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Dear John

Network Rail's response to ORR's consultation on Network Charges

We are writing in response to the Office of Rail and Road's (ORR's) 10 December consultation on Network Charges for Control Period 6 (CP6).

This letter summarises the key points which Network Rail considers that ORR should factor into its work programme for the 2018 Periodic Review (PR18). ORR's consultation is framed around three 'work packages' and we have structured this letter around these packages. We respond to ORR's specific consultation questions in the annex to this letter. We note that the Rail Delivery Group (RDG) is responding to this consultation. Network Rail has contributed to the RDG response and supports the points that it makes, on behalf of the industry.

Context

We start by making a few contextual points before addressing the specifics of ORR's consultation:

- The industry is currently subject to a number of reviews and whilst network charges are important, we think that ORR should focus its PR18 programme only on issues that are demonstrably in need of change (e.g. ways to encourage 3rd party financing of enhancements).
- ORR should strive to join-up its PR18 work programme with these reviews.
- There is a high 'cost of change' regarding incentives and access charges. ORR needs to make sure that any changes it proposes clearly outweigh their cost.
- ORR should seek to work much more collaboratively with the industry than has been the case in previous periodic reviews.

ORR's infrastructure costs package

Network Rail supports ORR's proposal to prioritise the development of the infrastructure costs package. The current approach to allocating our 'fixed' costs to train services, through Fixed Track Access Charges, is very simplistic. Costs are generally allocated based on traffic metrics such as train miles and not disaggregated below operating route level. In addition, no costs are allocated to freight or open access operators. If costs were allocated to all train services in a more accurate way this would make the distribution of costs and Government support within the industry more transparent. Increased transparency could result in a number of potential benefits, including improved industry decision making (e.g. in relation to franchise specifications). Improving transparency in relation to what Fixed Track Access Charges and Network Grant pay for was also identified as a priority for CP6, as part of the RDG Review of Charges project.

However, making cost causation more transparent and reflecting this information in operators' charges are separate decisions. There could be legitimate reasons to not charge train operators directly for all of the costs associated with the trains that they run. Freight operators, for example, generate considerable societal/environmental benefits by carrying goods by train. These benefits could be lost if they were charged the full costs associated with their usage of our network because their services may no longer be financially viable.

We also consider that ORR should be cautious about what may be achievable in this area for CP6. The challenges of developing a revised approach to attributing 'fixed' costs should not be underestimated. Incremental improvements may be possible for CP6 without implementing a 'perfect' new approach. A 'perfect' approach is likely to require more time to develop than is available as part of PR18.

In addition, we believe that ORR should not recover 'fixed' costs through 'variable' charges. Such an approach could 'price off' valuable traffic, unduly increase Network Rail's revenue risk and fail to reflect the fact that the railway is a fixed cost network.

ORR's value-based capacity package

Network Rail supports ORR's proposal not to take forward charging options based on the value of capacity. We consider that the implementation challenges would be considerable with limited benefits. In addition, this was not identified by the RDG Review of Charges as a priority for CP6. Network Rail strongly supports RDG's position on this.

The package of improvements to the current short-run variable charges

Network Rail considers that the main 'variable' charge that needs to be reviewed as part of PR18 is the Capacity Charge. This was also identified as a priority for CP6 as part of the RDG Review of Charges. However, we consider that it would not be appropriate to review the Capacity Charge without also reviewing Schedule 8 because they are closely linked.

Schedule 8 was also identified as a priority for change in CP6, along with Schedule 4, as part of the RDG Review of Charges. ORR has consulted on Schedules 4 and 8 separately. We do not want to repeat our response to that consultation here. However, as we set out in our response, we consider that there are some significant problems with the current arrangements, for example, with passenger operator reactionary delay.

Network Rail would not support ORR making material changes to other 'variable' charges in CP6. In particular, we consider that the Variable Usage Charge and Electric Current for Traction Charge are fit for purpose. We note that these charges were not identified by the industry, as part of the RDG Review of Charges, as a priority for refinement in CP6. ORR should not seek to make material changes to charges which the industry considers are not a priority for CP6. This would consume a disproportionate amount of industry time and effort. We consider that there would be considerable merit in ORR providing the industry with stability and certainty now by confirming that the structure of these charges will not change materially in CP6. More generally, the earlier that ORR can confirm that there will be no significant changes to charges, the more time the industry will have to focus on priority areas.

We also consider that it would have been better if ORR was more explicit about potential options for change in this area as part of its consultation document. ORR does not explicitly discuss any potential changes for CP6 and only tabled a ‘long list’ of options at the industry workshops that it hosted. We consider that by not setting out its view in this area, as part of the consultation document, ORR is increasing the burden on the industry in terms of responding to its proposals. We suggest that ORR develops its ‘short list’ of options in a transparent way and provides the industry with sufficient opportunities to feed into this process.

Network Rail’s view on wider issues

Safety

We welcome the fact that ORR’s assessment criteria, which it will use when deciding between potential changes to the existing regime, explicitly includes any potential safety concerns. In considering changes to the charges and incentives regime, we should always assess the extent to which each change improves safety.

Industry engagement

We strongly encourage ORR to work with the industry during PR18 and support instances where the industry has worked together to identify improvements to the current regime. Consistent with this, we welcome instances in ORR’s consultation document where ORR draws on the output from the RDG Review of Charges (e.g. the ‘states of the world’). However, we consider that ORR should place more weight on the RDG work, in particular the following areas that RDG identified as a priority for CP6:

- clarity of purpose of the charges and incentives regime;
- fundamentally reviewing the Capacity Charge;
- improving transparency in relation to what Fixed Track Access Charges and Network Grant pay for; and
- the performance and possessions regime (Schedules 4 and 8).

Network Rail supports RDG’s view that the areas, above, should be prioritised as part of the review of the existing charges and incentives regime.

More broadly, we consider that if ORR does not agree with RDG’s conclusions in terms of priorities, it should set out, fully, why this is the case. We do not think that it is unreasonable to expect that ORR provides a formal response to RDG’s work, given the level of effort the industry has put into it.

We are keen to continue to engage constructively with ORR and the rest of the industry throughout the periodic review process, with the aim of improving the current regime. We would like to see engagement and communication from ORR, both formally and informally, to keep stakeholders informed of its emerging views throughout PR18. This should start immediately.

Timing and costs of change

We welcome the fact that ORR is bringing forward the timing of this work forward relative to the 2013 Periodic Review (PR13), when it got 'timed out'. It is important that we use this extra time wisely to make demonstrable improvements to the charging structure, rather than making unnecessary tweaks or simply 'bolting on' more charges/complexity.

There are costs associated with unnecessary change and these costs extend beyond the immediate impact of charges being set at a different level. For example, changes to charges would need to be reflected in our billing system, which can be time consuming and expensive. In addition, following each access charges review, funders generally aim to hold franchised passenger operators 'harmless' to changes in the charges and incentives regime. This is done through operators' franchise agreements. The more complex and opaque the charging and incentive regime is the more challenging and expensive it is to calculate the effect of the periodic review process on operators' charges. This also potentially increases the risk to the taxpayer.

