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Paul Plummer  
Chair, Contractual and Regulatory Reform Working Group  
Rail Delivery Group  
c/o Network Rail  
Kings Place  
London N1 9AG

cc Nick Ellins, Peter Swatridge

Dear Paul,

### **Structure of charges review**

1. In our PR13 final determination<sup>1</sup> we committed to working with the industry to conduct a review of Network Rail's structure of charges. This letter describes our proposed approach to this review, including how we envisage it interacting with RDG's own work in this area, and high level timescales. The letter also sets out a proposed framework of charging aims and objectives for your, and wider stakeholder, comment.

2. The structure of charges is an important part of the framework for using the national rail network. It is the mechanism through which Network Rail recovers its costs from users of its network. This means that it affects the costs faced by franchise, freight and open-access train operators. The way in which Network Rail's charges are structured also has the potential to affect how train companies and Network Rail interact, and is one tool available to better align the incentives faced by all parties in the rail sector, which will ultimately benefit rail users and those funding the railway.

### **Proposed work programme**

3. Our proposed approach to carrying out the review includes three main parts of analysis each of which will involve engagement with interested parties.

#### *Objectives analysis*

The starting point for our review is to identify the various aims and objectives for charges. This is already underway and we set out below a suggested framework of aims and objectives. An important part of this work is to identify the various states of the world under

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<sup>1</sup> See Periodic Review 2013, final determination, October 2013, paragraph 16.27, [http://orr.gov.uk/\\_data/assets/pdf\\_file/0011/452/pr13-final-determination.pdf](http://orr.gov.uk/_data/assets/pdf_file/0011/452/pr13-final-determination.pdf)

which any future charging structure may need to operate. We have been working with RDG to develop these states of the world.

Another important part is a 'gap-analysis' to assess how far the existing charging structure is from meeting the aims and objectives and how well it might perform under different states of the world. Completion of this step of our analysis will help to identify where we should focus our efforts in developing a future charging structure. We are aiming to complete most of this work by the end of 2014.

### *Cost analysis*

Any future structure of charges will need to be supported by a thorough understanding of the underlying costs which it seeks to recover. The cost analysis part of our work will involve scoping, establishing the rationale for and carrying out the specific cost analysis work necessary to support the development and delivery of future charging options.

Network Rail is currently leading a consultancy study to review cost attribution and allocation approaches and to create a fact base for the future consideration of alternative approaches. We expect this to inform our thinking. An important part of our work is to establish what we currently know about costs, what more we would need to know about costs to support alternative future charging structures and the benefits associated with that improved understanding.

ORR is currently developing its thinking in this area and we expect this scoping and rationale work to be complete by Spring 2015. This is likely to be followed by quantitative work to carry out the cost analysis. We anticipate that the quantitative work will happen over the remainder of 2015 although the exact timescales for this work are likely to be determined by the approach which we adopt.

### *Options analysis*

The option analysis will involve identifying, developing and assessing a range of options for a future charging structure and arriving at a short-list. We will begin by developing a proposed long-list of options. We will make it clear how each of these options would help to move us towards achieving charging objectives and identify any conflicts. At this stage we will revisit the analysis around states of the world and decide what impact this should have on possible charging options.

We will then develop a framework for assessing and evaluating the likely effectiveness and impact of each of the options (building on the gap analysis as described above) and to narrow the options according to this framework. We expect to consult on the short-list of options in the final quarter of 2015.

## **Proposed approach**

4. In carrying out our analysis, as described above, the following factors will be crucial to our assessment and evaluation of the various charging options:

- *Whether a given option represents a **proportionate improvement** on the existing structure in terms of its ability to deliver on our charging objectives.* We propose to assess proportionality both in terms of the ability of a given charging option to deliver better on charging aims and objectives and whether the benefits of implementing the necessary changes are anticipated to exceed their costs. For

example, a radical change to the existing structure would need to have a significant corresponding benefit that is in excess of the costs before it would be considered.

- *A full understanding of the **impact** of a given option e.g. on different market segments such as freight and open access.* We propose to assess the impact, particularly on different market segments, such as freight and open access, of a given charging option. This would include consideration of distributional impacts and the effect of any changes on factors such as business planning and certainty.

