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Dear Joel,

### **PR13 – CONSULTATION ON THE CAPACITY CHARGE**

This letter contains the response of DB Schenker Rail (UK) Limited ("DB Schenker") to Network Rail's consultation document entitled "Periodic Review 2013 – Consultation on the Capacity Charge" issued on 26 July 2012.

#### General Comments

1.1. It is made clear in the consultation document that the primary purpose of the capacity charge is to allow Network Rail to recover additional Schedule 8 costs associated with the increased difficulty of recovering from incidents of lateness as the network becomes more crowded. The consultation document then goes on to say that a secondary purpose of the capacity charge is to promote efficient use of capacity on the network.

1.2. However, DB Schenker would certainly question the extent to which this secondary purpose is achieved, particularly in respect of freight, given the way in which the charge is currently applied at an aggregated level across both time and geography, thereby ensuring that all trains pay the same charge apart from during weekends when a different rate applies.

1.3. DB Schenker understands that track access charges are required to conform to the principles set out in the Railways Infrastructure (Access and Management) Regulations 2005 ("the Regulations"). DB Schenker is uncertain, however, as to where the capacity charge for freight sits within these principles. Given the stated primary purpose of the capacity charge, DB Schenker considers that the charge cannot conform to the principle set out in paragraph 1(8) of Schedule 3 to the Regulations (i.e. a charge which reflects the scarcity of capacity over the identifiable segment of the infrastructure during periods of congestion) as it is not levied by time of day, geography or level of congestion.

1.4. DB Schenker also considers that the capacity charge cannot conform to the principles set out in Regulation 14 of the Regulations (i.e. a performance scheme) as such schemes must encourage railway undertakings and the infrastructure manager to minimise disruption and improve the performance of the railway network. Whilst DB Schenker can see how it could be said that the Schedule 8 Performance Regime could be

considered to achieve these aims, the same cannot be said of the capacity charge which, in effect, is applied as an additional 'tax' on the operation of trains. This appears self evident from the statement in the consultation document that:

*"....Network Rail does not benefit financially from imposing the charge on all services. This is because the income would otherwise be recovered by means of fixed charges. In effect, through the current mechanism, in exchange for levying the capacity charge on all traffic, a discount is given to operators on fixed charges."*

1.5. If the capacity charge is in effect a substitute for fixed charges, then DB Schenker would argue that the charge is in effect a 'mark-up' which must then conform to the principles set out in paragraph 2 of Schedule 3 to the Regulations. Given that 'mark ups' can only be levied on market segments that can afford to pay them, DB Schenker would, therefore, submit that the majority of freight services should be exempted from the capacity charge altogether.

1.6. Notwithstanding the above comments, should it be substantiated legally that freight services, in whole or in part, should continue to be subject to a capacity charge, it is imperative that the charge remains simple to understand, straight forward to apply and does not create any competitive advantages for any one freight operator over any other. DB Schenker also considers that the capacity charge for freight should be kept as low as possible reflecting the considerable flexibility that Network Rail has in terms of how it can accommodate freight services in the timetable to avoid capacity bottlenecks and particularly busy periods.

1.7. The concern acknowledged by Network Rail in the consultation document that because the capacity charge is applied to all services and not just incremental trains it can be argued that this results in excessive cost recovery, is shared by DB Schenker. Whilst this appears to be of little importance to franchised passenger operators (who pay around 97% of the total value of the capacity charge) as it is in effect 'netted off' their fixed charges, it is of significant concern to freight operators who work in a highly competitive market where margins are extremely thin. Whilst DB Schenker notes the indication that capacity charge income will be deducted from any freight specific charge that may be set, that charge (if proceeded with) will only be levied on those market segments that are deemed by ORR to be able to afford a 'mark-up'. Therefore, how any 'netting off' will work in practice is currently uncertain.

1.8. The linking of the capacity charge with any freight-specific charge adds further weight to DB Schenker's argument that the capacity charge is in fact itself a 'mark-up' and should conform to the principles set out in paragraph 2 of Schedule 3 to the Regulations. DB Schenker will certainly be keen to ensure that whatever capacity charge mechanism is agreed for CP5, that there is no over-recovery by Network Rail from freight operators.

