ORR workshop on access charges framework

Engagement with freight operators

10 September 2024

Welcome

Agenda

No.	Item	Presenter	Time
1	Introductions & context of the review	ORR	10:00–10:10
2	Scope of the review	ORR	10:10–10:25
3	Variable Usage Charge	ORR / NR	10:25–11:15
4	ICC – freight services	ORR	11:15–12:05
BREAK – 12:05 [10 mins]			
5	Wrap-up	Frontier Economics	12:15–12:30
6	Next Steps	ORR	12:30–12:45
7	Questions	ORR	12:45–13:00

Context of the review

Background to this workshop

- Setting access charges is central to the periodic review.
- During PR23, questions were raised around the purpose, complexity, transparency and incentive properties of access charges.
- Simplification is expected to be a key theme of PR28.
- Some methodological issues with the setting of charges were identified including the complexity of the analysis that informs the calculation of charges, lack of clarity around the cost-base and the treatment of efficiency.

In our PR23 final determination, we committed to start working with stakeholders early in CP7 to better understand these issues to support developing solutions.

This workshop is aimed at gathering preliminary views to inform our planned consultation in early 2025 on potential options for changes to the access charges framework, ahead of the launch of PR28 in 2026.

Wider context

- If enacted, the Passenger Railway Services (Public Ownership) Bill will allow for passenger service operations to be transferred into public ownership when current national rail contracts end.
- Rail reform will bring track and train services together under Great British Railways.
- Commercial relationships between funders, Network Rail/Great British Railways/TOCs will change. This may create opportunities to simplify the charging framework.

Assumptions

- There is a periodic review which concludes in advance of the five-year period starting April 2029 (CP8).
- There will be train operators outside of GBR – most obviously freight and open-access, but also those with separate public funders.
- New legal framework ensures that the infrastructure arm of GBR charges operators for use of its network, according to the charging framework set by ORR.

Objectives and scope of the review

Network Rail's charging framework

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Fixed network costs

Recovered through

Network grant

FTAC

Open access ICC

Freight ICC

Paid by

Funders (TS + DfT)

Paid by **publicly-contracted passenger operators**

Paid by **some open access operators** (e.g interurban)

**

Paid on **some freight traffic** (e.g. biomass, iron ore)

Direct ('variable') network costs

Recovered through

Variable charges*

Station charges (LTC +QX)

Paid by

All operators

Paid by

All passenger operators

*** These are calculated on a cost-reflective basis**

**** Mark-ups – these are charges levied according to what the market can bear**

Current CP7 charges framework

Charges paid by operators	Recovers	CP7 total revenue forecast (£m, 2023-24 prices)	Proportion of CP7 total revenue forecast (2023-24 prices)
Fixed Track Access Charge (FTAC)	Income required to meet Network Rail's revenue requirement (net of other charges, grant payments and commercial income)	6,606	14%
Infrastructure cost charge (ICC) for freight	A proportion of Network Rail's fixed costs, based on an assessment of what contribution to fixed network costs each freight market segment can bear-ESI coal; iron ore; spent nuclear fuel; and ESI biomass.	26	0%
Infrastructure cost charge (ICC) for Open Access Operators	A proportion of Network Rail's freight fixed costs, based on an assessment of what contribution to fixed network costs each open access market segment can bear (interurban and major airports)	25	0%
Variable Usage Charge (VUC)	Maintenance and renewal costs that vary with small changes in traffic	2,069	4%
Traction Electricity Charge (EC4T)	Cost of supplying electricity to power electric trains	4,964	10%
Electrification Asset Usage Charge (EAUC)	Maintenance and renewal costs of electrification assets that vary with traffic	140	0%
Station LTC	Maintenance, renewal and repair costs for stations owned by Network Rail	1,726	4%
QX charge (management fee)	Day-to-day running and operation costs of stations.	568	1%

Charging framework objectives

A charging framework should help achieve the following:
(1) Incentivise **performance and efficient** use of the network – variable charges should reflect the efficient costs that are directly incurred.
(2) Support **asset and financial sustainability** – this is achieved not only by variable charges recovering directly and efficiently incurred costs, but also by ensuring that market segments that can bear a mark-up contribute to efficiently incurred fixed costs.
(3) **Practicability and simplification** – not unduly complicated and should minimise the risk of unintended consequences.
(4) **Transparency and predictability –** readily explainable.

We anticipate that rail reform will present an opportunity to consider simplification to the charging regime. We will ensure that the benefits of complying with and implementing any adjustments to access charges are proportionate to their costs.

