Rail Delivery Group

Response to

ORR's PR18 consultation on charges recovering fixed network costs

Date: 30 November 2017

Rail Delivery Group response to

ORR's PR18 consultation on charges recovering fixed network costs

Organisation: Rail Delivery Group

Address: 200 Aldersgate Street, London EC1A 4HD

Business representative organisation

Introduction: The Rail Delivery Group (RDG) was established in May 2011. It brings together Network Rail and passenger and freight train operating companies to lead and enable improvements in the railway. The purpose of the RDG is to enable Network Rail and passenger and freight train operating companies to succeed by delivering better services for their customers. Ultimately this benefits taxpayers and the economy. We aim to meet the needs of:

- Our Members, by enabling them to deliver better outcomes for customers and the country;
- Government and regulators, by developing strategy, informing policy and confronting difficult decisions on choices, and
- Rail and non-rail users, by improving customer experience and building public trust

For enquiries regarding this consultation response, please contact:

Tom Wood

thomas.wood@raildeliverygroup.com

Rail Delivery Group

2nd Floor, 200 Aldersgate Street

London EC1A 4HD

Introduction

1. This document outlines the key points from our members in response to the ORR's PR18 consultation on charges recovering fixed network costs. RDG welcomes the opportunity to respond to this consultation and is pleased to support many of the proposals set out by the ORR.

2. We would welcome the opportunity to engage further with the ORR and we would be pleased to discuss this response, including next steps.

3. Given its publication on 29 November, we will be considering the Department of Transport's strategic vision for rail in detail and, if necessary, will provide a further response to the ORR on this consultation.

4. We are content for this response to be published on the ORR website.

Passenger services

Interactions between the charging regime and the track access framework

5. RDG has stated in previous responses that it supports an approach to fixed-cost charging that ensures that the ORR is agnostic to decisions about granting franchise or open access rights on the network by creating an environment of revenue neutrality. Further, RDG acknowledges that one potential way to improve industry outcomes is by introducing more competition but that before implementing changes to this end, it is important to consider whether it will lead to the best possible outcomes and whether the benefits of such a change would significantly outweigh the costs.

6. The consultation indicates that a policy of recovering fixed-cost charges from all operators "*has the potential to improve competition between passenger services over the longer-term…because it would allow* [Open Access Operators] *to contribute an appropriate amount towards fixed costs where they are able to, in exchange for having greater access to the network*". However, the consultation does not detail how the access framework will change, or potential options for change.

7. RDG considers that that reform of the 'charging' and 'access' sides of this equation should not be looked at in isolation from each other. Rather, it would be preferable for the ORR to take a holistic approach to its review of this matter, considering both aspects concurrently. RDG considers that it is challenging to give a view on proposed changes to the charging arrangements without also having an understanding of how the access framework may change.

8. The current position, whereby the ORR has indicated that the access framework will change to allow Open Access Operators (OAOs) a greater level of access without providing additional clarity around this, creates uncertainty for prospective franchise bidders around the level of competition that they might face within the life of the franchise in question. There is a very real chance that this will impact upon bidding behaviour. For example, this may mean that prospective bidders build a greater risk premium into their bids, or elect not to bid at all.

9. For this reason, we would welcome early clarification from the ORR on how it intends to take this work forward. Similarly, additional clarity would be welcomed around how any change to charging arrangements or the track access regime would apply to existing OAOs which entered into track access contracts with Network Rail under the current access and charging frameworks.

10. RDG had anticipated that the ORRs' work on proposals for the recovery of fixed-cost charges from passenger operators would be at a more advanced stage by this point. Earlier this year, the ORR indicated that this consultation would include "*a proposal … on which passenger market segments should be subject to mark-up charges*" (See Charges and contractual incentives – consultation conclusions, 29 June 2017). Instead, the report prepared by the ORR's consultants' presents itself as a 'proof of concept'. RDG observes that neither that report nor the ORR consultation contain a firm proposal for how the market segments should be defined or on which segments may be able to bear an additional charge.

11. RDG has a concern with the suggestion that the next opportunity to comment on proposals in this area would be in response to the ORR's Draft Determination in Summer 2018, and would have a strong preference for seeking to resolve the likely position for CP6 at an earlier stage in the process.

