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Dear Ms Sareen

ORR's high-level review of track access charges for CP5

This letter sets out Network Rail's initial response to the ORR letter of 1 July 2010 and the accompanying release of the CEPA report[1]. We make a number of comments on the short-listed options proposed by CEPA, and outline what we see as the key opportunities for further analysis.

It is clearly important that the Structure of Charges is consistent with the incentive framework for the industry as a whole, and that charges be set in order to best meet specified objectives. We would expect this to be influenced by the conclusions of the Value for Money study, and we anticipate wishing to provide further comments in that context. In particular, as explained below, we are working with a number of operators on how we might develop much stronger and deeper partnerships at a local level. Changes in charging could help facilitate this and we would have major concerns if they inhibited such development.

Comments on the CEPA 'short-list' options

The CEPA report contains a significant amount of information and analysis and provides a useful basis for further work on the appropriate Structure of Charges for CP5. We were involved in a number of discussions with CEPA during the development of its report for which we are grateful. Through this process, as you know, we have already provided a number of specific comments.

[1] CEPA (June 2010) *High level review of track access charges and options for CP5*.

At this stage we would like to make the following high-level points on CEPA’s report:

- The ‘cost benefit sharing’ approach could have merit. To be fully effective, this is likely to require sharing on both sides of out- or under-performance against a target. Importantly in this scenario, the primary accountabilities for the safe and efficient management of the network and the operation of train services should, we consider, remain respectively with the infrastructure manager and the relevant train operators. In addition, there would be a clear need to maintain fair treatment of all operators including freight and open-access passenger operators. However, none of this precludes very different ways of working in close partnership across different parts of the railway and we are embarking on detailed discussions of how we could work differently with a number of operators. If parties were better able to share in the success or failure of others, then this would seem likely to change behaviours in a way that could benefit all parties and also provide improved ‘whole industry’ value-for-money.

- While the ‘long run incremental cost’ option has potentially attractive theoretical incentive properties, it is not clear whether this is a practical option for the industry at this stage given the very high degree of data analysis that would be required for such a charging approach. There is the further question about whether the incentives generated under such an approach would improve industry outcomes for planning and network development as compared to the current approach, which is more administrative in nature. It would appear that considerable expense could be incurred by the industry for limited benefit under this approach.

- It could be useful to examine more regional based options such as the ‘regional short run incremental cost’ approach. While this would introduce greater complexity to the charging system, there may be benefits in terms of better industry information and decision-making. For example, in terms of where government chooses to invest, and/or the design of rolling-stock to optimise outcomes for particular regional characteristics.

- A ‘track occupancy charge’ approach may have merit if complemented by cost benefit sharing but we consider that considerably more work would be needed to better evaluate this proposal. This is an option that appears best suited to a world where the primary focus is on managing scarce capacity. Similar comments apply to the ‘scarcity charge’ approach, where a sophisticated methodology would be required if it were to result in meaningful incentives that improve whole-industry outcomes.

A key challenge will be to identify a methodology to quantify the benefits and costs of the various options, which will be one part of the evidence base needed to inform the decision-making process for CP5.

While we see merit in considering ‘cost benefit sharing’ options it is important that it does not introduce excessive complexity, or cost into the industry. There could also be limits to the benefits of disaggregation, particularly given the high degree of common costs associated with operating, maintaining and renewing the rail network. It is important that system-wide benefits are preserved, and that lessons are learnt from the stations experience where the relatively arbitrary allocation of responsibilities for their maintenance has introduced costly interfaces between Network Rail and train operators.

The purpose of the structure of charges

In addition to the helpful ‘bottom-up’ work undertaken by CEPA to consider how different charging options might work; we consider that there is a need for ‘top-down’ analysis about what outcomes the structure of charges regime should incentivise. In addition, we consider that it is very important that there is an evidence-based and clearly articulated statement as to what problems exist with the current charging regime.

As we stated at ORR’s April industry seminar, we think there are opportunities to further investigate:

- incentives to enhance better co-ordination of franchise and network regulation; and
- options to support greater competition in well-targeted areas such as long-distance inter-city services.

Clearly these and other issues are also being considered as part of the DfT / ORR Value for Money study. We would, therefore, welcome the opportunity to provide further comment to the ORR on the role of the charging mechanisms to further improve industry outcomes, as it becomes clearer what the conclusions of the Value for Money study are.

A further consideration is the ongoing discussions around franchising and strategic timetabling and access-planning. The Structure of Charges will need to be designed to best facilitate any changes to franchise arrangements. For example, longer franchises would require a different approach in relation to track access agreements so as to deliver best use of scarce railway facilities. From a charges point of view there could, therefore, be merit in considering mechanisms to compensate operators for changes to their access rights over time if usage of the railway system leads to sub-optimal whole industry usage. If franchises were to be less ‘tightly’ specified, then greater reliance may need to be placed on the Structure of Charges to incentivise optimal whole-industry decision-making. There are also inter-relationships with the potential extension of ORR’s role in relation to franchisees.

Accelerated review of freight access charges

The possibility of an 'accelerated' review of freight charges was discussed at some length during the ORR workshop in April this year. It appeared to us that there was considerable industry agreement on the merits of such a review. The logic for considering this being the extent to which rail freight operates in a highly competitive market dominated by road haulage, where road hauliers have much simpler arrangements for access to the GB road network. Notwithstanding the uncertainty surrounding industry direction due to the Value for Money study, there appears to be merit in further consideration of an accelerated review of freight rail charging in order to deliver certainty to freight operators and their customers. Such certainty would be of benefit in terms of their ability to enter longer-term contracts (in keeping with road-based competitors), underpinning investment in long-lived freight assets, and providing stability to encourage new entrants.

Realistically, however, an accelerated review could only be based on a 'roll-over' of current charging arrangements. This could still provide an opportunity to address relevant issues including the scope to simplify the number of charges, definition of incremental costs, and the associated level of network capability. Although freight charges make a relatively small but important contribution (c. £50m p.a.) to financing the GB rail sector, it would be important to consider whether the conclusions from the VfM review are broadly consistent with such an approach.

We are content for this letter to be published by the ORR in its entirety. Please do not hesitate to contact me should have you have any queries or wish to discuss these issues in greater detail. We look forward to working with you and your colleagues on these and other issues for CP5, over the coming months.

Yours sincerely

Peter Swattridge
Head of Regulatory Economics