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Dear David,

**CONSULTATION ON PROPOSALS FOR A REBATE MECHANISM**

I have reviewed the ORR's consultation paper on a proposed rebate mechanism and set out below TfL's response to the proposal.

TfL is fully supportive of the proposal to enable third-party investors to recoup part of their investment and to develop the 'user pays' principle.

However, whilst such proposals are attractive from a local perspective it must also be recognised that wholesale adoption of such principles questions the effect on the present structure and method of deriving access charges. It would be helpful to understand ORR thinking regarding the future effect of expansion of local rebate mechanisms - and, therefore, a move towards access charges derived directly from use of the asset - on the present system which at present assumes a 'jam spread' of costs on charges.

Whilst the three primary objectives (no competitive disadvantages to investors, level of rebate to not foreclose efficient access and assurance of certainty to investors) are supported, the detail behind the proposed mechanism seems to be deficient in some areas. This is discussed below.

Firstly, the fact that a mechanism for some sort of local cost recovery is proposed should ensure that investors are not placed at a competitive disadvantage and should secure contributions from other beneficiaries. However, the assessment of benefits/beneficiaries may cause problems and disputes especially where these are investments on the existing network. For

example, if a third party invests in a route to secure more capacity, what is the position of existing operators regarding any remaining available capacity existing before the enhancement? Who has first call on this and who should pay a premium to the investor after the enhancement?

TfL supports a level of rebate which would encourage further use of the investment and broadly supports the concept of ensuring no 'over recovery' from other beneficiaries. However, the worked example (No.1) detailed in the slides at the workshop on 10<sup>th</sup> February would appear to indicate that the concept of having a capacity measure based on expected usage by the investor plus 50% of the residual capacity would actually lead to over recovery. The value of the path is based on an annualised cost divided by a number less than the actual number of paths available. This appears to lead to an enhanced value of the path and thus over recovery. We attach a brief assessment as annex 1 to this document we would appreciate ORR's view on whether our assessment is correct. TfL suggests that a figure based on total capacity created to arrive at an accurate value per path which is then adjusted down to prevent over recovery would be a clearer mechanism. The adjustment could also be weighted to reflect how much of the investment was used by the funder and, perhaps, the commercial value of the capacity to other beneficiaries.

TfL agrees with the concept that enhancements funded by Network Rail through the regulatory determination should not be eligible for a rebate. It follows that it may also be undesirable for central Government funded enhancements to qualify for a rebate. Such investment should be secured via the HLOS process and the regulatory determination. However, local government funded options (e.g. TfL, PTEs) should be treated as third parties for the purposes of this rebate scheme. TfL would like confirmation from ORR on this point.

Apart from the problems with over recovery detailed above, TfL supports the other elements of the calculation to derive the average cost.

TfL agrees with the proposal set out in section 17 of the consultation where multi-party funding is considered on the basis of separate eligibility and proportionality.

ORR has also raised questions regarding scenarios where additional capacity is created and the applicability of the rebate. Problems with such a situation have already been highlighted earlier in our response. The ORR has suggested that rebate should apply to all users and not marginal users or other beneficiaries. Whilst at face value this option appears to be sensible TfL would wish to understand the effect on users who may not be held cost neutral from changes to charges. For example, LUL may incur additional charges and yet be unable to cover such additional cost except by raising fares. Similar arguments apply to open access and other commercial operators such as

freight. TfL suggests that where added value is created for beneficiaries (e.g. faster journeys, additional revenue earning paths) they should be eligible to pay the rebate. If there is no added value it is questionable whether a charge should be levied on such users. A clear method of assessing 'added value' must form part of the mechanism.

Finally, TfL supports the proposal to activate the rebate mechanism through the Network Code.

In response to the ORR's questions set out in section 30, TfL's conclusions are:

- a) Practicalities of implementation  
The assessment of benefits and their applicability needs further work.
- b) Operation of the mechanism  
The mechanism appears to have some deficiencies which could lead to over-recovery of costs from other beneficiaries.
- c) Amendment to Network Code  
TfL supports the use of the Network Code to activate the mechanism.
- d) Extension to Government funders  
TfL would suggest that central Government funded enhancements should be dealt with under the existing mechanisms (i.e. regulatory settlement). However, local government funders (TfL, PTEs, etc) should come within the scope of these new proposals.

TfL fully supports the proposal for a locally-focused rebate mechanism but believes that further work needs to be undertaken to ensure that any proposals finally adopted are fair and fit for purpose.

That completes TfL's comments on the proposed rebate mechanism.

Yours sincerely,



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## Annex 1

### **Assessment of ORR methodology described as example 1 (Seminar - 10<sup>th</sup> February 2006)**

By dividing the annual investment by a number of paths less than those created the figure of rebate comes out at approximately £10 per path (i.e. 20 paths actually created/available but calculation of usage + 50% residual only gives 14).

Dividing the investment by the total annual daily paths ( $20 \times 365 = 7,300$ ) will give a rebate figure of just under £7 per path.

It thus appears that the ORR proposal would lead to an over recovery by allowing a disproportionate value to a path and thus the rebate amount payable by other beneficiaries (i.e. £10 per path under ORR figures against £7 per path based on an assessment of total paths created).