Process

Below, we set out a number of high-level points in relation to ORR's process. We expand upon these points in our responses to ORR's consultation questions in the annex to this letter:

- We welcome the fact that ORR has started by considering potential high-level options for change, rather than proposing changes to very detailed aspects of the regime.

- ORR should not make material changes to the existing charges and incentives regime late on in the periodic review process. If ORR makes material changes late on in the process, this severely limits the time for these changes to be reflected in the plans of Network Rail and other stakeholders. It also reduces the amount of time for implementing changes in Network Rail's billing system.

- ORR must be realistic about what can be achieved through charges and incentives. Charges and incentives cannot solve everything and there should not be an automatic presumption that charges will deliver better results than existing industry processes. For example, in relation to the allocation of capacity.

- ORR should be clear what problems it is seeking to address before considering making any changes.

- There is a high cost to making change in our industry. Therefore, before doing so ORR needs to very clearly explain how the benefits of changes would materially outweigh these costs.

- It is important that ORR considers potential changes to track access charges in the round, something ORR was criticised for not doing during PR13.

- We are concerned that ORR is already consulting separately on the Capacity Charge and Schedule 8. These parts of the charges and incentives regime are closely linked.

- We welcome the fact that ORR recognises that there are a number issues and projects (e.g. the Shaw review) that could impact upon this charging review. We must continue to be mindful of potential changes to the structure of the industry as the periodic review process progresses.

- We consider that ORR should be much clearer about what its next steps are for concluding on potential changes to charges for CP6. For example, when will it respond to the points raised in stakeholders' consultation responses?

If you would like to discuss the content of this letter in more detail, please contact myself or my colleague Ben Worley (Ben.Worley@networkrail.co.uk).

Yours sincerely

Peter Swattridge

Head of Regulatory Economics

Chapter 1 - Introduction

Question 1: How much does Network Rail's structure of charges matter today?

Network Rail considers the structure of charges to be very important today. Track access charges provide Network Rail with the vast majority of the funding that it requires for operating, maintaining, renewing and enhancing the Great Britain (GB) rail network in order to deliver benefits to users and taxpayers. In addition, the existing 'variable' charges (e.g. the Variable Usage Charge and Capacity Charge) mean that the amount of money that Network Rail receives varies in line with traffic levels. Therefore, if charges are not cost reflective, we will under/over recover our costs if traffic levels are lower/higher than expected.

We believe that the degree to which the structure of charges matter today to train operators will depend to a large extent on their exposure to them. In the current 'state of the world' we consider that:

- The structure of charges will matter to freight and open access operators who are exposed to changes in charges. This is because they have to pay Network Rail more/less money if charges go up/down.

- The structure of charges will matter less to franchised passenger operators. Funders generally aim to hold these operators 'harmless' to changes in charges through their franchise agreements. Therefore, any changes in charges are unlikely to materially impact the finances of these operators.

We note that the Chancellor's Summer 2015 Budget announced Government's wish to channel more public money to Network Rail through train operators (i.e. track access charges) in CP6. This potential increase in the amount of funding that Network Rail receives through track access charges (which will be offset by a reduction in Network Grant funding) is likely to increase the focus on the structure of charges in CP6.

Also, as long as the industry continues to be vertically separated (i.e. separate organisations are responsible for the managing the infrastructure and train operations) there will be a need for track access charges. Therefore, we should try to ensure that the structure of charges supports, rather than hinders, Network Rail and train operators in delivering value for users and taxpayers.

Question 2: What issues could a new structure address?

The issues that a new structure of charges could address will depend on the 'state of the world' in CP6. For example, in the current 'state of the world' where franchised passenger operators are held 'harmless' to changes in charges, the ability to address issues through charges will be significantly reduced.

Assuming broadly the same 'state of the world' in CP6 as in CP5, Network Rail considers that PR18 should seek to address the following issues identified as part of the RDG Review of Charges as a priority:

- Clarity of purpose of the charges and incentives regime;
- A fundamental review of the Capacity Charge;

- Improving transparency of what Fixed Track Access Charges and Network Grant (in lieu of Fixed Track Access Charges) pay for; and
- Reforming the performance and possessions regime (Schedules 4 and 8).

Network Rail also considers that there is potential scope for simplifying freight charges. For example, by consolidating the Freight Only Line Charge and Freight Specific Charge. These charges are levied on the same traffic and recover broadly the same costs. Therefore, consolidating them would serve to simplify the existing freight charging structure, without necessarily impacting freight operators' costs or Network Rail's income. However, Network Rail would only seek to pursue these potential changes if freight operators supported them and agreed that they would help to simplify the existing charging structure.

ORR should not make material changes to charges which were identified, as part of the RDG Review of Charges, as being broadly fit for purpose (e.g. the Variable Usage Charge and Electric Current for Traction Charge). We believe that seeking to substantially refine these charges would consume a disproportionate amount of industry time and effort, which would be better spent addressing those aspects of the regime which the industry consider to be a priority for change.

In addition, it is important that ORR is realistic about what can be achieved through charges and incentives. Charges and incentives cannot solve everything and there should not be an automatic presumption that changes to charges will deliver better results than existing industry processes (e.g. in relation to the allocation of capacity).

Question 3: Can you provide examples of behaviours that would change within your organisation or elsewhere in the rail industry with an improved structure of charges?

As noted above in response to question 2, the impact that an improved structure of charges is likely to have on behaviours will depend on the 'state of the world' in CP6.

However, Network Rail considers that a charging and incentive structure that is less complex and better understood could result in improved decision making across the industry, including in Network Rail. If the charging and incentive structure is not well understood and unduly complex, it is unlikely that it will be appropriately taken into account when making decisions.

However, we consider that charges are unlikely ever to be the sole basis on which decisions are made within Network Rail, or even elsewhere in the rail industry. Whilst they may be a consideration in certain decision-making processes, generally, there will also be other significant factors in play. For example, the income that Network Rail receives through track access charges and the Volume Incentive is a relevant consideration when deciding whether to approve the sale of additional access rights. However, when considering the sale of additional access rights, Network Rail also has to consider a range of other important factors. These include its ability to access the network to carry out the necessary level of engineering work in order to maintain performance levels. Therefore, when assessing the potential benefits of an improved charging structure, we should be mindful of the fact that whilst charges can support better outcomes for users and taxpayers (e.g. by aligning incentives within the industry), we should not assume that they can solve everything.

Generally, Network Rail would not want to see any changes to the structure of charges that create a disincentive for it to run additional trains, for example, because it is not adequately compensated for doing so. Network Rail should face appropriate financial incentives to accommodate higher than anticipated traffic levels on the network (in CP5 the Volume Incentive attempts to do this). We note that Network Rail does not 'profit' from the additional track access charge income that it receives when accommodating additional train services on the network, this income only aims to offset the incremental costs that Network Rail will incur.

As discussed in more detail, below, we also consider that attributing costs to train services and reflecting this information in operators' charges are separate decisions. It could be the case, for example, that better information alone would deliver the same benefits as reflecting this new information in the charging structure. Therefore, careful consideration will need to be given to the benefits that could result from changing the structure, as opposed to simply having better information available to inform decision making.

Chapter 2 – Background and approach

Question 4: Are the high-level gaps (in Figure 4) a good starting point for developing solutions? Would you have expected to see any other high-level gaps and, if so, what are they?

