



PR18: Infrastructure cost charges – final impact assessment on the Network Rail allocation methodology

October 2018

This impact assessment supports our conclusions following our June 2018 [‘infrastructure cost charges consultation’](#). The assessment of the options contained within this document have been updated to reflect points raised in response to the consultation. This impact assessment has been published alongside the [‘Supplementary document – Charges and incentives: Infrastructure cost charges conclusions’](#)

Policy	Charges – infrastructure cost charges
Policy area	Methodology for allocating fixed network costs
Background	<p>Infrastructure cost charges (ICCs) are intended to recover Network Rail’s fixed network costs. Network Rail’s fixed costs are the costs of operating, maintaining, renewing and enhancing the network that do not vary in the short-run.</p> <p>In order to calculate operators’ ICCs we first need a methodology for allocating fixed network costs to any type of service.</p> <p>The methodology used to allocate fixed costs to different types of services will set the maximum level of ICCs payable. The actual level of the ICCs for each type of service will be determined by the market can bear (MCB) test.</p> <p>The current approach to allocate Network Rail’s fixed network costs to services varies by type of operator.</p> <ul style="list-style-type: none">• Freight services: In PR13 Network Rail appointed consultants to estimate freight avoidable costs (i.e. those costs which would be avoided in the long-run if freight services stopped using the network), and allocate those to different freight market segments (i.e. commodities).

	<ul style="list-style-type: none"> • Franchised passenger services: The fixed track access charge (FTAC) allocates Network Rail’s net revenue requirement for each route to franchised passenger operators based on their forecast usage of that route for each year of the next control period. • Open access passenger services: No fixed costs are currently allocated to open access passenger services. <p>In 2014, Network Rail appointed Brockley Consulting to undertake a review of cost allocation and attribution approaches in the rail industry, and explore potential alternatives.</p> <p>Network Rail completed a pilot study for a new fixed cost allocation methodology on the Wales route (henceforth referred to as the “Network Rail allocation methodology”) in 2016. The Network Rail allocation methodology was subsequently rolled out to the rest of the network and in September 2017 Network Rail published a consultation seeking stakeholders’ views on the new cost allocation methodology.</p> <p>The purpose of this impact assessment is to determine whether the Network Rail allocation methodology is robust enough to be used for calculating ICCs in control period 6 (CP6)¹ and if it represents an improvement over the current approaches to allocating Network Rail’s fixed costs.</p>
<p>PR18 outcomes and objectives to assess each option against</p>	<p>➤ Outcome: The network is efficient <i>(The network is being operated, maintained and renewed at the lowest cost, given the level of use and performance)</i></p> <p>Objective:</p> <ul style="list-style-type: none"> • Provide Network Rail with accurate incentives to lower costs • Provide Network Rail with effective incentives to lower costs • Ensure Network Rail can recover its total costs

¹ CP6 will run from 1 April 2019 to 31 March 2024.

➤ **Outcome:** The network is better used
(Network Rail and operators find ways to improve network use and accommodate new services)

Objectives:

- Provide accurate incentives for Network Rail to add traffic to the network
- Ensure operators take costs of service into account when using the network
- Ensure capacity is allocated on the basis of the cost of provision and value of use

Problem under consideration with the current approach for allocating fixed costs

Compared to the avoidable cost approach currently used to allocate fixed costs to different freight market segments, the current approaches for allocating fixed costs to passenger services lack cost-reflectivity (i.e. fixed costs are not necessarily allocated to the operators that cause them). For instance, allocating FTAC to franchised passenger services on the basis of forecasts of their usage of each route in the next control period does not reflect that fixed costs can vary significantly across an operating route and some services may only run on relatively cheaper or more expensive parts of a route. At the same time, open access services are not allocated any fixed costs, even notionally. This lack of cost-reflectivity contributes to the weak understanding around the drivers of fixed network costs in the rail industry.

Both the lack of cost-reflectivity around the allocation of fixed costs to passenger services and the low degree of understanding around the drivers of these costs reduces the information available to Network Rail to make decisions in order to lower its fixed costs. It also limits the information funders and ORR have available to hold Network Rail to account on its fixed costs. This means that the current approaches for allocating fixed costs to services do not provide Network Rail with accurate or effective incentives to lower its fixed costs to the efficient level.

The current approaches for allocating fixed costs to passenger services also limit the incentive that operators have to take into account fixed costs when using the network. The limited information available on the drivers of fixed costs makes it difficult for operators to understand how they could reduce the fixed costs that they cause.

