

Emily Bulman
Head of Transport Economics, Railway Markets and Economics

Telephone 020 7282 3892
E-mail emily.bulman@orr.gsi.gov.uk



20 December 2013

To freight operating companies

Dear colleague,

Consultation on capacity charge baselines in CP5 for freight operators

1. The purpose of this letter is to update you on the proposed approach and draft values for capacity charge baselines for freight operators in CP5, as per the decisions set out in our *Periodic Review 2013: Final determination of Network Rail's outputs and funding for 2014-19*¹. If you wish to comment on these proposals, please do so by **20 January 2014**.
2. The consultation consists of this letter and two annexes (Annex A and Annex B) prepared by Network Rail. Annex A shows draft baseline values and explains how these have been calculated, and Annex B describes the allocation of freight trains to commodity types. Following this consultation, baselines will be calculated by Network Rail for our approval (or we will determine them if we do not approve Network Rail's proposed baselines); they will then be published by Network Rail on or before 10 February 2013.
3. In the remainder of this letter we recap on our final determination decisions on the capacity charge and associated baselines, explain changes to contractual wording in Schedule 7, and cross refer to Network Rail's definitions of commodity groups and calculation of the baselines. We also set out the next steps for finalising the baselines.

Final determination

4. In our final determination we concluded on how the capacity charge would be levied on freight operators in CP5. This followed a consultation process carried out over the summer of 2013 following the publication of our draft determination. This process involved input from industry stakeholder groups, such as the RFOA and RDG.
5. For freight operators, we concluded that we would adopt the "RDG proposal – no negative wash-up" option that we set out in our letter to RDG dated 8 October 2013².

¹ This may be accessed at: <http://www.rail-reg.gov.uk/pr13/PDF/pr13-final-determination.pdf>.

² This may be accessed at: <http://www.rail-reg.gov.uk/pr13/PDF/freight-capacity-charge-2013.pdf>.



This means that in CP5 freight operators will pay the capacity charge for traffic based upon their actual mileage at a capacity charge rate set at £0.1300 per train mile for weekday traffic and £0.0975 per train mile for weekend traffic (2012-13 prices). In addition, operators will pay a proportion of any capacity charge wash-up.

6. Network Rail will calculate the wash-up annually, at the end of the year. For the purposes of the wash-up, there will be three commodity groups: *coal (including biomass)*, *intermodal* and *other commodities*. Each commodity group will have a baseline set using 2012-13 actual traffic levels for that commodity group.
7. Each wash-up will be calculated as being the difference between the revenue Network Rail would have received if the capacity charge wash-up rates³ were applied to the actual traffic above the baseline, and its actual capacity charge revenue from traffic above the baseline. Any negative wash-up is reset to zero. The amount of any wash-up will be apportioned to freight operators in proportion to the capacity charges they have paid to Network Rail for the relevant commodity groups.

Contractual wording and definitions of commodities

8. On 30 September 2013 we consulted on the changes we would need to make to Schedule 7 of the track access agreements in order to implement the capacity charge policy options discussed with industry over the summer⁴.
9. Subsequent to this, we have refined the Schedule 7 contractual wording to correct for certain errors, including ensuring that the baselines are updated for inflation. And we have made three more substantive changes.
10. First, we have included a requirement for Network Rail to provide to the train operators such background data and workings as may reasonably be required for a proper understanding of Network Rail's calculations. We expect the wash-up calculation to be transparent.
11. Secondly, we have amended the formulae to ensure that the wash-ups work at the level of the commodity group rather than all freight traffic, following responses to our consultation from Network Rail and DB Schenker.
12. Thirdly, we no longer define Coal Trains, Intermodal Trains and Other Trains in Schedule 7 directly. Instead we define these terms with reference to a methodology approved or determined by ORR on or before 10 February 2014. It will therefore form part of the publication of the baselines, which we have postponed from 20 December 2013 to on or before 10 February 2014. We think that this is important because it

³ These wash-up rates are shown on Network Rail's List of Capacity Charge Rates and equate to the rates recalibrated by Arup for Network Rail as part of PR13, sometimes referred to as the "CP5 rates".

⁴ The consultation letter and contractual wording may be accessed at: <http://www.rail-reg.gov.uk/pr13/consultations/capacity-charge-implementation.php>.



allows us to update you on our and Network Rail's thinking regarding these definitions and gives you the opportunity to comment.