5. In reaching any decision around the future structure of charges we will make clear and explicit reference to our statutory duties<sup>2</sup>. Many of ORR's duties are of potential relevance to the charges review. These include our duties to: 'promote efficiency and economy on the part of the persons providing railway services'; and 'enable persons providing railway services to plan the future of their businesses with a reasonable degree of assurance'.

6. More generally, it is essential that our review incorporates industry and funders views, including the outputs of the RDG work, and those of the government and passenger groups. We are very pleased that RDG is carrying out its own work to consider what the charging structure should deliver in the long-run and the options available to achieve this. We see this as a positive example of the industry working together to improve incentives and value for money. We are keen to incorporate the findings of RDG's work in to our own review and where possible to work in tandem with RDG. A recent example of this is our working with RDG to develop future states of the world, as referred to above.

7. We are keen also to incorporate the views of the wider industry, passenger groups and governments. We will achieve this through on-going industry engagement, seeking specific input both informally as we develop our thinking and formally through consultation. We have already had some discussions with government around what problems changes to charges might help to solve.

8. We have provided a high-level, indicative timetable that we are working to in Annex A. As noted above, we intend to publish an initial consultation in the final quarter of 2015. This will include a draft impact assessment so will include the evidence we have used and the steps we have taken to get to a short list of options. This high-level timetable provides transparency around our process so that any stakeholder that wishes to provide analysis to inform our initial consultation can plan accordingly. Obviously, the earlier we receive any analysis from RDG and other industry stakeholders, the more scope we have to absorb this and incorporate this into our thinking in advance of our initial consultation. In Annex A, we have put this alongside what we know of RDG's timetable for clarity.

### **Objectives analysis - charging aims and objectives**

9. As noted above, the first step in our review is to identify charging aims and objectives. We have so far engaged both internally across ORR and externally with government to understand what problems changes to charges might help to solve. As a statutory body we have referred back to our statutory duties to ensure that these are captured within our thinking. In addition, RDG appointed consultants have recently concluded a piece of work to identify a 'vision' for the future charging structure. This work is now available on the

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<sup>2</sup> As specified under section 4 of the Railways Act 1993

RDG website - <http://www.raildeliverygroup.com/wp-content/uploads/2014/12/RDG-Review-of-Charges-Phase-1-vision-Dec-2014.pdf>.

10. We have carried out a mapping of views around some internal thinking we have done on what problems changes to the structure of charges might help to solve and the RDG vision. There is a high degree of alignment between the two. However, we propose to include an explicit objective of 'supporting effective competition'. This objective describes our intention to consider all types of operators, and both incumbent operators and future entrants.

11. Furthermore, we don't propose to include the objective of 'a single approach for the network' which is included in the RDG vision. This exclusion is because we think that it is important to be clear that a structure of charges could reflect differences between operators – and one interpretation of a single approach is that these differences might not be recognised.

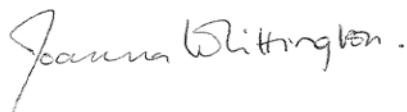
12. Annex B reflects our latest thinking on a high-level framework for charging aims and objectives. We propose to use this framework to assess our current charges, as described above, and it would form the beginning of a wider framework to assess and evaluate future potential charging options, also described above. We expect to consult on this framework as part of our wider charges consultation in the final quarter of 2015. In the meantime, we are happy to take any views on the content of this letter.

### **Next steps**

13. I hope that this letter has been helpful in clarifying our proposed approach to our review and will assist RDG in maintaining good levels of industry engagement as aspects of its own review develop. I would welcome any comments which you may have both on our approach and on our proposed framework of charging aims and objectives. Since this framework is similar to the RDG vision I would hope that you are content that it reflects RDG aspirations.

14. This letter is being published on our website to allow for wider stakeholder engagement and comment on its content. This feedback should be provided to Elise Weeder, Head of Regulatory Economics, [elise.weeder@orr.gsi.gov.uk](mailto:elise.weeder@orr.gsi.gov.uk), in the first instance.

