2018 periodic review draft determination

Supplementary document – Overview of charges and incentives decisions

June 2018

Context

The 2018 periodic review (PR18) is the process through which we determine what Network Rail[1] should deliver in respect of its role in operating, maintaining and renewing its network in control period 6 (CP6)[2] and how the funding available should be best used to support this. This affects:

- The service that passengers and freight customers receive and, together with taxpayers, ultimately pay for; and
- The charges that Network Rail's passenger, freight and charter train operator customers will pay for access to its track and stations during CP6.

This document forms part of our draft determination, which sets out our overall decisions on PR18 for consultation. We have also published an overview document, setting out:

- our proposed decisions in all the main areas of PR18 and next steps; and
- a summary of how we will regulate Network Rail's delivery in CP6; and

In addition, there are high-level summaries of our main decisions for each of England & Wales and Scotland. The full set of documents that form the draft determination is set out in the diagram below. After taking account of consultation responses, we will publish our final determination in October 2018.

A map of our earlier consultations and conclusions that have led up to our draft determination is available here.

Responding to the consultation on our draft determination

We welcome comments on this document and/or the other documents that form part of our draft determination by **Friday 31 August 2018**. Full details on how to respond are set out in Appendix B of our overview document. This includes how we will treat any information provided to us, including that which is marked as confidential. Subject to this, we expect to publish responses alongside our final determination in October 2018.

We have provided a pro-forma, should you wish to use this when responding. If you choose not to use the pro-forma, we would be grateful if you would make clear in your response that you are commenting on this supplementary document. This will assist our process for reviewing comments.

[1] All references to Network Rail in this document are to Network Rail Infrastructure Limited.

[2] CP6 will run from 1 April 2019 to 31 March 2024.

Our draft determination documents (includes weblinks)*

PR18 draft determination overview document

England & Wales summary

Scotland summary (and supporting annex)

Draft settlement documents

- FNPO route
- System Operator

Route review summaries

England & Wales

- Anglia route
- LNE & EM route
- LNW route
- South East route
- Wales route
- Wessex route
- Western route

Supplementary documents

SBP assessment

- Scorecards and requirements
- Health & safety
- Review of Network Rail's proposed costs
- Other single till income
- Stakeholder engagement

Policy

- Financial framework
- Review of network licence
- Overview of charges & incentives decisions
- Infrastructure cost charges consultation
- Variable usage charge consultation

Other documents

- Glossary
- Consultancy & reporter studies

Conclusions to earlier consultations

- Conclusions to working paper 8 on managing change
- Conclusions on our approach to assessing efficiency & wider financial performance

*Please note that some documents, including consultancy and reporter studies and impact assessments, will be published following 12 June 2018.

Introduction

1. This document summarises the final decisions we have made for charges and incentives in CP6. It should be read alongside the draft determination, which sets out a small number of additional decisions.

2. The principal purpose of this document is to consolidate references back to the relevant published statements of these decisions on charges and incentives, as each followed different, parallel decision-making processes. On the route-level efficiency benefit sharing mechanism, this document sets out our decision, rather than linking to another decision document.

3. This document covers the following aspects of charges and incentives:

- fixed and variable charges for using the network;
- the possessions and performance schemes (Schedules 4 & 8);
- the route-level efficiency benefit sharing mechanism (REBS); and
- the volume incentive.

4. For the recalibration of all CP6 charges and incentives, there is an established risk-based approach that recalibration leads (whether they are Network Rail, industry groups or ORR) are expected to follow. The detail of this approach is available on our website (here).

5. We note that Network Rail has published conclusions (available here) to its consultations on how fixed costs should be allocated to train users and how the variable and station access charges should be recalibrated for CP6. We encourage interested parties to review these documents and to engage with Network Rail if they have any concerns. If disputes over the approach to be used cannot be resolved then, consistent with the approach to the recalibration of all charges and incentives, parties should ask ORR to determine the matter and submit separate proposals to ORR within a reasonable and clearly specified timeframe.

6. Annex A of this document provides a high-level overview of the proposed charging structure for CP6, for different types of operators. This is based on policy decisions we have already made (as set out below), as well as policy we are currently consulting on in relation to the variable usage charge (VUC) and infrastructure cost charges (ICCs).

