Network Rail's conclusions on its methodology for allocating fixed costs to train operators in Control Period 6 (CP6)

04 May 2018

Contents

1 Executive summary

1.1. There are, broadly, three categories of costs associated with running Network Rail's infrastructure: 'wear and tear' costs that we incur each time that a train runs; those costs that are fixed in the short-term but change over time as the number of trains running changes ('traffic related' avoidable fixed costs); and those costs that are fixed even in the very long-term assuming the railway continues to serve the same parts of the country as it does today (minimum network fixed costs).

1.2. For Control Period 6 (CP6) we want to better understand the extent to which different passenger and freight train services drive our fixed costs (i.e. traffic related avoidable fixed costs). We have, therefore, reviewed the current methodology for allocating our fixed costs to train operators. The main reason for doing this is to provide the industry with improved information on which to base decisions. For example, this work will provide funders with more accurate information on the impact of trains on the level of fixed infrastructure costs when specifying franchises. This work will also make transparent the level of fixed costs in different parts of the network, and how they are funded through network grant and charges paid by train operators. This will result in a more accurate analysis of the cost of running different parts of the railway.

1.3. We plan to publish this new more accurate information on the fixed costs attributable to train operators alongside the CP6 track access charges price lists. In due course, we also hope that ORR will adopt our methodology for allocating fixed costs to train operators in its UK rail industry financial information document. ORR publishes this document on an annual basis with the aim of increasing transparency and strengthening the rail industry's accountability to customers, passengers and funders.

1.4. Over the past three years we have carried out a significant amount of work with the independent costing expert Brockley Consulting, in collaboration with industry colleagues, to develop a more accurate allocation of our fixed costs to train operators for CP6. In September 2017 we consulted the industry on this work. The purpose of this document is to set out our conclusions on our September 2017 consultation on our proposed methodology for allocating our fixed costs to train operators in CP6.

1.5. We consider that the Brockley Consulting methodology represents a significant improvement on the CP5 fixed cost allocation methodology. In particular, it makes the following improvements on the existing methodology:

- **Allocating costs to all operators on a consistent basis**. This means, for the first time, we are able to make like-for-like comparisons across franchised passenger, freight and open access operators. Under the current cost allocation methodology used to calculate Fixed Track Access Charges (FTACs), no fixed costs are allocated to freight or open access operators on the basis that they do not pay FTACs. Therefore, it is not clear what proportion of our fixed costs that these operators cause to be incurred.

- **Allocating costs to operators at a much more granular level**. The methodology estimates the cost of c. 3,100 track sections, before allocating the cost of each track section to the train services that use each of these track sections. This represents a significant improvement on the current approach which allocates costs at Network Rail route-level, based on each operator's share of traffic on the route. Under the current approach operators are allocated the cost of parts of the network that they do not use. The new methodology only allocates the costs of each part of the network to trains that use those parts of the network.

1.6. In our September 2017 consultation we explained how the Brockley Consulting methodology categorised our fixed costs as either:

- **'Traffic related' avoidable fixed costs** which could potentially be avoided in the long-run at lower traffic levels; or

- **'Minimum network' fixed costs** which it is not possible to avoid in the long-run at lower traffic levels, assuming the same parts of the country continue to be connected to the rail network with a minimal network capability.

1.7. In our consultation we proposed using the new Brockley Consulting methodology to allocate both 'traffic related' avoidable fixed costs and 'minimum network' fixed costs to train operators. In response to our consultation some stakeholders suggested that only 'traffic related' avoidable fixed costs should be allocated to train operators, and that 'minimum network' fixed costs should not be allocated to train operators at all.

1.8. Following careful consideration of consultation responses, we are now proposing to refine the proposal set out in our consultation in order to address this concern expressed by some stakeholders. We now consider that we should allocate only 'traffic related' avoidable fixed costs to train operators in CP6 (i.e. those fixed costs which could potentially be avoided in the long-run at lower traffic levels). We propose allocating the fixed costs associated with having a 'minimum network' which connects the different parts of the country to the rail network to funders, rather than train operators. This reflects the fact that funders are largely responsible for specifying those locations connected to the rail network, through the franchising process and wider Government policy. This revision to our proposed cost allocation methodology results in a significant reduction in operators' fixed cost allocations (c. 50%-60% lower on average compared to if we were to allocate both 'traffic related' avoidable fixed costs and 'minimum network' fixed costs to train operators).

1.9. It is ultimately ORR's decision whether to adopt the Brockley Consulting methodology when setting the level of operators' fixed charges in CP6. On 13 April 2018 ORR published a letter[1] stating that it will propose as part of its Draft Determination to use the new cost allocation methodology developed by Brockley Consulting when setting fixed cost charges for CP6 (ORR describes these charges as Infrastructure Cost Charges). Consistent with our conclusions in this document, ORR also stated that in its Draft Determination it will propose only allocating

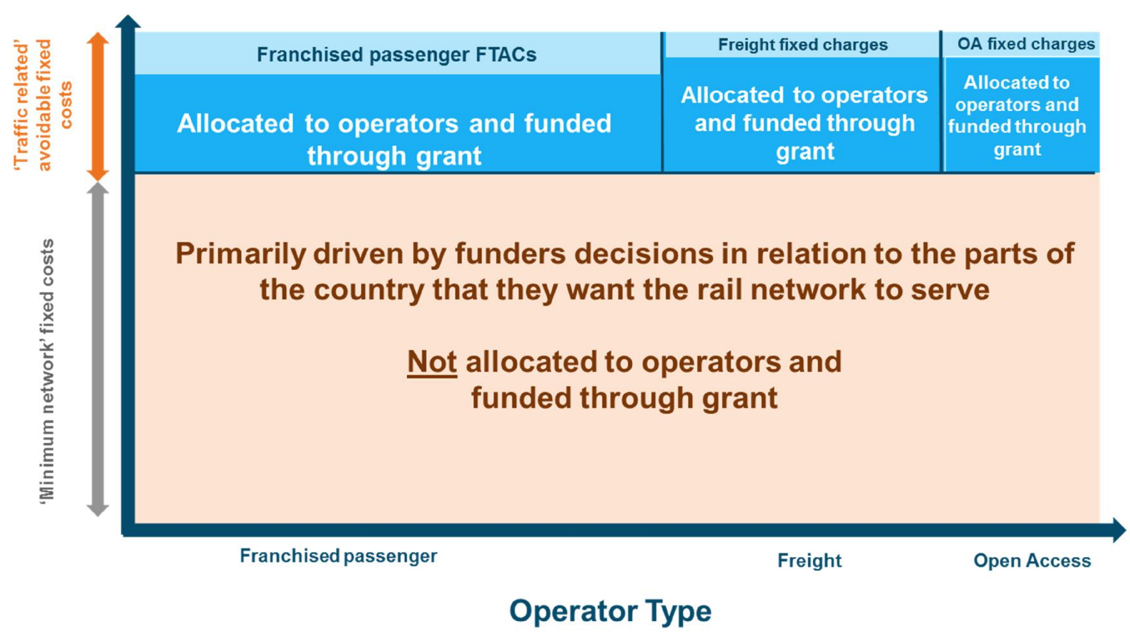
[1] Available here: http://orr.gov.uk/__data/assets/pdf_file/0010/27469/orr-variable-usage-charge-update-letter-april-2018.pdf

'traffic related' avoidable fixed costs to train operators in CP6 (not 'minimum network' fixed costs).