Network Rail agrees that it is sensible, before beginning to develop detailed policy proposals, to identify 'gaps' in the current charging regime (i.e. where it is not working as well as it could be). However, we consider that the 'gaps' identified as part of the RDG Review of Charges project are a better starting point for developing solutions. RDG identified a number of 'gaps', including significant issues with the Capacity Charge and the fact that the regime did not enable sufficient industry understanding of Network Rail's cost drivers. These 'gaps' underpin the priorities identified by RDG for CP6, which we have set out in response to question 2, above. The full list of 'gaps' identified by RDG is available here[1] on its website.

Network Rail does, however, recognise the high-level 'gaps' that ORR has identified. We note though that these 'gaps' are very general. We would welcome further information on the thinking behind them and the specific issues that ORR considers need to be addressed. We consider that further clarity in this respect will avoid any potential misunderstanding of the 'gaps' highlighted, and enable a better discussion in relation to whether ORR has identified the right issues.

We also think that it would be helpful for stakeholders if ORR clarified the relationship between the 'gaps' it has identified and its objectives. At the moment it is not entirely clear which objectives, and to what extent these objectives, are not being met as a result of the 'gaps' that ORR has identified.

In relation to the specific 'gaps' that ORR identifies we note the following:

- **Cost reflectivity**: We agree that there is scope for making the relationship between cost causation and train services more transparent. In particular, improving the transparency of what Fixed Track Access Charges and Network Grant pay for. However, we suggest that ORR does not automatically assume that improving the cost reflectivity of charges will drive down costs. If an improvement in cost reflectivity introduced undue complexity into the

[1] See section 1.7 of the report, page 9.

charging regime, this could potentially drive costs up rather than down. In addition, as noted in response to question 1 above, charges are less likely to matter to franchised passenger operators in the current 'state of the world'. We also note that outside of the track access charging regime Network Rail faces considerable incentives to drive down its costs (e.g. assumed efficiency improvements and the financial performance measurement framework). Before making changes to charges ORR should be clear what problems it is seeking to address. There is a high cost to making change in our industry. Therefore, prior to making any changes ORR needs to very clearly explain how the benefits of these changes would materially outweigh the costs.

- **Capacity**: We agree that the existing charging structure is 'cost' based rather than 'value' based. Therefore, it is not designed to provide specific incentives in relation to capacity allocation/utilisation. One reason for this is that the challenges of charging for 'value' at the necessary level of disaggregation by geography and time of day, reflecting the societal/environmental benefits of different train services, would be significant. As noted in response to question 2 above, there should not be an automatic presumption that charges will deliver better results than existing industry processes. We consider that even in an alternative 'state of the world' where franchised passenger operators are exposed to changes in charges, there would be certain complex decisions (e.g. allocating network capacity) where a degree of administration is always likely to be required.

- **Competition**: As part of these discussions we should be mindful of the fact that competition is not an end in itself. Instead, it is a means of potentially delivering benefits to users and taxpayers. At present, the re-franchising process represents the primary form of competition for access to the rail network. Therefore, it is also the primary means of securing value for users and taxpayers from franchised passenger train services. ORR should not make an automatic presumption that competition through the franchising process is insufficient and a reformed charges regime would deliver better results. It is, of course, possible that it could but it would be a significant change from the current approach and, therefore, need to be considered very carefully. We also note that, at present, there is a clear link between the charges that operators pay to access the network and their access rights (i.e. franchised passenger operators pay higher charges and get more access). If the competition 'gap' is referring to greater parity between open access and franchised passenger operators in terms of access rights, one would expect there also to be greater parity between the charges that these operators pay to use the network (i.e. a significant contribution from open access operators toward Network Rail's fixed costs). However, any contribution from open access operators would also have to be consistent with relevant European legislation and it is not clear, at present, how this would work. We also note that the recent Competition and Markets Authority (CMA) consultation identified a range of options for increased competition on the rail network, including more overlapping franchises, for example. As part of ORR's competition package it will be important to consider all of these potential options, and potentially other options, in the round. We note that the freight market is competitive and that ORR's proposals relate solely to passenger services.

- **Complexity**: There will always be a balance to be struck between complexity and cost reflectivity. Network Rail agrees that the complexity of the current charging regime is likely to be limiting its effectiveness. Indeed, this was one of the issues identified as part of the RDG Review of Charges. If stakeholders do not understand the current charging and incentive structure it is unlikely that they will factor it appropriately into their decision making. However, we note that ORR's description of the complexity 'gap' appears more to do with the stability of charges, than the complexity of them.

Question 5: Do the assessment criteria accurately reflect the main factors we should consider for assessing the impact of options?

Network Rail considers that the assessment criteria that ORR has set out broadly capture the key considerations when evaluating changes to charges. In particular, we welcome the explicit recognition, under wider external impacts, of safety concerns arising from a particular option. In considering changes to the charges and incentives regime, we should always assess the extent to which each change improves safety.

However, we would like to see the assessment criteria extended to include whether the potential change was identified as a priority by the industry as part of the RDG Review of Charges project.

We also note that Annex D of the consultation makes clear that there are quite a lot of sub-headings under each of the main assessment criteria headings. It is not clear to us, given the significant number of sub-headings, how ORR is going to prioritise and balance these wide ranging criteria. We would welcome any further clarity from ORR in this respect and consider that some criteria are clearly more important than others. For example, if the option being proposed is illegal and/or there is not sufficient information available to implement it, it does not really matter how it performs against the other criteria.

It is also appears that there are a number of overlaps in ORR's assessment criteria. For example, its charging objectives include 'be legally consistent', however, the high-level assessment criteria also includes 'legal impacts'. We suggest that ORR reviews its assessment criteria and seeks to remove duplication, wherever possible. In addition, we suggest that, going forward, ORR structures its impact assessments in a consistent way. We consider that this will make its proposals, and the associated impact of them, easier for stakeholders to understand. We note that whilst ORR uses the same overarching headings, in some ways its impact assessments are quite different. For example, the assessment of the value-based capacity package describes the potential impact on key stakeholder groups under separate headings, which we found helpful. However, the other two assessments do not. Also, the assessment of the infrastructure costs package does not contain a main conclusions section at the beginning, unlike the other two assessments.

Question 6: To what extent does the use of scenarios, in the form of the RDG 'states of the world', help to understand the likely effectiveness of future charging structures?

We welcome the fact that ORR has adopted the RDG 'states of the world'. We support the 'states of the world' defined by RDG and consider them to be a useful tool to assess the likely effectiveness of different charging structures in various future scenarios. However, we note that some of these 'states of the world' are much more likely to become a reality than others. Therefore, when assessing the effectiveness of future charging structures we suggest focusing on the more likely ‘states of the world’. For example, in DfT’s recent letter to ORR on improving financial incentives, DfT notes that it is considering whether it would be practical and appropriate to partially expose franchised train operators to changes in charges.

We also note that the likely ‘state of the world’ in CP6 will become clearer as PR18 progresses (e.g. following the Shaw review recommendations). Therefore, it will be important that as an industry we stop and test the charging proposals against the likely ‘state of the world’ as it emerges.

Chapter 3 – Options and proposal

Question 7: To what extent do the packages of options represent the key strategic choices available to improve the existing charging structure?