13. We have now completed our work on Schedule 7 contractual wording (which is being issued to you separately as part of a review notice on 20 December). That contractual wording is now finalised and does not form part of this consultation.

Proposals for calculating the baselines and defining commodity groups

14. As Network Rail explains in Annex A, it is proposing to use actual traffic data sourced from its track access billing system (TABS) to calculate the baselines and wash-up for each commodity group. Network Rail considers that this is the only practicable means of administering the wash-up at commodity level.
15. To be consistent with the Schedule 7 contractual wording, the baseline for each commodity group is equal to:
 - a. the revenue that Network Rail would have received under 2012-13 traffic levels if the capacity charge was levied at the wash-up rates (i.e. the new **full** CP5 rates as recalibrated by Arup as part of PR13),

minus:
 - b. the revenue that Network Rail would have received under 2012-13 traffic levels if the (**lower**) CP5 capacity charge was levied (i.e. the weekday rate of 13 pence per train mile in 2012-13 prices).
16. For each commodity group, the total wash-up, across all freight operators, is the difference between the revenue Network Rail would have received if wash-up rates were applied to the actual traffic for that commodity group for that year above the baseline (of 2012-13 traffic levels), and its actual capacity charge revenue across the year above the baseline (subject to it being greater or equal to zero). Consistent with our final determination, each baseline is defined such that its respective wash-up is equal to zero if traffic is at 2012-13 levels.
17. Network Rail sets out draft baselines for the three freight commodity groups for CP5 in Annex A, including an explanation of how it has used TABS to calculate the baselines.
18. We have independently calculated the baselines and reconciled our calculations with Network Rail's own in order to provide additional assurance.
19. Annex A also sets out Network Rail's proposed mapping of commodity types, as specified in the Track Access Billing System (TABS), to the Schedule 7 commodity groups. We welcome any comments on the proposed mapping in response to this consultation.

Next steps

20. If you wish to comment on the proposed definitions of commodities or baselines or the draft baseline values, please send these comments to Alexandra Bobocica,

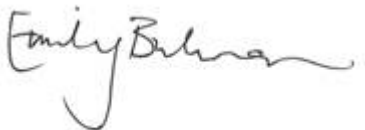


INVESTOR IN PEOPLE

alexandra.bobocica@orr.gsi.gov.uk, copied to Caitlin Scarlett,
Caitlin.scarlett@networkrail.co.uk, on or before **20 January 2014**.

21. In order to implement our decision for freight operators, Network Rail will publish a baseline for each of the three commodity groups, which will be approved by ORR (or determined by ORR if we do not approve Network Rail's calculation), on or before 10 February 2013.

Yours faithfully,



Emily Bulman



Annex A – Methodology for calculating capacity charge baselines and draft baseline values for CP5

For CP5, freight operators, charter operators and open access operators will be subject to a new charging arrangement for the Capacity Charge. In particular, these operators will pay the CP4 rates on existing traffic, and pay the newly recalibrated CP5 rates on traffic above the baseline by means of a year-end wash-up (these latter rates are labelled in the price lists as the “wash-up rates”).

Network Rail has prepared this Annex to go alongside ORR’s consultation on Capacity Charge baselines. We invite stakeholders to comment on any aspect of this Annex in their response to ORR.

This Annex explains the methodology which has been used by Network Rail to calculate the baselines for the Capacity Charge wash-up arrangements for CP5. ORR has reviewed the calculations and replicated the results bottom-up.

Freight operator baseline

The freight operator baseline will vary depending on the freight commodity group. ORR has determined that there will be three commodity groups – Coal, Intermodal, and Other.

