

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 October 2013

Introduction

1. According to article 31 (3) of Directive 2012/34/EU, 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*”.
2. In preparation for the said implementing act, the European Commission entered into a dialogue with the rail regulatory bodies both bilaterally and within the European Network of Rail Regulatory Bodies (ENRRB) in March 2013 in order to discuss with them certain issues the European Commission had been working on. One of these was a “Questionnaire on modalities for direct costs” (the Questionnaire) sent to each member state’s national regulatory body in April, which they were subsequently invited to complete.
3. In this context IRG-Rail developed this paper addressing the methodology outlined by the European Commission in its questionnaire and providing input to the discussions preparing the upcoming implementing act on its part.

I. General remarks

4. This paper builds on the IRG-Rail position paper published in October 2012, which aimed at clarifying the concept of “*cost that is directly incurred as a result of operating the train service*” as it was set out in article 7 (3) of Directive 2001/14/EC and provided explanatory guidelines on the way this charging principle may be interpreted and implemented. The key conclusions to the October 2012 paper were as follows:¹
 - The “*cost that is directly incurred as a result of operating the train service*” should be interpreted as being short-run marginal costs (SRMC).
 - Short-run marginal costs should include (but not necessarily be limited to):
 - Operating costs (e.g. signalling)
 - Maintenance costs (e.g. wear and tear repairs)
 - Renewal costs (the issue of what renewal costs should necessarily be considered is subject to further discussions, as the categorisation of costs included in renewals or maintenance costs has not yet been finalised).
 - All fixed costs are excluded from the costs directly incurred by the infrastructure manager as a result of operating the train service.

¹ The exception of article 8 (1) Directive 2001/14/EC should be taken into consideration where relevant.

II. Marginal costs and renewal costs

5. The directive 2012/34/EU uses the terms “*cost that is directly incurred as a result of operating the train service*” and “*marginal/direct cost*” as equivalent².
6. According to the October 2012 position paper of IRG-Rail, this should be understood as short-run marginal costs. IRG-Rail notes that the purpose of the European Commission’s approach on track access charging is to ensure efficient use of the existing European rail network, together with non-discriminatory charges. Marginal cost pricing is a way of meeting this objective as it provides the appropriate incentives to both the infrastructure managers and railway undertakings to behave in ways that are likely to deliver allocatively efficient outcomes on a fixed network.
7. It should be highlighted that the definition of cost directly incurred as a result of operating a train clearly depends on the timeframe considered. The concept of short-run marginal costs implies a short-to-medium time horizon. Since no specific time horizon is defined in the legal framework, members of IRG-Rail believe that it may be useful that the upcoming implementing act allows regulatory bodies to set the principles for a time horizon framework. This would need to be consistent with the constraints that exist in each member State.
8. IRG-Rail also believes that an indication of what is covered by maintenance and renewal should be provided. Renewal costs may represent a significant part of variable costs. In some member states some renewal costs (occurring within a shorter timeframe) are included as costs of short-run use. This differs from an approach of limiting direct costs to operating costs and maintenance costs only, with the consequence of allocating renewal costs differently. Some member states still have to determine a concrete approach. Regulatory bodies will need to address the issue of renewal costs in order to ensure that they are treated and expressed in a transparent way.

III. The generalisation method

9. The European Commission discusses a “*generalisation method*” of calculating direct costs. It would be useful, when introducing such a new method and terminology, to clarify its purpose and application in the implementing act. IRG-Rail notes the proposed methodology outlined in the Questionnaire. The proposed method aims at setting out a systematic way of estimating direct costs, starting from the total costs of the infrastructure manager and eliminating the fixed costs. The latter comprise extraordinary expenditure, expenditure that is not directly associated with infrastructure management together with cost categories and cost centres that do not vary with an additional train service or train runs.

² Our interpretation of the European Commission’s definition of costs directly incurred is that it relates to *Short Run Marginal Costs*, so the paper focuses on this interpretation of cost directly incurred.

10. IRG-Rail understands the reasons for highlighting the expected level of direct costs as a proportion of total cost. We believe, however, that any use of indicative levels such as those mentioned in the questionnaire has to be based on clear and recent research and reserved for cost categories that cannot be measured or estimated with accuracy. Furthermore, applying this research in a mandatory way could lead to unintended consequences – like market distortions – because railways across Europe are not homogeneous (in size, geography, macroeconomic conditions, maintenance and renewal policy, etc.) and direct costs will vary and can vary to reflect these differences.
11. We believe that the European Commission should not prevent member states with well-established charging regimes applying other methodologies. As an example, in some member states a combination of ‘*bottom-up*’ (engineering models) and ‘*top-down*’ (econometric approaches) methodologies is already in practice, providing the necessary transparency of costs.
12. We also have some specific remarks, as detailed below:

Elimination of cost categories that do not vary with additional trains:

13. The European Commission considers 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. With regard to the cost categories that were explicitly mentioned by the European Commission to be eliminated from the total costs, we have the following comments and concerns:
- **Network-wide overhead costs, including salaries and pensions of network-wide overhead staff:** IRG-Rail believes that these costs should be eliminated.
 - **Interest payable on capital:** IRG-Rail believes that these costs should be eliminated;
 - **Depreciation for other reasons than wear and tear, and costs related to information, communication or telecommunication equipment:** IRG-Rail members believe that these costs should be eliminated. Costs related to signalling and running of trains should not be eliminated;
 - **Handling requests for railway infrastructure capacity, notably the reception, the assessment and allocation of train paths :** IRG-Rail believes that these costs should be included as they can be related to traffic movements;
 - **Operating costs of some train control functions including signalling, regulation, dispatching and the communication and provision of information on train movement (operating expenditure only) :** IRG-Rail believes that these costs should be included where they can be related to traffic movements;
 - **Use of electric supply equipment for traction current, except wear and tear of the catenaries³:** IRG-Rail believes that these costs should be eliminated;
 - **All other information required to implement or operate the service for which capacity has been granted:** IRG-Rail believes that a large majority of these costs should be eliminated. The definition should however be refined to allow for a better understanding of the costs considered.

