GBR's future approach to mark-ups (passenger markets)

Industry Engagement to shape GBR's Charges Scheme ahead of PR28

Introduction

– Caitlin Scarlett

Workshop purpose

- This is the tenth of our workshops exploring options for GBR's future charges scheme: today we will focus on market segmentation informing GBR's approach to mark-ups (for open access and charter operators).
- During the workshop we will recap the **current approach taken by the Office of Rail and Road (ORR)** to set mark-ups (the Infrastructure Cost Charge, ICC) on specific passenger market segments. We will then briefly recap the **legislative changes in the Railways Bill** to contextualise the changes needed under GBR.
- We will provide a comprehensive overview of the **passenger market segmentation options** that have been prepared for Network Rail, in advance of GBR setting track access charges for Funding Period 1 (FP1; 2029 to 2034). We will also discuss the preferred approach to market segmentation and the efficient operator test. The interim note by Oxera has been circulated and published online, ahead of today's workshop.
- We will finish by exploring our **early-stage policy position on treating incumbent operators equally** and our **initial view on approaching the efficient operator test in FP1.**
- The key objective of today's session is to seek stakeholder views on our current position ahead of formal consultation by GBR in Spring 2027. Caveat: All policy options discussed during the workshop carry no legal weight or commitment that they will come into effect. We are seeking industry views to help shape our proposals, ahead of formal consultation. Toda's focus is policy options, not detailed calculation of rates.

Recap of ORR policy on passenger mark-ups

– Caitlin Scarlett

Understanding ORR passenger mark-up policy in CP7

Over successive Periodic Reviews, ORR has allowed NR to charge a mark-up on open access services to recover a proportion of Network Rail's fixed costs, based on an assessment of ability to pay.

PR18 (CP6) 1

ORR introduced the Infrastructure Cost Charge (ICC) to recover contributions from open access operator's to fixed costs and reduce reliance on public funding. Eligibility is based on the Market Can Bear (MCB) test. For existing OAOs, relief from any increase in charges from the ICC was provided. The ORR defined the following market segments: interurban open access and all other.

PR23 (CP7) 2

The current policy is still to levy the ICC based on the MCB test. Market segments are defined in the same way as PR18, with the addition of airport services as a standalone market segment. To determine eligibility ORR determined passenger entry/exit thresholds at stations and distance bands. As a result, existing OAOs fall outside of eligibility for the ICC.

In setting policy on mark-ups, ORR has broadly taken a three-step approach:

1. Review and define relevant passenger market segments;
2. Assess each segment's ability to bear an ICC, using service-code-level net revenue analysis; and
3. Set the ICC rate, taking account of the analysis, legal requirements and wider regulatory considerations.

Note: ORR has previously indicated that the relief policy for existing OAOs could be reconsidered at the next Periodic Review, if changes to market segmentation made the issue relevant.

ORR's PR23 Final Determination

Net revenue provides an indication of the mark-up that can be borne, while continuing to profitably operate.

The ICC rate is phased-in over 5 years for new services, with 25% of the rate paid in the third year.

Source: PR23 final policy position.

The PR23 calibrated rates (23/24 prices) were:

Market Segment	ICC rate (£ per train mile)
Major airport	5.00
Interurban	5.00

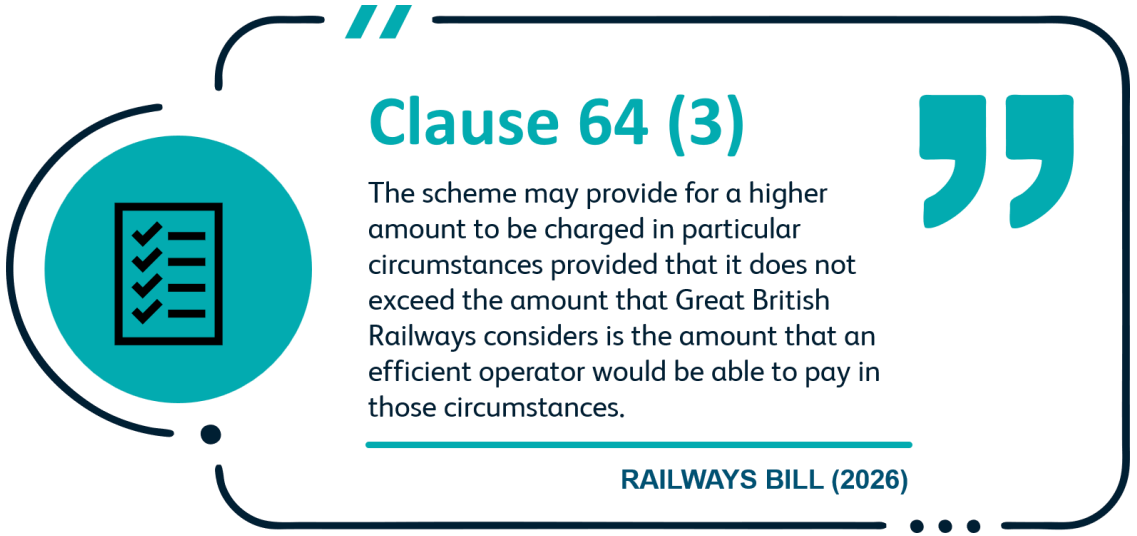
Legislative context & problem statement

– Conor Murrells

Key legislative principles of the Railways Bill – mark-ups

Ahead of further analysis on open access and charter mark-ups under GBR, we have tested the policy intent and sought a legal review of our proposed approach.

- As with ORR today, GBR is permitted to set charges at a higher amount than Costs Directly Incurred, only where GBR considers that an efficient operator could afford to pay the additional ('mark-up') charge. GBR is intended to have discretion in how this framework is applied.
- Policy intent: the shift from the ORR's market can bear test to GBR's efficient operator test reflects the need to establish a domestic statutory framework, following the replacement of EU-derived regulations, rather than a change in policy intent.
- Legislative compliance: our approach reflects internal legal advice that the assessment should consider comparable, like-for-like services when determining what an efficient operator would be able to pay "in those circumstances", with market segmentation providing the basis for that comparison.



Problem statement – balancing key trade-offs

With GBR assuming responsibility for setting mark-ups in FP1, we need to consider the appropriate balance between private sector contributions to the railway's fixed costs and the certainty needed for business planning.

In setting policy on this topic, GBR must balance important trade-offs:

- *Statutory duties:* promoting the interests of users and potential users of passenger services, as well as considering the costs to be met from public funds and the efficient use of these funds;
- *Charges objectives:* proportionate and sustainable cost recovery linked to providing infrastructure used by train operators, as well as supporting planning and investment (i.e., developing a charges scheme conducive to attracting inward investment from third parties).

KEY CONSIDERATIONS

- ***How GBR should assess the potential impact of higher charges on passenger markets when determining mark-ups***
- ***How GBR should understand passenger growth markets and a reasonable rate of profit***
- ***How GBR should enable parties to plan the future of their businesses with a reasonable degree of assurance***
- ***How GBR should be explicit about assumptions and decisions relating to the efficient operator test***

Summary of market segmentation research

– Conor Murrells

Oxera research – interim note industry update

- We commissioned Oxera to provide independent advice on passenger market segmentation for GBR to consider in relation to its mark-up policy in FP1, under the revised legislative framework set out in the Railways Bill.
- **Note:** the focus of today's workshop is phases one and two, which are complete. Subsequent phases remain under development.
- **Phase one and two scope:** starting at first principles, Oxera were asked to (1) present options on future passenger market segmentation, including a preferred option; and (2) assess whether relief should continue to be made available for incumbent OAOs.
- **Assumptions:** at present, there is no ex-ante target for how much mark-ups are meant to raise. In addition, mark-ups are to be calculated at the market segment level. Approaches will not explore setting mark-ups at the level of individual operators or individual services.
- The research provides recommendations for further consideration by GBR. It does not provide a definitive answer, rather an evidence-base to test for stakeholder views and support GBR decisions.

