



## **2018 periodic review final determination**

**Supplementary document – the  
Variable Usage Charge in control  
period 6: conclusions**

October 2018

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## About this document

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

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

In June 2018, we consulted on our [PR18 draft determination](#)<sup>3</sup>, setting out our proposed decisions in all of the main areas of PR18. Following receipt of consultation responses, we have reviewed stakeholders' comments and these have helped to inform the final decisions set out in our final determination. We are grateful to all those who responded to the consultation.

Accordingly, the [final determination](#) sets out our overall decisions on PR18. Among the documents that we have published is an [overview document](#), setting out:

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

In addition, there are high-level summaries of our main decisions for each of [England & Wales](#) and [Scotland](#).

We have also published a [document](#) summarising stakeholders' comments on the PR18 draft determination and our response to these.

The full set of documents that form the final determination is set out in the box overleaf<sup>4</sup>.

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<sup>1</sup> All references to Network Rail in this document are to Network Rail Infrastructure Limited.

<sup>2</sup> CP6 will run from 1 April 2019 to 31 March 2024.

<sup>3</sup> The full suite of PR18 draft determination documents are available from this [webpage](#). To access earlier consultation and conclusions documents that led up to the PR18 draft determination, please see the map of these documents [here](#).

<sup>4</sup> Our policy on managing change will be published in November 2018. Some documents, such as the consultancy and reporter studies, will be published shortly after the final determination.

## Our final determination documents (includes weblinks)

<b>PR18 final determination overview document</b>		
<b>England &amp; Wales summary</b>	PR18 draft determination consultation – summary of comments and our response	
<b>Scotland summary (and settlement details)</b>	<b>Supplementary documents</b>	
<b>Settlement documents</b>		
<b>FNPO route</b>	<b>SBP assessment</b>	
<b>System Operator</b>		
<b>England &amp; Wales</b>		Scorecards and requirements
		Health & safety
		Review of NR's proposed costs
	Other single till income	
	Stakeholder engagement	
	<b>Policy</b>	Financial framework
		Review of network licence: conclusions from consultation
Overview of charges & incentives decisions		
Infrastructure cost charges conclusions		
Variable usage charge conclusions		
<b>Other documents</b>		
<b>Glossary</b>	<b>Managing Change Policy</b>	
<b>Consultancy &amp; reporter studies</b>	<b>Grading of Network Rail's route and System Operator strategic plans for CP6</b>	

## Introduction

1. As part of PR18 we have reviewed the access charges paid by operators. Following our June 2018 'Variable Usage Charge' [consultation](#), published alongside our draft determination, this document outlines our final position. It supplements the information provided on the VUC within the 2018 periodic review [final determination](#).
2. Annex A of the supplementary document an 'Overview of charges and incentives [decisions](#)' provides a high-level summary of the proposed charging structure for CP6 for different types of operators. Consideration of the issues raised by stakeholders in response to our June 2018 consultation is included within the Charges & Incentives chapter of our document 'Consultation on the draft determination – Summary of comments and our response', which can be viewed [here](#).

## Background to the VUC

3. The VUC is a charge designed to recover the operating<sup>5</sup>, maintenance and renewal costs that vary with marginal changes in traffic. It does not reflect the costs of providing or changing the capability or capacity of the network.
4. The VUC makes up c.15% of the total charges income received by Network Rail<sup>6</sup> but constitutes the majority of the track access charges paid by some train operators.
5. The charge is important in delivering the PR18 objectives of a network that is efficient and better used. It does this by (either individually or in combination with other charges) affecting the incentives for:
  - operators to develop track friendly vehicles;
  - operators to only operate services where the short-run marginal benefit is greater than short-run marginal cost; and
  - Network Rail to accommodate additional traffic.
6. The VUC recovers costs relating to three broad cost elements: track, civil engineering and signalling. Track 'wear and tear' costs make up c.85% of the charge. The [methodology](#) for calculating VUC rates is an established process which draws upon third party research and is underpinned by the Vehicle Track Interaction

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<sup>5</sup> In practice, rail infrastructure operating costs are widely understood not to vary materially with traffic, and the charge was set in CP4 to recover variable maintenance and renewal costs only.