Scope of the review (1)

To meet these objectives, we are considering focusing on the following areas ahead of PR28

VUC (4% of Network Rail's CP7 income)

- Capping policy for freight and charter
- Reducing complexity of the calculation of the charge
- Incentive properties of the VUC

VUC price list simplification

- Both calculation and presentation

ICC (<1% of Network Rail's CP7 income)

- Market segmentation and market can bear methodology

Scope of the review (2)

- We anticipate there may be opportunities to simplify the charging framework given the expected rail reforms.
- We currently are **not considering changes** to the charging frameworks for **EC4T** and **EAUC** as no specific issues requiring framework changes were raised around these charges during PR23.

Do you agree with the objectives and our proposed scope?

Variable usage charge (VUC)

Potential changes of approach for VUCs

Capping policy for freight (and charter) & improving robustness and transparency of cost modelling

1. **Review freight (and charter) capping and phasing-in policy**
   - In PR23, we maintained the capping trajectory set in PR18 for VUC rates paid by freight (and charter) in CP7, rather than increasing to higher new cost-reflective rates.
   - In our final determination, we said VUC rates will increase to become fully cost-reflective by the end of CP8 (i.e. the remaining caps will be unwound over CP8).
2. **Review cost base and robustness of modelling**
   - Improve the engineering modelling/methodology, including the track damage formulae.
   - Assess validity of inputs and assumptions used.
   - Review expected costs incurred that are used to set charges (long term costs vs control period).
3. **Simplify price list & reduce model complexity**
   - Simplification would aim to reduce price list from the current circa 1,800 rates and simplify calculations.

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VUC price list simplification options

'Problem statement'

There is a **perception that the VUC price list is overly complicated**, with over 1800 vehicle rates. The wider industry has expressed the view that fewer rates would be preferable.

This presentation looks at **2 options for simplification of the price list** (i.e. adapting the model outputs, rather than the underlying calculations within the modelling):

Option 1

Reduce the number of rates on the price list

- Achieved by creating a **set of 'charging bands'**, into which each vehicle is placed.
- **Similar vehicles** (i.e. with similar individual rates) are charged at the **same rate**.
- The VUC rate of each band is a **weighted average rate** based on individual vehicle rates and mileage.
- Added as a **post-recalibration step** in the VUC model.

Option 2

Change the presentation of the price list*

- **Retains current price list** with approx. individual 1800 rates.
- **Presentational changes** to improve navigation and **accessibility**.
- Improvements based on **industry feedback**.

* Note that some improvements to accessibility of the price lists were made during PR23 consultation process in response to industry feedback, therefore Option 2 has been partially implemented already. Option 2 would aim to further develop the price list format. We would seek feedback from operators to help guide these improvements.