1.10. If ORR does use this new methodology when setting operators' fixed cost charges in CP6, freight and open access operators are unlikely to be impacted significantly financially. This is because relevant EU legislation states that operators should only be charged fixed costs to the extent that they can afford them. Franchised train operators would also typically be protected from any changes to fixed charges for CP6, through provisions in their franchise contracts.

1.11. We recognise that even though this work is unlikely to have a significant direct financial impact on train operators, some train operators may still find it unsettling if it makes them appear to drive a greater proportion of our fixed costs than at present. This is the case especially with freight and open access services, who are not allocated any of our fixed costs under the current FTAC methodology, and regional/urban services which the new methodology has found drive more of our fixed costs than we previously thought. However, we consider that this 're-balancing' of fixed cost allocations between train operators to be necessary, and a more accurate reflection of which train operators drive our fixed costs.

1.12. The diagram, below, illustrates our proposed approach to allocating fixed costs and network grant to train operators in CP6. This shows that we now propose only allocating 'traffic related' avoidable fixed costs to train operators (shown in light blue and dark blue) and not 'minimum network' fixed costs (shown in pink), as we originally proposed in our consultation. This diagram focuses on fixed costs and, therefore, excludes costs recovered through variable charges and commercial income.



1.13. In this document we also conclude that we will make transparent the extent to which train operators' 'traffic related' avoidable fixed costs are funded through grant income that we receive direct from funders, where the track access charges that operators pay do not cover these costs.

1.14. We also confirm our proposal to retain a simple approach to adjusting FTACs in CP6, when services transfer between train operators, based on the proportion of train miles that have transferred (rather than the proportion of vehicle miles which was used in CP5).

1.15. Our September 2017 consultation[2] included indicative cost allocations to train operators based on cost data from ORR's PR13 Final Determination (i.e. October 2013). As part of this document we set out the impact of updating operators' fixed cost allocations to reflect the cost data that we used in our February 2018 SBP. This cost data was not available at the time of our September 2017 consultation.

1.16. We will be concluding separately on our proposed methodology for calculating variable and station charges. Separately, the Rail Delivery Group (RDG) is co-ordinating the recalibration of Schedules 4 and 8 for passenger operators. Network Rail and freight operators are working together to recalibrate the freight Schedule 8 regime.

1.17. ORR will, ultimately, determine the level and structure of charges for CP6 in its Final Determination, due to be published in October 2018. It will publish a 'minded-to' decision as part of its Draft Determination, due to be published in June 2018. As noted, above, it will also be up to ORR to decide whether it wishes to adopt the Brockley Consulting methodology in setting fixed charges for CP6.

Summary of revised cost allocations

1.18. Table 1, below, summarises operators' fixed cost allocations based on the new Brockley Consulting methodology. The table also updates those numbers contained in our consultation to reflect CP6 cost data contained in our February 2018 SBP, rather than CP5 cost data from ORR's October 2013 Final Determination which was included in our consultation. These revised cost allocations also reflect our proposal to only allocate 'traffic related' avoidable fixed costs to train operators in CP6, and allocate 'minimum network' fixed costs to funders.

1.19. The revised cost allocations in Table 1, below, have not been reduced to reflect the grant income that we will receive direct from Government in CP6. If ORR uses the Brockley Consulting cost allocation methodology to calculate FTACs in CP6, these charges will also be calculated net of grant income.

1.20. The cost allocations in the table, below, incorporate a 'funding adjustment' in order to maintain the current funding arrangements between Transport Scotland (TS) and Department for Transport (DfT). These arrangements reflect the fact that TS specifies and funds the Scottish rail network, and DfT the England and Wales network.

[2] Available here: https://cdn.networkrail.co.uk/wp-content/uploads/2017/01/Network-Rails-consultation-on-its-methodology-for-allocating-fixed-costs-to-train-operators-in-Control-Period-6-September-2017.pdf

Table 1: Summary of operator fixed cost allocations in 2019/20 based on CP6 SBP cost data (£m, 2017/18 prices)

<table>
<tr><th>Operator</th><th>‘Traffic related’ avoidable fixed costs</th><th>‘Minimum network’ fixed costs</th><th>Total fixed costs</th></tr>
<tr><td>Arriva Rail London</td><td>53</td><td rowspan="28">Not allocated to operators and funded through grant</td><td rowspan="28">The sum of ‘traffic related’ and ‘minimum network’ costs</td></tr>
<tr><td>Arriva Trains Wales</td><td>97</td></tr>
<tr><td>c2c</td><td>49</td></tr>
<tr><td>Caledonian Sleeper</td><td>5</td></tr>
<tr><td>Chiltern Railways</td><td>32</td></tr>
<tr><td>CrossCountry</td><td>145</td></tr>
<tr><td>Crossrail</td><td>28</td></tr>
<tr><td>East Midlands Trains</td><td>136</td></tr>
<tr><td>Freight</td><td>253</td></tr>
<tr><td>Govia Thameslink Railway</td><td>439</td></tr>
<tr><td>Grand Central</td><td>14</td></tr>
<tr><td>Great Western Railway</td><td>257</td></tr>
<tr><td>Greater Anglia</td><td>157</td></tr>
<tr><td>Heathrow Express</td><td>6</td></tr>
<tr><td>Hull Trains</td><td>11</td></tr>
<tr><td>West Midlands Railway</td><td>129</td></tr>
<tr><td>London Underground</td><td>9</td></tr>
<tr><td>Merseyrail</td><td>56</td></tr>
<tr><td>Nexus</td><td>4</td></tr>
<tr><td>North Yorkshire Moors</td><td>0</td></tr>
<tr><td>Northern Rail</td><td>276</td></tr>
<tr><td>ScotRail</td><td>275</td></tr>
<tr><td>South Western Railway</td><td>216</td></tr>
<tr><td>Southeastern</td><td>203</td></tr>
<tr><td>Transpennine Express</td><td>71</td></tr>
<tr><td>Virgin Trains East Coast</td><td>145</td></tr>
<tr><td>Virgin Trains West Coast</td><td>170</td></tr>
<tr><td>West Coast Railways</td><td>1</td></tr>
<tr><td>Total</td><td>3,235</td><td>4,090</td><td>7,325</td></tr>
</table>

1.21. The cost allocation to Crossrail in Table 1, above, only reflects traffic currently running in Anglia. It does not include a cost allocation in respect of the Crossrail services due to start operating shortly on Western. We are in the process of updating Crossrail's cost allocation to reflect these additional services on Western and expect this to increase the level of fixed costs allocated to Crossrail, and reduce the costs allocated to Great Western Railway.

Consultation responses

1.22. We received 22 responses to our consultation from the following stakeholders:

- Aggregate Industries UK;
- Arriva;
- DB Cargo;
- Department for Transport;
- Esk Valley Railway;
- Freightliner;
- Freight Trade Association;
- GB Railfreight;
- Go Ahead;
- Institute for Transport Studies;
- Merseytravel;
- Nexus;
- North Yorkshire Moors Railway;
- Rail Freight Group;
- Rail North;
- Transport for London;
- Transport for Greater Manchester;
- Transport Scotland;
- Transworth Rail;
- Urban Transport Group;
- Virgin Trains; and
- Welsh Government.

1.23. We would like to thank all of the above stakeholders for taking the time to respond to this consultation and/or attending one of the meetings where we discussed this consultation. We really appreciate your feedback on our charging proposals. We have published non-confidential versions of the, above, consultation responses on our website[3].