³ According to the Annex II (e) of Directive 2012/34/EU the minimum access package shall comprise the use of electrical supply equipment for traction current. It has to be ensured that the costs of wear and tear of the catenaries are not already considered with the electric supply company and therefore not considered twice.

Estimation of direct costs

14. The European Commission proposes to ensure that the marginal costs estimates produced by member states stay within the percentages indicated under the proposed methodology (for the share of variable maintenance and renewal costs). In addition, the European Commission also states that direct costs could be calculated on costs differentials of different periods for the same network with different usage levels. IRG-Rail emphasizes that this is unclear. Furthermore it foresees the calculation of direct costs per unit by dividing direct costs by forecast train kilometres. IRG-Rail is concerned about the consistency in the European Commission's proposal, as the approach as a whole is not clear.
15. IRG-Rail believes that the estimation of marginal costs can be based on two approaches:
 - Direct estimation of marginal costs based on existing methodologies (econometric and/or engineering approaches); or
 - Calculation of the marginal costs by applying to the remaining costs (ie those remaining after eliminating the costs listed above) an estimated ratio (based on recent studies on marginal cost estimation in rail transport) and dividing those by forecast train.km (or tonne.km or other relevant unit).
16. It should be noted that, depending on the cost category, tonne.km, vehicle.km or train.km or other relevant unit could be potentially used. As a consequence, the charging regime may need to allow for the use of different metrics to cover all the cost categories, but has to be consistent within the same market segment (a possible, but not compulsory, differentiation may be made as within the following example: a charge per train.km to cover the direct wear and tear costs of trains using overhead electrified catenaries – if being a market segment – or a charge on a per tonne.km basis to cover the wear and tear-related track costs).

IV. Method of maximum values

17. As outlined in the Questionnaire and based on international studies it appears that the European Commission might intend to set some limit values for direct costs, amounting to e.g. 2 EUR per train km. IRG-Rail has not seen any evidence on the need for using those maximum values and how they should be calculated. IRG-Rail strongly disagrees with this approach and the fact that an implementing act would mention specific values. As already mentioned above, this could lead to unintended consequences and also to adverse effects, since it would provide infrastructure managers with incentives to set the charges at the limit value, even if the direct costs are lower.
18. IRG-Rail is in favour of an approach based on a robust evaluation of direct costs and therefore does not agree with the setting of a single maximum value.

V. **Data requirement to calculate and control direct costs**

19. IRG-Rail emphasizes that the question of data availability has to be addressed as it is an essential prerequisite for any calculation.
20. Therefore IRG-Rail welcomes the approach of Directive 2012/34/EU on monitoring of track access charges in Annex VIII (2). We recommend to include this approach in the implementing act to ensure that regulatory bodies are able to fulfil their monitoring/audit functions as quickly and effectively as possible.
21. A database based on the application of consistent monitoring principles is a prerequisite for the calculation of reliable and comparable direct costs and track access charges. Annex VIII of Directive 2012/34/EU provides an initial basis for standardising the accounting information to be supplied to regulatory bodies on request for the monitoring of track access charges, in order to allow them to review infrastructure managers' access charges.
22. IRG-Rail supports the establishment of a common approach for collecting specific, transparent and plausible cost and revenue information as set out in the information requirements in Annex VIII:
 - “(a) different cost categories, in particular providing sufficient information on marginal/direct costs of the different services or groups of services so that infrastructure charges can be monitored;*
 - (b) sufficient information to allow monitoring of the individual charges paid for services (or groups of services); if required by the regulatory body, this information shall contain data on volumes of individual services, prices for individual services and total revenues for individual services paid by internal and external customers;*
 - (c) costs and revenues for individual services (or groups of services) using the relevant cost methodology, as required by the regulatory body, to identify potentially anti-competitive pricing (cross-subsidies, predatory pricing and excessive pricing).”*

VI. **Conclusions**

23. IRG-Rail supports the European Commission's objective to establish a consistent approach on the development of modalities for the calculation of direct costs. This is consistent with our aims as a group, and is central to the approach that we each take as industry regulators to ensure the effective and efficient management of railway networks.
24. We support the overall approach of the European Commission and that the principles governing the consistent calculation of direct costs should be based on:
 - a consistent definition of direct costs;
 - a consistent approach for the calculation of direct costs;
 - transparent calculation and measurement methods;
 - similar methods across member states for econometric estimations (top-down) and technical/engineering approaches (bottom-up);
 - collaboration between national regulatory bodies.

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25. However, irrespective of the approach that is ultimately adopted, it is necessary that the proportion of total costs that are direct costs can and will vary depending on the characteristics of the network (for example, regardless of the absolute level of costs, direct costs may significantly vary across countries because of the heterogeneity of national choices with respect to renewal policy).
26. Finally, IRG-Rail would also support the European Commission's objective to incentivise infrastructure managers to reduce costs.
27. IRG-Rail would be very happy to be given the opportunity to collaborate with the European Commission and intends to continue to do so, as and when appropriate.