PHASES OF OUR MARK-UP RESEARCH

- **Phase one:** the policy rationale for applying mark-ups consistently to both current and prospective open access passenger services.
- **Phase two:** a proposed framework for passenger rail market segmentation.
- **Phase three:** a proposed approach to interpreting and applying the 'efficient operator' requirement set out in Clause 64(3).
- **Phase four:** a proposed proposed methodology for assessing ability to pay and determining future mark-up levels.

(1) Independent advice on consistent mark-up application

Phase one of the research by Oxera was to consider the policy rationale for applying mark-ups consistently to both current and prospective open access passenger services

In determining whether to apply a consistent mark-up framework to incumbent and prospective open access passenger services, Oxera has advised that GBR should consider two factors:

1. **Cost recovery:** consistent with its statutory duty to consider the costs met from public funds, GBR should consider sustainable cost recovery from private sector operators in relation to fixed costs; and
2. **Avoid distortions:** mark-ups should be levied in a way that minimises market distortions, including limiting any contraction in service provision. GBR should also avoid competitive distortions by treating operators equally, where they undertake comparable activities.

Moreover, past treatment should not determine future exemptions in perpetuity. As GBR redesigns capacity allocation tools, its approach to mark-ups should be developed consistently with that wider framework.

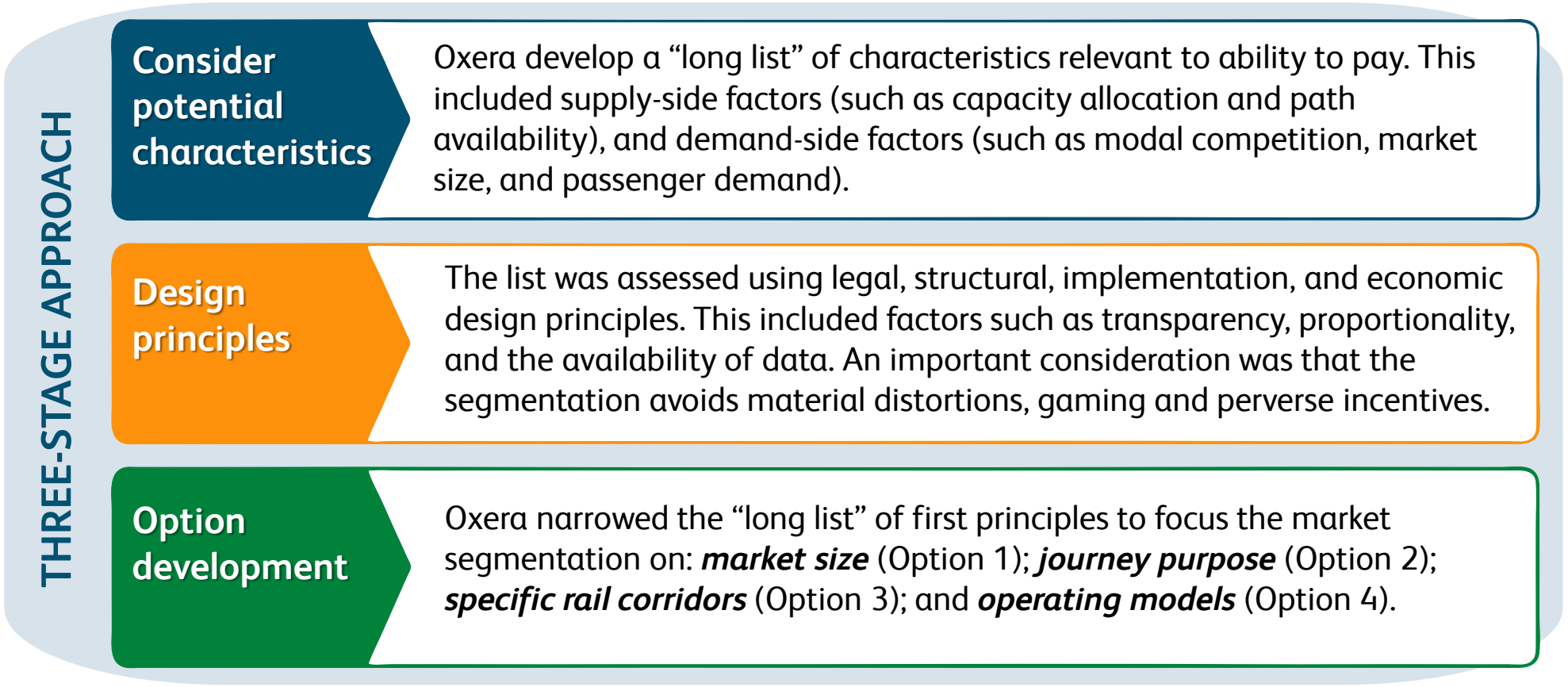


Overall, Oxera recommends that the framework applies equally to all open access passenger services, subject to a robust assessment of ability to pay.

Workshop discussion point:
Is there any further evidence to support Oxera's position, or evidence that would support the continued relief given to incumbent open access operators?

(2) Segmentation of passenger rail markets