As set out in response to question 2, above, we:

- Welcome the fact that ORR has started by considering high-level options for change, rather than proposing changes to very detailed aspects of the regime.

- Consider that the best way to improve the existing charging structure for CP6 would be to focus on the areas identified as a priority as part of the RDG Review of Charges project.

The ‘packages’ of options set out by ORR are sufficiently broad (i.e. include ‘fixed’ charges, ‘variable’ charges and potential value-based charges) that they are likely to cover the key strategic choices for the industry.

However, ORR should not consider these packages in isolation. As ORR recognises, it could be possible to implement certain aspects of the infrastructure costs package alongside certain aspects of the package of improvements to the current short-run variable charges. Therefore, we suggest that ORR always considers changes to charges in the round, irrespective of the package that they form a part of. This will help to enable interactions between potential changes to charges, and the overall costs/benefits, to be better understood.

We also strongly recommend that ORR closes out, in a transparent way, potential material changes to the existing charging regime (e.g. value-based charges) as soon as reasonably possible. However, we recognise that it will only be possible for ORR to do this if the industry broadly agrees that the potential change should not be a priority for CP6. Closing out potential material changes to charges early in PR18 would provide the industry with increased certainty about the charging structure in CP6. It will also mean that the industry is able to focus on those aspects of the existing regime most in need of reform.

Question 8: Would you expect the infrastructure costs package to deliver more (or fewer) benefits than the value-based capacity package at this stage and, if so, why?

Given both of these packages are still very much in their infancy, and at principles level, it is difficult to answer this question with any real certainty.

However, as set out in more detail, below, Network Rail supports:

- Improving transparency in relation to what Fixed Track Access Charges and Network Grant pay for. This was also identified as a priority for CP6 by RDG and appears to align well with ORR's infrastructure costs package.

- ORR's proposal not to take forward the value-based capacity package. This was not identified by the RDG Review of Charges as a priority for CP6 and Network Rail considers that the implementation challenges would be considerable, with limited benefits.

We note that if the infrastructure costs package were to be progressed and the value-based capacity package was not, it would not be possible to compare the outturn benefits of these two packages in CP6.

Chapter 4 - Infrastructure costs package

Question 9: We would welcome your views on our proposal to prioritise further development of the infrastructure costs package.

As noted, above, Network Rail supports improving the transparency of what Fixed Track Access Charges and Network Grant pay for. This was also identified as a priority for CP6 as part of the RDG Review of Charges project, and appears to align well with ORR's infrastructure costs package.

The current approach to allocating our 'fixed' costs to train services, through Fixed Track Access Charges, is very simplistic. Costs are generally allocated based on traffic metrics such as train miles and not disaggregated below operating route level. In addition, no costs are allocated to freight or open access operators. If costs were allocated to all train services in a more accurate way this would make the distribution of costs and Government support within the industry more transparent. Increased transparency could result in a number of potential benefits, including improved industry decision making (e.g. in relation to franchise specifications).

As ORR is aware, Network Rail is currently working with Brockley Consulting to investigate the feasibility of establishing an improved attribution/allocation of Network Rail's 'fixed' costs to train services. We hope that this work will provide useful information to inform ORR's infrastructure costs package[2]. The aim of the work is to attribute/allocate costs consistently across all train services (i.e. franchised passenger, freight and open access) and establish a closer link between these train services and cost causation.

In order to demonstrate what is likely to be feasible, and the potential implications of a revised cost allocation, we are conducting a pilot study in Wales. We are aiming to complete this pilot study in spring 2016. Whilst the initial indications are that there is likely to be sufficient data available in order to develop a revised attribution/allocation of costs, we urge ORR to be cautious about what is likely to be achievable in this area for CP6. The challenges of developing a revised approach to attributing 'fixed' costs should not be underestimated. Any new methodology is likely to rely on new data and assumptions which would need to be tested. Incremental improvements may be possible in CP6, without implementing a 'perfect' approach, which may require more time to develop. We are seeking to carry out this work in a transparent way and will continue to keep stakeholders informed as the work progresses.

[2] The initial report is available on Network Rail's website here.

It is important to be clear that whilst our work is seeking to develop an improved attribution/allocation of Network Rail's 'fixed' costs, we are still effectively apportioning operating route level costs. However, we are seeking to do this in a more sophisticated way than at present, for example, using detailed asset count data.

We would also reiterate making the drivers of cost causation more transparent and reflecting this information in operators' charges are separate decisions. There could be legitimate reasons to not charge train operators directly for all of the costs associated with the trains that they run. Freight operators, for example, generate considerable societal/environmental benefits in carrying goods by train. These benefits could be lost if they were charged the full costs associated with their usage of our network because the services may no longer be financially viable for the operator.

If, ultimately, the infrastructure costs package were to result in Fixed Track Access Charges being refined for CP6. We strongly consider that ORR should not seek to recover 'fixed' costs through charges that relate to traffic levels. The charge that a train service pays to use the network should reflect the costs that it imposes on the network. If costs are fixed, by definition they will not increase/decrease if a train operator runs slightly more/fewer services. If these costs were recovered through 'variable' charges we consider that it could increase the risk of 'pricing off' valuable traffic, unduly increase Network Rail's revenue risk, and fail to reflect the fact that the railway is a fixed cost network. The fact that the existing track access charging structure enables 'fixed' costs to be recovered through 'fixed' charges should be seen as a strength of the current regime, rather than a weakness.

Finally, we note the inclusion of Long Term Charges for franchised and managed stations as part of this package. Should the work on the infrastructure costs package conclude that changes to these charges are appropriate, it is important that ORR takes into account / is consistent with wider industry developments relating to stations. As ownership and management of stations becomes more diverse, as highlighted in RDG's review of station charges, a robust and consistent charging framework is increasingly important. Network Rail agrees with RDG's conclusion, in this regard. RDG's report can be accessed here.

Question 10: What costs and benefits do you see with the infrastructure costs package? Do you think our draft impact assessment is missing any significant impacts or has misrepresented any impacts?

As noted, above, Network Rail considers it challenging to identify with certainty, at this early stage, the costs and benefits that would be realised as a result of the infrastructure costs package. However, in principle, Network Rail considers that the potential benefits of making what Fixed Track Access Charges and Network Grant pay for more transparent could potentially include:

- **A consistent set of cost allocations across the GB rail industry**. At present, 'fixed' costs are only allocated to franchised passenger operators, in the form of Fixed Track Access Charges. As a result, there is little transparency over the fixed costs attributable to freight and open access operators, relative to franchised passenger operators.

- **A more accurate attribution of costs** relative to the current Fixed Track Access Charges methodology. The existing Fixed Track Access Charges methodology allocates fixed costs at Network Rail operating route-level using simple traffic metrics (e.g. train miles). The infrastructure costs package could result in an improved allocation of costs, which more closely reflects cost causation. For example, by allocating costs at a more geographically disaggregated level and/or not solely relying upon simple traffic metrics. However, the challenges of moving closer to an avoidable cost approach to attributing ‘fixed’ costs should not be underestimated. This would be a significant methodological change relative to the current approach and would rely on new data and assumptions which would need to be tested.

