



# URBAN TRANSPORT GROUP

*confidential*

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Consultation response

## **Network Charges – a consultation on how charges can improve efficiency**

Office of Rail and Road

**March 2016**

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<Click here to enter Contact Name>

### **Urban Transport Group**

Wellington House  
40-50 Wellington Street  
Leeds – LS1 2DE  
0113 251 7445  
info@urbantransportgroup.org



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## 1. Introduction

- 1.1. The Urban Transport Group (UTG) represents the seven largest city region strategic transport bodies<sup>1</sup> in England, which, between them, serve over twenty million people in Greater Manchester, London, the Liverpool City Region, the North East Combined Authority area, South Yorkshire, the West Midlands conurbation and West Yorkshire. Nottingham City Council, the West of England Partnership and Strathclyde Partnership for Transport (SPT) are associate members of the UTG. Our members plan, procure, provide and promote public transport in some of Britain's largest city regions, with the aim of delivering integrated public transport networks accessible to all.
- 1.2. We welcome the opportunity to respond to the Office of Road and Rail's consultation on Network Charges.

## 2. Chapter 1 - Introduction

### 1. How much does Network Rail's structure of charges matter today?

- 2.1. Rail infrastructure charges have the potential to convey signals about the cost of operational and investment decisions. In a complex and fragmented industry, with a degree of decentralised decision making, these signals can be potentially useful in coordinating the behaviour of train operating companies, infrastructure managers, rolling stock providers and public sector funders and specifiers, with the ultimate aim of achieving a more efficient outcome.
- 2.2. However, we feel that perhaps too much confidence is placed by the regulator on the charging framework given (a) practical limitations in developing a system that is at the same time accurate, well understood and manageable; and (b) the high degree of coordination that is required in order to operate and develop the rail network in a safe and efficient way. This explains why the industry has devised a number of alternative coordination mechanisms, which, in practice, play a more important and direct role over the decisions of industry stakeholders. These mechanisms include, for example, regulatory targets, industry working groups, market studies as well as government strategies and plans.
- 2.3. Although the effect of the charging framework can be observed in some parts of the industry, we believe that this is modest, and not always in the direction intended. While we support the ORR in seeking to continuously improve the charging framework we would argue that more attention needs to be paid by the regulator to the role of other coordination mechanisms and to the wider policy objectives which the rail network is aiming to achieve.

### 2. What issues could a new structure address?

- 2.4. We have previously argued that the ORR should undertake a cost-benefit analysis of individual charges and only continue with those charges that show a positive balance. Whilst we accept that there are benefits from maintaining a stable regulatory framework, we believe

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<sup>1</sup> With the exception of Transport for London, these bodies were formally known as Passenger Transport Executives (PTEs) and the UTG was previously known as the Passenger Transport Executive Group (*pteg*). In recent years, some PTEs have been abolished with their functions transferred onto successor bodies, such as Combined Authorities. The new name for our group reflects these changes.



that an exercise of this nature would be worthwhile as it would potentially strengthen the legitimacy of the charging framework and help to identify those areas most in need of improvement.

- 2.5. As part of such a process, we feel that it is also important to reflect on what the charging framework is trying to achieve more generally and whether there are alternative systems which could be more effective, including through grant funding, franchise specification and the strategic planning process.
- 2.6. Focussing on the existing framework, our priority areas for improvement are the Fixed Track Access Charge and the Capacity Charge. We have consistently argued throughout PR13 that, if they are to remain relevant, then both charges need to become more cost reflective, both in terms of spatial, temporal granularity and operational context. At the same time, there is a cost involved in achieving this aim and it is important to understand whether this is proportional to the potential benefits before embarking on a more detailed work programme.
- 2.7. One new area that we feel could be more closely examined in the context of both these charges is the role of track usage at stations (e.g.: dwell time, platform length requirements) as stations can be critical infrastructure bottlenecks. In the case of the FTAC, we would also suggest that consideration is given to the role of quality of service (e.g.: operating speed) in allocating infrastructure costs.
- 2.8. In parallel with potential improvements in the accuracy of track charges, we feel it is critical to develop a better way to account for the full socio-economic benefits of different types of service as part of regulatory and strategic planning processes. Track access charges tend to reinforce the industry's focus on financial flows and this is very significant concern our members have with the current system.