Charges recovering fixed network costs

Infrastructure cost charges

Policy

7. We have made the following policy decision:

Decision	Consultation	Conclusion
To merge CP5 freight mark-ups (freight specific charge (FSC) and freight only line (FOL) charge) into a single ICC for freight market segments.	Proposed in our December 2016 consultation on charges and incentives (paragraph 2.28).	Published in our June 2017 charges and incentives conclusions (paragraph 5).

8. We are setting out final proposals on all other aspects of our infrastructure cost charging policy in the supplementary document 'Charges and incentives: infrastructure cost charges', which we are publishing alongside the draft determination.

Recalibration

9. ORR is leading the recalibration of infrastructure cost charges (ICCs) for freight and open access market segments[3]. As part of this work we are consulting on proposed levels for these charges; this consultation is available here.

10. Network Rail is leading the recalibration of the fixed track access charge (FTAC). As part of this work, Network Rail developed, and consulted on, a new cost allocation methodology for allocating fixed costs to services.

11. Having considered Network Rail's proposed cost allocation methodology and the responses to its consultation, we are proposing to approve the use of this methodology in the calibration of the FTAC, excluding the elements that allocate non-avoidable costs to services. We are consulting on this proposal here.

Station charges

Policy

12. We have not taken any policy decisions that affect the station long-term charge (LTC) or the qualifying expenditure (QX) management fee.

[3] We note that this is the first time we have calibrated ICCs for open access services.

Recalibration

13. Recalibration of the LTC and QX management fee is being led by Network Rail. We have discussed with Network Rail its proposed approach for recalibrating these charges, and our approval for use in CP6 is pending Network Rail's submission of final proposals.

Variable charges

Variable usage charge

Policy

14. We have made the following policy decision:

Decision	Consultation	Conclusion
Not to geographically disaggregate the VUC	Proposed in our December 2016 consultation on charges and incentives (paragraph 3.14).	Published in our June 2017 charges and incentives conclusions (paragraph 43).

15. In April we published a letter updating stakeholders on our intention to cap or phase-in the VUC for freight and charter services and to explore whether capping is appropriate for open access passenger operators.

16. We confirm our intention to phase-in increases to the VUC for freight and charter operators but not for franchise nor open access operators. These decisions are outlined in more detail in the supplementary draft determination document 'Charges and incentives: variable usage charge consultation'.

Recalibration

17. We concluded in our June 2017 charges and incentives conclusions, that there would not be a fundamental review of the methodology for calculating the VUC – in particular, we would not replace the role that the Vehicle Track Interaction Strategic Model (VTISM) has in setting the charge. However, the charge is subject to recalibration as part of the PR18 process (in line with other charges). Recalibration of the VUC is being led by Network Rail.

18. We have discussed with Network Rail its proposed approach and Arup has been engaged as an independent reporter to quality assure the VUC calculation. This work is ongoing. We will take a final decision on the approach adopted following final proposals from Network Rail.

Capacity charge

19. We have made the following policy decision:

Decision	Consultation	Conclusion
To remove the capacity charge.	Proposed in our December 2016 consultation on charges and incentives (paragraphs 3.20 to 3.37).	Published in our June 2017 charges and incentives conclusions (paragraphs 61 to 69).

Coal spillage charge

20. We have made the following policy decision:

Decision	Consultation	Conclusion
To remove the coal spillage charge.	Proposed in our December 2016 consultation on charges and incentives (paragraphs 3.47 to 3.51).	Published in our June 2017 charges and incentives conclusions (paragraphs 58 to 60).

Electrification asset usage charge (EAUC)

Policy

21. We have made the following policy decision:

Decision	Consultation	Conclusion
Not to alter the principles of the application of, or the approach to recovering, the EAUC.	Proposed in our December 2016 consultation on charges and incentives (paragraph 3.46).	Published in our June 2017 charges and incentives conclusions (paragraph 53).

Recalibration

22. Network Rail is leading the recalibration of the EAUC. The scope of its work includes, where possible, improving upon the CP5 assumptions and enriching the evidence base.

23. We have discussed with Network Rail its proposed approach for recalibrating the charge. In a number of areas, we have indicated that we are content for the recalibration to proceed as proposed, although our approval for use in CP6 is pending Network Rail's submission of final proposals.