Engagement and next steps

1.24. The principal future milestones for this periodic review, relevant to establishing the structure of charges for CP6, are summarised in Table 2, below.

1.25. In our September 2017 consultation we stated that we were planning to publish draft CP6 fixed charges price lists, consistent with our SBP, as part of this document. However, in its

[3] Available here: https://cdn.networkrail.co.uk/wp-content/uploads/2018/01/Responses-to-methodology-for-allocating-fixed-costs-to-train-operators-in-CP6.zip

letter of 13 April 2018[4] ORR instructed us to postpone publishing draft CP6 price lists until after it has issued its Draft Determination. Therefore, in this document we have not included draft CP6 fixed cost charges price lists. We now propose publishing draft price lists in July 2018, consistent with ORR's Draft Determination.

Table 2: Future periodic review milestones

Key milestone	Information	Date
ORR's Draft Determination	ORR's minded-to view in relation to setting structure of charges for CP6, including its views on our May 2018 conclusions	12 June 2018
Draft CP6 price lists	Publication of draft CP6 price lists by Network Rail, consistent with ORR's Draft Determination	End July 2018
ORR's Final Determination	ORR's final view which will ultimately set the structure of charges for CP6	31 October 2018
Final CP6 price lists	Publication of final CP6 price lists by Network Rail, consistent with ORR's Final Determination	December 2018

1.26. As noted, above, this document contains allocations to train operators of our forecast fixed costs in CP6. We reiterate that there is not an automatic link between these cost allocations and train operators' fixed cost charges. FTACs for franchised passenger operators are calculated net of the grant income that we receive from funders, which means that their charges will be significantly lower than the cost allocations set out in this document. Franchised passenger operators are also typically protected by funders from any increases in the level of their fixed charges through provisions in their franchise contracts. Charges recovering fixed costs from freight and open access passenger operators will be set based on ORR's assessment of what level of fixed cost charges different market segments can bear (i.e. limited to what ORR considers that they can afford).

1.27. The remainder of this document is structured as follows:

- Background;
- Safety;
- The Brockley Consulting review;
- Operators' comments on potential changes in cost allocations;
- Transparent grant; and
- Approach to adjusting FTACs for franchise re-mappings.

[4] Available here: http://orr.gov.uk/__data/assets/pdf_file/0010/27469/orr-variable-usage-charge-update-letter-april-2018.pdf

2 Background

Current fixed cost allocations

2.1 At present, neither Network Rail nor any other industry body allocates the fixed costs of the GB rail network to all train services on a consistent basis. This means that it is not clear which train services cause our fixed costs to be incurred, and it is not possible to make meaningful like-for-like comparisons between different types of train services.

2.2 There are, however, examples in CP5 where our fixed costs have been allocated to a subset of train operators, using different approaches. These are summarised, below:

- **FTACs**: Our fixed costs are allocated to train services as part of the process of calculating FTACs. However, as part of this process we only allocate costs to franchised passenger operators, on the basis that it is only these operators that pay FTACs. No fixed costs are allocated to freight or open access operators as part of this process because these operators do not pay FTACs. The cost allocation methodology is also very simple, allocating costs at Network Rail operating route-level based on operators' shares of traffic on each operating route. It is this cost allocation methodology which has been reviewed by Brockley Consulting, resulting in suggested improvements for CP6.

- **ORR's UK rail industry financial information document**[5]: This document aims to provide transparency in relation to the money flows across the entire rail industry and strengthen the industry's accountability to customers, passengers and funders. As part of this document our costs are allocated to franchised passenger operators but not freight or open access operators. The allocation methodology is also very simple, using slightly different metrics to those used to calculate FTACs.

- **L.E.K.'s analysis of freight avoidable costs**[6]: As part of PR13 Network Rail commissioned L.E.K. Consulting to estimate our freight avoidable costs (i.e. the total costs that we would avoid in the long-run in the absence of freight traffic). ORR used this cost estimate to inform the level of freight mark-ups during CP5. This analysis did not calculate avoidable cost estimates for passenger operators and is not directly comparable to the 'traffic related' avoidable fixed cost estimate developed by Brockley Consulting.

2.3 This document concludes on Network Rail's proposal to improve the way that we allocate our fixed costs to train operators in CP6. Because of the potential use by ORR of the Brockley Consulting methodology to set fixed cost charges in CP6, we summarise, below, the CP5 charging approach. We also set out what ORR has stated to date with regards to setting fixed cost charges for CP6.

[5] Available here: http://orr.gov.uk/rail/publications/reports/uk-rail-industry-financial-information
[6] Available here: https://cdn.networkrail.co.uk/wp-content/uploads/2017/02/LEK-report-on-estimating-freight-avoidable-costs.pdf

CP5 charges designed to recover fixed costs

2.4 Fixed cost charges currently represent the 'balancing figure' in our overall revenue requirement. This means that we recover through fixed cost charges (or network grant in lieu of access charges) any costs associated with running the railway not recovered through other sources of income (e.g. variable charges, station charges or commercial income).

2.5 As part of the current CP5 charging framework, franchised passenger operators and freight operators pay the following track access charges explicitly designed to recover our fixed costs:

- **FTACs paid by franchised passenger operators only**. In 2016/17 we received £392m of income through FTACs and £4,380m in grant income from Governments in lieu of FTACs.

- **The Freight Only Line Charge (FOL) and Freight Specific Charge (FSC).** Paid by freight operators and only by those segments of the freight market deemed by ORR as being able to contribute towards our fixed costs. In CP5 these charges were paid by freight traffic carrying coal for the electricity supply industry, nuclear fuel and iron ore. In 2016/17 we received £1m of income through FOL and FSC combined. The level of these charges was ultimately set based on ORR's view of how much these market segments could afford to contribute towards our fixed costs.

ORR's view on charges designed to recover fixed costs in CP6

2.6 As part of PR18, ORR has issued several documents in relation to fixed cost charges in CP6. We have summarised the views expressed by ORR in relation to fixed cost charges, below:

- **ORR's August 2016 letter supporting the continuation of the cost attribution work that we commissioned[7].** ORR stated that it considered that our work could potentially deliver significant benefits in terms of greater transparency around network costs and provide useful information to decision makers, including Network Rail, operators and funders. Reflecting this, it was supportive of us continuing our work in this area.

- **ORR's November 2016 conclusions on its initial consultation document[8]**: ORR stated that it would prioritise the reform of fixed cost charges so that open access operators make an appropriate contribution towards our fixed costs. Consistent with this, it would continue working with DfT on introducing a public service obligation (PSO) levy for open access operators. It also committed to updating its analysis of the extent to which different passenger and freight market segments can bear higher fixed cost charges.

- **ORR's June 2017 conclusions on its December 2016 charging consultation[9]**. ORR stated it would continue to work towards levying fixed cost charges on all operators (including open access operators), subject to a market can bear test and potentially based on our

[7] Available here: https://cdn.networkrail.co.uk/wp-content/uploads/2017/01/Network-Rail%E2%80%99s-cost-allocation-work-%E2%80%93-Letter-to-Network-Rail.pdf
[8] Available here: http://orr.gov.uk/__data/assets/pdf_file/0003/23196/pr18-initial-consultation-conclusions-letter.pdf
[9] Available here: http://orr.gov.uk/__data/assets/pdf_file/0008/24992/conclusions-on-consultation-on-charges-and-contractual-incentives-june-2017.pdf

new cost allocation methodology. However, it also said that before implementing the new methodology it would consider responses to this consultation, and the potential impacts on customers of using our new cost allocation methodology. ORR also stated that it will be merging the two existing freight mark-ups (FOL and FSC) into a single charge.