- **More cost reflective fixed track access charges for franchised passenger train operators**. We would reiterate that making the relationship between train services and cost causation more transparent, and reflecting this information in operators’ charges are separate decisions. However, in the current ‘state of the world’ there would appear to be a low risk of valuable traffic being priced off the network if this information were to be reflected in franchised passenger operators ‘fixed’ charges. The primary reason for this being that franchised passengers operators are generally held ‘harmless’ to changes in charges, through their franchise agreements.

- **Better information for decision making across the industry**. The current absence of a consistent and accurate set of cost allocations across the industry means that the distribution of costs/Government support within the industry is not transparent. This could potentially be adversely impacting industry decision making, for example, by Government when considering franchise specifications. We note, however, that it would be necessary to combine any improved allocation of infrastructure costs with other information (e.g. franchising premiums/subsidies) in order to establish a whole-industry view of costs/benefits.

- **Reputational benefits for the industry**. As noted above, the existing approach to cost allocation is very simplistic, especially given the large amount of money being allocated (c. £4bn-£5bn p.a.). The recent announcement by The Chancellor in the Summer 2015 Budget regarding Government’s wish to channel more public money to Network Rail through train operators (i.e. track access charges) in CP6 will increase the focus on Fixed Track Access Charges and Network Grant. Therefore, this appears to be a good time to review the existing allocation methodology.

In principle, Network Rail considers that the potential costs of making what Fixed Track Access Charges and Network Grant pay for more transparent could include:

- **Network Rail and industry resources** required in order to refine the existing cost allocation methodology.

- **Sub-optimal decision making** on the back of the new cost attribution/allocation. The revised cost allocation will only ever be as good as the methodology and data that underpins it. We referred to the challenges of developing a revised approach to the attribution of fixed costs in our response to question 9, above. If decisions (e.g. in relation to franchise specifications) were based on a revised attribution/allocation of costs, which subsequently turned out to be ‘wrong’, this could adversely impact users and taxpayers.

In relation to ORR's impact assessment of the infrastructure costs package we note the following:

- Given ORR's proposal is very much in its infancy, the scale of the associated costs/benefits is not clear and difficult to measure accurately, at this stage. Therefore, going forward we urge ORR to suitably caveat the costs/benefits that it has identified and avoid implying undue levels of certainty in either respect.

- Consistent with this, we consider that the 'welfare gains' that ORR suggests could be realised if the current balance between variable and fixed charges was found to be incorrect appear to be somewhat arbitrary. It is not clear to us what evidence underpins the assumption that if it were found that 'variable' charges were understated by £1bn p.a. this could be having an adverse impact of £70m p.a.

- It is important to remember that charges are unlikely ever to be the sole basis on which decisions are made within the rail industry. Whilst they will often be a consideration in certain decision making processes, generally, there will also be other important factors which need to be balanced.

- As set out in more detail in response to question 14, below, it is not clear to us why any of the cost-based options, including the infrastructure costs package, would necessarily send sensible signals about the value of capacity.

- We urge ORR to be cautious about potentially recovering costs that are not directly attributable in a way that encourages "better behaviours". It is not clear to us what ORR means by this. However, we would not support any change to the charging structure that would introduce undue complexity and/or would be a 'bolt on'. For example, it would seem perverse to us for ORR to actively decide to not pursue value-based charges but then seek to attribute common costs in a way that aims to reflect 'value'.

- We welcome the fact that ORR explicitly recognises, by assessing two sub-options, that attributing costs and then charging these costs are separate decisions.

- We suggest that ORR consistently adopts the approach that it has in its value-based capacity package impact assessment and considers the impact on key stakeholder groups under separate headings. We believe that this would increase transparency and make it easier for stakeholders to consider impacts in the round.

- Although ORR has not sought to quantify the cost of reflecting any changes to the charging structure in franchise agreements, we note that in DfT's letter to ORR in relation to financial incentives it states that these costs are significant.

Question 11: To what extent do you think the benefits of this package can be realised through more information, rather than through the use of charges?

As noted, above, Network Rail considers that making the relationship between trains services and cost causation more transparent and reflecting this information in operators' charges are separate decisions. Therefore, careful consideration should be given to reflecting any new information in operators' charges. Indeed, for certain types of operators (e.g. freight operators) there could be legitimate reasons to not charge train operators directly for all of the costs associated with the trains that they run (e.g. the societal/environmental benefits that they generate).

We consider that costs should always be attributed on a consistent basis across all train services. Trains services will drive costs irrespective of whether these train services are franchised passenger, freight or open access services. It is important to make this reality more transparent than is currently the case. An improved cost allocation, which is consistently applied across all operators, is likely to have benefits (e.g. supporting improved decision making) even if it is not reflected in operators' charges.

However, we note that the current 'state of the world' would appear to mitigate some of the potential risks associated with reflecting an improved attribution of Network Rail's 'fixed' costs in the charges of franchised passenger operators. The main reason for this is that, at present, franchised passenger train operators are generally not exposed to changes in track access charges.

We also note that franchised passenger operators' train services are typically quite rigidly specified in their franchise agreements. Therefore, whilst it might be possible to improve the cost reflectivity of Fixed Track Access Charges, franchised passenger operators will have limited ability to respond to changes in these charges by flexing their service offering.

Chapter 5 - Value-based capacity package

Question 12: We would welcome your views on our proposal not to prioritise further development of charging options based on the value of capacity.

Network Rail supports ORR's proposal not to take forward the value-based capacity package. Closing out material changes like this early on in the periodic review process will allow the industry to focus on others areas of the charging and incentives regime identified as a priority for reform (e.g. the Capacity Charge and Schedules 4 and 8). If ORR concludes that it is not going to prioritise further development of value-based charges, we strongly suggest that it does not re-open the discussion at a later point in the periodic review process.

Value-based charging was not identified by the RDG Review of Charges as a priority for CP6 and Network Rail considers that the implementation challenges would be considerable, with limited benefits. For example, one would need to quantify the 'value' of train services, which is likely to vary considerably by geography and time of day, and should also factor in the wider societal/environmental benefits that these services generate.

It is not clear at the moment that, as an industry, we are in the position to do this at the required level of granularity for either information or charging purposes. However, we recognise that if it were possible to accurately quantify the 'value' of different train services, this could provide another piece of information to inform industry decision making.

We note that, in ORR's consultation, it states that the Capacity Charge provides "some incentive for Network Rail to increase use of the network". This is incorrect. In fact, the Capacity Charge recovers Network Rail's additional Schedule 8 costs associated with incremental traffic on the network. To this extent, it only holds Network Rail financially neutral from increasing traffic, as it only recovers the additional costs incurred. It does not provide Network Rail with any incentive to increase traffic.

Question 13: What costs and benefits do you see with the value-based capacity package? Do you think our draft impact assessment is missing any significant impacts, or has misrepresented any impacts?

Similar to the infrastructure costs package, given this option is very much in its infancy, it is difficult to answer this question with any real certainty at this stage. However, in principle, Network Rail considers that the potential costs of the value-based capacity package could include:

- **Significant implementation challenges** because the ‘value’ of train services are likely to vary considerably by geography and time of day, and also must factor in societal/environmental benefits. It is not clear at the moment that, as an industry, we are in the position to quantify ‘value’ at the required level of granularity for either information or charging purposes.

