IRG-Rail (14) 7

Independent Regulators' Group - Rail

Second position paper on the European Commission's upcoming draft implementing act on the modalities for the calculation of the cost that is directly incurred as a result of operating the train service

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Executive summary

IRG-Rail supports the idea of an implementing act on direct costs but has a number of concerns on the European Commission's proposal, including :

- **A process that is too rigid** will prevent member states from using appropriate/alternative methodologies (*e.g.* the approach on modulation, paragraph 10)
- **The current proposals lack clarity** (*e.g.* the approach to scarcity charging)

I. Introduction

1. Paragraph 3 of article 31 of the Directive 2012/34/EU states the following :

   The European Commission *"shall adopt measures setting out the **modalities for the calculation of the cost that is directly incurred** as a result of operating the train service"*.

2. In preparation for the implementing act, the European Network of Rail Regulatory Bodies (ENRRB) held a meeting, on 26 November 2013, dedicated to direct costs. The European Commission used this opportunity to present its proposed approach with respect to the forthcoming implementing measure.

3. IRG-Rail developed this position paper in order to respond to the European Commission's proposals and to contribute to the discussions.

II. General remarks

4. As a reminder, IRG-Rail wishes to stress that two IRG-Rail position papers have been published to clarify the concept of *"cost that is directly incurred as a result of operating the train service"* and to provide explanatory guidelines on the way this charging principle should be interpreted and implemented. IRG-Rail considers that the definition of 'direct costs' is of primary importance. Indeed, one of the key challenges associated with this objective is to design proper price signals and incentives to railway undertakings and infrastructure managers which will ensure optimal allocative efficiency.

5. IRG-Rail understands and supports the rationale for setting out a consistent set of principles across member states on direct costs. There is also benefit in helping some member states which do not already have a sophisticated charging regime to design a "straightforward" and "easy-to-control" methodology, so that their regimes will be consistent with these agreed principles.

6. However, it should be highlighted that the current methodology presented by the European Commission is not consistent with the econometric and engineering approaches already implemented in practice by some member states, which are consistent with providing proper price signals and incentivising efficient use of the network, nor with the CATRIN[1] report presented as a reference.

7. For this reason, IRG-Rail thinks that it is essential that there is a more flexible approach, leaving the opportunity to use '*bottom-up*' (engineering models) and/or '*top-down*' (econometric approaches) methodologies to compute direct costs. It is difficult to understand how infrastructure managers will assess the proportion of maintenance and renewal costs that are attributable to direct costs, without the use of such methods. The European Commission's approach does not explicitly address this. [2]

III. Specific issues related to the suggestions presented by the European Commission

8. **Elimination of cost categories that do not vary with additional trains from full costs of infrastructure management:** IRG-Rail preserves its concerns and the suggested amendments concerning the elimination of cost categories that do not vary with an additional train service or train run from the total costs of the infrastructure manager as outlined in the IRG-Rail position paper on direct costs dated 14 and 15 October 2013.[3]

9. **Review period**. As outlined in the presentation held at ENRRB in November 2013, it appears that the European Commission might intend to set a five years limit to the review period. IRG-Rail would very much welcome the introduction of guidance on the length of the review period in the implementing act. However, IRG-Rail considers that member states should be able to extend the period, depending, in particular, on the experience of the regulatory body

[1] *Cost Allocation of TRansport INfrastructure cost* (2009).

[2] The European Commission's approach should also not prevent the use of a regulatory asset base to compute direct costs with a bottom-up approach.

[3] See IRG-Rail "*Position paper on the European Commission's upcoming draft implementing act on the modalities for the calculation of the cost that is directly incurred as a result of operating the train*", 14-15 0ctober 2013, (IRG-Rail (13) 8 rev1). IRG-Rail believes that the following cost categories should not be eliminated from full costs :

- Handling requests for railway infrastructure capacity, notably the reception, the assessment and allocation of train paths;
- Operating costs of some train control functions including signaling, regulation, dispatching and the communication and provision of information on train movement (operating expenditure only);
- Wear and tear of the catenaries due to running of an extra train service.

with respect to charging review. Removing this option for the long term may stop regulators from being able to improve incentives for investments and innovation in the future.

