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**To: list of recipients in Annex B**

The consultation is open to all

Dear colleagues,

**PR13: Our draft conclusions on structure of charges and Schedule 8 performance regime for charter operators**

This letter forms part of our periodic review (PR13) draft determination<sup>1</sup> and sets out our draft conclusions in relation to charter operators in CP5.

Our key conclusions are:

- We will introduce benchmarks for the charter Schedule 8 regime calibrated on the basis of all delay minutes. We will introduce a menu of incident caps and access charge supplements (ACS) options, which will deliver financial neutrality of the regime if performance benchmarks are met.
- We broadly accept Network Rail's conclusions on structure of charges, though we are still considering practicalities of implementing EC4T, which we will set out in our consultation on implementing the changes to charter.
- We will bring charter services into line with other services with respect to levying a capacity charge.
- On average, our analysis shows that the package we plan to introduce will result in charter operators being marginally better off financially than they have been in CP4.

Our consultation is set out in Annex A to this letter. We are publishing this letter and consultation on our website.

**Responses to this document**

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<sup>1</sup> Periodic Review 2013: Draft determination of Network Rail's outputs and funding for 2014-19, June 2012. This can be found at: <http://www.rail-reg.gov.uk/pr13/PDF/pr13-draft-determination.pdf>

We welcome responses on any aspect of this consultation letter.

This is a four week consultation. Please send your responses in electronic format (or if not possible, in hard-copy format) by **20 September 2013** to:

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If you send a written response, you should indicate clearly if you wish all or part of your response to remain confidential to ORR. Otherwise, we would expect to make it available on our website and potentially to quote from it. Where your response is made in confidence please can you provide a statement summarising it, excluding the confidential information, which can be treated as a non-confidential response. We may also publish the names of respondents in future documents or on our website, unless you indicate that you wish your name to be withheld.

We will publish our final determination, including that with respect to charter operators, on 31 October 2013.

Yours faithfully

A handwritten signature in black ink, appearing to read 'Cathryn Ross', with a stylized flourish at the end.

**Cathryn Ross**

# Annex A: Draft conclusions on structure of charges and performance regime for charter operators

## Key messages on our draft conclusions, for consultation

- We will introduce benchmarks for the charter Schedule 8 regime calibrated on the basis of all delay minutes. We will introduce a menu of incident caps and access charge supplements (ACS) options, which will deliver financial neutrality of the regime if performance benchmarks are met.
- We broadly accept Network Rail's conclusions on structure of charges<sup>1</sup>, though we are still considering practicalities of implementing EC4T, which we will set out in our consultation on implementing the changes to charter.
- We will bring charter services into line with other services with respect to levying a capacity charge.
- On average, our analysis shows that the package we plan to introduce will result in charter operators being marginally better off financially than they have been in CP4.

## Introduction

1. This is a consultation on the structure of charges and performance regime for charter operators in CP5. It forms part of our periodic review (PR13) of Network Rail<sup>2</sup>. It sets out our draft conclusions in relation to charter operators in CP5.

<sup>1</sup> Network Rail's conclusions document can be accessed at:  
<http://www.networkrail.co.uk/WorkArea/DownloadAsset.aspx?id=30064787226>.

<sup>2</sup> PR13 will establish Network Rail's outputs and access charges for control period 5 (CP5), which will run from 1 April 2014 to 31 March 2019. PR13 also involves establishing the wider regulatory financial and incentive framework for CP5 that applies to Network Rail and train operators.

2. Charter services generally consist of excursion trains or privately hired trains, which do not carry passengers at ordinary fares and that operate on a bespoke basis. The structure of charges for these operators is consistent with that for other operators, but takes account of the scale of charter operations. This ensures that the administrative burden associated with billing track access charges is not disproportionate. These charges are set out in the model charter passenger Track Access Agreement<sup>3</sup>.
3. In 2013, five train operators holding charter passenger Track Access Agreements operate charter services: DB Schenker, West Coast Railway Company, Direct Rail Services, GB Railfreight and First Great Western.
4. Charter services run approximately 410,000 train miles per year on Network Rail infrastructure. That represents less than 0.2% of total passenger (franchised and open access) mileage. Network Rail's income from these operators in 2012-13 was approximately £1m.
5. The rest of this consultation is structured as follows:
  - a) Process for determining charges and the performance regime for charter operators in CP5;
  - b) Charges in CP4;
  - c) Draft conclusions on:
    - i. variable usage charge (VUC);
    - ii. traction electricity charge (EC4T);
    - iii. electrification asset usage charge (EAUC);
    - iv. Schedule 4;
    - v. slot and cancellation charges; and
    - vi. station charges;
  - d) Draft conclusions on Schedule 8;
  - e) Draft conclusions on the capacity charge;
  - f) Overall financial impact on charter operators; and
  - g) Next steps.

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<sup>3</sup> This charter train model contract can be found here: <http://www.rail-reg.gov.uk/upload/pdf/model-charter-contract-2011-12-06.pdf>

6. All values in this consultation are in 2012-13 prices unless otherwise stated. In addition, costs and charges for CP5 are presented at end of CP5 levels of efficiency (which is the basis on which charges for CP5 will be levied) unless otherwise stated.