The current methodologies for allocating fixed costs to passenger services also affect decisions on the allocation of capacity. The shortage of information on the drivers of fixed costs means the parties involved in the allocation of capacity, such as Network Rail, funders and ORR, do not have detailed information on the long-run fixed costs caused by adding or removing services on different parts of the network. This makes it difficult for these parties to allocate capacity based on the long-run cost of provision and value of use. It also means Network Rail lacks accurate incentives to add traffic to the network.

Options to be considered

Option 0: 'Do nothing'

The 'do nothing' option is to continue to use the approaches used in CP5 to allocate fixed costs to services. This means the approach used to allocate fixed costs to services would continue to vary by type of operator:

Freight services

The allocation of fixed costs to freight services would continue to be based on the PR13 estimates by L.E.K of the long-run fixed costs that would be avoided on the network if freight services no longer used the network, known as freight avoidable costs. This approach does not allocate any fixed costs that would not be avoided if freight services no longer used the network (henceforth referred to as “non-avoidable costs”), such as Network Rail’s central costs.

Network Rail is not planning to re-run the L.E.K analysis to reflect the CP6 cost base, therefore the freight avoidable cost estimates from PR13 would continue to be used.

Franchised passenger services

Under the ‘do nothing’ option, fixed costs would be allocated to franchised passenger operators using the existing FTAC approach.

The first step in the current FTAC methodology is to calculate Network Rail’s net revenue requirement for each route. The net revenue requirement for each route (in this case) is defined as the sum of the route’s operating costs, maintenance costs, Regulatory Asset Base (RAB) amortisation and RAB return, minus Network Rail’s total income from track access charges and other sources of income. RAB amortisation and RAB return are not forecasted at the route level so they are allocated to each route based on each route’s proportion of total long-run renewals expenditure.

Next, each route’s costs are allocated to each asset category (e.g. track, signalling and bridges). The costs for each asset category are then allocated between franchised passenger operators based on each operator’s share of specified traffic metrics on a route. The traffic metrics used varies between asset categories: for example, signalling costs are allocated based on train miles and track costs are allocated using equivalent million gross tonnes Per Annum miles (EMGTPA miles).

The total income for each route is allocated to franchised passenger operators based on their share of specified traffic metrics on the route. The traffic metrics used varies between income categories. For example, variable usage charge (VUC) income is allocated using vehicle miles and the electricity asset usage charge (EAUC) is allocated using electric train miles.

The total income allocated to each franchised operator is subtracted from the total costs allocated to them to give the net allocation for each franchised operator on each route.

The total allocation for each franchised passenger operator is the sum of the net allocations across all the routes that it runs on.

Finally, the network grant paid by governments to Network Rail is netted off each franchised passenger operator’s total allocation to determine each operator’s final FTAC allocation, which is included on the price list. The network grant is subtracted from each operator’s total allocation in proportion to its share of total FTAC.

It is important to note that under the current FTAC methodology, all costs on the Scotland route are allocated to the franchised passenger operators specified by Transport Scotland and franchised operators specified by Transport Scotland are not allocated any costs on any of the routes they run on outside of Scotland. This is to reflect an agreement between Transport Scotland and the Department for Transport (DfT) that all infrastructure on the Scotland operating route is specified and funded by Transport Scotland.

Open access services

For CP5 no fixed costs were allocated to services run by open access operators (OAOs). In our [June 2017 conclusions letter](#), we explained that we would continue to work towards levying ICCs on all operators, including OAOs. Therefore, for CP6 fixed network costs will need to be allocated to open access services.

In the event that the Network Rail allocation methodology is not deemed robust enough to be used for the calculation of ICCs, the current FTAC approach, described above, would be used to allocate fixed network costs to open access services. This includes netting off a proportion of the network grant off each OAO's total allocation.

Option 1: The Network Rail allocation methodology

This option would use the Network Rail allocation methodology to allocate Network Rail's total net revenue requirement for CP6 to different types of services.

The Network Rail allocation methodology makes several revisions to the existing FTAC methodology:

- a. Allocate total costs to all operators
- b. Geographical disaggregation of the cost base
- c. Avoidable cost approach
- d. Allocate RAB return on the basis of asset costs
- e. Revise the allocation of variable and third party income

If this option is implemented all these revisions will be made to the existing FTAC methodology.

a. Allocate total costs to all operators

The Network Rail allocation methodology allocates Network Rail's net revenue requirement to all operators (i.e. including freight and OAOs), based on each operator's share of specified traffic metrics.