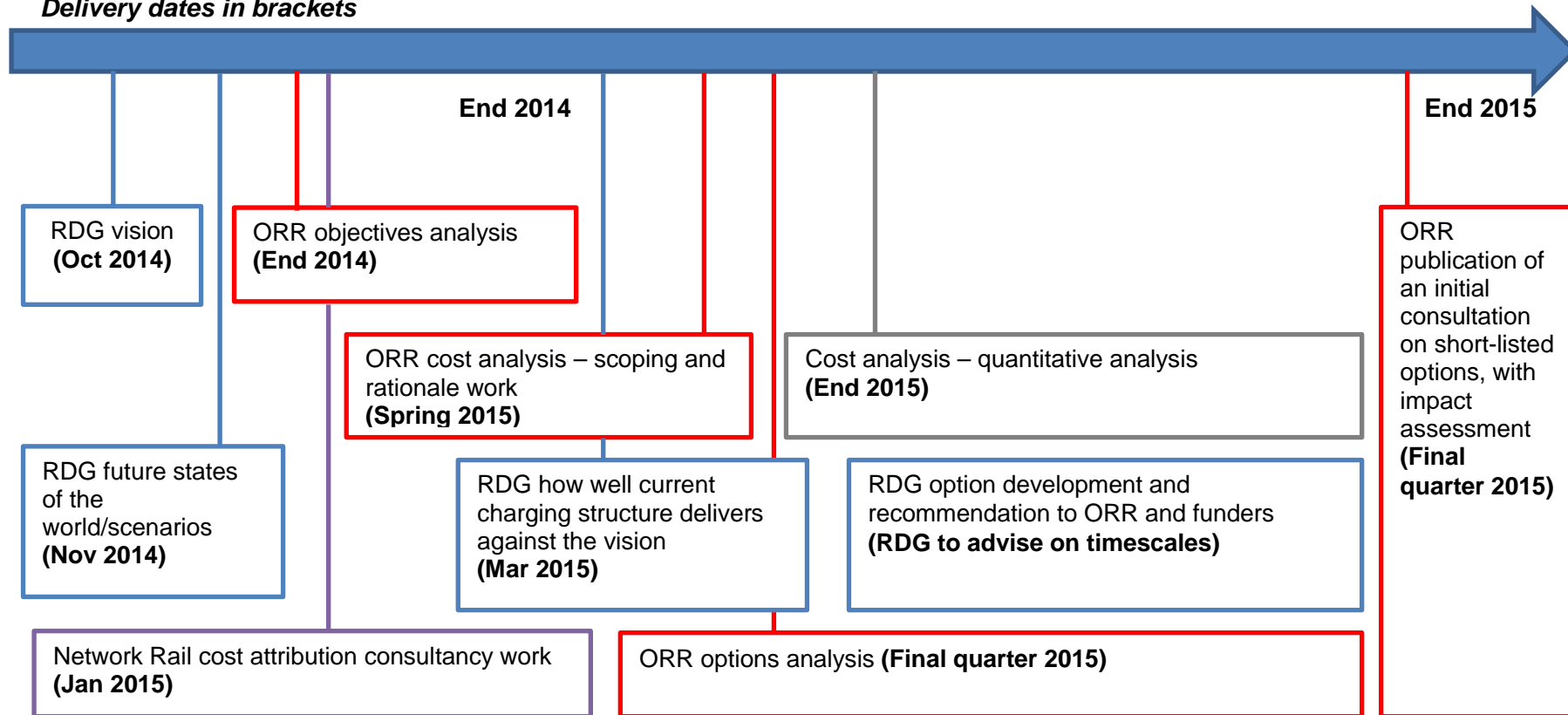
Yours sincerely,



Joanna Whittington

## Annex A: High-level timetable for structure of charges work

*Delivery dates in brackets*



## **Annex B: Suggested aims and objectives framework for comment**

We propose to develop a charging structure which is assessed relative to the following aims and objectives.

- **Improves efficiency and supports cost recovery**
  - Supports efficient use and provision of network capacity
  - Supports lower network costs and efficient decision making
  - Allows Network Rail to recover its full costs
  
- **Meets charging principles**
  - Predictability
  - Stability
  - Simplicity
  - Transparency
  - Practicality, cost effectiveness, comprehensibility, and objective in operation
  
- **Is legally compliant**
  - With domestic legislation
  - With European legislation
  - Promotes the objectives of our statutory duties
  - Supports effective competition
  
- **Achieves better outcomes**
  - Improved Network Rail accountability
  - Improved cost reflectivity
  - Aligned industry incentives
  - Improved value for money for funders, taxpayers and users