## PR13 process for charter operators

7. We are responsible for developing the charging framework including consulting on changes to charging policy. Network Rail is responsible for calculating all existing track access charges, including charges for charter operators, in accordance with the charging objectives and general guidance that we specify. As part of this, it consults on its charging proposals and then concludes on them. We review all Network Rail's charging proposals and conclusions.
8. Table 1 shows milestones in PR13 of particular relevance to charter operators.

**Table 1: PR13 process specific to charter operators**

Date	Description
26 November 2012	ORR consultation on Schedules 4 & 8 – consulted on updating the charter Schedule 8 payment rate and removing the requirement for NR to provide charter operators incident cap
28 May 2013	Network Rail published a consultation letter, setting out its proposals for changes to the charging arrangements outlined above. The consultation period ended on 11 July 2013
12 June 2013	We published our draft determination – set out our intention to introduce a charter capacity charge, and also to introduce benchmarks in Schedule 8 while retaining the free incident cap
24 June 2013	We hosted a workshop with charter operators and NR to discuss the PR13 proposals
1 August 2013	Network Rail published its conclusions on its 28 May consultation
8 August 2013	We hosted a follow-up workshop with charter operators and Network Rail to discuss NR's conclusions, the capacity charge and Schedule 8
23 August 2013	We published our draft conclusions for charter operator (this document)
20 September 2013	Deadline for responses to our draft conclusions on changes for charter operators
mid September 2013	We consult on implementing PR13 through the charter Track Access Agreements
31 October 2013	We publish our final determination, including for charter operators setting out our final decisions on policy issues, expenditure and outputs for CP5

## Charges for charter services in CP4

9. This section will cover the following charges:
  - a) variable usage charge (VUC);
  - b) traction electricity charge (otherwise known as the electric current for traction charge (EC4T));
  - c) electrification asset usage charge (EAUC);
  - d) slot and cancellation charges; and
  - e) Schedule 4
10. We will not be discussing the capacity charge or Schedule 8 in this section. We will discuss these in separate sections later.
11. The VUC is designed to recover Network Rail's operating, maintenance and renewal costs which vary with traffic. Unlike other passenger and freight operators, who were charged on a "per vehicle" basis, in CP4 charter operators were charged on a "per train" basis in order to reduce the administrative complexity of the charge.
12. In CP4, there were effectively three VUC rates that applied to charter operators. The first was based on the notional "average" non-steam-hauled train and the second on the notional "average" steam-hauled charter trains. These were consistent with other VUCs, but reflected a typical charter train. This simplification was intended to reduce administrative burden.
13. The third VUC rate applied to "light locomotive movements". These were defined as the movement of a single locomotive, or two coupled together, before working, or after having worked a relevant service. In CP4, light locomotive movements were technically charged a rate of zero. If a locomotive carried one support coach however, they were charged at the rate of the full notional "average" train.
14. EC4T charges are used to recover the costs of electricity supplied by Network Rail to train operators. In practice, only around 1% of total charter traffic mileage is run with electric trains.
15. In CP4, the charter model contract has included charges for EC4T on the basis of modelled rates and, as with freight services, an indexed electricity price. Unlike passenger and freight

services, it has not included provisions for a year-end volume reconciliation. However, Network Rail did not actually invoice the charge to charter operators previously. It explained in its May 2013 consultation that historically, 'it was deemed too administratively inefficient to put in place a robust process to charge operators for their EC4T, this is because charter operators typically operate only around 4,000 electric train miles, which represents just 1% of their total mileage (which is very small)'.

16. The EAUC is designed to recover the variable maintenance and renewal costs associated with electrification assets. Similarly to EC4T charges, the charter model contract in CP4 includes provisions to bill the EAUC although Network Rail has deemed it to be administratively inefficient to levy the EAUC on charter operators.
17. Slot charges contribute towards Network Rail's costs for overheads in administering its charter business, for which it is not otherwise funded. During CP4, this normally involved issuing a Special Traffic Notice and the routine administration of calculating the access costs, invoicing and providing advice during the planning stages. It also included assessing the gauge clearances along the line of route, the capability of underline structures, and the practicality of locations that were identified for locomotive en-route servicing.
18. Cancellation charges were designed to compensate Network Rail or the train operator for abortive work when a planned service is cancelled. In the event of a cancellation, the party cancelling the service would pay a cancellation charge to the other. This has been calculated as a proportion of the slot charge that would have been paid in relation to that service. It is discounted depending on how many days before the planned service the cancellation occurs.
19. Schedule 4 of the passenger and freight track access agreement sets out the arrangements for compensation paid to operators when Network Rail takes possession of the network. Currently Schedule 4 provisions are typically not included in charter operators' contracts (with the exception of provisions for service variations) because Network Rail has considered that engineering possession plans are typically agreed before the majority of charter services are planned and offered.