ORR has outlined in Schedule 7 of the track access agreements that the definitions of the three commodity groups will be published alongside the baselines rather than in Schedule 7 itself. In defining the commodity groups, Network Rail has taken a pragmatic approach, and has mapped existing commodity definitions, contained in the Track Access Billing Systems (TABS) to each of these commodity groups, according to the table, below.

| Commodity ‘group’ for Capacity Charge baseline | NR reporting commodity name |
|------------------------------------------------|-----------------------------|
| Coal | Biomass |
| | Coal ESI |
| | Coal Other |
| Intermodal | Domestic Intermodal |
| | European Intermodal |
| Other | Chemicals |
| | Domestic Waste |
| | Engineering Haulage |
| | Enterprise |
| | European Automotive |
| | European Conventional |
| | General Merchandise |
| | Industrial Minerals |
| | Iron Ore |
| | Mail and Premium Logistics |
| | Other |
| | Petroleum |
| | Royal Mail |
| | Steel |
| | Construction Materials |
| Domestic Automotive | |

Annex B describes how Network Rail allocates freight trains to the commodity types listed in the above table.



The baseline for each commodity group is calculated as follows:

$$\text{baseline} = \text{weekday train miles} * (\text{Wash-Up Rate (weekday)} - \text{Weekday rate}) + \text{weekend train miles} * (\text{Wash-Up Rate (weekend)} - \text{Weekend rate})$$

The 'wash-up rate', 'weekday rate' and 'weekend rate' are as specified in the Capacity Charge price list, and are equal across commodity groups.

Using traffic data from TABS for the financial year 2012/13, for each commodity we calculate the annual mileage, split by weekend and weekday. This is shown in the table, below.

| Commodity group | Weekday train miles | Weekend train miles | Total train miles |
|-----------------|---------------------|---------------------|-------------------|
| Coal | 6,060,941 | 1,014,695 | 7,075,636 |
| Intermodal | 7,665,716 | 1,051,961 | 8,717,677 |
| Other | 8,332,748 | 996,695 | 9,329,443 |
| Total | 22,059,405 | 3,063,351 | 25,122,756 |

For example, for the commodity group 'Coal', the baseline would be:

$$\begin{aligned}
 & [6,060,941 * (0.7315 - 0.1300)] + [1,014,695 * (0.4901 - 0.0975)] \\
 & \text{weekend train miles} \quad \text{Wash-Up Rate (weekdav)} \quad \text{Weekday rate} \quad \text{weekday train miles} \quad \text{Wash-Up Rate (weekend)} \quad \text{Weekend rate} \\
 & = \pounds 3,645,476.64 + \pounds 398,354.21 \\
 & = \pounds 4,043,830.85
 \end{aligned}$$

The draft CP5 baselines for all commodity groups are shown in the table, below:

| Commodity group | Baseline (2012/13 prices) |
|-----------------|---------------------------|
| Coal | £4,043,830.85 |
| Intermodal | £5,023,685.60 |
| Other | £5,403,189.00 |



Annex B - Allocation of freight trains to commodity types

Within the Track Access Billing System (TABS), there is the functionality to assign freight vehicles to commodity types. This is currently used for the purposes of the Variable Usage Charge (VUC) and is therefore subject to a great deal of challenge and scrutiny from freight operators, since any incorrect reporting will result in a FOC being charged at an incorrect rate for their movement on the network. Going forward, Network Rail believes that this should be used to assign freight vehicles to three commodity groups (Coal, Intermodal and Other) for purposes of the Capacity Charge wash-up. Network Rail considers that using these definitions is the only practicable way that the baselines and actuals could be assessed.

Freight vehicles are automatically assigned a commodity type through TABS on the basis of service groups. Each existing service group is 'mapped' to a specific commodity, **following agreement with freight operators.**

On occasion, service groups are redefined, or new service groups are classified. This requires a new service group 'mapping' to commodity type. The commodity type is generally based on location (e.g. if the service group runs to a power station, the commodity will typically be Coal ESI), but wagon type will also influence this. Any allocation will be agreed following discussions with the freight operator and the Network Rail Account team.

Whilst every care is taken to ensure this 'mapping' is correct, it is possible for errors to occur in TABS and for freight vehicles to be assigned the wrong commodity type. To guard against this, the Network Rail billing team reviews the commodity type of freight vehicles frequently, prior to billing freight operators. There are a number of detailed enquiries that can be performed in TABS to aid this process (e.g. checking the weight of the freight vehicle gives a good indication as to the commodity carried). The responsibility, however, is primarily on the freight operator to review their billing information and raise any issues for Network Rail to review and correct the allocation where appropriate. As noted above, there is a great deal of scrutiny at this stage since freight operators could experience a real financial impact if any 'mapping' is incorrect.