### **3. Can you provide examples of behaviours that would change within your organisation or elsewhere in the rail industry with an improved structure of charges?**

- 2.9. An improved understanding of infrastructure cost drivers could lead to more effective prioritisation of infrastructure investment and service specification decisions. Greater transparency over infrastructure costs could also help us to hold Network Rail to account, which we hope would lead to better control of infrastructure development costs. In the long term, this would also enable our members and other third parties to more confidently take on greater responsibility over infrastructure, which could potentially help in funding, financing and getting more value out of existing assets.
- 2.10. In the case of under-utilised parts of the network, more cost reflective charges could potentially lead to higher service levels as train operators and public sector sponsors are asked to pay charges closer to the (lower) marginal cost which they actually incur. On the other hand, higher charges on more congested parts of the network would have the opposite effect. Whilst we acknowledge the ORR's point that this could act as a signal to Network Rail and funders regarding the need for further capacity, we are not convinced that it would necessarily act as an effective incentive on its own, as Network Rail could simply decide to maintain capacity constraints so as to maximise profit on those parts of the network.



- 2.11. At the same time, higher charges on more congested parts of the network need to be accompanied by a better understanding of the wider socio-economic benefits of individual services. This is particularly important for city region commuter networks, which often require high capacity at peak times but whose passengers have comparatively low willingness to pay. The rationale for investment in those services hinges, to a large extent, on the benefits to non-users (largely through reductions in road congestion) and the improvements in productivity due to the agglomeration economies that result from higher concentration of jobs around rail stations<sup>2</sup>.

### 3. Chapter 2 – Background and approach

#### 4. Are the high-level gaps (in Figure 4) a good starting point for developing solutions? Would you have expected to see any other high-level gaps and, if so, what are they?

- 3.1. We agree that cost reflectivity and complexity, as identified in the ORR consultation document, are a good starting point for further work. However, we note that the consultation document seems to confuse complexity and certainty. We would argue that both are important aspects to consider as part of a review of charges.
- 3.2. We accept that the existing charging structure fails to provide “*specific and strong incentives for the efficient provision and use of network capacity*”. However, it is important to recognise that the complex nature of the UK rail network also means that capacity allocation in particular requires coordination and prioritisation mechanisms that go beyond track access charges (see response to question 1).
- 3.3. We feel that the complexity of the UK rail network also makes it difficult for direct or on-track competition to play out as it might do in more conventional markets. As we argue in our response to the recent Competition and Markets Authority consultation on rail competition, there are also additional reasons why on-track competition may be undesirable.
- 3.4. Track access charges are of little consequence to competition for the market (franchising).
- 3.5. Our view is therefore that the high-level gaps relating to capacity and competition are of lesser value to the development of structure of charges relative to cost-reflectivity and complexity.

#### 5. Do the assessment criteria accurately reflect the main factors we should consider for assessing the impact of options?

- 3.6. In addition to the assessment criteria identified by the ORR, we suggest that more explicit consideration be given to the financial cost of operating the regulatory system for all stakeholders involved. Could there be simpler and less costly ways of achieving the same objectives? This would point in the direction of a cost-benefit analysis of alternative regulatory/charging options.

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<sup>2</sup> See, for example, [www.transportworks.org](http://www.transportworks.org).



**6. To what extent does the use of scenarios, in the form of the RDG ‘states of the world’, help to understand the likely effectiveness of future charging structures?**

- 3.7. Scenarios are a potentially helpful mechanism to understand the impact of changes to the structure of charges. We would find more worked examples particularly useful.

**4. Chapter 3 – Options and proposal**

**7. To what extent do the packages of options represent the key strategic choices available to improve the existing charging structure?**

- 4.1. The packages of options considered miss out the possibility of a significant simplification of the structure of charges, which we feel would provide a useful benchmark to test other options against.