## **Draft conclusions on structure of charges and Schedule 4**

20. On 28 May 2013, Network Rail published a consultation setting out its proposals for changes to charter operators' structure of charges and performance regime<sup>4</sup>. This consultation closed

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<sup>4</sup> Network Rail consultation letter of 28 May on structure of charges for charter operators in CP5, <http://www.networkrail.co.uk/WorkArea/DownloadAsset.aspx?id=30064786015>

on 11 July and Network Rail set out its conclusions on 1 August 2013<sup>5</sup>. After outlining Network Rail's main conclusions, we set out our draft conclusions below.

## Variable Usage Charge (VUC)

### Network Rail's conclusions

21. Network Rail concluded on three main changes for calculating the VUC in CP5 compared with CP4. These are:
- a) updating the rate for all charter coaches, consistent with its consultation proposal (see Network Rail's August conclusion letter for further details);
  - b) significantly amending the methodology for calculating the charge rate for a steam locomotive; and
  - c) estimating a VUC for a light locomotive movement that is consistent with other charter journeys.
22. Steam locomotive rates in CP4 were calculated by applying a 50% uplift factor to the charter non-steam locomotive rate. In Network Rail's May consultation, rather than using this 50% uplift factor, it proposed setting the charge to be consistent with the average of relevant published steam locomotive rates<sup>6</sup>: Network Rail, at the time, considered this to be more cost reflective than the 50% uplift applied historically. Table 2 shows that this would have had the effect of increasing the charge that would have been applied to steam-hauled charter trains.
23. Network Rail concluded that to calculate the steam locomotive charge, it would use an average of published steam locomotive rates as proposed in its May consultation. However, following responses from the consultation and based on information obtained from Total Operations Processing System (TOPS) and its own engineering judgement, Network Rail's August conclusions updated certain assumptions regarding these vehicle characteristics<sup>7</sup>: Network Rail considers this to have the effect of making the charges more cost reflective. The new assumptions also have the effect of significantly reducing the VUC rate to be applied to steam-hauled charter trains. The rates that Network Rail has concluded upon are shown in the final column of Table 2. Coincidentally, the rates for steam- and non-steam-hauled trains are the same under this methodology.

<sup>5</sup> Network Rail conclusions letter of 1 August on structure of charges for charter operators in CP5, <http://www.networkrail.co.uk/WorkArea/DownloadAsset.aspx?id=30064787226>

<sup>6</sup> Specifically, Network Rail calculated this new rate for steam locomotives using an average of class 98/5 and 98/8 steam locomotives with a 2:1 weighting in favour of the class 98/8.

<sup>7</sup> Specifically, it made an additional refinement for Class 98/5 amending the characteristics from 4 to 6 axles and for Class 98/5 from 4 to 7 axles, with an increase in the vehicle weight from 142 tonnes to 150 tonnes.



**Table 2: Charter VUC (£ per train mile)**

Service type	CP4	NR May 2013 consultation	NR August 2013 conclusions
Loaded train or ECS train hauled by diesel or electric equipment or consisting of EMU or DMU	1.21	1.20	1.05
Loaded train or ECS train hauled by steam driven equipment	1.45	1.52	1.05

Source: Table 1 from Network Rail consultation letter of 28 May on structure of charges for charter operators in CP5, <http://www.networkrail.co.uk/WorkArea/DownloadAsset.aspx?id=30064786015>

24. In CP4, the VUC for light locomotive movements was zero. Network Rail concluded that for CP5, light locomotives movements should be charged consistently with other charter journeys. In light of consultation responses it received, it concluded that the steam light locomotive charge be calculated on the basis of transporting a single Mark 1 coach. Table 3 shows the rates on which Network Rail concluded on for light locomotive movements.

**Table 3: Charter VUC for light locomotive movements (£ per train mile)**

Service type	VUC (£/train mile) CP4	VUC (£/train mile) NR August 2013 conclusions
Light locomotive movements (non-steam)	0.63	0.56
Light locomotive movements (steam)	0.95	0.60

Source: Table 3 from Network Rail consultation letter of 28 May on structure of charges for charter operators in CP5, <http://www.networkrail.co.uk/WorkArea/DownloadAsset.aspx?id=30064786015>

### Our draft conclusions

25. We accept Network Rail's conclusions on charges for light locomotive movements and the updated rate for all charter coaches as we agree that these amendments will make these charges more cost reflective.
26. We have reviewed the changes Network Rail has made since its consultation concerning vehicle characteristics of steam locomotives. We are content that the values it has used are broadly appropriate with respect to axle load and weight distribution and also with respect to dynamic forces. Although there is considerable uncertainty around the modelling used to measure the track damage from the curving characteristics, we recognise that further research into this for PR13 would be disproportionately costly given this limited traffic flow. We are content that the refinements in the estimation of VUC which Network Rail has made are an improvement in terms of reflecting the costs that charter trains impose on the network.