In phase two, Oxera considered a broad range of potential segmentation characteristics and, applying the agreed design principles, developed four options for further assessment.



(2) Segmentation of passenger rail markets

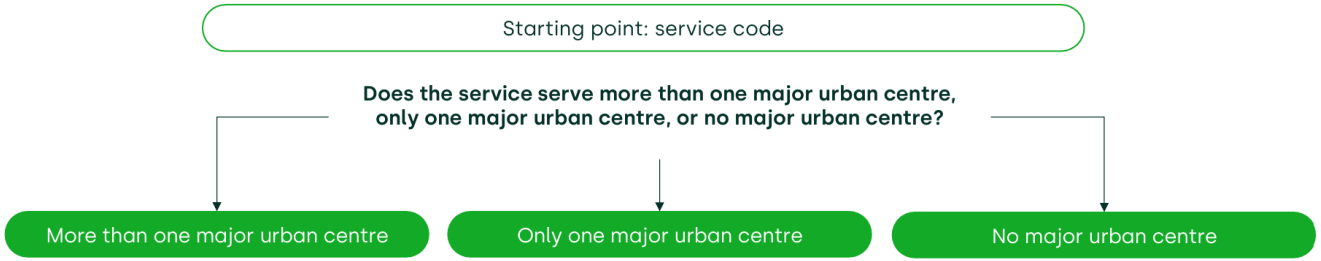
Option 1: passenger rail market segments based on market size

The primary basis for this option is to distinguish between services connecting major markets from services serving smaller or more local markets.

This is predicated on the view that major markets may:

- Have higher passenger demand, thus increasing ability to pay towards fixed costs;
- Be more likely to support higher fares.

Observable metrics of market size could include station use of population size.



Note: The figure presents only the primary segmentation, additional sub-segments based on other characteristics may be necessary.
Source: Oxera.

Pros: market size is practical to observe and measure using readily available metrics, and is likely to be an important driver of ability to pay.

Cons: market size may not capture differences in service characteristics or operating models.

(2) Segmentation of passenger rail markets

Option 2: passenger rail market segments based on journey purpose

This option segments services based on journey purpose, which may indicate passenger price sensitivity and willingness to pay.

For example, business and commuting journeys may be associated with lower price sensitivity than leisure journeys, potentially indicating a greater ability to bear higher fares.

Identifying journey purpose could be challenging. While ticket type provides a potential proxy, it could misclassify services and be susceptible to changes in ticketing strategies.



Note: The figure only presents the primary segmentation, additional sub-segments based on other characteristics may be necessary.
Source: Oxera.

Pros: journey purpose is closely linked to passenger price sensitivity and willingness to pay.

Cons: journey purpose is difficult to observe and classify robustly, relying on imperfect proxies and assumptions to implement.