<sup>6</sup> Including pass-through charges such as the EC4T.

Strategic Model (VTISM) – an engineering model owned by the Rail Safety and Standards Board (RSSB) and used by Network Rail.

7. The charge is disaggregated by vehicle class and freight commodity to increase the cost reflectivity of the charge. Broadly, heavier and faster vehicles incur a higher VUC, reflecting the relatively higher levels of damage that they cause.
8. In order to simplify the following discussion, we have focused on the *average* rates for different operator types (franchised, open access, charter and freight). However, it is important to highlight that there will be considerable variation in the *individual* rates as the charge is broken down by vehicle class and (for freight) commodity.

## PR18 work on the VUC

### Overall approach

9. In June 2017 we [concluded](#) on our consultation on changes to ‘charges and contractual incentives’. These conclusions stated that there would not be a fundamental review of the VUC. In particular, we would not geographically disaggregate the charge nor replace the role that the VTISM model has in setting the charge.
10. However, we concluded that the charge would be subject to recalibration by Network Rail as part of the PR18 process (in line with other charges).
11. The table below lists the main PR18 publications that have documented the recalibration and policy development for the VUC.

**Table 1: publications related to the VUC in PR18**

Date	Document	Published by
December 2016	<a href="#">Consultation</a> on ‘charges and contractual incentives’	ORR
June 2017	<a href="#">Conclusions</a> on the ‘charges and contractual incentives’ consultation	ORR
July 2017	<a href="#">Consultation</a> on ‘variable and station charges in CP6’	Network Rail
April 2018	<a href="#">Update letter</a> on the ‘variable usage charge and infrastructure cost charge’	ORR
May 2018	<a href="#">Conclusions</a> on the ‘variable charges and station charges in CP6’ consultation	Network Rail

Date	Document	Published by
June 2018	<a href="#">Consultation</a> on the 'variable usage charge in CP6' (draft determination)	ORR
July 2018	<a href="#">Draft CP6 price lists</a> consistent with the draft determination	Network Rail

## Our June 2018 consultation

12. In our June 2018 consultation document 'the variable usage charge in CP6', we provided an update on the ongoing recalibration of the charge and outlined our policy proposal for capping/phasing-in the increase in the VUC for freight and charter operators.
13. Responses to the consultation were received from a wide range of stakeholders with a particularly high concentration of comments from rail freight industry participants.
14. Both Network Rail and the Department for Transport ("DfT" or the "Department") were supportive of our capping/phasing-in proposal. Network Rail commented that the proposal struck a reasonable balance between maintaining a stable 'package' of charges for freight and charter operators, whilst continuing to move towards operators paying cost reflective VUCs. The Department was pleased that the short term impact of increases in charges would be limited through the phasing-in of the increases over two control periods but noted that the capped operators should move towards paying an appropriate share of their costs over time.
15. However, rail freight stakeholders generally argued that the capping and phasing-in needed to go further as the proposed increase in charges risks a loss of traffic to road and may negatively affect investment decisions made by customers, freight operators and other parts of the supply chain.
16. The various issues raised by respondents on both the recalibration of the charge and our capping/phasing in policy are summarised along with our comments and conclusions within the "Consultation on the draft determination – Summary of comments and our response" document, available [here](#).
17. After careful consideration of all responses to our consultation, we have decided that we will retain the recalibration approach and capping/phasing-in policy that we proposed in our June 2018 consultation document. Any changes in the summary figures presented in this conclusions document are therefore driven only by the latest recalibration amendments. We set out our reasons below.

## PR18 recalibration

18. The PR18 recalibration of the VUC has primarily involved the charge being updated to reflect factors such as changes to Network Rail's costs and patterns of traffic on the network. In particular, work in the following areas has contributed to the calculation of the charge for CP6.