## Electrification current for traction (EC4T)

### Network Rail's conclusions

27. Network Rail concluded that notwithstanding the very small scale of electric charter traffic, charter services should be charged for EC4T on a consistent basis with other services.
28. Network Rail noted that the CP4 charter model Track Access Agreement allowed for the recovery of EC4T charges, even though Network Rail had not billed such services in CP4. The CP4 methodology for charter services differed from those for non-charter passenger operators. It did not include charter services in the annual volume reconciliation. And it charged for electricity based on an index rather than market rates (in CP4, this was the case for freight services also). For CP5, Network Rail proposed to align charter charges with those of other passenger and freight services. Subject to a sufficiently practical billing mechanism, the new arrangement would include:
- a) the billing of charter services based on metered or modelled rates;
  - b) using actual unit electricity rates paid by Network Rail, instead of indexed rates; and
  - c) incorporating charter operators in the volume reconciliation.

### Our draft conclusions

29. We think that it is appropriate that charter operators pay a unit rate for electricity (£ per kWh) that is cost reflective. This is best achieved with market rates (with opportunities for operators to fix future prices through procurement contracts). This brings the basis on which electricity is charged into line with other fuel, in particular diesel (which operators do not procure via Network Rail). And it brings charter services into line with other passenger services. We are implementing an equivalent change for freight services as part of PR13.
30. In principle, we agree that charter services should be included in the volume reconciliation and cost reconciliation. To do so achieves greater cost reflectivity. But we are concerned as to the administrative complexity that it may entail. In particular, it may require that charter operators' contracts incorporate the Traction Electricity Rules (in CP4 the EC4T Metering Rules). And it may entail disproportionate changes to Network Rail's billing system. We will work with Network Rail and charter operators to resolve this issue through our consultation on implementing changes to charter contracts. We will publish this consultation in September 2013.

## Electrification asset usage charge (EAUC)

### Network Rail's conclusions

31. For CP5, Network Rail concluded that it would charge the EAUC for charter services at the same rates as that which applied to other passenger services. The charges are set out in Table 4.

**Table 4: EAUC rates from Network Rail's conclusions**

	Passenger	
	DC (third rail) pence per electrified vehicle mile	AC (OLE) pence per electrified vehicle mile
CP5	0.72	1.62

Source: Table 4 from Network Rail consultation letter of 28 May on structure of charges for charter operators in CP5, <http://www.networkrail.co.uk/WorkArea/DownloadAsset.aspx?id=30064786015>

### Our draft conclusions

32. We confirm that we are content with Network Rail's conclusions on the EAUC as they bring charter operators into line with other operators. They improve cost reflectivity and allow direct costs that charter operators impose on Network Rail to be recovered.

## The possessions regime (Schedule 4)

### Network Rail's conclusions

33. Under the CP4 contract, Schedule 4 provisions are typically not included in charter operators' contracts (with the exception of provisions for service variations).

34. Network Rail has concluded that charter operators should remain exempt from Schedule 4, on the basis that engineering possession plans are typically agreed before the majority of charter services are planned and offered. Network Rail has also noted that if Schedule 4 were to be introduced for charter operators, it would request that the arrangement should be funded, for example by means of an Access Charge Supplement.

### Our draft conclusions

35. We note that in response to Network Rail's consultation, charter stakeholders were broadly content with Schedule 4 not being in the contract. We confirm that we are content with Network Rail's conclusions to continue to have no Schedule 4 for charter operators. This is because Network Rail's assumption that the majority of planned possessions are agreed before charter services are arranged is broadly reasonable so introducing a Schedule 4 is unnecessary.

## Slot and cancellation charges

### Network Rail's conclusion

36. Network Rail also concluded on slot and cancellation charges for CP5. After reviewing the current arrangements, Network Rail concluded that the level of charges remain broadly cost reflective so it concluded to retain the current structure and levels of charges, adjusted annually for RPI.

### Our draft conclusions

37. We confirm we are content with Network Rail's proposals with respect to slot and cancellation charges. We acknowledge that a recalibration of these charges might have improved their cost reflectivity. Given the revenue associated with the charges, however, it would not necessarily be proportionate to do this.

## Station charges

### Network Rail's conclusion

38. The station charges on which Network Rail consulted were those that charter operators have to pay to access one of Network Rail's 17 Managed Stations. Whilst acknowledging that station charges do not form part of the Track Access Agreement, Network Rail set out its position on station charges in its May consultation and August conclusion papers.

39. Network Rail concluded that it would continue with current charging arrangements at managed stations. It saw merit in further considering an operator's suggestion to publish a tariff of standard charter operator charges for commonly requested services during CP5. It proposed discussing this further with operators during CP5.

### Our draft conclusions

40. Station charges paid to Network Rail by charter operators at managed stations are typically negotiated on a case-by-case basis. We do not approve them as part of PR13 (though they are included in our assessment of Network Rail's single till income). Hence we are not concluding with respect to these charges.

41. We think that Network Rail's consultation on these charges and the responses it received were useful, however. They can be used to inform future policy development in this area, including possible publication of standard Network Rail station tariffs.