10. **Modulations list**. The intention of the European Commission is to define a modulation list for the calculation of direct costs for each train type according to the following dimensions:

    - "*Speed*";
    - "*Unsprung mass and train mass*";
    - *"Traction power of engine*";
    - "*Axle weight and wheel flats*".

    IRG-Rail considers that a modulation list can be reasonable for the calculation of direct costs.[4] An exhaustive list would nevertheless cause problems as there are other factors that cause direct costs to the infrastructure manager, in cases when the infrastructure manager allows additional traffic on the network. For example, in Great Britain, the infrastructure manager has direct costs associated with cleaning up coal spillage that cause point failures from freight vehicles carrying coal. Path and track quality could also be considered to differentiate basic charges. The list would also, for example, prevent further charging regimes to take into account unexpected technical changes.

    As well as not being exhaustive, this list should not dictate everything that infrastructure managers should modulate for. It should only give example dimensions. It may not be proportionate to attempt to calculate costs incurred from some of these factors. The costs incurred from wheel flats, for example, are extremely complex to estimate.

    Therefore, IRG-Rail recommends that both any modulation list itself and the dimensions that are mentioned by the European Commission should not be exclusive, but should allow for the further inclusion of cost categories if the regulatory bodies consider that there is a clear case to do so.

11. **Costs covered by specific grants**. IRG-Rail has strong concerns about the intention of the Commission to exclude the "*depreciation of assets financed by grants*" from direct costs as the concrete implications are unclear. A consideration mixes the "costs-side" with the "revenues-side" – in terms of cost accounting. Hence, the calculation of direct costs cannot be affected by the level of grants. IRG-Rail would welcome a clarification in order to understand precisely the potential consequences for the direct costs computation. Without such clarification IRG-Rail opposes to a consideration of specific grants as suggested by the European Commission.

12. **Scarcity costs.** The European Commission states that scarcity effects might be included in direct costs. IRG-Rail believes that capacity constraints have to be considered in charging systems in order to drive charging systems towards an efficient use of the network by railway undertakings. However, IRG-Rail is unclear how this can be consistent with what the European Commission is proposing with regards to scarcity costs and would appreciate clarification.

[4] Some member states levy mark ups for specific market segments as described in article 32 of directive 2012/34/EU (considering what the market can bear). In that case the calculation of direct cost per market segment will be entirely sufficient.

13. **Charging unit**. In its presentation, the European Commission suggests using first the train.km and then applying a modulation by train type according to train mass and other dimensions. IRG-Rail would like to reiterate that such an approach raises questions. In particular, for wear and tear-related track costs, train.km may not reflect precisely how costs are incurred. It could make more sense to compute directly the charge on a (gross) tonne.km basis. IRG-Rail therefore proposes using train.km or (gross) tonne.km where appropriate. It is important that charges should be levied in a unit consistent with how the cost is incurred unless it can be justified why this is not possible. For example for passenger transport, train.km could be a good charging unit, for instance in special cases of homogeneity of passenger train characteristics, while for freight, (gross) tonne.km appears to be a good indicator, if train weight has not already been considered as dimension in the modulation list.

14. **Limit value**. IRG-Rail wishes to reinforce the message that no clear and robust results that could support the existence of a unique limit value for direct costs can be found in recent studies on marginal cost estimation in rail transport. On the contrary, it seems clear that direct costs can vary significantly according to the nature of the infrastructure concerned. Therefore, it is essential that the implementing act does not include such a limit value.

15. **Averaging of the charges**. The European Commission states that charges based on direct costs could be averaged across times and train services to avoid disproportionate "*fluctuations of traffic in terms or route and time*". In the interest of consistency, this step should be clarified. Indeed, depending on the chosen weighting scheme, resulting charges (and corresponding price signals) may differ significantly.[5]

[5] It is to be noted that it may prove necessary or appropriate to average out at more than one levels in the process of charges determination.