### Minor methodology improvements

19. Both our December 2016 'charges and contractual incentives' [consultation](#) and Network Rail's July 2017 consultation on '[variable and station charges in CP6](#)' asked for and/or proposed minor methodological changes to the charging methodology, primarily focused on improving cost reflectivity.
20. Responses to its July 2017 consultation were considered by Network Rail, and the company outlined proposed changes to the VUC calculation methodology in its May 2018 conclusions document, accessible [here](#). For example, giving passenger operators the option of setting VUC rates based on the maximum line speed over the route on which they operate (instead of the maximum speed of the vehicle). We confirm our support for the changes to the methodology outlined by Network Rail and can confirm that these amendments will be implemented for the VUC in CP6.

### Assessment of excludable direct costs

21. Network Rail's May 2018 conclusion document also considered how its VUC estimates comply with relevant EU legislation. In particular, how they comply with the new EU implementing regulation (2015/909) issued in June 2015, which provides further clarification on the calculation of the cost that is directly incurred as a result of operating a train service. Network Rail's assessment in light of the implementing regulation has resulted in a 9% reduction in the average level of the uncapped VUC.
22. ORR has not undertaken a detailed review of Network Rail's assessment of excludable costs, nor have we reviewed costs that were previously excluded to assess whether there could be a case for reflecting them in the VUC. This is proportionate as the capping policy outlined in this paper significantly reduces the impact of the decisions on the appropriate scope of costs on the VUC charge paid by freight and charter operators in CP6. However, as charges move closer to costs – as they are expected to in CP7 – it will become increasingly important to have greater clarity on which costs should be reflected in the VUC. This will need to be reviewed during CP6 to facilitate decision-making ahead of PR23.



## Efficiency assumptions

23. The calculation of the VUC reflects the expected change in the efficiency of Network Rail's spending on maintenance and renewals (M&R) during CP6 in the estimate of costs directly incurred. In particular, it uses the forecast efficiency level in the final year of CP6 and applies this to the charge for the whole period.
24. The recalibrated VUC will reflect ORR's final determination efficiency targets which assume that Network Rail will save an additional c.3% on M&R than had been assumed in Network Rail's SBP – this takes the total efficiency savings to around 11.4% over CP6. We have not anticipated any further efficiencies or inefficiencies beyond CP6.

## Indexation of charges to CPI

25. We have concluded that in CP6 we will move from RPI to CPI for the inflation indexation of track access charges (and other payment rates where we set the method of indexation).
26. Annual RPI inflation is forecast to exceed CPI inflation by c.1% per annum over the period of CP6. As part of its PR18 SBP planning, Network Rail assumed that it would receive indexed charges income based on RPI and so without intervention the movement to CPI would significantly reduce the level of income Network Rail is forecast to receive. To avoid this shortfall in funding, a 4% upward adjustment will be made to the opening CP6 rates of indexed charges (including the VUC) so that the income forecast to be received by Network Rail over CP6 is held neutral.
27. Train operators will therefore be expected to pay the same charges in cash terms over the course of CP6 as they would have under RPI – this will be achieved through the payment of higher initial charges which are forecast to increase at a slower rate. As outlined later in this document, this adjustment will not apply to capped operators. Our approach for the indexation of charges in CP6 is detailed in Annex B of our 'Overview of charges and incentives [decisions](#)' document.

## Vehicle characteristics updates

28. On the basis of the information available at the time (including our proposed approach to capping/phasing-in the VUC), Network Rail published its [draft price list](#) for access charges in July 2018 and asked that train operators notify it of any issues or inaccuracies. A number of updates and corrections have been made as a result (e.g. the updating of rolling stock and vehicle characteristics) which have been incorporated into the VUC calculation model. Consistent with our approach in PR13,

it will not be possible to re-open these vehicle characteristics during CP6. The next opportunity to amend these vehicle characteristics will be as part of PR23.