## Performance regime (Schedule 8)

## Schedule 8 in CP4

42. The performance regime, Schedule 8 of the Track Access Agreement, compensates train operators for unplanned service disruption caused by Network Rail and/or other train operators. In CP4, charter operators were subject to different performance arrangements to other passenger operators, reflecting the fact that charter services (generally trains used for leisure purposes) do not carry passengers at ordinary fares and the revenue implications of disruption are complex.
43. Like freight, the Schedule 8 regime for charter operators has been a standardised regime. Payment rates have been common across all charter operators, and the Network Rail payment rate has been the same as the Network Rail payment rate for freight operators.
44. There are also no benchmarks within the CP4 charter operator Schedule 8 regime. Under this regime charter operators make compensation payments in respect of all delays they cause to other operators of three or more minutes; Network Rail compensates charter operators for all delays of three or more minutes caused by Network Rail or other operators.

## Draft determination

45. In our draft determination, we outlined our intention for CP5 to:
  - a) introduce benchmarks into the Schedule 8 for charter operators. This was to ensure financial neutrality of the Schedule 8 regime, and bring it in line with the Schedule 8 used by other types of operators;
  - b) retain the £5,524 cap on the amount of Schedule 8 payment a charter operator or Network Rail has to make in respect of a single incident it causes;
  - c) implement a recalibrated charter operator payment rate to replace the rate used in CP4 which was set equal to the Schedule 8 freight operator payment rate, reflecting updated evidence on the revenue impacts of delay.
46. Our decision to introduce Schedule 8 benchmarks was part of a package of changes including introducing a capacity charge for charter services, which we discuss in the next section.
47. In our draft determination we confirmed that new data, which had become available in CP4, should be used to calculate a charter operator payment rate, using the same methodology as that used to calculate the freight operator payment rate. We confirmed therefore that the charter operator payment rate would reflect the average impact of a minute of delay caused by a charter operator to other train operators.

48. Using this methodology, Network Rail calculated a draft charter operator payment rate of £69.31 per minute of delay, which we consulted on as part of our draft determination. This is almost double the CP4 charter operator payment rate, which was set equal to the Schedule 8 freight payment rate. The increase was driven by the increase in draft Schedule 8 payment rates for passenger operators. For our final determination, Network Rail will recalculate the charter operator payment so it is consistent with the final Schedule 8 payment rates for passenger operators.
49. We recognise the potential impact this increase in the charter operator payment rate would have if we were to continue with the charter operator Schedule 8 without benchmarks. **Our proposal to introduce benchmarks into the charter operator Schedule 8 for CP5 will mitigate the overall impact of this as net payments will be zero when all parties are performing at benchmark.**
50. In our draft determination we proposed that for CP5, the Network Rail payment rate in the charter operator Schedule 8 regime will continue to be equal to the Network Rail payment rate in the freight operator regime, i.e. £19.13 per minute of delay in 2012-13 prices.
51. In CP4, incident caps limited the amount of compensation per incident paid by charter operators to Network Rail under the Schedule 8 regime to £5,524. The same incident cap applied to compensation paid by Network Rail to charter operators, but has rarely been employed in practice, with Network Rail compensation to charter operators typically being for minor delays. In CP4 charter operators have not paid an access charge supplement (ACS) for incident caps.
52. Following our November 2012 consultation on Schedules 4 and 8, we set out in our draft determination that we are minded to leave the incident cap (with no ACS) unchanged. Stakeholders provided evidence that the private insurance market would be unlikely to provide an affordable alternative to obtain financial protection facilitated by the incident cap.

### **Our draft conclusions**

53. We published our draft determination on Schedule 8 for charter services prior to the completion of Network Rail's work on charges for charter services and associated conclusions. We have subsequently discussed the PR13 package with charter operators at two workshops and received Network Rail's conclusions on charges for charge services. And we have updated our analysis of the overall financial impact of PR13 for charter services.
54. **In the light of this new information, we have revisited some aspects of our draft determination with respect to Schedule 8.**

55. We have presented a number of options here, which aim to bring charter services in line with other operators, thus improving incentive properties both on operators and Network Rail. Our assessment is that overall, through the package of changes we are proposing to conclude on, we will not be making charter operators worse off financially in CP5.
56. To inform our decision making, we presented different options for Schedule 8 to operators at the charter workshops. The options we considered, and subsequently refined in the light of Network Rail's and operators' comments, are shown in Table 5.