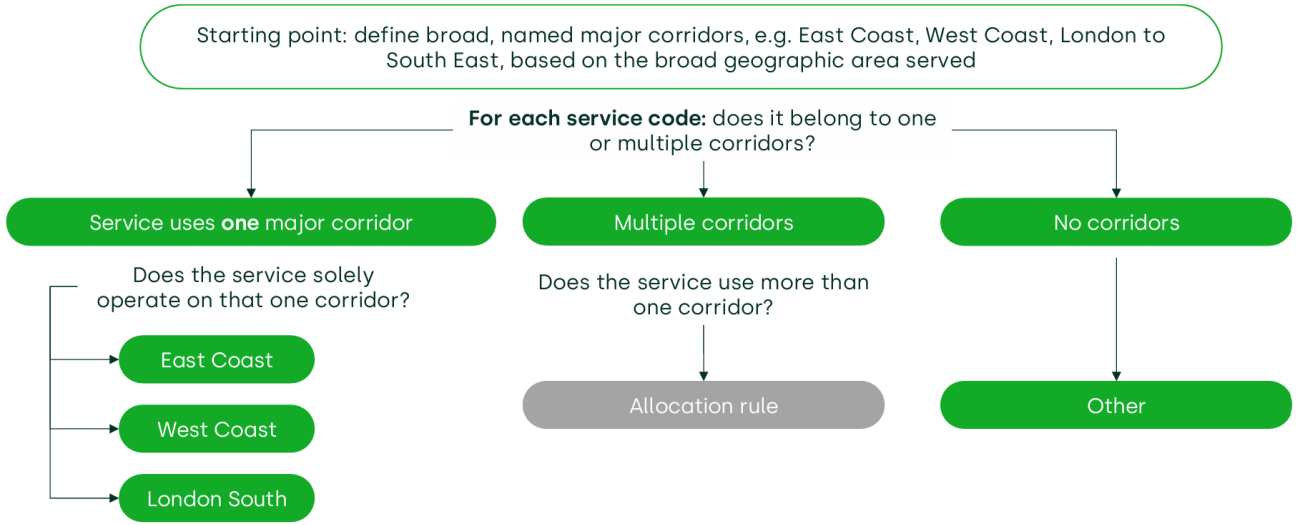
(2) Segmentation of passenger rail markets

Option 3: passenger rail market segments based on specific corridors

The aim of this option is to group services based on the major rail corridors they serve, reflecting the associated market conditions on those corridors (which would be determined in advance).

The corridors would reflect several aspects of the commercial markets they serve which may influence ability to pay, including:

- Infrastructure (capacity and capability)
- Rail competition
- Alternative modes.



Note: The figure only presents the primary segmentation, additional sub-segments based on other characteristics may be necessary.

Pros: captures multiple demand and supply characteristics that may influence ability to pay.

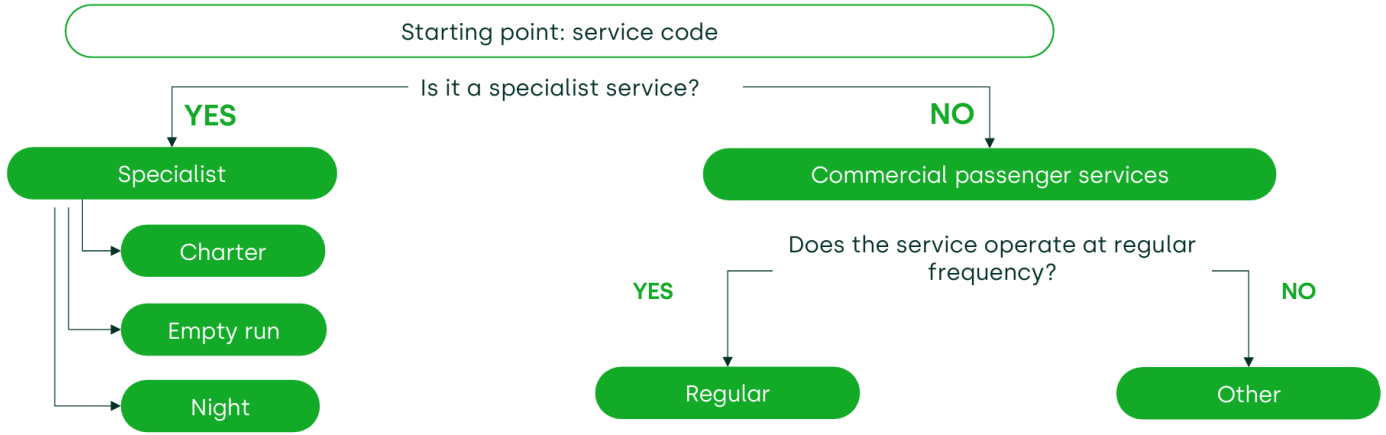
Cons: defining corridors and allocating services would require judgement, particularly for services operating across multiple corridors.