## Quality assurance

29. We have worked closely with Network Rail throughout the recalibration of the VUC. We jointly commissioned Arup as an independent reporter to quality assure the PR18 VUC calculation work – the Arup report is available [here](#). Due to the requirements of the recalibration timeline, this audit was carried out before ORR decided to cap VUC rates payable by freight and charter operators. Network Rail has therefore also completed its own assurance to confirm that ORR's policy and any unaudited recalibration amendments have been implemented correctly.
30. We have reviewed Network Rail's proposed methodologies and independent audit for the recalibration of the VUC. We are content with the methodologies and audit Network Rail has proposed to date. Our final approval of the recalibrated VUC will be provided once we are satisfied that Network Rail's final submission reflects all the decisions included in our determination. Our approval letter will be published on our website [here](#).

## Policy considerations

### Increase in VUC

31. The cost of repairing the wear-and-tear that train operators cause the network is forecast to be significantly higher in CP6 than in CP5. Without policy intervention the VUC would have to materially increase in CP6 to meet these costs.
32. The below table illustrates the forecast size of the uncapped VUC increase on average across franchised, open access, freight and charter operators.

**Table 2: forecast average increase in the VUC relative to the final year of CP5 (2017/18 prices<sup>7</sup>, constant traffic (2018/19), post-efficient (ORR final determination<sup>8</sup> assumption))**

	Uncapped average CP6 increase
Franchised	34%
Open access	38%
Freight	38%
Charter	31%

33. The change in the (uncapped) VUC rate is driven by:

- **Forecast CP5 efficiency savings not being realised:** in PR13, we applied an 18.9% efficiency overlay to the VUC, from the first year of CP5. These efficiencies have not been realised in CP5.
- **Deterioration in Network Rail efficiency:** Network Rail has become less efficient compared to CP4. This has led to an increase in the costs used to calculate the VUC.
- **Unwinding PR13 caps:** in PR13 we capped the average freight VUC rate increase at 10%. This cap was phased-in over CP5<sup>9</sup>. Removing the PR13 caps increases the charges relative to the capped end CP5 rates.
- **Other recalibration adjustments:** any other changes affecting the calculation of the charge (such as those outlined above) will feed through into the VUC rates.

<sup>7</sup> Including the adjustment that will be applied to the opening VUC rates for franchised and open access operators to reflect the indexation move from RPI to CPI.

<sup>8</sup> The figures presented in our June 2018 consultation reflected the M&R efficiency assumption from the Network Rail SBP (8.4%). The figures now showing in table 2 reflect the expected level of efficiency determined by ORR as part of the final determination (11.4% for M&R).

<sup>9</sup> In PR13, we concluded that the new rates for VUC freight traffic should be implemented subject to a cap on the average VUC. This cap was relative to CP4 rates and was 10%. The capped average increase to the VUC for freight traffic was phased in over the duration of CP5 (0% in years 1 and 2, rising to 20% in year 3, 60% in year 4 and 100% in year 5).

## Our legal requirements and balancing our statutory duties

34. We have considered the VUC increase in accordance with the Railways (Access, Management and Licensing of Railway Undertakings) Regulations 2016 and the Commission Implementing Regulation (EU 2015/909). The legislation is broadly in line with standard network pricing principles; namely, that charges should cover at least short-run marginal cost.
35. Our interpretation of this legislation is that, while costs directly incurred have to be recovered from train operators, we have the flexibility to allow for such changes to the level of the VUC to be brought in over a period of time (i.e. the charge can be capped/phased in).
36. However, such capping/phasing-in must not be open-ended or indefinite; there must come a time when full costs are charged. We also consider that our decision should be credible over time and not, for example, imply an extremely unlikely change in charges at the next review.
37. Furthermore, we have had regard to our statutory section 4 duties in reaching our decision on capping/phasing-in. In particular:
  - 4(1)(b) promote the use of the railway network in Great Britain for the carriage of passengers and goods, and the development of that railway network, to the greatest extent that it considers economically practicable;
  - 4(1)(c) promote efficiency and economy on the part of persons providing railway services;
  - 4(1)(g) enable persons providing railway services to plan the future of their businesses with a reasonable degree of assurance;
  - 4(5)(b) not render it unduly difficult for [Network Rail] to finance its activities; and
  - 4(5)(c) to have regard to the funds available to the Secretary of State for the purposes of his functions in relation to railways or railways services.
38. In light of our statutory duties, we considered the following when assessing the use of a VUC cap in PR18:
39. **Better use of the network:** the VUC provides an incentive for efficient use of the network. In the long run a cost-reflective VUC will encourage operators to invest in track-friendly vehicles (supporting longer-term efficiency improvements) and only to use the network where the marginal benefit is greater than or equal to the short-run marginal cost. In addition, the VUC income affects the incentives on Network Rail to