**8. Would you expect the infrastructure costs package to deliver more (or fewer) benefits than the value-based capacity package at this stage and, if so, why?**

- 4.2. We agree with the ORR’s assessment that the infrastructure costs package would deliver more benefits than the value-based capacity package at this stage.
- 4.3. In fact, it is not clear to us what the net impact of the proposed value-based package would be. One view is that it would help Network Rail in extracting consumer surplus from users of the infrastructure, which seems to go against the main purpose of regulation.
- 4.4. On the other hand, we entirely support the proposal to move from a narrow focus on financial value to a broader consideration of the economic value of rail services and infrastructure, though this is not something that we see needs to be translated into access charges (value is different to cost).

**5. Chapter 4 - Infrastructure costs package**

**9. We would welcome your views on our proposal to prioritise further development of the infrastructure costs package.**

- 5.1. We welcome the ORR’s recognition that FTACs do not operate at a sufficiently disaggregate level, be it in terms of quality of service/service type, geography or time of day/day of week. This distorts the information available to decision makers, both in terms of infrastructure investment and franchise specifications. We have argued for a move towards long run avoidable costs as part of PR13 and we feel that this is now long overdue.
- 5.2. The ORR’s consultation document provides a concise yet accurate description of key cost allocation issues. However, we would like to raise a couple more detailed points:
- Quality of service. The ability to run faster or heavier trains can have a very substantial impact on infrastructure costs (e.g.: the need for cuttings/embankments/tunnels/viaducts and for higher strength structures, which may also need to be monitored more frequently) and should therefore be taken into consideration when determining avoidable costs.
  - Station capacity. Track/platform capacity at stations can be the most critical capacity bottleneck and should be treated explicitly.



- 5.3. Finally, we would point out that virtually all costs can be thought of as avoidable given a sufficiently long time frame. This point should be recognised from the outset as it can lead to a more flexible and robust framework for tackling the problem.

**10. What costs and benefits do you see with the infrastructure costs package? Do you think our draft impact assessment is missing any significant impacts or has misrepresented any impacts?**

- 5.4. We broadly agree with the ORR's assessment of costs and benefits from this package.
- 5.5. We particularly welcome the discussion on potential challenges and the fact that the ORR is thinking about transitional arrangements from the outset. The impact of changes on funders outside central government (including our members) would require careful consideration and mitigation.

**11. To what extent do you think the benefits of this package can be realised through more information, rather than through the use of charges?**

- 5.6. Views on this question vary between our members.

**6. Chapter 5 - Value-based capacity package**

**12. We would welcome your views on our proposal not to prioritise further development of charging options based on the value of capacity.**

- 6.1. We agree with the ORR's proposal not to prioritise this further.
- 6.2. In one sense, this proposal seems to amount to an enabler of monopolistic pricing by Network Rail, who would more easily be able to extract consumer surplus from users of the infrastructure.
- 6.3. At the same time, we strongly support the proposal to move from a narrow focus on financial value to a broader consideration of the economic value of rail services and infrastructure, though this is not something that we see needs to be translated into access charges (value is different to costs). More generally, we feel that the wider socio-economic value of urban and regional rail networks (and not just of individual services) should be considered much more fully and explicitly as part of the capacity allocation process.

**13. What costs and benefits do you see with the value-based capacity package? Do you think our draft impact assessment is missing any significant impacts, or has misrepresented any impacts?**

- 6.4. We agree with ORR's assessment of positive impacts from better information but disagree with its assessment of positive impacts that would result from translating this into charges (see our previous comments on monopolistic pricing).





**14. Would you expect a better understanding of costs to be an essential precursor to value-based charges?**

- 6.5. Yes, as they are likely to be correlated. Better quality of service will command higher prices but will also require more costly infrastructure.

**15. To what extent do you think the benefits of this package can be realised through more information alone, without passing that into charges?**

- 6.6. Information alone offers greater benefits than charges – see our previous point on monopolistic pricing and wider industry decision making processes.

**7. Chapter 6 - Package of improvements to short-run variable charges**

**16. What options would you expect to see in a long list of improvements to Network Rail's short-run variable charges?**

- 7.1. We would like the ORR to consider the option to scrap REBS and the volume incentive as they currently stand.