- **ORR's September 2017 consultation on CP6 fixed cost charges**[10]. For freight services, ORR proposed extending freight fixed cost charges to include biomass traffic (in CP5 these charges were limited to ESI coal, iron ore and spent nuclear fuel traffic). For passenger services, ORR set out the emerging findings from its consultants' analysis of the passenger services market. This work found that intercity and long-distance commuter services appear to have the ability to pay fixed cost charges. It also set out its approach to levying charges on passenger operators, and stated that it would continue to work with stakeholders as it develops its final proposals in this area.

- **ORR's April 2018 letter on charges and contractual incentives**[11]. ORR stated that it has taken the following high-level decisions, in principle, which it will consult on as part of the Draft Determination:

    - Using the new cost allocation methodology developed by Brockley Consulting when setting operators' fixed cost charges for CP6. ORR also stated that it will propose only allocating 'traffic related' avoidable fixed costs to train operators in CP6 (not 'minimum network' fixed costs).

    - Levying any fixed cost charges on open access operators in CP6 as a rate per train mile, and varying franchised passenger operator FTACs in CP6 based on changes in timetabled traffic levels.

[10] Available here: http://orr.gov.uk/__data/assets/pdf_file/0008/25649/pr18-consultation-on-charges-recovering-fixed-network-costs-september-2017.pdf
[11] Available here: http://orr.gov.uk/__data/assets/pdf_file/0010/27469/orr-variable-usage-charge-update-letter-april-2018.pdf

3 Safety

Summary of proposal in our consultation

3.1 We did not consider that the proposals set out in our consultation were likely to impact the safety of the network. However, we asked stakeholders for their views on this issue.

Summary of consultation responses

3.2 The vast majority of stakeholders considered that the proposals set out in our consultation would not have an impact on the safety of the network. However, North Yorkshire Moors Railway (NYMR) expressed concern that if costs allocated to heritage operators were translated into charges, this would divert resources away from safety innovation.

Network Rail conclusion

3.3 We would like to thank stakeholders for considering this issue. We agree with the vast majority of consultees that the proposals set out in our consultation will not impact the safety of the network. Therefore, we are confident that the conclusions that we reach in this document will also not adversely impact network safety. The decision regarding the extent that cost allocations get translated in to charges, including for heritage operators such as NYMR, rests with ORR, rather than Network Rail

4 The Brockley Consulting review

The cost allocation methodology

Summary of proposal in our consultation

4.1 Because the current approach to allocating our fixed costs to train operators is not very sophisticated, and in fact has significant flaws, we have decided to try and improve it for CP6.

4.2 We employed an independent costing expert, Brockley Consulting, to review the current cost allocation approach which underpins the CP5 FTACs and suggest improvements for CP6. This review commenced in late 2014 and has been carried out in a collaborative transparent way, with regular presentations to industry colleagues. More information in relation to the review carried out by Brockley Consulting is available on our website here.

4.3 In September 2017 we consulted on implementing the new methodology developed by Brockley Consulting to allocate our fixed costs to train operators in CP6. This new methodology is different to the current approach, used in the calculation of franchised passenger operators' FTACs, in the following key ways:

- **It allocates costs to all operators**. The current CP5 FTAC methodology only allocates costs to franchised passenger operators on the grounds that freight and open access operators do not currently pay FTACs. Brockley Consulting considers that, from a cost causation perspective, there was no reason to distinguish between different types of operators.

- **It further geographically disaggregates the cost base**. The current FTAC cost allocation method allocates costs at Network Rail operating route level. The revised cost allocation methodology developed by Brockley Consulting significantly improves upon this approach by estimating the costs of circa 3,100 individual track sections, and then allocating the costs of each of these smaller sections to the traffic that uses each section. This more granular approach to allocating costs results in cost allocations to operators that better reflect the relative costs of the parts of the network that they use.

- **It applies an avoidable cost approach**. Unlike the current FTAC methodology, the new approach developed by Brockley Consulting seeks to adopt an avoidable cost approach when allocating costs to train operators. This approach aims to establish an objective and transparent allocation of costs between operators, in a way which reflects long-run patterns of cost causation.

- **It adopts a different approach to allocating our Regulatory Asset Base (RAB)**. The FTAC methodology allocates RAB 'interest' costs based on forecast long-run renewals expenditure for each asset category. Brockley Consulting considers that this is unlikely to mirror the pattern of past enhancement expenditure and, where possible, it would be better to allocate RAB 'interest' costs in line with the depreciated replacement cost of assets on each route section.

- **It allocates the costs of the Scotland route on the same basis as routes in England and Wales**. Under the current FTAC methodology the fixed costs of the England and Wales network are only allocated to franchised passenger services specified by DfT. Similarly, the fixed costs of the network in Scotland are only allocated to franchised services specified by TS. This reflects the fact that the respective networks are specified by different funders. However, Brockley Consulting notes that, from a cost causation perspective, there seems no clear reason to treat services specified by DfT that run in Scotland differently to those specified by TS.

4.4 In our consultation we also stated that we were not aware of a change to the current funding arrangements between Governments. Therefore, we applied a 'funding adjustment' to the results of the Brockley Consulting analysis to reflect the existing agreement between DfT and TS. The impact of this adjustment was that we continued to not allocate any of the fixed costs of the Scotland route to train operators with franchises specified by DfT, or allocate any of the fixed costs associated with England and Wales to franchises specified by TS.

4.5 The cost allocations that we published in our consultation based CP5 cost data (uplifted to 2017/18 prices), are set out in Table 3, below[12]. Due to the fact that these cost allocations were based on data from October 2013 some of the operator names in Table 3, below, have subsequently changed as a result of the refranchising process.

Table 3: Summary of operator fixed cost allocations in 2018/19 based on CP5 ORR FD cost data (£m, 2017/18 prices)

Operator	'Traffic related' avoidable fixed costs	'Minimum network' fixed costs	Total fixed costs
Arriva Trains Wales	45	207	252
c2c	21	31	53
Chiltern Railways	13	58	72
CrossCountry	47	162	209
East Coast Main Line	53	110	163
East Midlands Trains	60	139	199
Eurostar	0	0	0
First Capital Connect	82	117	199
First Great Western	48	350	399
Freight	103	532	636
Grand Central	7	11	18
Heathrow Express	2	3	7
Hull Trains	6	7	12
London Midland	48	120	168

[12] Table 4 in this document updates these cost allocations to reflect the CP6 cost data contained in our February 2018 SBP.

LOROL	26	26	52
LUL Bakerloo	3	4	8
LUL District (Richmond)	2	1	3
Merseyrail	30	28	58
Miscellaneous	9	24	34
National Express East	82	193	275
Nexus	2	6	8
North Yorkshire Moors	0	2	2
Northern Rail	120	322	442
ScotRail	127	384	512
South West Trains	101	194	295
Southeastern	134	177	310
Southern	79	164	243
Transpennine Express	51	106	157
Virgin Trains	37	189	227
West Coast Railway	0	2	2
Total	**1,342**	**3,671**	**5,013**

Summary of consultation responses

4.6 Virgin Trains supported our proposal to use the new methodology developed by Brockley Consulting to allocate fixed costs to train operators in CP6. It considered the new methodology improves upon the very simple approach used previously.