accommodate additional traffic. To the extent that the VUC income from extra traffic is below the additional costs incurred, this may discourage Network Rail from supporting growth.

40. **Impact on funding:** the use of capping/phasing-in will reduce the variable charges income received by Network Rail. In its March 2018 [letter](#) DfT stated that, as funder and shareholder, it is satisfied that capping the VUC for freight and charter operators at end of CP5 levels would be consistent with the assumptions it made in the Statement of Funds Available (SoFA).
41. **Supporting rail sector growth and stability:** it is important to consider the impact that material increases in the VUC will have on different operators. Freight operators have, in particular, engaged with ORR throughout the charges and incentives project and have highlighted: the importance of a stable charging environment in supporting investment decisions, their tight operating margins and the sensitivity of the industry to price (with competition from road being a particular issue). More generally, the rapid decline in coal freight has prompted significant restructuring in the sector.
42. Funders have also stressed the need for the charges and incentive framework to provide a stable platform to enable and encourage growth in the rail freight sector. Transport Scotland included specific freight growth targets in its HLOS and confirmed in its March [letter](#) that it is looking to grow both the rail freight and rail tourism market in Scotland. DfT stated that it considers freight and charter capping in CP6 to be appropriate but not for either franchised or open access operators.

## Looking at increases ‘in the round’

43. When assessing the appropriateness of capping/phasing-in the VUC, it is important to also consider the expected changes to other charges for different operator types given wider ORR policy decisions around charges and incentives, the recalibration of charges, and changes in Network Rail’s cost base.
44. We have developed a PR18 charges and incentives impact model, which we describe in our accompanying [note](#). The impact model has allowed us to understand the scale of changes in the level of charges for various segments (e.g. commodities) or types of operators (e.g. franchised passenger versus open access) resulting from policy changes and recalibration.
45. For assessing the VUC capping/phasing-in policy for PR18, we have particularly considered forecast ‘total variable charges’ which we have taken to include the VUC, the electrification usage charge (EAUC), the traction electricity charge (EC4T), the capacity charge and the coal spillage charge.

46. In our June 2017 ‘charges and contractual incentives’ consultation conclusions [letter](#) we decided that two of the CP5 variable charges (capacity charge and coal spillage charge<sup>10</sup>) would be removed in CP6, providing a benefit to operators. Different operators pay different mixes of variable charges and so the net impact of the reduction of these charges and the increase in the VUC (to uncapped levels) varies.
47. The effects of changes to variable charges on **franchised operators** are mitigated by franchise contracts: franchised passenger operators are held harmless to any changes in these charges. In practice this means that any increase in the VUC or reduction in the capacity charge they pay is offset by a reduction in the franchise premiums they pay or an increase in franchise support.
48. **Open-access operators (OAOs)** are not expected to see a material increase in their total variable charges in CP6. The forecast increase in VUC will be broadly offset by the removal of the capacity charge.
49. Forecasts show that the removal of the capacity charge will not offset the material increase in the VUC for **charter operators**. The level of profitability of certain operators and services varies significantly, reflecting the varied nature of charter operations. We are also mindful of the relatively moderate level of charges income generated by the charter VUC and of the need to maintain simplicity in the overall charges framework.
50. It is forecast that the removal of the capacity charge and coal spillage charge will not offset the increase in the VUC for **freight operators**. Our forecasts indicate that they will see a material increase in their total variable charges unless steps are taken to mitigate the increase in the VUC. As outlined above, the extent of this net increase will vary for the different commodity types.

