence per vehicle mile, then we propose to commit that the differential in CP5 will be at least 5 pence adjusted by the retail price index. (We will consider whether the differential should be retained for CP6 and beyond at a later date.)

14. In CP5, charges for unmodified vehicles should be calculated and included in the charges price list alongside those of modified vehicles. We will approve charges for unmodified vehicles following the same process that we use for the approval of other charges, even if all relevant vehicles have been modified. We will do this because we understand from the Department for Transport that this will allow operators to benefit from the investment they have made to modify vehicles beyond the current control period.

Bespoke deals under the track access contract framework

15. Bespoke deals between operators and Network Rail require our approval if they involve changes to the track access contract, or they relate to matters that would normally be included in the track access contract. As set out in section 22 or section 22A of the Railways Act 1993, without our approval such deals will be void and legally unenforceable.

16. We have set out in paragraph 10 above our understanding that in some instances a change in the variable usage charge in CP4, calculated strictly in accordance with methodology of the PR08 charging model, might not adequately reflect the savings in track

³ An example of undue discrimination might be where services by two operators competing in the same market face track access charges that have been calculated on an inconsistent basis.

costs. Network Rail has asked whether, in those circumstances, rather than reflect any discrepancy in a newly-calculated variable usage charge, it and an operator may simply agree a payment to reflect the discrepancy.

17. In principle, we are supportive of bespoke deals between operators and Network Rail that deliver benefits to the industry and / or railway customers, including deals associated with vehicle modification.⁴

18. We would not, however, expect to consent to a bespoke deal that is a direct substitute for a track access charge. This is because the variable usage charges are calculated using a transparent charging mechanism, clearly set out for the whole industry after consultation and substantial consideration. Any bespoke deal to make a payment which has not been calculated in accordance with these same principles will by definition lack the transparency of the modelled charges (and carry with it a risk of discrimination in the way Network Rail makes such bespoke deals with individual operators). Such an approach would be contrary to our charging objectives and legal obligations.⁵

19. Similarly, Network Rail and the Association of Train Operating Companies (ATOC) have asked whether we would approve a bespoke deal under which Network Rail indemnifies an operator against changes in policy relating to track access charges for CP5 that could result in the operator's return on its investment being undermined. Our intention is that the statements made in this letter provide the reassurance that train operators need, so that such indemnification would not be necessary. If Network Rail and an operator were still to make an agreement, we would not, however, expect to approve such an approach for the same reasons (and with the same consequences) as those given in the preceding paragraphs.

20. We propose that the approach we have outlined in paragraphs 18 and 19 above only applies to change in costs to Network Rail resulting from vehicle modifications. It does not cover other areas where bespoke deals may be demonstrated an appropriate way forward.

⁴ We would of course need to consider proposed bespoke deals that resulted in dis-benefits to customers or had other negative consequences, such as asset deterioration, in greater depth and consult relevant stakeholders, including funders.

⁵ Our charging objectives are set out in paragraph 18.19 of the PR08 determination, see: <http://www.rail-reg.gov.uk/upload/pdf/383.pdf> .

Consultation

21. We welcome comments on our proposed policy on how operators should benefit from the savings in track costs brought about by vehicle modification. We would particularly welcome comments on:

- a) criteria for diverging from the PR08 charging model (para 11)
- b) our proposal to retain the charging differential in CP5 (para 13)
- c) our views on bespoke deals that are a direct substitute for track access charges (paras 18 and 19)

22. Please send comments electronically⁶ by 20 May 2011 to:

Rupika Madhura
Economist
Office of Rail Regulation
Email: rupika.madhura@orr.gsi.gov.uk
Tel: 020 7282 2055

23. You should indicate clearly if you wish all or part of your response to remain confidential to ORR. Otherwise, we would expect to make it available on our website and potentially to quote from it. Where your response is made in confidence please can you provide a statement summarising it, excluding the confidential information that can be treated as a non-confidential response. We may also publish the names of respondents in future documents or on our website, unless you indicate that you wish your name to be withheld.

24. Our aim is that all documents on our website adhere to certain standards of accessibility. For this reason, we would prefer to receive your correspondence in an editable format such as Microsoft Word. If you do send a PDF document or similar, we would be grateful if you could create it from an electronic file rather than an image scan; and ensure that no security is set in the document properties.

25. A copy of this letter can be found on the ORR website (www.rail-reg.gov.uk).

26. When we have considered consultees' views, our intention is to revise the letter as a statement of our policy with respect to track access charges for modified vehicles.

⁶ If you have difficulty sending your consultation response views electronically, please liaise with us and we will make alternative arrangements.



Yours faithfully,

A handwritten signature in black ink that reads "Emily Bulman". The signature is written in a cursive style with a large, sweeping "E" and a long, horizontal flourish at the end.

Emily Bulman

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