12. More broadly, the reform of the access and charging arrangements envisaged by the ORR is an important and complex project, with far-reaching implications and the potential to impact upon railway funding, franchising and other areas. It is essential that, as an industry, we give ourselves sufficient time to get this right, for the benefit of passengers and taxpayers. RDG considers it unlikely that there is sufficient time remaining in the PR18 timetable to reach a satisfactory conclusion and allow implementation at the start of CP6.

13. In summary:

- reform of the access and charging arrangements should be considered together as a single project;
- given the complexities and potential implications, there is unlikely to be sufficient time in PR18 to complete this work in time for implementation at the start of CP6;
- RDG would welcome early clarity from the ORR around the envisaged scope of work in relation to reform of the access framework, timescales and how this might affect existing OAOs.

Design of infrastructure cost charges for franchised passenger operators

14. With regards to the proposed design of charges to recover fixed costs from franchised TOCs, the ORR has proposed that charges are adjusted on an annual basis to reflect changes in timetabled traffic. In principle, RDG supports Network Rail being financially incentivised to accommodate additional trains on the network, particularly given ORR's decision to remove the Capacity Charge in CP6. Without additional income to replace the Capacity Charge, Network Rail will be financially worse off when it runs additional trains because, on expectation, it incurs increased Schedule 8 costs as the network becomes busier.

15. The consultation document suggests that infrastructure cost charges could be levied using rates per unit of traffic that could be different for each franchised passenger operator. If this suggestion were to be implemented in CP6, the ORR would need to be careful to ensure that it does not inadvertently create a financial incentive for Network Rail to discriminate in favour of traffic that incurs higher unit rates than when faced with competing requests for additional traffic on the same route. Although, we recognise that Network Rail would be unlikely to act on such an incentive, as the process for granting access to its network takes into account many other factors, and that a number of safeguards are in place to ensure that fair access to the network is maintained.

16. RDG also considers that the guiding principle must be to ensure that Network Rail is not left underfunded for its activities as a result of annual adjustments to charges. Like other

network businesses, Network Rail's fixed costs do not vary with small changes in traffic levels. Therefore, if it receives less income to fund these fixed costs in CP6 it would have to reduce activity and outputs in other areas, which would be an unsatisfactory outcome for the industry, with adverse impacts on customers.

17. One way to mitigate the potential financial risk that this proposal could introduce for Network Rail would be to base charges on a 'business as usual' traffic forecast, which it has a reasonable expectation of outperforming. An alternative option would be to adjust the network grant on an annual basis to make up for any shortfall in Network Rail's income arising from a reduction in timetabled traffic. However, this may be challenging to implement in reality.

Other comments on the charging proposals

18. Though we recognise that the ORR's consultant's report is presented as a 'proof of concept', we consider that basing an assessment of operating surpluses on a single year's worth of data is inappropriate and may yield an incorrect conclusion. We would suggest to the ORR that this assessment (as and when used in conducting the final market-can-bear assessment) should be based on multiple years' worth of data.

19. Additionally, we would suggest that the ORR needs to be clear how future changes (such as timetable changes or the introduction of competing services) within market segments would impact upon the assessment of which segments can bear fixed cost mark ups.

Freight services

20. We accept the ORR's proposal to retain the existing freight market segmentation by commodity, and agree that it is sensible not to introduce further market segments.

21. It is, of course, vital that the ORR's evidence as to whether each commodity can afford to pay a contribution towards Network Rail's fixed costs is robust. If charges were levied on commodities inappropriately this could result in rail freight traffic switching to road, which would have an adverse environmental and societal impact (e.g. increased pollution levels and congestion).

22. The ability of rail freight operators to pass increased costs through to end-user customers should not be taken as a given and the ORR should ensure that any proposal to levy charges in more market segments (such as biomass) is based on sound evidence on the expected customer response to such a change. The extent to which this point has been considered by the ORR in relation to the biomass proposal is unclear.

23. In addition, we agree with the ORR's consultants that there are wider considerations which the ORR should take into account in determining the commodities that can bear an additional charge, such as whether it is appropriate to take a decision which could be seen as penalising investment in railway infrastructure. In the case of the biomass proposal, it is largely unclear from the ORR's consultation how it has taken these wider contextual considerations into account and how it has sought to balance the full range of its statutory duties in arriving at this proposal.

24. Before extending infrastructure charges to additional freight commodities, we believe that the ORR should provide a full assessment of the impact that such a change would have on the industry and in relation to the policies of other government departments (eg BEIS).