4.7 However, responses from other stakeholders were generally not supportive of our proposal. Several stakeholders expressed concern over the level of fixed costs which would be attributed to freight and regional services, if the new methodology were to be introduced. A number of consultees also considered that it was not appropriate to allocate fixed costs to train operators if these fixed costs were not avoidable with reductions in traffic levels, even in the very long-run. Freightliner stated that allocating non-avoidable fixed costs gives the impression that operators drive fixed costs which in reality they are not able to influence.

4.8 There was, however, support from some stakeholders for using the new methodology to allocating ‘traffic related’ avoidable fixed costs to train operators, rather than total fixed costs.

4.9 Merseyrail suggested that all fixed costs should be funded by Government and operators should only pay variable charges.

Network Rail conclusion

4.10 We recognise stakeholders' concerns in relation to changes in the level of fixed cost allocations under the new Brockley Consulting methodology. We also note the views expressed by several stakeholders that it is not appropriate to allocate 'minimum network' fixed costs to train operators because these costs would not vary with traffic levels in the long-run (assuming the same parts of the country continue to be served by the rail network).

4.11 Therefore, in light of consultation responses that we have received from stakeholders, we have modified the proposal set out in our consultation.

4.12 We agree with stakeholders that it is appropriate to draw a distinction between 'traffic related' avoidable fixed costs and 'minimum network' fixed costs. In particular, we agree with those stakeholders who argued that it is reasonable to only allocate 'traffic related' avoidable fixed costs to train operators in CP6. There is a causal link between the presence of these costs and operators' trains. The link between operators' trains and 'minimum network' fixed costs is, however, less direct.

4.13 We consider that the parts of the country served by the rail network are to a large extent specified by funders through train service requirements in operators' franchises and through wider Government policy. These costs do not vary, even over a long period of time, if more or fewer trains run on the network. Therefore, we propose not allocating these non-avoidable fixed costs to train operators. Instead, we propose allocating a proportion of the network grant that we receive directly from funders to cover these costs.

4.14 We consider that our revised approach should significantly mitigate the concerns expressed by some stakeholders' in relation to the level of the cost allocations that they would receive under the Brockley Consulting methodology. Our modified approach to only allocate 'traffic related' avoidable fixed costs to train operators in CP6 results in a significant reduction in operators' fixed cost allocations (c. 50%-60% lower on average compared to if we were to allocate both 'traffic related' avoidable fixed costs and 'minimum network' fixed costs to train operators).

4.15 The revised cost allocations, based on the CP6 cost data contained in our February 2018 SBP, are summarised in Table 4, below. These only allocate 'traffic related' avoidable fixed costs to train operators.

4.16 The cost allocations in Table 4, below, are different to those set out in our consultation shown in Table 3, above. This is a result of updating cost allocations to reflect CP6 cost and income data, rather than CP5 cost and income data. Overall our fixed cost base has increased from c. £5bn p.a. in CP5 to c. £7.3bn p.a. in CP6.

4.17 The cost allocation to Crossrail in the table, below, only reflects traffic currently running in Anglia. It does not include a cost allocation in respect of the Crossrail services due to start operating shortly on Western. We are in the process of updating Crossrail's cost allocation to reflect these additional services on Western and expect this to increase the level of fixed costs allocated to Crossrail, and reduce the costs allocated to Great Western Railway.

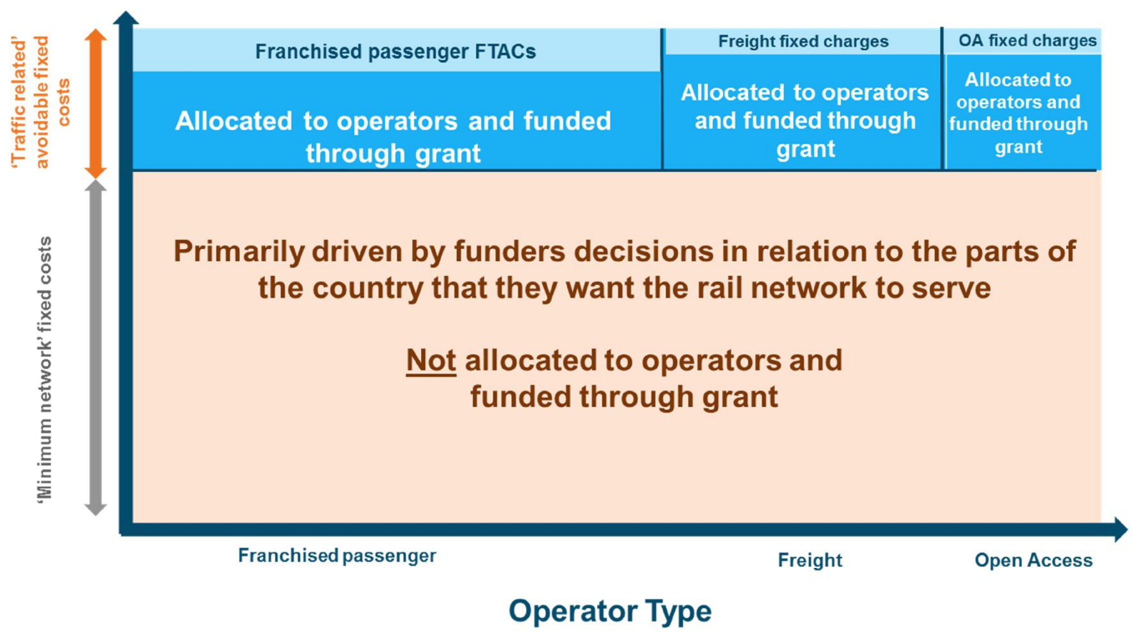
Table 4: Summary of operator fixed cost allocations in 2019/20 based on CP6 SBP cost data (£m, 2017/18 prices)

Operator	'Traffic related' avoidable fixed costs	'Minimum network' fixed costs	Total fixed costs
Arriva Rail London	53	Not allocated to operators and funded through grant	The sum of 'traffic related' and 'minimum network' costs
Arriva Trains Wales	97		
c2c	49		
Caledonian Sleeper	5		
Chiltern Railways	32		
CrossCountry	145		
Crossrail	28		
East Midlands Trains	136		
Freight	253		
Govia Thameslink Railway	439		
Grand Central	14		
Great Western Railway	257		
Greater Anglia	157		
Heathrow Express	6		
Hull Trains	11		
West Midlands Railway	129		
London Underground	9		
Merseyrail	56		
Nexus	4		
North Yorkshire Moors	0		
Northern Rail	276		
ScotRail	275		
South Western Railway	216		
Southeastern	203		
Transpennine Express	71		
Virgin Trains East Coast	145		
Virgin Trains West Coast	170		
West Coast Railways	1		
Total	**3,235**	**4,090**	**7,325**

4.18 The diagram, below, illustrates our proposed approach to allocating fixed costs and network grant to train operators in CP6 (it excludes variable costs recovered through variable charges and commercial income). This shows that we are proposing to:

- **Only allocate 'traffic related' avoidable fixed costs to train operators**. These costs are shown in blue in the diagram, below, and will either be funded through fixed cost charges payable by train operators, or grant income which we receive direct from funders.

- **<u>Not</u> allocate 'minimum network' fixed costs to train operators**. These costs are shown in pink in the diagram, below. These costs do not vary, even over a long period of time, if more or fewer trains run on the network. Therefore, we propose allocating these non-avoidable fixed costs to funders, rather than train operators. In CP6 these costs will be funded through grant income which we receive direct from funders.