1.9. DB Schenker notes from the consultation document that the capacity charge has not been systematically updated in real terms since its inception following the Access Charges Review 2000. Since that time, freight productivity has increased dramatically as evidenced by recent figures published by Network Rail showing that freight train

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productivity (kgmts/trains) has increased by 35% since 2005. The productivity achieved by freight operators is also recognised in Sir Roy McNulty's "Rail Value for Money Study" published in May 2011. Paragraph 3(2) of Schedule 3 to the Regulations states that "*the charging system shall respect the productivity increases achieved by applicants*". DB Schenker will, therefore, be keen to understand how any CP5 capacity charge for freight reflects the productivity increases achieved by freight operators.

#### Responses to the Specific Questions

***Q1. Do you agree that, beyond the arrangements that are currently in place, capacity charge tariffs that vary across time should not be introduced?***

2.1. Freight operators require a charging framework that is certain, simple to understand and apply so that they may respond to their customers quickly and easily as other freight transportation modes are able to, most of whom are not subject to such charges. Therefore, DB Schenker would not support any further complexity that would be inevitable from introducing different tariffs by time of day.

***Q2. Do you agree that the weekend discount should remain in place? Do you agree that the magnitude of the discount should be revisited, and informed by analysis undertaken as part of the capacity charge recalibration exercise?***

2.2 DB Schenker agrees that the weekend discount should remain in place reflecting the tendency for less traffic and, consequently, less scope for reactionary delay. DB Schenker also agrees that the level of that discount should be reviewed. In this respect, DB Schenker considers that Network Rail itself is also a significant user of capacity, particularly during weekday nights and at weekends by virtue of its requirement to take possessions to carry out maintenance, renewal and enhancement works. DB Schenker believes that the review and magnitude of the discount should also take this requirement into account.

***Q3. Do you agree that the capacity charge should be disaggregated to service code (rather than service group) level in CP5?***

2.3. Given that all freight services are levied the same capacity charge rate, this appears to be a question aimed particularly at passenger operators.

***Q4. What are your views on developing a tool to calculate capacity charge tariffs for new or amended service codes? How could this be best accommodated contractually?***

2.4. Again, this appears to be a question aimed particularly at passenger operators.

***Q5. Do you agree that all freight operators should pay the same single capacity charge tariff in CP5? What are your views on the level of the discount applied to freight services?***

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2.5. As stated earlier in this response, DB Schenker questions the basis upon which the capacity charge is currently levied on freight operators as it argues that it is in fact a 'mark up' for the purposes of the Regulations and should, therefore, only be levied on market segments that are deemed by ORR to be able to afford such a 'mark up'. However, to the extent that any capacity charge continues to be levied on freight services in CP5, it is imperative that all freight services continue to be charged the same single rate as this reduces complexity, transaction costs and creates a 'level playing field' for all freight operators.

2.6. DB Schenker considers that the current 10% reduction for freight services which reflects the considerable flexibility that Network Rail has in terms of how it can accommodate freight services in the timetable to avoid capacity bottlenecks and particularly busy periods should be reviewed for CP5 to ensure that there is no over-recovery of costs. In addition, a greater recognition should be given to the fact that, unlike franchised passenger operators, freight operators are subject to a benchmarked third party delay performance regime which already compensates Network Rail for each minute of delay freight operators cause to third parties on the network.

2.7. Furthermore, as already highlighted in paragraph 1.9 above, freight operators have achieved significant productivity gains since the inception of the capacity charge following the Access Charges Review 2000. Therefore, DB Schenker considers that the principle set out in paragraph 3(2) of Schedule 3 to the Regulations (i.e. "*the charging system shall respect the productivity increases achieved by applicants*") should be taken into account in any review of the discount.

**Q6. Do you agree with Network Rail's proposals in relation to the de minimis threshold?**

2.8. Whilst the consultation document states that around 10% of service codes (presumably passenger service codes) are exempt from the capacity charge, there is no information as to how many services are included in these service codes and, more importantly, the total value of the capacity charge that such services would have paid. Given that each and every train on the network has the capacity to cause reactionary delay, such information is crucial to enable DB Schenker to consider and respond fully to this question. This is because DB Schenker will wish to understand the extent to which those services that are subject to the capacity charge are cross-subsidising those that are not.

2.9. DB Schenker notes, however, that a de minimis threshold does not apply to freight, even though many freight services (particularly those travelling short distances) are subject to very low capacity charges. For example, a freight service travelling 20 miles would currently only be subject to a capacity charge of £3.45 weekdays or £2.59 at weekends. DB Schenker will be keen to understand how the amounts that the services exempted from the capacity charge would have paid compare to these levels.