**Table 5: CP5 charter operators Schedule 8 options**

Description of option	Comments
<p><b>Option 1: do not introduce benchmarks.</b> We included this option as a baseline for comparative purposes: we had already concluded in our draft determination that we would introduce benchmarks.</p>	<p>With the increase in the draft Schedule 8 charter operator payment rate, this would result in an increase in the net payments from charter operators to Network Rail from around £171k per year in CP4 (on average), to more than £600k per year (at the same level of performance).</p>
<p><b>Option 2: Introduce benchmarks calculated so that the Schedule 8 regime for charter would be financially neutral at expected levels of performance.</b> This would be done by only including in the benchmark calculation delay minutes during the recalibration period that were below the incident cap:</p> <p>a. Tougher benchmark and incident cap retained at CP4 monetary value (£5,524 or 80 delay minutes if payment rate is £69.31 per delay minute)</p> <p>b. More lenient benchmark with incident cap retaining CP4 cap of 147 delay minutes (£10,219 if payment rate is £69.31 per delay minute)</p>	<p>This option would allow Network Rail to recover the costs it incurs when operators breach the incident cap. The funding would not be coming through an ACS. Rather, by excluding minutes above the cap from the charter operator benchmark, the resulting benchmark would be relatively tough, and for current levels of performance, Network Rail would expect to receive total payment which overall would compensate it for providing the free incident cap.</p>
<p><b>Option 3: Introduce benchmarks. Charter operator benchmark to include all delay minutes and incident cap set at £5,524, with no ACS.</b></p>	<p>With this option, Network Rail would need funding to cover the cost of the cap (approximately £500k per annum). In effect, the financial impact of large incidents caused by charter operators would be subsidised.</p>

57. While Option 3 would be consistent with our draft determination, it requires subsidy to Network Rail for providing the free incident cap to operators, and it provides a subsidy to the charter industry. There have also been some changes since our draft determination:

- a) the final Schedule 8 charter operator payment rate is likely to be lower than that in our draft determination as a result of the final set of Network Rail payment rates for passenger operators being lower; and
- b) we now have greater clarity regarding the financial impact of PR13 on charter operators, including changes to track access charges. We can therefore make this decision with reference to that analysis, in particular without resulting in an overall financial disbenefit to charter operators.

58. During our workshops, a charter operator expressed concern about option 3, explaining that it might contribute to a perception that charter services created significant delays to other traffic. They did not express a preference for option 3.

59. In the light of these discussions and further analysis, we have revisited the draft decision we made on Option 3, and generated further options which we have discussed at the charter meeting.

60. Option 2 would allow Network Rail to recover its additional costs by virtue of the way the benchmarks would be calculated. During the 8 August meeting, Network Rail and charter operators argued that this was not a transparent way of establishing benchmarks, with one operator suggesting we introduce a menu of incident caps and associated access charge supplements (ACS) which each operator could choose from.

61. We developed a new Option 4 in response to comments we received by from operators and Network Rail at the 8 August meeting. This option is shown in Table 6. Under this option, operators would be able to choose their level of protection against costs of individual delay incidents for an associated ACS. The ACSs would be calculated so that the regime was financially neutral. This is a feature of the freight Schedule 8. With this option, Network Rail’s costs of providing the incident cap would be covered, and no subsidy would be required.

**Table 6: CP5 charter operators Schedule 8, Option 4**

Description of option	Comments
<p><b>Option 4: Introduce benchmarks for charter services calibrated on the basis of all delay minutes. Introduce a menu of ACS and incident cap options.</b></p>	<p>Like Option 2, this option would be calibrated to be financially neutral. The ACS would cover the cost to Network Rail of providing the incident cap to operators. The ability to choose the level of protection desired in effect acts as an insurance policy for operators. For the freight Schedule 8, the ACS incorporates a 10% insurance premium, and this would also feature in the arrangements for charter under this option.</p>



62. If Option 4 were implemented, operators who are better able to manage their performance would be more likely to select a higher cap, with a lower ACS. The menu of incident caps introduces a level of moral hazard, with poorer performing operators more likely to opt for a lower cap with a higher ACS. Therefore, consistent with the freight regime, we would uplift the ACS by 10% to reflect the risk Network Rail incurs through providing this protection.
63. We are grateful to stakeholders for the constructive engagement they have provided on Schedule 8 and the structure of charges. While we are keen to take their input into account, we also want to ensure that the option we determine is consistent with our regulatory principles and incentivises parties appropriately.
64. We agree that transparency is very important in Schedule 8. Option 4 is more transparent than Option 2 and achieves financial neutrality.
65. It is important that we understand the incentive properties of each option. The introduction of benchmarks into the regime will incentivise both Network Rail and charter operators to improve their performance with respect to each other, while at the same time being financially neutral when all parties are performing at expected levels.
66. In light of our discussions with stakeholders and considering the package of PR13 for charter operators as a whole, we therefore conclude on implementing Option 4, which consists of:
- a) introducing benchmarks for the charter Schedule 8 regime calibrated on the basis of all delay minutes; and
  - b) introducing a menu of caps and ACS options, which will ensure financial neutrality of the regime. The ACS will include a 10% uplift to reflect the risk premium placed on Network Rail.
67. The rates shown in Table 7 are illustrative and based on current charter performance, with a 10% premium applied. They show how the menu of options would work, and are not the rates we are proposing as final. The final rates will be outlined in our charter implementation consultation which we will publish in mid-September.

**Table 7: Illustrative ACS values with two different cap options (draft rates)**

Cap (delay minutes/100 miles)	ACS (£/train mile)
80 delay minutes	1.33
147 delay minutes	0.94

68. We are concluding on two other Schedule 8 issues which we have discussed at our meetings with operators and Network Rail:

- a) to introduce a yearly adjustment to the charter operator benchmark; and
- b) to implement an annual Schedule 8 cap, consistent with the freight Schedule 8.

