

RDG PR18 working group on route-level regulation, charges & incentives

Note of meeting held on 1 August 2016 at RDG's offices

Attendees: Bill Davidson (RDG) (chair); Nigel Jones (DB Schenker); Martin Bayhnam-Knight (Keolis); Lee Shuttlewood (SWT); Peter Swatridge (Network Rail); Caitlin Scarlett (Network Rail); Jonathan Cooper (Alliance Rail); Chantal Pagram (Go-Ahead); Lindsay Durham (Freightliner); Richard McClean (Arriva); Oliver Mulvey (DfT); Gareth Evans (Welsh Government); Deren Olgun (ORR); Irene Dell'Orto (ORR).

Apologies/not present: Simon Tew (Welsh Government); Russell Evans (First); Mike Hewitson (Transport Focus); Steven Price (ATOC); Maggie Simpson (Rail Freight Group); Steven McMahon (Transport Scotland); Graeme Hampshire (SWT).

Introduction and context

1. The main substantive item on the agenda was the discussion of options for the capacity charge.
2. ORR recognised that the industry had some concerns on the way the capacity charge is currently designed. Among the options ORR was considering for the capacity charge was the option of incorporating the capacity charge into Schedule 8 benchmarks, which RDG and the Schedules 4 & 8 and capacity charge sub-group had been considering.
3. It was noted that the capacity charge was introduced to replace the system of negotiated settlements that existed prior to it and that it reasonably approximates the increased Schedule 8 costs historically associated with adding traffic to the network.
4. However, it was suggested that this mechanism has not worked very well for freight as, it was suggested, it does not recover the incremental costs associated with delay, and a lower payment would have been sufficient.

ORR's approach

5. While the capacity charge was not specifically designed as an incentive mechanism (rather, it was introduced to replace negotiated arrangements), it does have some incentive effects. The group discussed these:

- **Decisions that Network Rail makes about the allocation of capacity;**
 - While it was recognised that the capacity charge does represent extra income to Network Rail from adding traffic, the group agreed that maintaining the level of performance is Network Rail's biggest driver in its decision about whether or not to accommodate extra traffic.
 - It was suggested that Network Rail's capability at trading-off performance and capacity is currently low.
 - It was suggested that the reputational effects might work as an incentive for Network Rail to accommodate more traffic on the network, perhaps more than financial incentives.

 - **Decisions that operators make about the use of capacity**
 - The current capacity charge is not very correlated with congestion – meaning that the incentives on passenger operators to avoid congested areas may be weak.
 - For freight operators, the charge does not provide any incentive to avoid congested areas, because they pay the same rate on all parts of the network.
6. ORR's work aimed to look at whether improvements in these areas could be made. Fully addressing issues in these areas was a long-term project; ORR is looking into what could be done for PR18.

Ideas for improving the charge and wider incentives

7. ORR explained that it had been developing some ideas for how the capacity charge and wider incentives could be improved in order to better deliver the desired outcomes. The following ideas were discussed with the group:
- A. **Adjust other charges:** retain the existing capacity charge and seek to improve incentives through other variable charges and incentives;
 - B. **Fully applied capacity charge:** retain the existing capacity charge but remove the wash-up and, possibly, disaggregate the freight charge in a way similar to the passenger charge;
 - C. **Include in schedule 8 benchmarks:** incorporate capacity charge into schedule 8;
 - D. **Improved volume incentive:** provide Network Rail with additional direct funding to accommodate extra traffic, corresponding to the OMR cost increase;

- E. **“Performance cost” recovery charge:** Recover OMR cost of keeping performance the same when traffic added instead of recovering the schedule 8 costs associated with adding traffic.
8. It was agreed that there were no unambiguously good or straightforward options for solving the issues with the current regime.
 9. It was suggested that Network Rail often overlooks timetabling solutions to accommodating extra capacity even though such solutions would limit the performance impacts of the extra capacity. It was noted that, at present, the charging structure does not provide Network Rail with a means for recovering the costs of such re-timetabling. It was agreed that a better understanding of costs was critical to that sort of work, but that developing that would be a long-term project.
 10. It was suggested that problems related to both Network Rail and operator decision making about use of capacity are unlikely to be solved through charging solutions alone, and that the solution to these problems is likely to be a long-term one.
 11. ORR recognised that any solution to these problems will need to recognise which tools are most effective at incentivising Network Rail and operators, whether they be financial, reputational, or of some other form.

Next steps

12. ORR’s proposed approach was to develop the options and assess each of these against:
 - how well it delivers to the PR18 objectives;
 - wider financial and non-financial impacts on operators and other parties.
13. ORR would engage with the industry during this process and would consider returning to the RDG working group to discuss the options in more detail before the publication of the December 2016 consultation on charges and incentives.
14. ORR noted that all options will be assessed against four different states of the world, to account for how changes to the structure of the industry and wider changes could affect either the effectiveness or the financial impact of any given option. ORR would publish impact assessments of the options as part of its consultation.
15. ORR noted that the December 2016 consultation may include a recommended option or a set of options for consultation. It added that responses to the consultation would be used to inform the final assessment of the options and the decision on which option to pursue.