## Our PR18 capping/phasing-in policy

51. We set out below our conclusions for capping/phasing-in the VUC in CP6. Further details of the policy options considered are summarised in the accompanying (final) [impact assessment](#).
52. As noted above, EU and UK legislative requirements mean that costs directly incurred have to be recovered from operators but there can be capping/phasing-in of any increase in charges on the basis that such capping/phasing-in must not be open-ended or indefinite; there must come a time when full costs are charged.

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<sup>10</sup> The coal spillage charge is paid by a small proportion of freight operators only.

53. We have considered our statutory duties when considering our policy options. In particular, we are mindful of the potential benefits to operators of keeping charges at a sustainable and predictable level. Indeed, these concepts are related as, if operators are provided with advanced warning of changes, this provides time for them to adjust to the future charges levels. Reflecting this, our policy provides these operators with time to adjust and plan for the required increases in their VUC charges.
54. We also placed weight on the need to provide a credible long-term trajectory as this will provide operators and rolling stock companies with clearer expectations on the future level of charges. This will support the incentives on all parties to invest appropriately in track-friendly vehicles over time. Related to this, we consider it important for the profile of charges to be credible over time and for the approach taken to be repeated at PR23 without implying a change in charges that would not be viewed as credible at the time.
55. Some responses to the consultation challenged whether there was likely to be a significant response to any incentive to reduce the damage caused by freight vehicles. In this respect, we note the earlier [research](#) undertaken into the effectiveness of various charges, which highlights the potential for the VUC to affect freight rolling stock choices and the importance of providing a long-term credible profile of charges.
56. We have also had particular regard to the impact on train operators' total variable charges. This is particularly important in CP6 as we have already announced some significant changes to variable charges as part of our wider simplification of access charges. In particular, we have decided to remove the capacity charge for CP6, which leads to a significant reduction in one element of total variable charges.
57. Against this background, our approach to cap/phase-in the VUC for certain operators can be summarised as follows:
- The following policy will not apply to franchised operators nor to open access passenger operators. Franchised operators are 'held harmless' by their franchise agreements and the open access passenger operator group is not forecast to incur a material increase in their total variable charges in CP6.
  - The capping/phasing-in policy will apply to freight and charter operators who are forecast to incur material increases in their (uncapped) total variable charges in CP6. North Yorkshire Moors Railway's services and West Coast Railway Company's Jacobite services will also be subject to the capped VUC transition profile.

- The increase in costs will be reflected in the VUC for freight and charter operators in CP6 based on a transition to cost-reflectivity over a 10 year period (i.e. over CP6 and CP7).
- In years 1 and 2 of CP6, total variable charges (including forecast VUC, EAUC, EC4T, the capacity charge and the coal spillage charge<sup>11</sup>) for the freight and charter operator sectors will be held constant in real terms (i.e. equal to the final year of CP5). This will necessitate an increase in the VUC charge in year 1 to offset the fall in other variable charges due to the removal of the capacity charge and the coal spillage charge in CP6.
- In the following three years of CP6, the VUC for each individual vehicle will be based on a straight-line transition to full cost reflectivity by the end of CP7 (i.e. reaching the current estimates of the uncapped charges level).
- In line with our decision to change our indexation approach for PR18, the indexed variable charges (VUC and EAUC) for all operators will be linked to CPI in CP6. However, for capped operators there will be no increase to the opening CP6 rates for these charges to adjust for the movement from RPI and, in contrast to franchised and open access operators, they will retain the forecast benefit from this change to provide them with greater stability over time. By the final year of CP6, capped operators are forecast (in nominal terms) to pay rates which will be approximately 5% lower under CPI than RPI.

