RDG PR18 working group on improvements and stations

Note of meeting held on 18 July 2016 at RDG's offices

Attendees: Bill Davidson (RDG) (chair); Nigel Jones (DB Schenker); Steven McMahon (Transport Scotland); Martin Baynham-Knight (Keolis); Maggie Simpson (Rail Freight Group); Russell Evans (FirstGroup); Chris Simms (Abellio); Richard McLean (Arriva); Peter Swattridge (Network Rail); Ben Worley (Network Rail); Lindsay Durham (Freightliner); Richard McClean (Arriva); Dan Moore (DfT); Oliver Mulvey (DfT); Gareth Evans (Welsh Government); Chris Hemsley (ORR); Mary Davies (ORR); Paul Cornick (ORR); Irene Dell'Orto (ORR);

Apologies/not present: Simon Tew (Welsh Government); Mike Hewitson (Transport Focus); Steven Price (ATOC)

Structure of Charges: Initial shortlisting of options

1. The main agenda item of the meeting was for ORR to discuss its latest thinking in relation to station and short run variable charges, including how ORR proposes to prioritise future work on the charges review.

Overview and Context of Review

2. ORR explained that it valued RDG's involvement with the charges review – for example, through the RDG Charges Review and its response to ORR's consultation – and that this work had informed thinking to date.

3. ORR provided context to the charges review – explaining the aims of the project and the wider policy context in which the work would be delivered and the criteria which would help prioritise options.

4. A point was made that it was unclear what was meant by "efficient use of the network". ORR clarified that the goal here was to try to bring costs down and ensure that the system delivers value for money.

5. The group also raised why the ORR was focusing on a small part of Network Rail's variable costs and not on its fixed costs. ORR clarified that the options under consideration represented only an element of the charges work and that other work streams would address other issues.

6. A point was raised as to how the different 'states of the world' would be included in the assessment of options. ORR explained these states of the world would be included as work progresses (for example, developing full impact assessments).

ORR clarified that the Capacity Charge work has its own work stream and that this would be the subject of a separate stakeholder engagement session.

Variable Usage Charge (VUC)

7. There was an extensive discussion relating to the VUC. ORR outlined two broad options under consideration – disaggregation of the VUC and ensuring the VUC includes all relevant costs. ORR stated that further evidence was required to inform the decision regarding whether to take these options forward.

8. **Variable Usage Charge – Disaggregation:** ORR said that the aim of this was to explore, and potentially address, reasons which may mean that the average VUC charge is not always reflective of the costs caused by operator activities.

9. ORR stated that disaggregation could take different forms, from charges reflecting regional variations in input prices and other systematic variations across the network through to charges that vary by route or at sub route level.

10. ORR considered that the rationale for this option could include operators paying more accurate costs, with potential efficiency benefits, and its relevance to route based regulation / TOC exposure discussions. Clearer evidence (e.g. magnitude of variation) was required to inform policy development in this area.

11. **Variable Usage Charge – Accuracy of charges:** ORR indicated that this option was being considered to ensure the VUC captures all relevant costs that vary with traffic and that the VTISM model is properly understood. Rationale for considering this option included that in PR13 some modelling results were not fully understood and it was felt this merited further work to ensure the robustness of the model. ORR also considered that ensuring operators pay accurate level of costs would send better signals relating to network use and efficiency. ORR also stated that it thought the work of relevance to the potential disaggregation of VUC.

12. In response to these two options, the group raised the following points:

    - The RDG charges review did not consider that VUC work should be a priority.

    - The group felt that the options would not lead to significant incentives or behavioural change for operators. They noted that: franchises were not exposed to changes; much investment had already occurred; and that there are limited routing choices – meaning it was likely there would be little impact arising from any changes.

    - The group considered that charges were already too complex and a move to disaggregation could significantly exacerbate this issue – particularly if disaggregated by route section.

- With regards to the different disaggregation options presented by ORR, the group stated these characteristics were already captured by the VITSM model.

- A conversation relating to ‘perverse incentives’ (where more congested lines had a lower VUC relative to lightly used lines) occurred. ORR noted that this could be addressed through wider changes to charging (for example fixed cost charging or charging the VUC at the point of step change in the asset management regime). Members of the group stated they did not support the use of a scarcity charge to address this issue. They thought ORR had already stated they were not planning to introduce value based charges in CP6.