69. The yearly adjustment to the charter operator benchmark has the purpose of reflecting changes in traffic levels across the network. It currently exists in the freight Schedule 8, and we propose to apply this to the charter Schedule 8 benchmarks in the same way as we outline in our draft determination that it would apply to freight.

70. This involves adjusting the charter operator benchmark using the following formula:

$$ATOB = TOB * [(Ta * CF) + 1]$$

71. Where:

- o ATOB = adjusted to the train operator benchmark
- o TOB = train operator benchmark
- o Ta = change in traffic level
- o CF = congestion factor

72. Consultants Arup, working for Network Rail as part of its recalibration of the capacity charge, has recently calculated the CF for freight Schedule 8 (a value of 1.044). For simplicity, the freight CF will be used for charter Schedule 8.

73. At the 8 August meeting, a charter operator suggested that for consistency with freight Schedule 8 we should also introduce reciprocal annual Schedule 8 caps. These would be aimed at capping the net Schedule 8 liability faced by a charter operator or Network Rail.

74. We propose to introduce annual caps consistent with the 'small operator' caps currently in place for the freight Schedule 8 – i.e. an annual cap of approximately £0.5m with all charter operators treated as 'small operators'.

# Capacity charge

## Purpose of the capacity charge

75. Charges are set to reflect costs directly incurred, which means the costs that vary with traffic. Under the performance regime (Schedule 8 of passenger, freight and charter Track Access Agreements) Network Rail is liable for train lateness or delays and cancellations that are not the fault of other operators, in particular delays caused by Network Rail or due to other factors such as the weather. The scale of Network Rail's Schedule 8 payments varies with traffic, however, as the volume of traffic affects Network Rail's ability to manage the knock-on delays resulting from incidents. This variation in Schedule 8 payments is a cost directly incurred that is recovered through the capacity charge.

## The capacity charge in CP4

76. The capacity charge was introduced as part of the Access Charge Review 2000, and in CP4 has been levied on passenger and freight traffic. In contrast, it has not been levied on charter services during CP4. This is because:

- at the time PR08 was conducted charter operators' access agreements did not contain a periodic review re-opener, so that there was no provision to levy a capacity charge as part of PR08; and
- following PR08, during CP4, we developed the charter model Track Access Agreement, but we did not include provision for a capacity charge. This was because introducing what would have been a new charge on charter operators could only be implemented through a formal periodic review process rather than through the contract change mechanism.

77. The model terms do however include a periodic review re-opener, so that a capacity charge can now be levied as required as part of PR13.

## Our draft determination on the capacity charge

78. In our draft determination we did not conclude on a capacity charge for charter services. Instead we said that we thought that a capacity charge should be introduced for charter services to reflect the impact of those services on capacity utilisation and the financial risk they imposed on Network Rail. We explained that we would engage with charter operators on this issue, and have subsequently done so through the two charter workshops.

79. In our draft determination we published our draft conclusions on the capacity charge for passenger and freight services (but not charter services). We explained that Network Rail had

engaged consultants Arup to review thoroughly and recalibrate the capacity charge, and that it had done so with extensive industry engagement. We said that the work appeared to have been carried out well and to be robust.

80. We noted that we are to conduct a major review of charges for CP6, in which we will work closely with the industry including the Rail Delivery Group. We explained that as part of this, we are planning an extensive review of the way that charges reflect cost and in doing so incentivise efficient allocation, use and expansion of capacity. We also explained that we may therefore substantially change the design or role of the capacity charge in future.
81. We noted that the Arup review would result in very substantial overall increases in the capacity charge. And that it was undesirable for track access charges to fluctuate significantly from one periodic review to the next from the perspective of industry investment and planning. We therefore wished to consult on how to implement the capacity charge for CP5.
82. We proposed either approving capacity charge rates that have been calculated using the methodology established in CP4, uprated for inflation. Or implementing an alternative proposal put forward by the rail freight operators' association (that might also apply in some form to passenger traffic). We set out in more detail how the RFOA approach might be applied to freight and other traffic in a subsequent consultation letter.
83. Under this approach, traffic would be charged relative to one or more baselines. For traffic above the baselines, Network Rail would receive revenue equivalent to the additional revenue it would have received had the recalibrated capacity charge been levied. It would thus be correctly compensated for the additional Schedule 8 costs it bore. The revenue would take the form of a year-end charge, levied on each operator in proportion to value of their total traffic run.
84. For traffic below the baseline, RFOA proposed that no charge be levied. We noted that another option was for such traffic to pay the capacity charge at the CP4 rates.
85. In our consultation letter, we expanded the RFOA proposal. We set out how it might be implemented in practice and how it might be applied to passenger services. We set out illustrative options, for example where there could be separate traffic baselines and revenue reconciliations for different types of traffic.
86. Network Rail said that it did not propose introducing a capacity charge for charter operators in CP5. It stated that it continued to believe that charter operations impose additional Schedule 8 costs on Network Rail (which is the basis for the capacity charge). It noted that we were

considering whether to impose a capacity charge on charter operators, and that it was assisting us in this work.