(2) Segmentation of passenger rail markets

Option 4: passenger rail market segments based on operating models

Option 4 defines segments according to the service's operating model, as different services may have different underlying cost structures and associated demand profiles, affecting ability to pay.

This would allow specialist services, such as charter and sleeper services, to be identified separately, with other commercial services further segmented using observable market characteristics.



Note: The figure only presents the primary segmentation, additional sub-segments based on other characteristics may be necessary.
Source: Oxera.

Pros: explicitly recognises differences in operating models and underlying cost structures.

Cons: does not capture demand-side drivers of ability to pay and would therefore need to be combined with other characteristics.

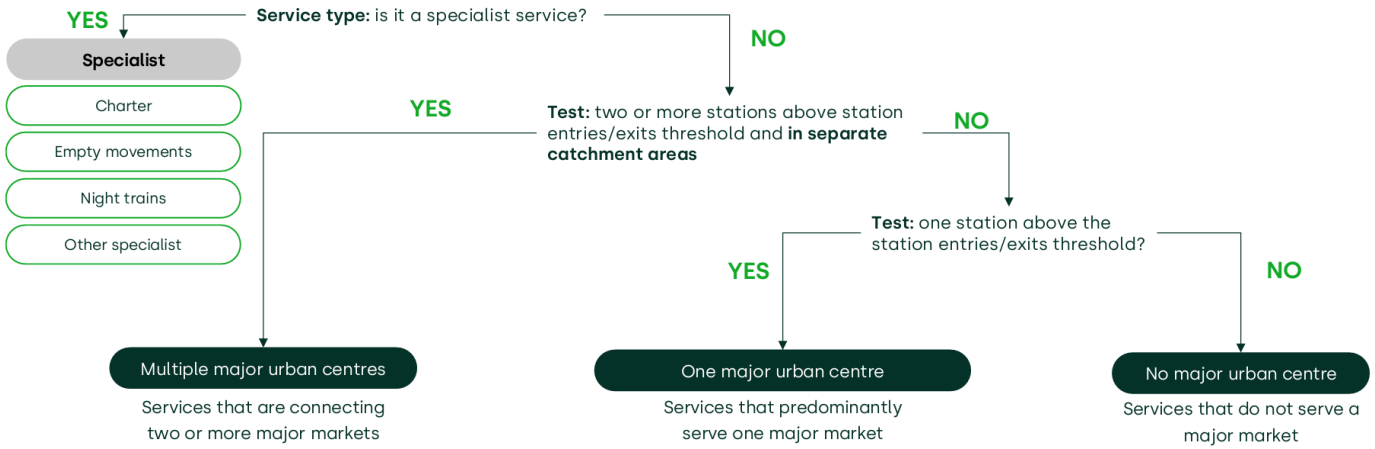
(3) Recommended option

Workshop discussion point:
Do you agree with the proposed segmentation approach, including (i) the characteristics retained and excluded, and (ii) the use of station usage to identify major urban centres?

The final part of phase two was to develop a recommended segmentation approach, combining elements of the four options.

The recommended approach combines **operating model and market size**, while excluding journey purpose and rail corridors given the practical challenges identified. It introduces several tests to isolate specialist services, which will be assessed separately.

For commercial passenger services, further tests identify whether a service connects multiple, one or no major urban centres. We will consider during rate calibration whether London should be treated separately.



Source: Oxera.

What variable should be used to identify major urban centres?

On balance, **station usage is considered a better proxy than population size**, providing a more direct indication of rail market potential and drawing on published ORR data. Distance thresholds will also be considered to address proximity between stations.

Next steps: calibrate station usage thresholds using net revenue data, to identify service clusters of ability to pay.

Our emerging thinking on an efficient operator

– Conor Murrells

A brief update on phase three: the efficient operator test

Considering international best practice, Oxera has identified two principal ways of operationalising the concept of the efficient operator test.