2.10. Consequently, DB Schenker will be unable to support the continuation of the de minimis threshold until further information is made available and can be properly

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considered, perhaps through the medium of an industry working group (assuming it is established) (please see DB Schenker's answer to Q14 below).

***Q7. What are your views in relation to arrangements for handling large timetable changes in CP5?***

2.11. DB Schenker agrees with Network Rail's view that once the capacity charge is recalibrated and set for CP5, it should remain in place for the whole Control Period. Whilst DB Schenker acknowledges that major timetable changes could cause material changes to the levels of reactionary delay on the routes affected, such changes can invariably be foreseen many years in advance and could, to the extent to which they are known, be taken into account in the re-calibration work (for example, the changes that will be generated by the introduction of Crossrail services in and around London). DB Schenker considers that the advantages of having future certainty by leaving the capacity charge unaltered for the entirety of CP5 outweigh the disadvantages of constantly updating it to reflect each major timetable change during the Control Period.

***Q8. Do you consider that the proposed methodology for recalibration of the capacity charge described above and detailed in Appendix 2 is appropriate?***

2.12. As recognised in the consultation document, the process used for calculating the capacity charge is quite complex as it uses relationships between metrics that are not easily expressed and generates results using complicated mathematical equations. DB Schenker understands that the proposed methodology is broadly similar to that applied previously. However, as already highlighted in paragraph 1.7 above, a significant concern surrounding the current capacity charge is that it leads to excessive cost recovery. DB Schenker will, therefore, wish to see demonstrated that whatever methodology is used for the recalibration of the capacity charge for CP5, that it seeks to eliminate any over-recoveries, particularly for freight whose capacity charge is not merely 'netted off' any fixed charge.

***Q9. Do you agree that the CUI should be used as the basis for capacity charge recalibration as part of PR13?***

2.13. If no better metric can be identified, then DB Schenker would have no objection to the continued use of the CUI subject of course that the concern expressed in paragraph 2.12 above (i.e. that the inherent over recovery of costs in the current charge should be eliminated) is fully addressed.

***Q10. What are your views about accounting for other determinants of reactionary delay as part of the CP5 recalibration of the capacity charge?***

2.14. As already highlighted in paragraph 2.2 above, DB Schenker considers that Network Rail is also a significant user of capacity, particularly during weekday nights and at weekends by virtue of its requirement to take possessions to carry out maintenance, renewal and enhancement works. This use of capacity often results in the train services affected by such possessions being subject to a level of alteration (e.g. through

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retiming and/or diversion). Such alterations result in a greater possibility of reactionary delay because in the case of retiming, more services have to be squeezed into the reduced capacity remaining on the routes subject to the possessions or, alternatively, in the case of diversions, more services have to be introduced onto other routes. Both scenarios result in an increased propensity for reactionary delay. DB Schenker, therefore, considers that this factor should also be taken into account in the recalibration exercise.

***Q11. What are your views about the functional form used to model the relationship between reactionary delay and capacity utilisation?***

2.15. Given Network Rail's acknowledgement in the consultation document that the choice of functional form should be based on statistical testing and careful judgment, DB Schenker has nothing further to add at this stage but hopes that this issue can be further developed and considered by the industry working group (assuming it is established) (see DB Schenker's answer to Q14 below).

***Q12. How do you think the industry can guard against analytical risk in the capacity charge recalibration? In the unlikely event that statistical recalibration approach described above is not fully successful, how should we proceed to secure a capacity charge which is fit for purpose in CP5?***

2.16. Again, it is difficult to answer this question until the progress of the recalibration exercise can be assessed. However, if the recalibration is totally unsuccessful then DB Schenker would advocate a return to the simplest and certain approach which would be to revert to PR08 tariffs, updated by RPI. Again, this is a topic that could be further considered by the industry working group (assuming it is established) (see DB Schenker's answer to Q14 below).

***Q13. How should changes in the capacity charge between CP4 and CP5 be managed?***

2.17. DB Schenker agrees with Network Rail's view that as part of any recalibration exercise there needs to be a detailed explanation of the differences between the current capacity charge and that proposed for CP5, particularly if the level of the proposed charge is due to materially alter. DB Schenker understands that as far as franchised passenger operators are concerned, the capacity charge is merely 'netted off' any fixed charge that they pay so any material change is unlikely to cause major concerns to such operators as their overall level of charges will remain the same. However, for freight, the capacity charge is not currently 'netted off' any fixed charge. Therefore, if it is proposed that any capacity charge for freight in CP5 is to be materially increased, then DB Schenker considers that such increases should be introduced gradually over the course of the Control Period and not as a step change from 1 April 2014.