87. In its conclusions, Network Rail also set out the strong concerns it had with our draft determination with respect to the capacity charge. In particular, it argued against setting the capacity charge on an inconsistent basis to that of Schedule 8, which it referred to as "fracturing" the alignment between the two regimes. It said that it believed this approach would discourage traffic growth on the network, and in some areas would impose financial incentives on Network Rail to reduce traffic levels.

### **Our draft conclusions**

88. In our draft determination, we explained our intention to introduce a capacity charge for charter operators. We have since discussed this with charter operators at the two workshops, and presented information on the estimated financial implication of this charge. We see this change as complementary to the reforms on which we have concluded for Schedule 8.

**89. We have estimated the package of PR13 changes, including the introduction of the capacity charge consistent with our draft determination, to result in a small net financial gain for charter services overall.** We set this out in Table 9 of this letter.

90. The level of the charter operator capacity charge to be set by Network Rail will depend on our overall policy decision on the capacity charge. This is an issue on which we are currently consulting with the industry. We will publish our final decision on this in the final determination at the end of October 2013.

91. It is for Network Rail to calculate the value of the capacity charges applied to charter services. At the charter workshops we and Network Rail explained that we thought a single rate for charter services would be appropriate (to which, as with all capacity charges, a weekend discount might be applied). This would avoid the administrative complexity of a more disaggregate charge. It is also consistent with the single Schedule 8 Network Rail payment rate for charter services, and the single capacity charge for freight services.

92. For the purpose of our discussions with stakeholders, we asked Network Rail to calculate indicative values for the charge. These are shown in Table 8. We have concluded that the Arup rate capacity charge would only be levied on traffic above a baseline, though not the precise form that that would take. The average charge per train mile would therefore be considerably below that implied by the Arup rates.

**Table 8: Indicative estimates of capacity charge for charter services (£ per train mile)**

Basis for estimate	Weekday rate	Weekend rate
Consistent with CP4 rates	0.24	0.18
Consistent with Arup rates	1.20	0.80

Source: Network Rail indicative analysis.

93. We will conclude on the basis on which the capacity charge is levied as part of our final determination. The basis on which charter services are charged will be consistent with the charging regime for other traffic, subject to the complexity of the mechanism being proportionate to administer.

## Overall financial impact on charter operators

94. The charter sector is small compared to other passenger and freight operations on the GB rail network. We are mindful of this. We think it is appropriate to bring arrangements for charter operators more in line with other sectors, while not imposing disproportionate administrative burden.

95. Table 9 shows our estimate of the overall financial impact of our draft conclusions on charter operators. It has the following components:

- a) VUC: update of payment rates and introduction of a charge for light locomotive movements;
- b) EC4T and EAUC: billing the charges;
- c) performance regime (Schedule 8): implementing option 4 set out in the Schedule 8 section of this document, which includes updating the charter payment rate and introducing benchmarks; and
- d) capacity charge: introduce a capacity charge consistent with the charge for other services.

96. We have made some assumptions/simplifications to make this analysis possible for example the proportion of light locomotive trains. Please note:

- a) our assessment is based on the current level of charter traffic on the network;
- b) our analysis refers to the whole charter market, and the underlying effects on each operator might vary compared to the overall effect; and
- c) the CP5 capacity charge is consistent with CP4 rates.

**Table 9: Estimated financial impact – yearly total across all charter operators**

<b>£/year</b>	<b>VUC</b>	<b>EC4T</b>	<b>(Schedule 8)<sup>1</sup></b>	<b>Capacity charge</b>	<b>Total</b>
CP4	-£521,000	£0	-£174,000	£0	-£695,000
CP5	-£477,000	-£6,000	£0	-£101,000	-£584,000
<b>Variance</b>	<b>£44,000</b>	<b>-£6,000</b>	<b>£174,000</b>	<b>-£101,000</b>	<b>£110,000</b>

<sup>1</sup>The introduction of benchmarks in the Schedule 8 regime means an expected payment of £0, at expected levels of performance  
**Note:** there might be small differences in the totals above due to rounding.

97. Table 9 shows that on average, subject to the necessary caveats above, the package we plan to introduce will result in charter operators being marginally better off financially than they have been in CP4.

## Next steps

98. **The deadline for responses to these draft conclusions is 20 September 2013. The process for responding to the consultation is set out in the letter to which this consultation forms an annex.**

99. We will consider representations from stakeholders, as well as work undertaken to date and engagement with operators in reaching our final conclusions in relation to charter operators.

100. We will set out our final conclusions in our final determination which we will publish on 31 October 2013.

101. We will be consulting on contractual drafting that implements these changes, consistent with the draft conclusions set out in this consultation, in September 2013.

102. We welcome your views on any aspect of this document.

# Annex B: Circulation list

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