Traction electricity charge (EC4T)

Policy

24. We have made the following policy decision:

Decision	Consultation	Conclusion
To keep the loss incentive mechanism.	Proposed in our December 2016 consultation on charges and incentives (paragraph 3.44).	Published in our June 2017 charges and incentives conclusions (paragraph 55).

Recalibration

25. Network Rail is leading the recalibration of the EC4T. We have discussed with Network Rail and the industry (through the Traction Electricity Steering Group) the proposed approach for recalibrating the charge. In a number of areas, we have indicated that we are content for the recalibration to proceed as proposed, although our approval for use in CP6 is pending Network Rail's submission of final proposals.

Incentives

Schedule 8

Policy

26. We have made the following policy decisions:

Decision	Consultation	Conclusion
Not to change the measure of passenger operators' performance in CP6.	Proposed in our December 2016 consultation on charges and incentives (paragraph 4.43).	Published in our June 2017 charges and incentives conclusions (paragraph 81).
Not to restrict the losses eligible for compensation under Sustained Poor Performance provisions to cost only.	Proposed in our December 2016 consultation on charges and incentives (paragraph 4.49).	Published in our June 2017 charges and incentives conclusions (paragraph 96).
Not to incorporate formulaic recovery of passenger compensation into Schedule 8.	Proposed in our December 2016 consultation on charges and incentives (paragraph 4.24).	Published in our June 2017 charges and incentives conclusions (paragraph 74).
To remove the annual traffic adjustment to FOC benchmarks.	Proposed in our letter to industry on 8 November 2017.	Published in our letter to industry on 9 March 2018.

Recalibration

27. RDG is leading the recalibration of the Schedule 8 regime for passenger operators. RDG has made available the detail of its submissions to us (on its website here).

28. A working group consisting of Network Rail and freight and charter operators is leading the recalibration of the Schedule 8 regime for freight and charter operators.

29. In a number of areas across the recalibration of both the passenger, freight and charter regimes, we have indicated that we are content for the recalibration to proceed as proposed, although our approval for use in CP6 is pending the submission of final proposals.

30. We have given our final approval for RDG's re-calibrated Monitoring Point Weightings and Cancellation Minutes to be used in CP6. Our approval letter is available on our website (here).

31. In some areas, as the industry could not reach agreement on how the recalibration should proceed, we were asked to determine the basis for the recalibration in accordance with the agreed process. These areas were:

- which delay multipliers should be used for CP6. Our decision, including the rationale for it, is available on our website (here);
- what the risk premium (charged for the provision of incident caps in the freight regime) should be. Our decision, including the rationale for it, is available on our website (here); and
- how the freight and charter operator benchmarks should be recalibrated. We have communicated our decision to the freight and charter operator recalibration working group. That decision, and the rationale for it, will be published on our website shortly.

Schedule 4

Policy

32. We have made the following policy decisions:

Decision	Consultation	Conclusion
Not to pursue the following issues in PR18: • **liquidated damages passenger train operator cost compensation:** • **liquidated damages freight compensation;** • **cancelled possessions;** • **scope of incentives; and** • **joint working on timetabling.**	Proposed in our December 2016 consultation on charges and incentives (paragraph 4.58).	Published in our June 2017 charges and incentives conclusions (paragraph 102).
Not to amend the principles behind the Access Charge Supplement (ACS)	Proposed in our December 2016 consultation on charges and incentives (paragraph 4.65).	Published in our December 2017 consultation on amending Schedule 4 notification factors (Annex B).

Decision	Consultation	Conclusion
Not to amend the Schedule 4 negotiated compensation arrangements	Proposed in our December 2016 consultation on charges and incentives (paragraph 4.74).	Published in our December 2017 consultation on amending Schedule 4 notification factors (Annex C).

Recalibration

33. We have decided to amend the notification factors in Schedule 4:

- we consulted on this in December 2017 (available here); and
- published our decision in May 2018 (available here).

34. RDG is leading the recalibration of the remainder of the Schedule 4 regime for passenger operators. A working group consisting of Network Rail and freight and charter operators is leading the recalibration of the Schedule 4 regime for freight and charter operators.

35. There were some aspects of the ACS recalibration that industry were unable to agree on. So, as per the agreed process, we were asked to determine the basis for the recalibration. These were:

- whether emergency timetable possessions forecasts should be included in the ACS; and
- the notification assumptions that should be used in the ACS recalibration.