- **Network Rail and industry resources** required in order to develop a methodology for quantifying ‘value’, particularly given the implementation challenges highlighted, above. It should also be noted that, at present, Network Rail’s billing system is not able to bill train services by time of day and introducing this functionality would represent a significant system upgrade. The feasibility of such an upgrade has not been assessed at this stage.

- **Sub-optimal decision making** on the back of any new cost estimates. Similar to the infrastructure cost ‘package’, a value-based methodology will only ever be as good as the methodology and data that underpins it. If decisions (e.g. in relation to capacity allocation) were based on assumptions in relation to value, which subsequently turned out to be ‘wrong’, this could adversely impact users and taxpayers.

- **Potentially pricing valuable traffic off the network**. For example, if a value-based charge were to be payable by freight operators (which would be subject to relevant EU legislation), and was set at the wrong level and/or did not appropriately take into account the societal/environmental benefits of freight services, it could prevent these services running to the detriment of the freight industry and GB plc.

- **Introducing undue instability into the charging structure**. Moving to a value-based charging structure would represent a significant change, relative to the existing cost-based structure, particularly for those operators exposed to changes in charges.

Network Rail considers that the potential benefits of the value-based capacity package could include:

- Another piece of **information to inform decision making**. However, for this information to be useful we would need to overcome the significant implementation challenges noted, above.

- Potentially **encourage more efficient use of network capacity**. However, as noted above, there should not be an automatic presumption that charges will deliver better results than existing industry capacity allocation processes. Especially in the current 'state of the world' where franchised passenger operators are not exposed to changes in charges and are required to fulfil their franchise obligations, irrespective of the prevailing charging structure.

In relation to ORR's impact assessment on the value-based capacity package Network Rail notes the following:

- Given ORR's proposal is very much in its infancy, the scale of the associated costs/benefits is not clear and very difficult to measure with any real accuracy, at this stage. Therefore, going forward we urge ORR to suitably caveat the costs/benefits that it has identified and avoid implying undue levels of certainty in either respect.

- It is important to remember that charges are unlikely ever to be the sole basis on which decisions are made within Network Rail, or elsewhere in the rail industry. Whilst they will often be a consideration in certain the decision making processes, generally, there will also be other important factors which need to be balanced.

- We are concerned that ORR suggests that if it were able to quantify 'value' this could provide an additional 'metric' to measure performance and hold Network Rail to account. There should be a high hurdle for introducing new 'metrics'/output targets and careful consideration would have to be given to how any new 'metric' aligns with existing ones, and whether it would deliver benefits for users and taxpayers.

- As set out in more detail in response to question 14, below, it is not clear to us why any of the cost-based options would necessarily send sensible signals about the value of capacity.

- We welcome the fact that ORR explicitly recognises, by assessing benefits in two stages, that quantifying 'value' and charging on this basis are separate decisions.

- We welcome the fact that ORR's impact assessment explicitly considers, under separate headings, the impact on train operators, funders/taxpayers and Network Rail. Its other impact assessments do not do this and we consider that it would be useful if they did going forward.

Question 14: Would you expect a better understanding of costs to be an essential precursor to value-based charges?

It is, of course, important that Network Rail receives sufficient funding to cover its 'wear and tear' costs in the short term and fully allocated costs in the long term. However, Network Rail does not necessarily see a better understanding of 'fixed' (infrastructure costs package) or 'variable' costs (short-run variable charges package) as an essential precursor to value-based charges.

As noted above, the existing charging structure is 'cost' based rather than 'value' based and the two concepts are very different. Therefore, it is not clear to us why an improved understanding of ‘costs’ would support an improved understanding of ‘value’. Intuitively, value-based charges should be higher on parts of the network where capacity is scarce and lower on parts on the network where capacity is plentiful. However, analysis carried out in PR13, in relation to geographically disaggregating the Variable Usage Charge, indicated that Network Rail’s ‘wear and tear’ costs per train mile were actually lower on busier routes than quieter routes. Also, given that the railway is largely a fixed cost network; it is possible that total infrastructure costs per train mile could also be lower on busier routes than quieter ones, due to higher traffic volumes. Therefore, it could be the case that both ‘wear and tear’ costs and total infrastructure costs per train mile turn out to be lower on parts of the network where you would expect value-based charges to be high.

As ORR notes in its impact assessment, in order to quantify ‘value’ one could:

- Look at Network Rail’s costs from a long-run perspective (i.e. the cost to Network Rail of enhancing capacity constrained parts of the network); or

- Expand the calculation of short-run marginal costs to include the opportunity costs of those operators who would like to access capacity constrained parts of the network but are not able to do so.

Network Rail considers that both options are likely to be very challenging and not easily generalised, particularly quantifying operators’ opportunity costs.

Question 15: To what extent do you think the benefits of this package can be realised through more information alone, without passing that into charges?

In order for potential benefits from this package to be realised, either through better information or charges, it would be necessary to be able to quantify ‘value’ at the appropriate level of granularity (i.e. by geography and time of day), including the value of train services to society. It is not clear at the moment that, as an industry, we are in a position to do this.

We also consider that value-based charging brings an additional set of risks over and above that of quantifying ‘value’ for information purposes only (e.g. pricing off valuable traffic). Therefore, the bar for introducing value-based charges should be set quite high, especially in the current ‘state of the world’ where franchised passenger operators have a limited ability to respond to charges due to their franchise obligations.

<u>Chapter 6 - Package of improvements to short-run variable charges</u>

Question 16: What options would you expect to see in a long list of improvements to Network Rail’s short-run variable charges?

Network Rail considers that the main ‘variable’ charge that needs to be refined as part of PR18 is the Capacity Charge. This was identified as a priority for CP6 as part of the RDG Review of Charges. However, it would not be appropriate to review the Capacity Charge without also reviewing Schedule 8 because they are closely linked. Schedule 8 was also identified as a priority for change in CP6, along with Schedule 4, as part of the RDG Review of Charges work. Therefore, Network Rail suggests that the Capacity Charge, Schedule 8 and Schedule 4 are considered in the round and reviewed as a priority for CP6.

Network Rail considers that there may be scope to absorb the additional Schedule 8 liability resulting from increased traffic on the network directly into Schedule 8. This could mean that the Capacity Charge would no longer be needed.

Network Rail also considers that there is potential scope for simplifying freight charges in CP6. For example, consolidating the Freight Only Line Charge and Freight Specific Charge. These charges are levied on the same traffic and recover broadly the same costs. Therefore, consolidating them could serve to simplify the existing freight charging structure, without necessarily impacting freight operators' costs or Network Rail's income. However, Network Rail would only seek to pursue these potential changes if freight operators supported them and agreed that they would help to simplify the existing charging structure.

Network Rail would not support ORR making material changes to the structure of other 'variable' charges, in particular the Variable Usage Charge and Electric Current for Traction Charge. These charges were not identified by the industry, as part of the RDG Review of Charges, as a priority of refinement in CP6 and were considered to be broadly fit for purpose. ORR should not seek to make material changes to charges which the industry considers are not a priority for change as this would consume a disproportionate amount of industry time and effort. However, we recognise that as part of PR18 it would still be necessary to re-calibrate the level of 'variable' charges.