4.19 We also set out in Table 5, below, how operators' new CP6 'traffic related' avoidable fixed cost allocations based on our February 2018 SBP compare to those which they would have received if the CP5 FTAC methodology was used to allocate these costs. Table 5 shows:

- **More costs allocated to freight and open access operators** who are not allocated any costs under the CP5 FTAC methodology on the basis that they do not pay FTACs.

- **Lower cost allocations for franchised passenger operators.** This reflects our conclusion to allocate 'minimum network' fixed costs to funders, rather than train operators. Under the CP5 FTAC methodology these costs were allocated to franchised passenger operators.

Table 5: Summary of operator fixed cost allocations in 2019/20 based on CP6 SBP cost data (£m, 2017/18 prices) – Proposed new method versus CP5 FTAC method

Operator	CP5 FTAC cost allocation method	Proposed new method ('Traffic related')	Proposed new method ('minimum network')	Change (£m)	Change (%)
Arriva Rail London	78	53	Not allocated to operators and funded through grant	(26)	(33%)
Arriva Trains Wales	324	97		(227)	(70%)
c2c	89	49		(40)	(45%)
Caledonian Sleeper	24	5		(20)	(80%)
Chiltern Railways	95	32		(64)	(67%)
CrossCountry	371	145		(226)	(61%)
Crossrail	58	28		(30)	(52%)
East Midlands Trains	270	136		(134)	(50%)
Freight	0	253		253	N/A
Govia Thameslink	1,014	439		(575)	(57%)
Grand Central	0	14		14	N/A
Great Western Railway	761	257		(504)	(66%)
Greater Anglia	373	157		(217)	(58%)
Heathrow Express	0	6		6	N/A
Hull Trains	0	11		11	N/A
London Midland	282	129		(153)	(54%)
London Underground	0	9		9	N/A
Merseyrail	53	56		3	5%
Nexus	0	4		4	N/A
North Yorkshire Moors	0	0		0	N/A
Northern Rail	594	276		(318)	(54%)
ScotRail	795	275		(519)	(65%)
South Western Railway	485	216		(269)	(55%)
Southeastern	422	203		(219)	(52%)
Transpennine Express	172	71		(101)	(59%)
Virgin Trains East Coast	415	145		(270)	(65%)
Virgin Trains West Coast	649	170		(480)	(74%)
West Coast Railways	0	1		1	N/A
Total	**7,325**	**3,235**	**4,090**	(0)	(0%)

The maximum level of fixed cost charges

Summary of proposal in our consultation

4.20 As stated earlier, it is a matter for ORR to determine train operators' fixed cost charges for CP6. However, in our consultation we suggested that the revised Brockley Consulting cost allocations should form the maximum level of operators' fixed cost charges in CP6.

Summary of consultation responses

4.21 Stakeholders' responses on this issue were mixed. Some stakeholders agreed in principle that the revised cost allocations should form the maximum level of operators' charges. However, many stakeholders also noted that the decision regarding whether to charge fixed costs to train operators rests with ORR, rather than Network Rail. Arriva considered that for charges to be properly cost reflective they should be based on 'traffic related' avoidable fixed costs.

4.22 Several stakeholders did not support our proposal. Transport for Greater Manchester stated that there was an argument that fixed cost charges should be abolished all together (these costs could be funded by Government) with train operators only paying variable charges.

4.23 Generally, there was a request from stakeholders for greater transparency of the cost data included in our consultation.

Network Rail view

4.24 In light of our revised proposal to only allocate a 'traffic related' avoidable fixed costs to train operators in CP6, we also consider that these cost allocations should form the maximum level of operators' fixed cost charges.

4.25 We agree with those stakeholders who considered that, ultimately, setting the level of charges is a matter for ORR, rather than Network Rail. We also stress that we are not suggesting that these cost allocations should necessarily be reflected in charges. As noted in our consultation there are good reasons for not always translating cost allocations into charges (e.g. the environmental and economic benefits generated by rail freight). In addition, any fixed cost charges levied on freight and open access passenger operators in CP6 will be set based on ORR's assessment of what train operators in different market segments can bear.

4.26 In response to stakeholders' requests for increased transparency, we have published alongside this consultation a more detailed breakdown of operators 'traffic related' avoidable fixed cost allocations.

Approach to allocating income

Summary of proposal in our consultation

4.27 In order to calculate operators' fixed cost allocations it is necessary to allocate the income that we receive through variable charges and other commercial sources to train operators (fixed cost allocations = total cost allocations – variable and commercial income allocations).

4.28 The FTAC methodology allocated income to franchised passenger operators only, typically based on vehicle miles or electric train miles. The new methodology developed by Brockley Consulting seeks to improve upon this approach by allocating income to all operators in a way that better reflects the sources of income.

Summary of consultation responses

4.29 Stakeholders' responses on this issue were mixed. Virgin supported our proposed approach and Arriva broadly agreed with it. DB Cargo and GBRf noted that we appeared to have excluded income from FOL and FSC charges. DB Cargo also noted that we did not allocate income to individual freight operators, so it was hard for them to comment on this question.

4.30 Urban Transport Group said that the allocation of income to train operators should reflect the charges that they pay and that it was not clear whether our methodology achieves full alignment in this respect. Merseyrail requested that we explain why our proposed methodology is better than the current FTAC method.

Network Rail conclusion

4.31 We have concluded that we should implement the revised approach to allocating income to train operators as set out in our consultation. We consider that the revised approach is better than the current FTAC method because it achieves better alignment between the charges that operators pay and the income that they are allocated. It also seeks to allocate certain cost and income categories (e.g. stations) on a consistent basis so that operators receive the same share of costs and income. There is misalignment in this respect under the current FTAC method.

4.32 As noted by freight stakeholders the fixed cost allocations presented in our consultation were net of variable charges, and not charges designed to recover fixed costs (e.g. FOL and FSC charges). The reason for this is that Brockley Consulting define fixed costs as total costs less income received through variable charges and other sources, and not income designed to recover fixed costs. Unfortunately, because our freight traffic forecast is by commodity type rather than by freight operator, cost allocations to individual freight operators are not readily available.

4.33 In response to the point raised by Urban Transport Group, we consider that the revised approach developed by Brockley Consulting achieves better alignment between the charges that operators pay and their allocation of income than the current FTAC approach. For example, under the Brockley Consulting method, Variable Usage Charge income is allocated to operators based on the charges that we forecast each operator will pay in CP6. This improves upon the current approach where this income is allocated between operators based on their of share vehicle miles on each route. However, there is still not full alignment under the Brockley Consulting method between the charges that operators will pay in CP6 and the income that they are allocated. One example of this is the allocation of income which we receive through depot lease charges, which we allocate to passenger train operators that use Network Rail depots on a particular route based on their respective share of route vehicle miles. The reason that we allocate depot income on this basis is to mirror the approach that we have adopted for allocating depot costs to train operators, so that operators receive a consistent share of both depot costs and income.

5 Operators' comments on potential changes in cost allocations

Summary of proposal in our consultation

5.1 In our September 2017 consultation we presented the, below, changes in the level of operators' cost allocations (not charges) as a result of introducing the new Brockley Consulting methodology. As noted, above, in our consultation we proposed allocating both 'traffic related' avoidable fixed costs and 'minimum network' fixed costs to train operators under the proposed new method.