36. We will make a determination on these in due course.

37. We have made it clear that we expect industry to propose any recalibrations needed to the Schedule 4 freight regime. To date we have not received a definitive proposal from operators in this area[4].

[4] We are aware the industry is considering some options, and we will review any proposal submitted to us.

Route-level efficiency benefit sharing (REBS) mechanism

38. We have made the following policy decisions:

Decision	Consultation	Conclusion
To remove the REBS mechanism.	Proposed in our November 2017 working paper on collaborative working on the rail network.	We have concluded to remove REBS in CP6 (see below).

39. In PR13, we introduced the REBS mechanism to strengthen the financial incentives on operators to work with Network Rail to reduce network costs.

40. Following widespread concern as to the effectiveness of REBS, we explored alternative approaches to supporting collaboration between operators and Network Rail. As part of this process, we published in November 2017 a working paper that set out two options: improving REBS and removing REBS in favour of facilitating an industry-led approach[5].

41. There was a strong view from stakeholders supporting the removal of REBS. In addition, a number of respondents expressed a preference for an industry-led approach going forward. We consider that an industry-led approach – where we facilitate industry striking more deals itself – is likely to be more effective in driving collaborative behaviour.

42. Reflecting this, we have concluded to remove REBS for CP6.

The volume incentive

43. We have made the following policy decisions:

Decision	Working paper	Conclusion
To remove the financial payment elements of the volume incentive in CP6 (but continue reporting on volume metrics).	Proposed in our November 2017 working paper on the volume incentive.	Published in our May 2018 conclusions letter to Network Rail.

[5] Working paper 7: Collaborative working on the rail network, ORR, November 2017. Responses to this working paper are available here.

Annex A: Summary of proposed CP6 charging structure

Table 1 summarises the proposed CP6 charging structure for different types of operators. Figure 1 on the following page shows how, at a high-level, the charging structure is set to change between CP5 and CP6. Some of these changes have already been confirmed (e.g. the removal of the capacity charge and coal spillage charge), as set out in this document. We are currently consulting on proposals in relation to the VUC and ICCs.