***Q14. Do you support the creation of a capacity charge working group? How do you consider that its membership should be decided? What should be its remit?***

2.18. DB Schenker generally supports the creation of industry working groups to review, consider and discuss key issues concerning changes to the access contract and charges framework. It believes such groups play a valuable role in ensuring that any change proposals are subject to thorough industry debate, consideration and development prior to any formal consultation process being conducted. Consequently, DB Schenker believes that change proposals developed through industry working groups, (supported by workshops for the wider industry) tend to receive a greater support than those developed by a sponsor in isolation and in correspondence.

2.19. Given the above comments and the importance of the capacity charge within the overall structure of access charges, DB Schenker would support the creation of an industry working group to discuss and review the development and recalibration of the capacity charge for CP5 as well as the other matters highlighted in this consultation response. As acknowledged in the consultation document, the methodology and metrics surrounding the recalibration of the capacity charge is an extremely complex area. DB Schenker, therefore, considers that a regular forum allowing Network Rail to present, explain and discuss its emerging proposals and receive relevant feedback will be of great value to both Network Rail and participating industry stakeholders alike.

2.20. DB Schenker concurs with Network Rail's view expressed in the consultation document that membership should be open to Network Rail, its consultants, train operators, ORR and funders.

***Q15. Do you have any further views or suggestions about our approach to stakeholder engagement in relation to the capacity charge?***

2.21. DB Schenker considers that any relevant information should be shared with members of the industry working group (assuming it is established) well in advance of any meetings to ensure that such meetings are as productive as possible.

***Q16. Do you prefer fewer and longer consultations or more regular and shorter consultation?***

2.22. DB Schenker would prefer fewer consultations of whatever length given the amount of work and effort required in firstly producing the documents, then providing responses to them and then considering those responses. Furthermore, given the large number of consultations currently covering a whole range of different aspects of the PR13 review from both Network Rail and ORR, DB Schenker wishes to understand how ORR is going to amalgamate the results from all of these consultations so that a coherent picture of the overall impact on freight operators and their customers can be considered. DB Schenker would expect ORR to take account of other significant areas of railway policy, such as the Rail Reform, Statement of Funds Available and Guidance to ORR issued by the Secretary of State to ensure that the administrative burden on operators from the PR13 review is minimised.

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2.23. In addition, DB Schenker also believes that restricting reviews of the access and charging framework to those key aspects where changes are known to be of benefit rather than the current tendency to spend time and effort reviewing each and every aspect, whether or not those aspects would benefit from any review or change, will reduce industry time and effort in this respect.

2.24. For example, freight access charges represent an insignificant proportion of Network Rail's total income yet both ORR and Network Rail continue to insist on examining every facet of the freight charging structure every five years. Apart from the uncertainty that such reviews generate in the rail freight market place, this approach imposes a significant management time and cost burden on freight operators who can little afford it. To allow freight operators to continue to plan their businesses with a degree of assurance, DB Schenker proposed at the start of the PR13 review that the ORR should give an early indication that the current freight charging structure should remain largely intact, particularly given the thorough review of the structure conducted for PR08 together with the significant delay in the commencement of the PR13 review. However, given the depth and extent of ORR's and Network Rail's review of the freight charging framework for PR13, DB Schenker's view appears, unfortunately, to have been largely discounted.

***Q17. Do you have any further views or suggestions about our approach to stakeholder engagement in general?***

2.24. Freight operators require a charging framework that is simple to understand and apply so that they may respond to their customers quickly and easily as other freight transportation modes are able to. The current piecemeal approach of the PR13 review in looking at each aspect of the charging framework separately does not allow freight operators to understand and gain an appreciation of the effects the review will have on the level of freight access charges as a whole. Such an approach hampers productive debate and creates significant uncertainty as changes to particular aspects of the charging structure cannot be properly considered until the proposed changes to other aspects are also understood.

DB Schenker hopes that these comments are helpful. If you require any further clarification on any of the matters raised, please let me know.

Yours sincerely,



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