**17. What options do you see as a priority for this package?**

- 7.2. The Capacity Charge. Unless it can be made more cost reflective, we feel that it can do more harm than good. At its worst, the Capacity Charge is an expensive process that acts to deter economically beneficial services. This is evident, for example, in the fact that services within the same group are charged the same regardless of whether they run at 8.30pm into a city centre station or at 10pm into a suburban terminus.
- 7.3. We would also like to see on-going improvement to the possessions and performance regime, so as to avoid windfall gains to any one stakeholder, circular financial flows with little or no incentive power, and excess complexity. We would also like to see the system reformed so as to ensure sure passengers receive any compensation element which they are due, though we note steps are being taken by the industry in this respect already.

**18. What costs and benefits do you see with this package?**

- 7.4. This package involves a trade-off between greater cost and complexity, on the one hand, and the potential for introducing more effective incentives. It is not clear to what extent more effective incentives can actually be achieved in practice.



## 8. Chapter 7 - Supporting packages

### 19. We would welcome comments on:

- a) whether open access operators should face charges implemented under the infrastructure costs package;
- b) what forms of adjustments to charges might be appropriate for open access operators, relative to franchised operators; and
- c) how current incumbent open access operators should be treated.

- 8.1. As a point of principle, we feel that the structure of charges should provide a level playing field between open access and franchised train operators. There is a perception that the current system facilitates cream-skimming and other types of opportunistic behaviour by open access operators, with franchised operators and sponsors left to pick up the pieces. In practice, this tends to mean a revenue shortfall for franchised operators and sponsors of a similar magnitude to the additional fare-box revenue to open access operators.
- 8.2. Paragraph 164 of the ORR's consultation documents makes an interesting distinction between parts of the network where capacity may be plentiful and scarce, suggesting that open access operators should be exempt from fixed track access charges in the former case. Going back to first economic principles, this is an argument for charging both franchised and open access operators short run marginal costs where there is spare capacity, rather than an argument for treating the two types of operation differently. We would argue that whether a given train service ends up being operated as a franchised or open access service is largely arbitrary and there is therefore little rationale in a charging system that treats the two types of service differently.
- 8.3. Ultimately, we see this issue as a largely political decision on who to apply a mark-up to in order to recover a given proportion of infrastructure costs.
- 8.4. We note the ORR's reference to a High Court decision on this issue. It is important to point out that this is a ruling in response to a complaint over state aid (i.e., a complaint by a franchised train operator, not an open access operator), not the economics of infrastructure pricing. It is also worth noting that it is largely the ORR which has set the legal and economic framework against which the High Court decision was made.

### 20. Would you like to see either of the complexity options developed further?

- 8.5. The two ORR proposals for a charges calculator and a complexity test seem fine. Both should make the system easier to use. However, we are concerned by the lack of an explicit goal to reduce complexity or to consider both the costs and benefits of a given charging framework.

### 21. Are there other options you would like assessed to reduce complexity?

- 8.6. Yes, see previous paragraph.



**22. What costs and benefits would you expect with these options?**

8.7. We have no comments on this question.

**9. Chapter 8 - Implementation of the structure of charges**

**23. In chapter 8, we started to highlight issues associated with implementation of a new charging structure and potential actions to alleviate negative impacts. Do you have any views on options for implementing a new structure and what would be the impacts of these options?**

- 9.1. It is critical that funders outside central government are compensated for the impact of changes to the charging structure. Grant funding should be adjusted in the short term to compensate such funders and/or operators for any increased fixed charges they face, giving time for the organisations affected to adjust to the change, and also to use the disaggregated cost data to commence a dialogue with Network Rail to enable greater efficiency in future.
- 9.2. Funders outside central government and operators should be given a greater formal role in setting future access charges that affect them if they are required to take direct responsibility for a greater proportion of the funding supplied to the rail industry.

**24. We understand the structure of charges has the potential to impact different groups in different ways. In developing the options in this consultation (particularly in the draft impact assessments), have we drawn out the implications for different groups? Please explain your response.**

- 9.3. Not in great detail, but that seems sufficient at this relatively early stage. We would expect to see more work, possibly worked examples, on the impact on individual franchises and sponsors, in particular outside central government.