58. A 'statement of methodology'<sup>12</sup> detailing how Network Rail applied our capping/phasing-in policy when calculating the rates for the draft price list is available [here](#). We confirm that this statement of methodology accurately reflects our capping policy set out in this document.

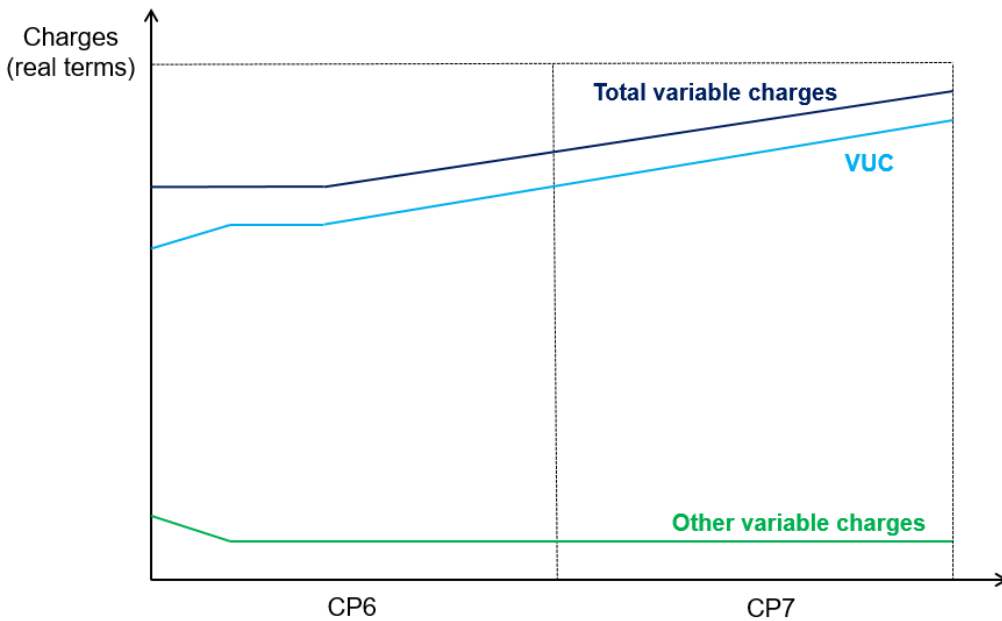
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<sup>11</sup> The capacity charge and coal spillage charge are to be removed in CP6 but are included in the calculation of total variable charges in the final year of CP5.

<sup>12</sup> N.B. This document refers to figures included in the draft price list.



**Figure 1: The transition profile for capped operator groups<sup>13</sup>**



59. As illustrated in figure 1, capped operators will benefit from a two-year adjustment period during which there will be no increase in their total variable charges in real terms (shown in dark blue). The transition to uncapped levels is then based on a steady straight-line 'glide path' to the end of CP7. This means that the VUC for capped operators will also include phasing-in to adjust for the changes to other variable charges (including the removal of the capacity charge).
60. It is important to note that while this profile illustrates the expected trajectory of charges in CP7, the charges will need to be recalibrated as part of PR23 and decisions regarding the level of the VUC for operators will be revisited at that time.
61. When making decisions regarding passenger operators it is important to note that we have considered the two main high-level market segments: public service contract operators (i.e. franchised operators) and other passenger services. We consider the other passenger services can be further sub-segmented between charter and open access operators.
62. These segments all differ in terms of access regime and the nature/purpose of the service. The charging scheme should take account of these differences and we do not consider that adopting a different approach across these different operators is

<sup>13</sup> Diagram is not generated directly from the underlying data. Illustrative only.

unduly discriminatory. Indeed, it would risk undue discrimination if we were to not reflect such differences in a charging scheme.

63. While they are both in possession of fixed access rights (in common with OAOs), we have treated the North Yorkshire Moors Railway and the Jacobite services run by West Coast Railways as being akin to charter services in the context of our VUC capping/phasing-in policy given the nature of their services (primarily steam heritage services provided over the summer).