Notional operator model

1

This "bottom-up" approach constructs a hypothetical, properly managed operator providing services in each segment.

The modelling process would specify operator's service parameters including route stopping patterns, timetable, and a representative cost structure.

It is a forward-looking model of estimating associated costs (e.g., fleet leasing).

Benchmarking approach

2

This "top-down" approach applies statistical benchmarking methods to the operator cost data.

The modelling process would use actual net revenue data to determine efficiency through methods such as medians or inter-quartile range.

The use of historical data makes it backward-looking model of actual costs (e.g., crew rosters)

Workshop discussion point:
Do you agree that the benefits of a benchmarking approach outweigh those of a notional operator model for the efficient operator test?

Our preferred option at this stage is the **benchmarking approach**. It is grounded in **observed data** (using actual operator costs) and captures actual supply-side characteristics. It also **reduces subjective decision-making** by GBR about interpreting service efficiency.

The notional operator model could be more closely tailored to individual route economics and avoid reliance on historical costs or legacy inefficiencies. However, these benefits need to be weighed against greater reliance on assumptions, stakeholder challenge and scalability.

Our emerging policy proposals

– Conor Murrells

Our emerging policy position

Workshop discussion point:
Do you agree with these emerging policy positions? What evidence or considerations should inform their further development ahead of formal consultation?

We have considered the research from Oxera alongside the current framework for implementing an ICC. Our emerging policy position is summarised below.

(1) Treat incumbent and new OAOs equally when assessing eligibility for mark-ups

Eligibility will be determined through a robust economic assessment of ability to pay and formal consultation; historic relief would not continue where there is evidence of ability to pay.

Rationale: non-discrimination, equal treatment and a move away from legacy capacity-based exemptions.

(2) Review mark-up eligibility annually, while managing fluctuations

Eligibility would be kept under review, allowing services that become eligible to be brought into scope in FP1. To provide stability during phasing-in, services would not ordinarily be removed from scope, unless there is a material change in circumstances.

Rationale: keeps mark-ups aligned with ability to pay while providing reasonable stability for operators

(3) Phase in mark-ups for services becoming liable for the first time.

Phasing-in would reflect first exposure to the charge rather than market entry, with the trajectory recalibrated so that contribution to fixed costs begins earlier than under the current approach.

Rationale: provides transitional protection while allowing an earlier contribution to fixed costs.

Next steps

– Caitlin Scarlett

Summary and next steps

- The purpose of today's session has been to provide an overview of the work completed by Oxera.
- Starting from first principles, Oxera has developed a preferred option for passenger market segmentation. As things stand, this will form the basis of our approach to setting mark-ups in FP1.
- **Next step:** working with Oxera we will finalise this research project, refining the approach to the efficient operator test and establishing a methodology to set mark-ups in FP1. We hope to give early visibility of this methodology in our Spring consultation. Following this, we will start work to calculate rates and determine eligible passenger services.

Key dates / Look ahead – upcoming charges workshops

Overview of charges proposals on 13 January 2027 – this will be a concluding session where we present our proposals ahead of formal consultation.

For more information on our charges and performance workshops, please visit this link: GBR's Charges and Performance Schemes.

The immediate priority is to reflect on the feedback from this session and refine our three emerging policy positions as appropriate, ahead of formal consultation.

How you can help shape GBR's Charges Scheme and Performance Scheme Statements for FP1

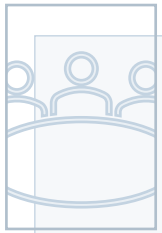
Ways to get involved:

- Technical workshops on important charges and performance scheme topics.
- Targeted engagement with freight, devolved bodies, open access, other infrastructure managers, and funders.

We are committed to:



Early visibility of emerging approaches.



Open feedback and transparent reporting.



Listening to concerns and perspectives.

For more information on our emerging proposals for charges and performance , please visit this link:
https://www.networkrail.co.uk/industry-and-commercial/developing-gbrs-charges-and-performance-schemes/

If you have any questions or would like to discuss this further, you can contact the team via our dedicated inbox:
chargesandperformanceschemes@networkrail.co.uk