Table 1: Proposed CP6 charging structure for different types of operators

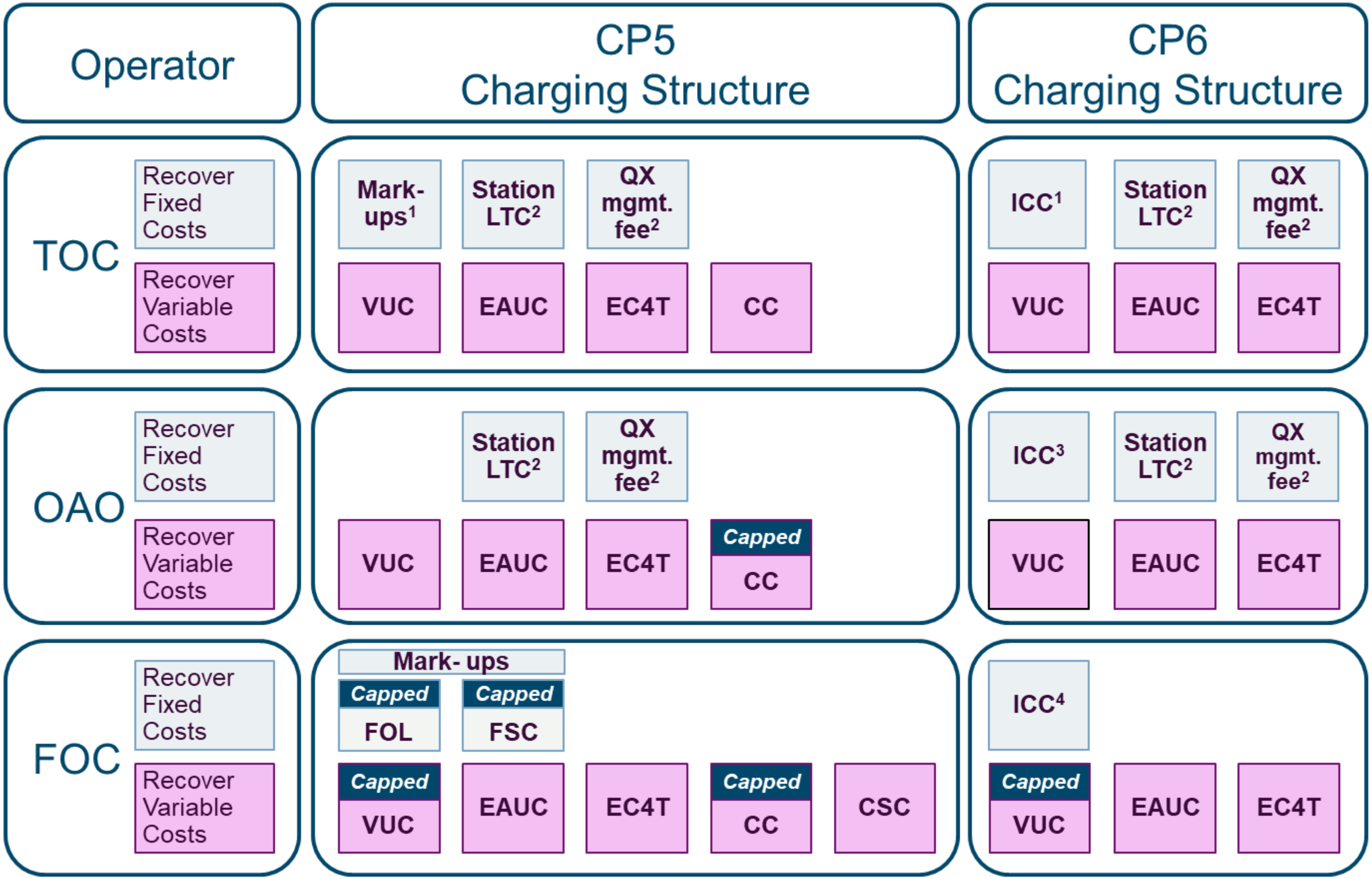
Type of operator	Infrastructure cost charges (ICCs)	Variable usage charge	Other charges[6]
Franchised passenger	Continue existing approach (fixed track access charge), but charge will vary annually to reflect changes in timetabled traffic.	No change from CP5. Unaffected by capping policy.	Remove capacity charge. No other change in policy from CP5.
Open access			
A. Existing open access operators	No ICCs in CP6 (unless significant changes to access rights).	No change from CP5. Unaffected by capping policy.	Remove capacity charge. No other change in policy from CP5.
B. New entrant open access operators – 'interurban' market segment	Will pay ICCs in CP6 according to a specified phasing-in profile.		
C. New entrant open access operators – 'other' market segment	No ICCs in CP6.		

[6] This includes the EAUC, EC4T, SLTC and QX management fee, the capacity charge and the coal spillage charge.

Type of operator	Infrastructure cost charges (ICCs)	Variable usage charge	Other charges[6]
Freight			
A. Commodities subject to ICCs (ESI coal, iron ore, spent nuclear fuel, ESI biomass)	Will pay ICCs in CP6.	Capping policy applies – VUC increases phased-in over CP6 and CP7.	Remove capacity charge and coal spillage charge. No other change in policy from CP5.
B. All other commodities	No ICCs in CP6.		
Charter (incl. heritage[7])	No ICCs in CP6.	Capping policy applies – VUC increases phased-in over CP6 and CP7.	Remove capacity charge. No other change in policy from CP5.

[7] In the context of our VUC capping/phasing-in policy, we have treated the North Yorkshire Moors Railway and the Jacobite services run by West Coast Railways as being akin to charter services.

Figure 1: High-level illustration of changes in charging structure between CP5 and CP6



Notes to Figure 1:

1. For CP6, we have called all charges recovering fixed network costs ‘infrastructure cost charges’ (ICCs). The ICC for franchised passenger operators will continue to be called FTAC.

2. Station charges: There is also qualifying expenditure (we only regulate the QX management fee at managed stations), facility charges (which we approve) and franchised station lease income (which we do not regulate).

3. We have proposed to levy ICCs on open access services in the interurban market segment in CP6, as a rate per train mile.

4. For CP6, we have called all charges recovering fixed network costs ‘infrastructure cost charges’ (ICCs). These are the charges we have previously referred to as mark-ups. For freight services, we have confirmed the FOL and FSC will be merged in CP6, and only one ICC will be levied, which for billing purposes will be called the FSC.

This publication is available at orr.gov.uk

Any enquiries regarding this publication should be sent to us at orr.gov.uk