Network Rail notes that the Regional Efficiency Benefit Sharing mechanism (REBS) and Volume Incentive are also included in the scope of ORR's incremental improvements package. Before focusing on specific changes to these incentives, there is a more fundamental question on their effectiveness and, in particular, the extent to which they are influencing behaviours appropriately 'on the ground'. Network Rail has an important role to play in this regard. However, there would also be considerable merit in reviewing the effectiveness of these incentives on operators' behaviour, particularly REBS. This should lead to a more targeted discussion on potential changes.

If REBS is to continue in CP6, we consider that its ability to adapt with our business needs to be reviewed. For example, we would welcome a review of the current requirement for the nine England & Wales REBS route baselines to reconcile back to the Final Determination England & Wales baseline on a line and year basis. As a result of this requirement route plans are not fully reflected in the REBS mechanism which undermines its effectiveness. We also consider that the scope of REBS (i.e. what expenditure and income lines are included) should be revisited to include only those expenditure items over which operators can exert genuine influence.

In respect of the Volume Incentive, we would support a review of the existing metrics/payment rates and whether they create the right incentives.

Question 17: What options do you see as a priority for this package?

As noted in response to question 16, above, Network Rail considers that:

- The Capacity Charge, Schedule 8 and Schedule 4 should be considered in the round and reviewed as a priority for CP6.

- There is potential scope for simplifying freight charges in CP6.

- ORR should not seek to make material changes to other ‘variable’ charges because these were identified by the industry as being broadly fit for purpose.

- Before focusing on specific changes to REBS and the Volume Incentive, there is a more fundamental question on their effectiveness which needs to be addressed.

Question 18: What costs and benefits do you see with this package?

The costs and benefits of this package will depend on which ‘variable’ charges ORR proposes refining as part of PR18. Throughout the periodic review process we would urge ORR to be mindful of the fact that whilst ‘variable’ charges represent a relative small proportion of Network Rail’s income, they represent a significant cost to freight and open access operators.

Generally, if ORR focuses on areas that the industry considers are not a priority for change in CP6 (e.g. the Variable Usage Charge and Electric Current for Traction Charge), this is likely to consume a disproportionate amount of industry time and effort for little benefit. We consider that there would be considerable merit in ORR providing the industry with early certainty by closing out material changes to charges, that the industry consider to be broadly fit for purpose, as soon as reasonably possible. The earlier that ORR can confirm that there will be no significant changes to these charges, the more time the industry will have to focus on priority areas.

Network Rail considers that it would have been better if ORR was more open about its emerging views on potential options for change in this area as part of its consultation. It is clear from the consultation that ORR is considering making changes to existing ‘variable’ charges. However, ORR does not explicitly discuss any changes in the consultation and only tabled a ‘long list’ of options at the industry workshops that it hosted. As a result, ORR will have to consult/discuss its ‘long list’ of potential changes to ‘variable’ charges separately with the industry at a later date. We consider that by not setting out its view in this area, as part of the consultation document, ORR is increasing the burden on the industry in terms of responding to its proposals.

We suggest that ORR develops its ‘short list’ of options in a transparent way and provides the industry with sufficient opportunities to feed into this process. As a starting point, we strongly encourage ORR to use the list of charges identified by RDG as a priority for change in CP6. We would welcome further discussion with ORR and the rest of the industry in relation to this as soon as possible.

With regard to the Capacity Charge, the current structure of the charge creates a great deal of financial uncertainty for freight, charter, open access operators and Network Rail. Addressing this financial uncertainty would benefit all parties involved. The uncertainty results from the new arrangements introduced for certain operators in CP5, whereby CP4-equivalent rates are paid on traffic below a given baseline, and the higher, CP5 rates are paid on all additional traffic. Due to limitations of Network Rail’s Track Access Billing System, this must be calculated by means of a year-end wash-up. It is this annual wash-up process which introduces uncertainty regarding the amount of Capacity Charge income that Network Rail receives, and the amounts of Capacity Charge that these operators must pay. Network Rail considers that we should seek to refine the mechanism whereby Network Rail recovers the Schedule 8 liability from additional traffic as a matter of priority for CP6 such that these year-end wash-up arrangements are no longer required. This may involve refinement of the structure of the Capacity Charge or, as noted above, absorbing it directly into Schedule 8. Either of these options would assist Network Rail and train operators with business planning by providing greater certainty in relation to money flows.

We are also concerned that one of the examples that ORR cites in its consultation document, in terms of known weakness with existing charges, is the cost reflectivity of the Variable Usage Charge. We believe that ORR may be referring to the fact that the Variable Usage Charge is not geographically disaggregated. We consider that geographic disaggregation of Variable Usage Charges is likely to adversely impact upon the complexity and stability of the charging regime. It would also be a significant rather than incremental change to the current charging structure, particularly for those operators exposed to changes in variable charges. In addition, we consider that it is likely to provide perverse incentives in terms of capacity utilisation (analysis in PR13 indicated that it would make it cheaper to run trains on busier parts of the network and more expensive to run trains on quieter parts of the network) and could potentially price off valuable traffic.

As noted above, Network Rail considers a benefit of consolidating some of the existing freight charges would be to simplify the existing freight charging structure, without necessarily impacting freight operators' costs or Network Rail's income.

Chapter 7 - Supporting packages

Question 19: We would welcome comments on:

a) whether open access operators should face charges implemented under the infrastructure costs package;

As set out, above, Network Rail considers that all operators, including open access operators, should be attributed costs under the infrastructure costs package. However, the attribution of costs to operators and deciding whether to charge these costs are separate decisions. There may be legitimate reasons why it would not be appropriate to pass on all costs in the form of charges.

At present, there is a clear link between the charges that operators pay to access the network and their access rights (i.e. franchised passenger operators pay higher charges and get more access). If open access operators were to face higher charges under the infrastructure costs package, we would expect this to be considered in the round along with their rights to access the network. If there was greater parity between the charges that open access operators and franchised passenger operators pay to use the network, we would also expect there to be greater parity in relation to access rights.

We note that any contribution from open access operators under the infrastructure costs package would also have to be consistent with relevant European legislation and it is not clear, at present, how this would work.

We also note that the recent CMA consultation identified a range of options for increased competition on the rail network, including more overlapping franchises, for example. As part of ORR's competition package it will be important to consider all of these options, and potentially other options, in the round. ORR should not automatically presume that competition through the franchising process is insufficient and more market-based competition would deliver better results.

It is, of course, possible that it could but it would be a significant change from the current approach and, therefore, would need to be considered carefully.

In assessing potential options for change in this area we would encourage ORR to use the following criteria, which we set out in our response to the CMA consultation:

- The extent to which each option improves safety;
- The extent to which the option improves passenger and freight user experience; and
- The extent to which the option improves value for money for the taxpayer.

Finally, we note that in its letter to ORR in relation to improving financial incentives, DfT expresses concern in relation to the financial impact, and risk to the franchising system, from open access services. If ORR decides that it wishes to progress its competition package, we would encourage it to have regular open communication with DfT in relation to its proposals.

b) what forms of adjustments to charges might be appropriate for open access operators, relative to franchised operators; and

As set out above, the charges that open access operators pay should be considered in the round alongside their access rights. If open access operators were to have similar access to the network as franchised passenger operators, one would expect greater parity in terms of the access charges that they pay.