5.2 The cost allocations in our consultation and Table 6, below, were also based on PR13 Final Determination cost data (i.e. October 2013 cost data) because, at the time, we had not finalised our CP6 SBP. Due to the fact that these cost allocations were based on data from October 2013 some of the operator names in Table 6, below, have subsequently changed as a result of the refranchising process.

Table 6: Summary of operator fixed cost allocations in 2018/19 based on CP5 data (£m, 2017/18 prices) – CP5 FTAC method versus method proposed in our consultation

Operator	CP5 FTAC cost allocation method	Proposed new method	Change (£m)	Change (%)
Arriva Trains Wales	238	252	13	6%
c2c	56	53	(3)	(6%)
Chiltern Railways	58	72	13	23%
CrossCountry	275	209	(65)	(24%)
East Coast Main Line Rail	343	163	(180)	(52%)
East Midlands Trains	222	199	(24)	(11%)
Eurostar	0	0	0	N/A
First Capital Connect	300	199	(102)	(34%)
First Great Western	478	399	(80)	(17%)
Freight	0	636	636	N/A
Grand Central	0	18	18	N/A
Heathrow Express	0	7	7	N/A
Hull Trains	0	12	12	N/A
London Midland	195	168	(27)	(14%)
LOROL	49	52	2	5%
LUL Bakerloo	0	8	8	N/A
LUL District (Richmond)	0	3	3	N/A
Merseyrail	36	58	24	63%

Miscellaneous Passenger	0	34	34	N/A
National Express East	314	275	(39)	(13%)
Nexus	0	8	8	N/A
North Yorkshire Moors	0	2	2	N/A
Northern Rail	295	442	147	50%
ScotRail	581	512	(70)	(12%)
South West Trains	313	295	(18)	(6%)
Southeastern	267	310	43	16%
Southern	290	243	(47)	(16%)
Transpennine Express	165	157	(8)	(5%)
Virgin Trains	537	227	(310)	(58%)
West Coast Railway	0	2	2	N/A
Total	**5,013**	**5,013**	**0**	**0%**

Summary of consultation responses

5.3 Virgin believed that the new approach was a significant improvement on the current model. However, there was little support from other stakeholders for the revised cost allocations set out in our consultation.

5.4 Freight operators expressed concern that the cost allocations could be misinterpreted and potentially reduce support for the sector. It was suggested that when presenting numbers in public documents we should only attribute 'traffic related' avoidable fixed costs to train operators. Freight stakeholders also questioned why their allocation of fixed costs was 13% even though they are only responsible for 6% of train miles.

5.5 Merseyrail expressed concern in relation to the shift in costs away from long-distance operators and towards regional/local operators. Urban Transport Group also opposed the direction of movements in costs as a result of our proposals, in particular the increased cost allocations to regional services. Merseyrail also questioned why its allocation of fixed costs has increased given the infrastructure that it uses is not shared with other train operators.

5.6 TfL stated that any changes in fixed cost charges for regional services are more likely to be paid for by devolved funders. Therefore, any change in cost allocations due to the new methodology should be reflected in compensation to/from DfT. DfT also considered that the financial arrangements between different funders needs to be considered in more detail before any changes are made. TS stated that cross-border services should pay their fair share for using the Scottish network.

5.7 Govia supported the findings of our report but wished to understand how the cost allocations translate into fixed cost charges.

Network Rail conclusion

5.8 We consider that our proposal to only allocate 'traffic related' avoidable fixed costs to train operators in CP6 should significantly address concerns expressed by freight and regional stakeholders. The reason for this is that operators' avoidable 'traffic related' fixed cost allocations are significantly lower (c. 50%-60%) compared to if we were to allocate both 'traffic related' avoidable fixed costs and minimum network fixed costs to train operators.

5.9 We can confirm that the allocation of 13% of fixed costs to freight operators in our consultation was underpinned by an assumption that freight traffic accounted for 7% of total train miles (rather than the 6% suggested by freight stakeholders). The principal reasons why the costs allocated to freight in our consultation exceeded its share of train miles were:

- The allocation of some cost categories (e.g. central IT costs) were based on vehicle miles, which freight traffic has a greater share of than train miles;
- Freight pays a small proportion of variable charges, therefore, its share of fixed costs is greater than its share of total costs (fixed costs = total costs – income from variable charges); and
- Other factors, including the fact that freight operators have a network-wide 'foot print', and run on lots of lightly used routes which have a higher cost per train mile.

5.10 We can confirm that in our new PR18 traffic forecast freight traffic accounts for 6% of train miles in 2019/20 and, as shown in Table 5 above, 8% of 'traffic related' avoidable fixed costs in 2019/20 . A key reason for this reduction in the gap between freight train miles and freight 'traffic related' avoidable fixed costs is that, in light of responses to this consultation, Brockley Consulting has slightly modified its cost allocation methodology. In particular, some cost categories (e.g. central IT costs) which were previously allocated to operators based on vehicle miles, are now allocated to operators in proportion to their directly attributable costs.

5.11 Although Merseyrail operates over routes which are not typically shared with other operators its cost allocation will still change following the introduction of the new Brockley Consulting methodology. The reason for this that under the current FTAC methodology Merseyrail is allocated a proportion of our total LNW route costs based on its share of traffic on the LNW route (like other franchised operators). Therefore, at present, the cost allocation methodology does not aim to restrict Merseyrail's cost allocation to the infrastructure that it uses. In fact, this is one of the aims of the new Brockley Consulting methodology, and one of the key reasons for the change in Merseyrail's cost allocation.

5.12 In response to Govia's query regarding how their cost allocations translate into fixed cost charges this is a decision for ORR. However, because we receive grant income direct from funders, FTACs in CP6 (like in CP5) are likely to be significantly lower than the cost allocations set out in this document.

5.13 We note TS's view in relation to fixed cost charges levied on cross-border services. However, as set out in our consultation, unless TS and DfT agree a revised approach to the treatment of these services we will retain the current arrangements.

5.14 We recognise the concern expressed by TfL and DfT regarding the potential exposure of regional funders to increases in the level of FTACs for CP6 (unlike franchised train operators more generally who would be compensated by DfT/TS). We will work closely with DfT and regional funders in order to ensure that any changes in the level FTACs for CP6 are understood well in advance of these new charges coming into effect. This information should help to facilitate discussion between DfT and regional funders in relation to how best to manage this change, which is not a matter for Network Rail.

6 Transparent grant

Summary of proposal in our consultation

6.1 In our consultation we proposed that where a market segment (e.g. freight services carrying certain commodities) cannot afford to pay all of the fixed costs attributable to it, that some of the network grant that we receive from funders should be allocated to these services to pay for their fixed costs. At present, the costs attributable to these services are not transparent and are included in franchised passenger operators FTACs (or the grant income received by Network Rail in lieu of access charges). This approach does not make clear the actual distribution of fixed costs and network grant across the GB rail industry.

6.2 We also stated that there are good reasons for not automatically reflecting fixed costs allocations in operators' fixed cost charges. However, we did not consider this to be a reason for not allocating fixed costs in a consistent and transparent way across the GB rail industry.

6.3 Ultimately, funders decide on the level of network grant that they wish to provide to the GB rail industry.

Summary of consultation responses

6.4 There were mixed views from stakeholders in response to this question. Virgin, Govia, Merseyrail, TfL, NYMR and Esk Valley Railway expressed support for transparency over which operators cause our fixed costs to be incurred.