## **Indicative impact of our proposal**

64. We present high level numbers below to illustrate the estimated impact of the capping/phasing-in policy, updated to include any recalibration amendments since our June 2018 consultation.
65. These figures are presented in real terms and do not incorporate the impact of the move to CPI for the indexation of track access charges in CP6 which for capped operators is forecast to result in affected charges being inflated by c.1% less per annum than would have been the case under RPI. By the final year of CP6, capped operators are forecast to pay (nominal) rates which will be approximately 5% lower under CPI than RPI. This impact has not been incorporated into the below figures which are presented in 2017/18 prices.
66. Table 2 presents a summary of the forecast overall impact of the above capping/phasing-in policy on total variable charges. It shows the increase in the charges from the last year of CP5 ('close CP5') to the levels that would apply in CP6 if the VUC were not capped or subject to any phasing-in. The impact of capping/phasing-in can then be understood by considering how average charges across the five years of CP6 relate to this 'close CP5' level and how they compare to the charges in the final year of CP6.

**Table 3: Forecast average increase in total variable charges<sup>14</sup> relative to the final year of CP5 for the freight and charter operator sectors**

	Uncapped increase from close CP5 to CP6	Capped increase averaged across CP6	Capped increase from close CP5 to final year of CP6
Freight	26%	4%	10%
Charter	13%	2%	5%

**Note:** 2017-18 prices, constant traffic (2018-19), and uses ORR’s final determination assumptions on efficiency. This provides an approximate indication of changes to average charges, before taking account of the change from RPI to CPI indexation.

67. As a result of the two-year adjustment period, there will initially be two years where total variable charges will increase by only CPI. They will then increase by an average of CPI plus 3.2% and 1.6% per annum over the last three years of CP6 for freight and charter operators, respectively. As noted above, the switch to CPI will reduce increases in annual charges by approximately one percentage point per annum relative to RPI.
68. As explained above, the VUC for capped operators is driven by the transition profile set out for total variable charges. There will be an increase in the VUC above CPI in the first year of CP6 (to offset the removal of the capacity charge and the coal spillage charge). The VUC will then increase by only CPI for one year (to deliver the two-year total variable charges adjustment period) and then increase at a rate above CPI to deliver the above increases in total variable charges.
69. Increases in the VUC for capped operators are set to increase to reflect the full costs of wear-and-tear on the network towards the end of CP7, subject to our review of charges in PR23.
70. There is considerable variation in the changes of the individual vehicle and (for freight) commodity rates around the average figures presented in table 9.1 due to the differing impacts of the PR18 recalibration and the unwinding of CP5 caps. Freight respondents to our June 2018 consultation highlighted the issue of the variability of impacts across freight commodities, both in terms of the rates applied and the impact of this on potential volumes.
71. We have analysed the potential impact of the proposed (draft price list) increases in variable charges in CP6 across the various freight commodity segments. The implied

<sup>14</sup> Including the VUC, EUAC, EC4T and the capacity charge and the coal spillage charge as applicable

impact of the higher charges on traffic in CP6 was calculated based on each commodity segment's elasticity ([MDST, 2012](#)) and compared to the forecast traffic growth for that commodity segment ([MDST, 2017](#)). The proposed increase in total variable charges is not expected to result in a material contraction of any of the freight commodity segments and the phasing-in and capping will prompt higher rail freight volumes than would otherwise occur.

72. The ORR is committed to supporting the growth and development of the rail freight industry, a position that is consistent with that of DfT and Transport Scotland. We have sought to apply considerable flexibility in our approach to variable charges in CP6, supported by earlier stakeholder input into how the legislative requirements could be interpreted. We consider that the PR18 charging policy strikes the right balance between our statutory duties, and provides an approach that supports longer-term stability and predictability in charges for freight operators in CP6 and beyond.

## Next steps

73. Network Rail will publish the final price list<sup>15</sup> reflecting the capping/phasing-in of the VUC (as detailed within this paper) in December 2018.

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<sup>15</sup> The price list will include prices by vehicle and commodity type (for freight).



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