- The group noted that a significant increase in VUC would have strongly negative consequences for the rail freight business;

- The importance of stability in the charging regime was noted (particularly for long term investment) and it was felt that the changes being considered were not compatible with this objective;

- The group felt that both options relating to the VUC would require significant further work and that this resource should be focussed on other major elements of PR18.

- Concerns were raised by the group that the data required to do the envisaged disaggregation analysis was not available.

- The group raised concern as to the age of the CATRIN report which suggested that not all relevant costs are recovered through the current VUC methodology. The group stated that more up to date studies on the industry should be considered in the analysis.

Action: ORR to circulate the CATRIN report.

- A point was made that, whilst it could be useful for planning to understand how infrastructure costs vary by geography, it was not necessary to translate this understanding into charges.

- The group suggested that a potentially useful change to the VUC could be to introduce sub-classes for the same vehicle class when run at different average speeds on the network.

Other Short Run Variable Charges

13. ORR summarised its thinking on possible changes to other charges

Traction electricity charges (EC4T):

14. ORR outlined that it had considered three options for further work. These options involved the recalibration of elements of the EC4T regime rather than a change in design or purpose of the charge. All three options were possible due to new data arising from the metering of trains.

15. ORR stated it was not minded to use metered data to recalibrate modelled consumption rates. The group agreed that this option should not be taken forward.

16. ORR considered that using metered data to improve transmission loss uplift estimates and regenerative breaking estimates were both worth pursuing. There was broad agreement within the group that this seemed sensible.

Electrification Asset Usage Charge (EAUC):

17. ORR noted evidence that the EAUC was too small to incentivise decision making. It said that one possible option could be to combine the EAUC with another charge. The group queried what this would achieve and did not think that the option would be worth considering. ORR responded that it had raised this option to see whether there was an appetite to simplify the charging structure by removing the charge.

Coal Spillage Charge:

18. ORR stated that it was minded to abolish the Coal Spillage Charge. This was on the basis of falling levels of coal freight. The group were in agreement with this point. ORR noted that a contractual approach to recovering costs of coal and other freight commodity spillages was raised by Network Rail. It was noted that this option might struggle to identify those responsible for spillages and therefore it would be difficult to recoup costs.

Station charges

19. ORR outlined that, while station charges were not thought to be a priority for PR18, there were some options examined in the RDG charges review which it was considering. In addition, a methodological issue had been identified which could warrant further work.

Station Long Term Charge - Revenue Sharing:

20. ORR noted that one option considered in the RDG charges review was to expose Network Rail to changes in operator revenues at franchised stations. ORR stated it was not minded to take forward this option, noting that for stations where this would be most beneficial, other options may be better. In addition, it was thought that there could be significant implementation costs associated with the creation of a new incentive mechanism. The view not to take forward this option was in line with the findings of the RDG review. There was agreement within the group that this option should not be taken forward.

Station Long Term Charge – Setting Charge at Station level:

21. Another option outlined in the RDG station charges review was to set the Station LTC at station (not portfolio) level. ORR stated that it had considered this option and found it not to be a priority for further work. This view was in line with the RDG charges review. In particular ORR stated its view that the volatility and/or data requirements of such an approach made the work undesirable. The group noted expenditure / work banks for franchised stations are managed at a portfolio level anyway. There was agreement within the group that this option should not be pursued.

Station Long Term Charge – Methodology Improvement:

22. ORR noted that a methodology issue had been identified within the Station Long Term Charge at managed stations. ORR noted that this work had not been considered within the RDG Charges review but that it seemed sensible to explore the opportunity to address the accuracy of the charge. Network Rail had agreed to look into this. There was general agreement within the group that this option should be taken forward.

Qualifying Expenditure (QX) Transparency:

23. ORR noted that the RDG charges review assessed the option of QX becoming fully regulated. The review stated that making QX charges more publically available would also achieve benefits. ORR stated that it currently thought the option to increase QX transparency was worth pursuing. There was agreement from the group that this seemed appropriate for further work.

Other Charges

24. ORR outlined that further options had been considered – because of their inclusion in the RDG charging review or due to points raised by other stakeholders.

25. **Effluence Charging:** ORR stated certain vehicles dispose of effluence on the tracks – this is both unsightly and a concern has been raised as to the potential health risk for Network Rail employees. ORR considered that this charge was not a priority for further work. This was due to RSSB research showing there to be a low health risk to workers, and that requirements placed on franchises meant the proportion of trains with this characteristic had fallen. There was general agreement within the group that this charge should not be a priority.

26. It was noted that ORR was not minded to pursue either **Externality Charging** or **Average Cost Charging**.