Any charges that open access operators pay will, or course, also have to be consistent with relevant European legislation.

c) how current incumbent open access operators should be treated.

When levying charges on train operators Network Rail is not allowed to unduly discriminate between operators. Any new charging structure should not create any undue discrimination. However, Network Rail recognises that existing open access operators have entered the market and made long-term investment decisions on the basis of the existing charging structure. Therefore, any material changes to the current charging structure would have to be carefully considered. However, as noted above, we would expect changes to charges to be considered in the round alongside access rights. Hence, one might expect existing open access operators to only face higher charges if they were to obtain increased access to the network, which would in turn provide them with more revenue. For the avoidance of doubt, we are not suggesting that any incremental revenue would offset the higher access charges. Further analysis would clearly need to be carried out in this area if this package were to be progressed.

Question 20: Would you like to see either of the complexity options developed further?

Network Rail would support the development of a charges calculator, if stakeholders would find this useful. At present, we aim to ensure transparency in relation to the track access charging structure (e.g. by publishing price lists and consultation and documents) and have published a Variable Usage Charge calculator[3]. However, we accept that the existing charging structure is complex and that some stakeholders may find a charging calculator useful.

[3] Available here.

Network Rail does not support the introduction of a formal complexity test to assess new charging options. Any formal complexity test is unlikely to be pass/fail and is likely to include a relatively subjective assessment of costs and benefits. Therefore, we foresee a risk that introducing such a test would make an already very detailed and protracted periodic review process more bureaucratic, without providing any certainty that it will prevent the introduction of undue complexity. We should, of course, all seek to avoid introducing undue complexity into the charging structure. However, we consider that it would be better to do this as part of ORR's assessment criteria and impact assessments, rather than a formal complexity test.

Question 21: Are there other options you would like assessed to reduce complexity?

Network Rail recognises that there is always likely to be a trade-off between cost reflectivity and complexity, which will require an appropriate balance to be struck. However, we consider that that the existing charging structure is complex and that this complexity is likely to be limiting its effectiveness. Indeed, this was one of the issues identified as part of the RDG Review of Charges. If stakeholders do not understand the current charging structure it is unlikely that they will factor it appropriately into their decision making.

Network Rail considers that the Capacity Charge, Schedule 4 and Schedule 8 represent the biggest opportunity for the industry to reduce undue complexity and improve its understanding. As noted, above, we consider that there may be scope to absorb the additional Schedule 8 liability resulting from increased traffic on the network directly into Schedule 8. This could mean that the Capacity Charge would no longer be needed.

As also set out, above, we consider that there is potential for consolidating some of the existing freight charges in order to simply the existing charging structure, without necessarily impacting freight operators' costs or Network Rail's income.

We would welcome further discussion with ORR and the rest of the industry regarding these opportunities as soon as reasonably possible, particularly in relation to the Capacity Charge, Schedule 4 and Schedule 8.

Question 22: What costs and benefits would you expect with these options?

Network Rail considers that the costs associated with a charges calculator would include the required industry resource to develop it. The main benefit would appear to be a single, agreed, tool that is readily available to stakeholders and could be used to calculate the charges that they would pay if they were to run an additional train service.

Network Rail considers that a benefit of a complexity test could potentially include an additional safeguard against introducing undue complexity into the charging structure. However, as set out above, we consider that it would be better to guard against this through ORR's assessment criteria and impact assessments, rather than introducing an additional test.

More generally, there are costs to the industry of undue levels of complexity. For example, the more complex and opaque the charging and incentive regime is, the more challenging and expensive it is for funders to calculate the effect of the periodic review process on operators' charges. DfT notes the significant administrative costs, associated with holding franchised passenger operators 'harmless' to changes in charges through their franchise agreements, in its letter to ORR in relation to financial incentives. In addition to these direct costs, undue complexity is also likely to increase the risk of funders inadvertently over/under compensating franchised passenger train operators as a result of any changes, potentially also increasing the risk to the taxpayer.

However, we also note that it is possible for some charges to be sophisticated without necessarily increasing the burden on the industry. For example, the Variable Usage Charge in underpinned by some quite complex engineering assumptions but the rates charged to customers are relatively easy to understand (e.g. levied on passenger vehicles on a pence per mile basis). In addition, because rolling stock lasts for 30-40 years it is not a significant burden to calculate a charge specific to each vehicle. When considering the extent to which the existing charging structure can be simplified, we should try to distinguish between complexity which imposes a burden on the industry and complexity which does not. We would not want lose certain benefits associated with the existing charging structure (e.g. the incentives that the Variable Usage Charge provides to operate 'track friendly' vehicles), as a result of simplification, unless greater benefits were going to be realised elsewhere.

Chapter 8 - Implementation of the structure of charges

Question 23: In chapter 8, we started to highlight issues associated with implementation of a new charging structure and potential actions to alleviate negative impacts. Do you have any views on options for implementing a new structure and what would be the impacts of these options?

We note the list of issues set out in the consultation that are associated with implementation of a new charging structure. We support transitional measures which are aimed at phasing-in significant changes to the current regime, particularly for those operators exposed to changes in charges. We note that freight operators, for example, invest in long-life assets and, therefore, need sufficient stability in the charging structure over time in order to recover their investments.

As the consultation notes, changes will be implemented through amendments to Track Access Contracts. It is important to be mindful of and manage the complexity of implementing changes to charges through Track Access Contracts, particularly for new policy areas. We recommend, therefore, that changes to Track Access Contracts are consulted on alongside proposed policy changes (e.g. new charges), rather than being something that is consulted on towards the end of the periodic review process (which has previously been the case). This will allow stakeholders to understand how the changes will be applied in practice. It will also allow more time to consider whether the proposed drafting changes give effect to the policy intentions. An early understanding of the potential contractual drafting implications will also assist in scoping out the potential changes required to the Track Access Billing System, particularly for more complex system changes.

More generally, the early confirmation of key decisions will also assist in allowing sufficient time to make the required changes to Track Access Contracts and the Track Access Billing System.

Question 24: We understand the structure of charges has the potential to impact different groups in different ways. In developing the options in this consultation (particularly in the draft impact assessments), have we drawn out the implications for different groups? Please explain your response.

Network Rail's welcomes the fact that ORR is being mindful of the impact of changes to charges on different stakeholder groups. We strongly encourage ORR to consider potential changes in the round and regularly revisit its impact assessments throughout the periodic review process.

Network Rail's view on the implications of the proposals in the consultation document, on itself and other stakeholders, are set out in detail above and not repeated here.

However, we would reiterate that:

- ORR's proposals are very much in their infancy. Therefore, the impact on different stakeholder groups is not yet clear and very difficult to measure with any real accuracy, at this stage.

- The impact of the short-run variable charges package on stakeholders is, particularly, unclear because ORR does not explicitly propose any changes in this area in its consultation.

- Going forward, we suggest that ORR structures its impact assessments in a consistent way (e.g. always assess the impact on key stakeholder groups under separate headings). We consider that this will makes its proposals, and the potential impact of them, easier for stakeholders to understand.