6.5 Arriva stated that it would support being transparent about the 'traffic related' avoidable fixed costs attributable to operators and that the non-avoidable fixed costs should be funded by network grant. Freight operators also did not support being allocated non-avoidable fixed costs. Freightliner considered that network grant should only be attributable to a sector to cover any 'traffic related' avoidable fixed costs not funded through charges.

6.6 Transport for Greater Manchester and Urban Transport Group agreed that it is important to be transparent about fixed costs but that this should be built on realistic assumptions, which they do not believe that our new methodology provides, particularly for regional services.

6.7 RFG and Aggregate Industries considered that transparency can only aid effective decision making if there is a clear link to how costs can then be reduced.

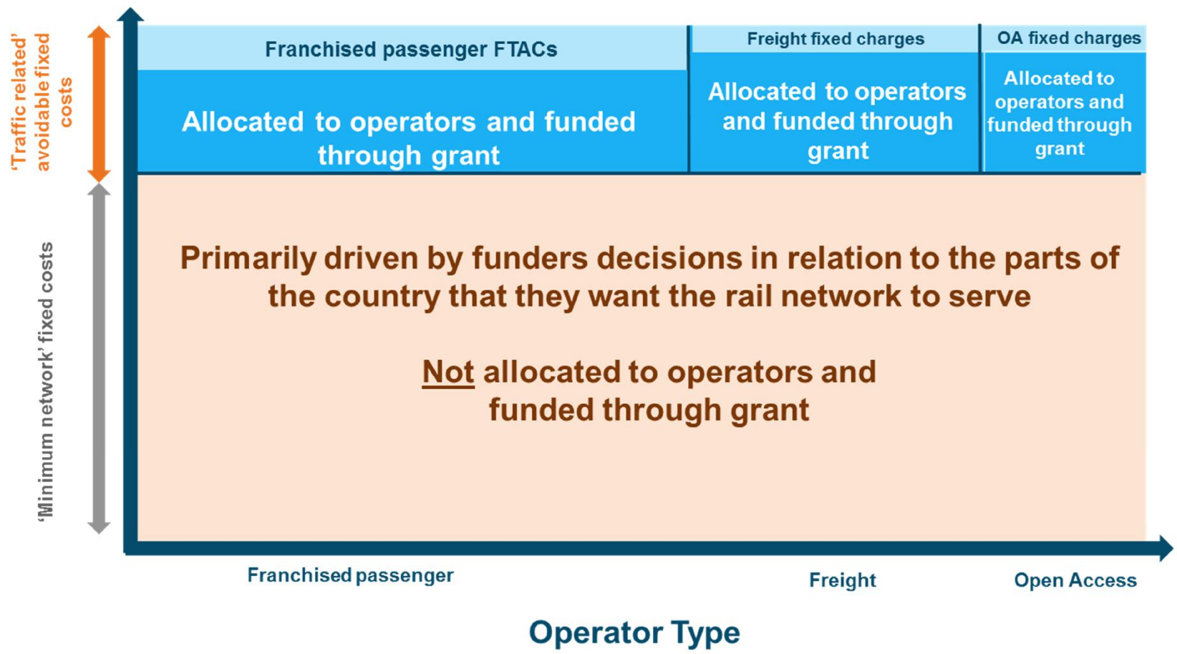
Network Rail conclusion

6.8 We consider that it is important to allocate our fixed costs to all operators, irrespective of whether they are franchised, freight or open access operators. This will enable a like-for-like comparison between different types of train services, which is not possible at the moment. However, as noted above, in light of responses received from stakeholders we have concluded that we should only allocating 'traffic related' avoidable fixed costs to train operators.

6.9 For CP6, we have conclude that we will allocate the network grant that we receive from funders to the following fixed costs, which are not recovered through fixed cost charges:

- **Fixed costs associated with having a 'minimum network' which connects the different parts of the country to the rail network** (shown in pink in the diagram, below). We propose allocating these costs to funders on the basis that they largely specify the parts of the country served by the rail network through the franchising process and wider Government policy.

- **'Traffic related' avoidable fixed costs where the fixed cost charges that train operators pay do not cover these costs** (shown in dark blue in the diagram, below).



6.10 In order to improve transparency in this area we propose publishing allocations of fixed costs and network grant alongside CP6 FTAC price lists in July 2018. An illustrative example is provided in Table 7, below, of how we propose making transparent the fixed costs that different train operators impose on the network, and extent to which these costs are funded through track access charges versus network grant.

Table 7: Illustrative example of how we propose making transparent 'traffic related' avoidable fixed costs funded by grant

	A	B	A – B	C	B + (A-B) + C
Operator	**'Traffic related' avoidable fixed costs (£m)**	**Fixed cost charges payable in CP6 (£m)**	**'Grant funded' avoidable fixed costs (£m)**	**Grant funded 'minimum network' fixed costs (£m)**	**Total fixed costs (£m)**
Franchised operator (1)	120	100	20		
Franchised operator (2)	50	40	10		
Open Access	5	0	5		
Freight	25	5	20		
Total	**200**	**145**	**55**	**300**	**500**

7 Approach to adjusting FTACs for franchise re-mappings

Summary of proposal in our consultation

7.1 In our consultation we proposed retaining a simple approach to calculating adjustments to FTACs, when services transfer between operators. In summary, we proposed adjusting operators' FTACs in proportion to the share of services that have been transferred. However, for CP6 we proposed basing any adjustments on the proportion of train miles that have transferred, rather than the proportion of vehicle miles, which was used in CP5. This reflects the fact that train length does not drive the level of our fixed costs.

Summary of consultation responses

7.2 There were mixed views from stakeholders in response to this question. Arriva, Govia and Virgin supported our proposed approach to retaining a simple approach to adjusting FTACs using train miles, rather than vehicle miles.

7.3 TfL supported a simple approach to adjusting FTACs but considered that it should be based on vehicle miles to reflect the fact that longer heavier trains drive more costs. Urban Transport Group was also supportive of continuing to base any adjustments on vehicle miles. Merseyrail did not support our proposed approach on the basis that it would treat an 11-car train and a 2-car train the same.

7.4 Esk Valley Railway stated that it would not support our proposed simple approach to adjusting FTACs, if the new Brockley Consulting methodology were to be introduced. It considered that this would be perverse given that we are proposing to introduce a more sophisticated cost allocation methodology. Instead, it effectively supported updating and re-running the Brockley Consulting cost allocation model each time that there is a franchise re-mapping.

Network Rail conclusion

7.5 Following careful consideration of consultation responses, we confirm the proposal set out in our consultation. We will retain a simple approach to adjusting FTACs when services transfer between operators but based on the proportion of train miles that have transferred, rather than the proportion of vehicle miles, which was used in CP5.

7.6 Whilst train length is an important driver of 'wear and tear' costs, we do not consider that it has a significant impact on the level of our fixed cost base. Therefore, we consider it appropriate to base any adjustments to operators' FTACs on train miles, rather than vehicle miles.

7.7 We agree with Esk Valley Railway that our proposal in this area represents a simplification of the new more sophisticated Brockley Consulting methodology. However, we consider that this simplification is proportionate given the relatively small number of franchise re-mappings each control period, and the fact that franchised train operators are held harmless to changes in the level of charges. If we were to update all of the relevant inputs into the Brockley Consulting work to reflect the franchise re-mapping (e.g. operators' share of traffic on each of the track sections that they use) this would be a significant analytical exercise, and in our opinion require a disproportionate amount of effort and cost.