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14 October 2011

Dear Paul,

Using Incentives to Improve Capacity Utilisation – ORR workshop

Thank you for hosting the workshop on 23 September 2011 on '*Using Incentives to Improve Capacity Utilisation*' and for the opportunity to participate in this debate. The workshop was very helpful in aiding discussion on the issues and options relating to capacity utilisation.

As you know, we continue to support incentives to improve utilisation of capacity on the rail network. This letter is to reiterate the points we made at the workshop, and to draw your attention to the suggestions we made in our consultation response¹ to ORR's First Periodic Review 2013 Consultation² to address this issue and at the same time to simplify the charging regime.

Network Rail's key points

At the workshop we made some key points, which are set out below:

1. The existing charging framework is complex; we strongly support the objective to keep charges simple and easy to understand. We also need to devote some collective effort to explaining the charging regime so it is better understood.
2. When considering capacity issues distinction should be made between different objectives, including making best use of capacity and promoting competition. In this context it is important to recognise that even if there is limited scope for competition

¹ Network Rail (Sep 2011), 'Periodic Review 2013: First Consultation – Network Rail's response', http://www.networkrail.co.uk/uploadedFiles/networkrailco.uk/Contents/Publications/Delivery_Plans/Control_P_eri od_5_delivery_plan/Planning_for_CP5/ORRFirstPR13ConsultationFull.pdf.

² Office of Rail Regulation (May 2011), 'Periodic Review, First Consultation', <http://www.rail-reg.gov.uk/pr13/PDF/PR13-first-consultation-document.pdf>.



between operators in their relevant markets, it is increasingly critical that we deal effectively between competing uses of scarce capacity on the network. We also noted that there are complex tradeoffs between capacity, frequency, journey times, opening hours etc. and an over-reliance on simple metrics to drive decisions can have unintended consequences.

3. We believe there could be a role for charging in improving the use and development of capacity. We consider that the current regime is (implicitly) designed to help to neutralise the cost implications for relevant parties from changes in utilisation. In principle, charges could be used to drive optimal use of the network but we consider this to be unrealistic. As NERA helpfully stated at the workshop, charges are unlikely to solve all issues relating to scarce capacity but they could help. We consider that they can be used to encourage changes in the right direction.
4. Any possible use of charging for the allocation of capacity should be considered against the existing administrative procedures. It follows from the previous point that capacity utilisation charges are unlikely to completely replace the current administrative approaches, but they may have a role in helping to encourage more efficient use of capacity. Given the success of RUSs, for example, we consider that they should continue to have an important role in informing the use of capacity as a key input to both franchise specification and, increasingly franchise bids.

Capacity utilisation workshop

We note that there was little appetite at the workshop to introduce the options for a 'Capacity Utilisation Charge' presented by NERA³. There appeared to be fairly strong views that current mechanisms, such as the Volume Incentive; the Capacity Charge; or Part J of the Network Code, could be re-designed to increase their effectiveness in achieving the best use of capacity. One specific suggestion was the possibility of disaggregating the Volume Incentive by route/area, to provide more focussed incentives to Network Rail to accommodate additional capacity in the highly utilised areas.

We agree that existing charges and/or mechanisms could be developed to provide incentives for better use of capacity. You will recall that in our response to ORR's First Periodic Review 2013 Consultation we suggested removing the Volume Incentive, and instead applying a 'volume incentive uplift' to the existing Capacity Charge, we still consider that there is considerable merit in exploring this suggestion. In that same response, we also suggested the possibility of applying a 'scarcity uplift' to the existing Capacity Charge in areas where there is scarce capacity. In practice, these two uplifts could be combined.

³ NERA Economic Consulting (National Economic Research Associates)



Our suggestions are similar, in some ways, to those made at the workshop, since the current Capacity Charge is more disaggregated than the current Volume Incentive⁴. For this reason the Capacity Charge may be better equipped to deal with charges which reflect the level of scarcity, since, it is more disaggregated across the network (than the Volume Incentive), and it also considers, the level of capacity utilisation in those segments. An added advantage of replacing the volume incentive would be simplification of the charging regime. It should be recognised, however, that higher charges could discourage some otherwise viable services. For these reasons we suggest that both options are considered further.

Next Steps

At the workshop, you explained that ORR plans to issue a consultation on incentives in November 2011, in which you will seek to further explore the issues and options for using incentives to improve capacity utilisation. We look forward to seeing this consultation document.

If you would like to discuss this letter, or our response to your first Periodic Review 2013 consultation, please do not hesitate to contact me.

Yours sincerely



Peter Swatridge

Head of Regulatory Economics

⁴ The current Capacity Charge is levied at a rate per service code, whereas the current Volume Incentive is paid out on a network-wide basis.

