Proposal for the inclusion of the freight capacity charge into the Schedule 8 performance regime

BACKGROUND

- Network Rail (NR) state the purpose of the capacity charge as:

The capacity charge allows Network Rail to recover additional costs beyond the Schedule 8 baseline associated with the increased difficulty of recovering from incidents of lateness as the network becomes more crowded. In so doing, the charge helps neutralise the increased Schedule 8 risk to Network Rail of accommodating additional traffic. A secondary objective of the charge is to provide appropriate incentives and price signals to train operators and funders to make efficient use of network capacity.

- The current capacity charge fails NR's stated aim with respect to freight operators (FOCs) because:

  a) It over recovers the marginal cost of additional traffic by way of applying the marginal cost to all traffic. We recognise the consistent principle of a marginal rate being applied to all traffic, in-line with the variable usage charge. However, this does not take into account that unlike variable usage charges the capacity charge should only recover additional costs above the baseline. The result is a substantial over recovery: NR's accounts show in 2010/11 c. £180M capacity charge receipts compared to a total Schedule 8 payment of £80M. We can only conclude the charge is massively over stated;

  b) By maintaining consistency with the VUC charging principle the incentive effect on FOCs (TOCs capacity charge is "recovered" by way of reduction to their fixed charge) is very marginal because the charge is levied on all miles run even if they reduce; and,

  c) The capacity charge, in its current structure as established in 2001, is inappropriate for freight in light of the UK's transposition of the 2001 EU Directive (2001/14/EC) into the Railways Infrastructure (Access & Management) Regulations 2005 which requires an affordability test, in effect it acts as a mark-up.

- The Schedule 8 regime is already highly effective at incentivising improved day to day performance. There has been nearly a 40% improvement from both NR and the FOCs, since 2003/04, as a direct result of investments made by the FOCs, and NR, to improve reliability on the back of the penalty or reward available under the Schedule 8 regime. This has been achieved in parallel to a considerable increase in trains on the network over the same period.

THE PROPOSAL

- The adjustment can be expressed simply as an annual factor equal to the % movement in total FOC & TOC miles run. The TOC miles used should correspond to the TOC service codes included in the FOC Schedule 8 payment rate calculation.

$$\sum\left(NR\ Regulatory\ Benchmark^{t+1} \times (Total\ Network\ Miles^{t} \div Total\ Network\ Miles^{t-1})\right)$$

t = year just ended

- The FOC benchmark is already adjusted by all train mile activity annually and it is suggested this arrangement remains. The inclusion of an activity adjustment to the NR benchmark would balance out the Schedule 8 regime. It is proposed not to make any adjustment to the payment or bonus rates because the current deficiency is activity based not cost based.

- This proposal could be implemented for freight without affecting the passenger capacity charge. There are fundamental differences in the circumstances faced by freight and passenger operators that supports this:

  a) FOCs do not pay the fixed charge therefore there is no offset of the capacity charge;

  b) The existing charge is not compliant with EU Directive 2001/14/EC or the Railways Infrastructure (Access and Management) Regulations 2005 in respect of freight but remains compliant for passenger operators under the current structure of franchising;

  c) The incentives are real for FOCs as they do not have a contracted train specification from HM Government (HMG) but run services to meet customer demand; and,

  d) The freight regime accounts for delay at all Recording Points across the network rather than measuring lateness at a fewer number of specific Monitoring Points under the passenger regime.

- In conclusion, the proposal delivers a more effective[1] and accurate cost recovery to NR for changes in activity than the current capacity charge and creates a stronger incentive on FOCs to make efficient use of the network. By incorporating an activity adjustment into the Schedule 8 regime there is a greater incentive on both NR and the FOCs to improve performance, the issue of the capacity charge's legal validity for freight is removed and the NR regulated benchmark gets recognition of changes in activity more frequently than once every 5 years. It is a relatively straight forward change to implement, albeit it is understood that the Office of Rail Regulation (ORR) will need to approve it.

[1] Still time lagged but only by 1 year versus the current 5 years