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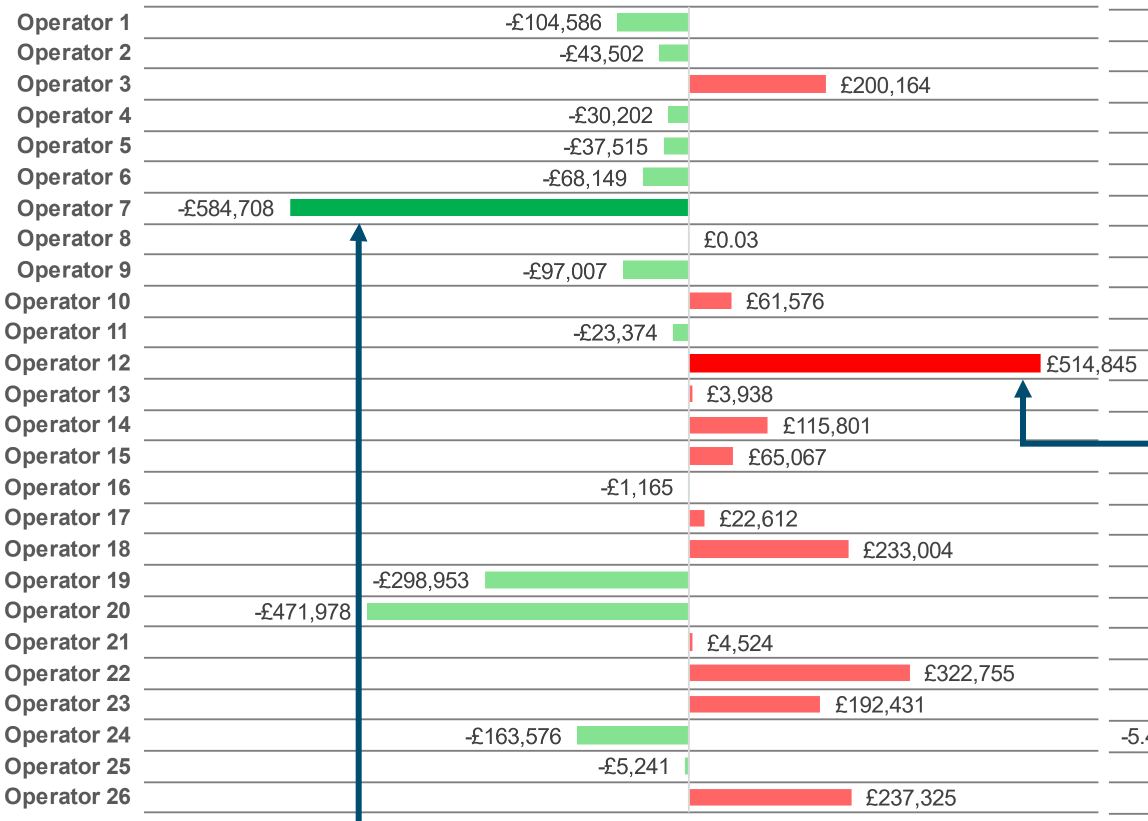
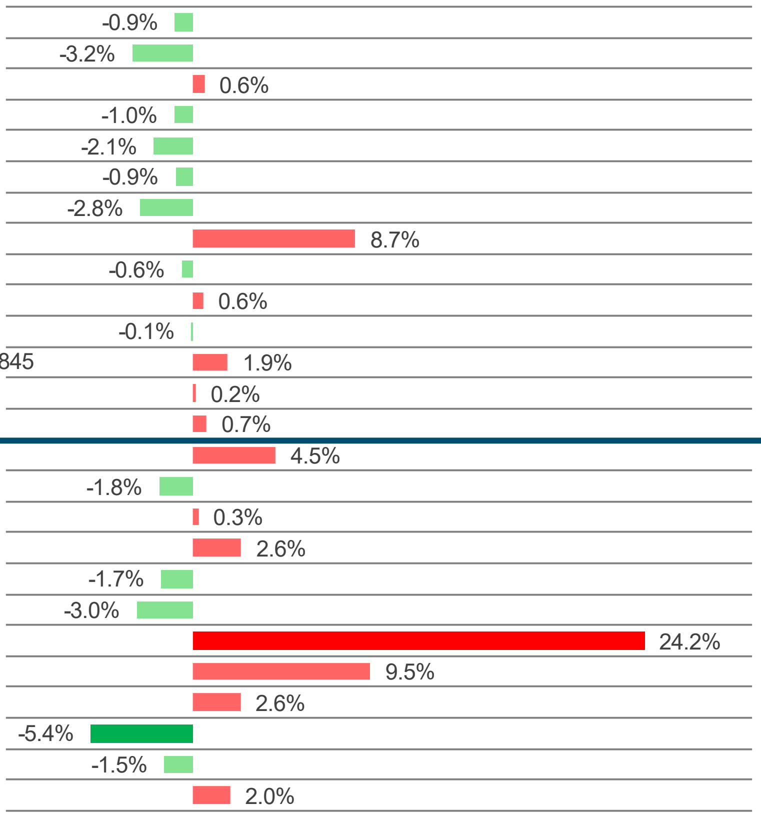
Operator impact assessment – Option 1

Note that under **Option 2** there is **no impact on operators** / vehicle rates as the change is purely presentational.

Sample impact on operator charge (£) over one year of simplifying the VUC price list



Sample impact on operator charge (%) of simplifying the VUC price list



The difference in annual charge for each passenger operator when using 'charging bands' vs. the current CP7 prices.

Based on mileage over the course of one year.

Operator 12 runs several vehicles whose individual rate is on the low end of the charging band and have high mileage.

Operator 7 runs 3 vehicle types, all of which have an individual rate at the top end of its charging band.

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Pros and cons

	Option 1 – fewer VUC rate	Option 2 – change of presentation
Pros	✓ Price list would be shorter. ✓ Additional step is added post-recalibration.	✓ There would not be any material changes to the VUC model. ✓ Changes to accessibility and presentation are transferrable to other price lists. ✓ Cost reflectivity would be retained. ✓ Retains the transparency of the current model and price list. ✓ Maintaining the current calculation methodology provides stability in a time of change.
Cons	× There are 'winners and losers'. × Disincentivises operators from making track friendly modifications. × Without listing individual vehicles, the price list is meaningless × To 'simplify' (shorten) the price list, the VUC model would be larger and more complex. × Potential for inadvertent bias and possible disputes. × Reduced transparency. × Reduced cost-reflectivity. × Grouping vehicles may make it harder to identify errors.	× The price list will still contain approx. 1800 individual vehicles and rates.

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Conclusion

Network Rail is choosing to move forward with option 2 – a change/update in presentation of the existing price list.

This decision is based on there being overall greater accuracy, transparency and cost-reflectivity, with only one very minor downside compared to choosing option 1.

Discussion questions

a) How does the VUC influence your decisions about rolling stock / network use? How can these incentive properties of the VUC be improved?

b) How should we move to cost reflectivity (i.e. removal of the cap on VUC for freight) in CP8?

c) Is the complexity of the VUC an issue for you? If so, what aspects of the charge or its modelling do you find complex and how can they be improved?

d) Should the price list be simplified and, if so, how? What benefits would this have?

e) What are your views on the areas we have identified to work on as we try to reduce the complexity of the VUC? Please provide your views on each area separately.

f) Apart from the areas we have identified above to improve the simplicity and transparency of the VUC, are there other areas you think we should work on as well?

Infrastructure cost charge (ICC)

The Freight Infrastructure Cost Charge (ICC)

Purpose of the ICC:

- The ICC recovers a portion of Network Rail's freight traffic-related avoidable fixed costs
- It is determined based on each freight market segment's ability to bear these fixed network costs, assessed through a "market-can-bear" test focused on the potential impact of the ICC on traffic levels.

Application of the ICC:

- **Commodities charged an ICC**: ESI coal, iron ore, spent nuclear fuel, and ESI biomass.
- **Charge basis**: levied as a rate in pounds (£) per thousand gross tonne miles (kgtm), paid by freight operators based on network usage.

Current State:

- The ICC currently recovers only a small proportion of the freight traffic-related avoidable fixed costs due to the assessment of the market segments' ability to bear these charges.

Discussion questions – ICCs for Freight

a) Currently our market can bear methodology differs between freight and passenger TOCS, whereby our assessment of 'ability to bear an ICC' for passenger TOCs is assessed directly on net revenues, while freight is assessed via the impact on traffic. This reflects the ready availability of analytical information (e.g. the level of disaggregated revenues is more available for TOCs).

   While there is no legal requirement for a common approach, should ORR revise its methodology by taking a similar approach to assessing passenger and freight markets, and if so, how e.g. should our analysis of freight markets be based on some form of direct profitability analysis?

b) Currently, our market segmentation for freight does not include distance bands. Analysis in PR23 suggested that for some commodities, rail freight competitiveness with road increases with distance. Should ORR take account of distance as part of its market segmentation?

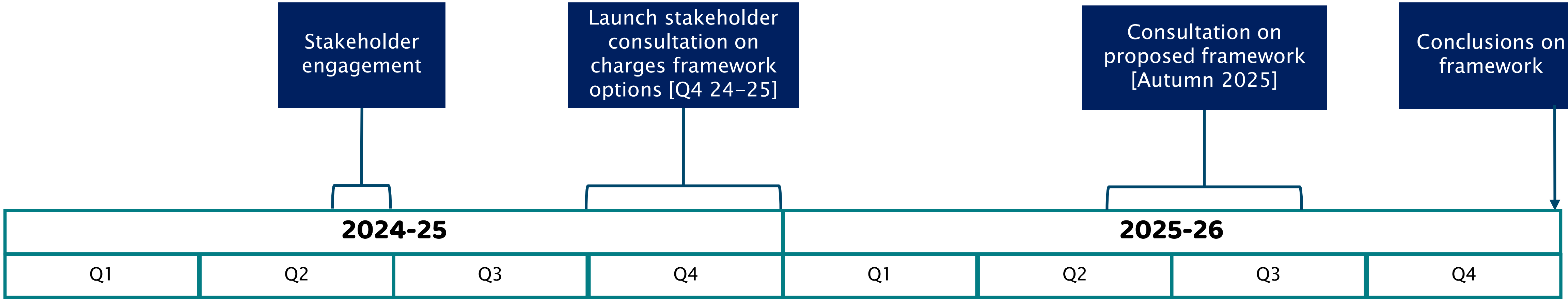
c) Any other views about freight market segmentation?

Break

Wrap-up

Next steps

Timeline for review of access charges framework



Post workshop engagement

- A summary of the key findings/emerging themes from the workshop will be sent out to all invitees.
- There will also be an opportunity after the workshop to provide a written response to help inform the review. Stakeholders who wish to do so can send their responses to the following email:

  prm@orr.gov.uk

- We will be updating our webpage dedicated to the access charges framework review with relevant materials as this review progresses

Questions