The methodology also allocates costs to all operators that run on the Scotland operating route, and franchised passenger operators specified by Transport Scotland are allocated costs on all the routes they run on. However, for franchised passenger services, Network Rail has included a 'funding adjustment' to maintain the current approach of only allocating costs on the Scotland route to Scottish franchised operators and not to allocate any costs to Scottish franchised operators for the other routes they run on. This

is to reflect the existing funding arrangement between DfT and Transport Scotland. It should be noted that, even after the funding adjustment, costs on the Scotland route are still allocated to freight and open access services

b. Geographical disaggregation of the cost base

The costs for each Network Rail operating route are allocated to constant traffic sections and route sections. Constant traffic sections are sections of track that all trains must enter and exit at the same point. Route sections are made up of constant traffic sections, for instance on a two-track section of a route, a route section comprise two parallel constant traffic sections. There are 1,900 route sections and 3,100 constant traffic sections on the network.

The Network Rail allocation methodology maps assets onto constant traffic and route sections, estimates the costs for each section based on whole life maintenance and renewal costs and allocates these costs to the traffic running on each route section using specified traffic metrics.

This approach can be applied to significant asset categories, such as track and signalling. However, approximately 30% of Network Rail's total cost base relates to costs such as traction electricity and central support costs, which cannot be disaggregated to the constant traffic section or route section level. In addition, cost data is not available for a proportion of assets located at the local level, such as electrical plant and telecoms. These costs account for around 15% of Network Rail's total cost base. Network Rail's local asset cost database is continually updated, therefore, it is likely that the proportion of local asset cost data available will increase overtime.

c. Avoidable cost approach

An avoidable cost approach aims to estimate the costs that would be avoided in the long-run if particular types, or increments, of traffic no longer ran on the network.

The Network Rail allocation methodology considers two categories of avoidable costs, traffic characteristic avoidable costs and 'vanilla' traffic avoidable costs. Traffic characteristic avoidable costs are those costs that are avoidable by removing traffic with specific characteristics, such as high-speed or electrified trains. Traffic characteristic avoidable costs are allocated to the services with those characteristics. Vanilla traffic avoidable costs are costs that would be avoided in the long-run by removing traffic in general. For example, at very low levels of traffic, only a single track would be needed and the cost of parallel tracks would, in the long-run, be avoided. These costs are allocated to services on each route section based on each service's share of annual trains running on the route section.

The Network Rail allocation methodology also allocates costs to operators that would still be incurred on a 'minimal traffic network'. A minimal traffic network represents the assets that would be required to facilitate minimum traffic levels (e.g. one train per day)

and maintain the current connectivity of the network. The costs on a minimal traffic network would be incurred regardless of changes to the type and volume of traffic that runs on the network, thus, they are non-avoidable costs. Since these costs are non-avoidable, there is no single correct way to allocate them to operators. The Network Rail allocation methodology has used an “Equi-Proportional Mark-Up” (EMPU) approach. The EMPU approach allocates the non-avoidable costs to operators based on the proportion of total avoidable costs (i.e. the sum of traffic characteristic and vanilla traffic avoidable costs) allocated to each operator. For cost categories where no avoidable costs are identified, the non-avoidable costs are allocated using the traffic metrics used under the current FTAC approach.

d. Allocate RAB return on the basis of asset costs

The Network Rail allocation methodology allocates the RAB return to asset categories return on the basis of estimated depreciated replacement cost.

This methodology could apply in CP6 to Network Rail’s forecast financing costs, as ORR has not calculated the RAB return as part of Network Rail’s CP6 revenue requirement calculations.

e. Revise the allocation of variable and third party income

The Network Rail allocation methodology also revises how variable and third party income is allocated to services in order to better reflect the sources of that income. For example, while the FTAC methodology allocates variable usage charge (VUC) income to operators based on vehicle miles the Network Rail allocation methodology proposes to allocate this income based on forecasts of the amount each operator will pay.

More detail on each the refinements described above is available in the [technical report](#) produced by Brockley Consulting for Network Rail.

Assessment of Option 1: The Network Rail allocation methodology

Outcome: The network is efficient

Objective: Provide Network Rail with accurate incentives to lower costs

We have not identified any issues or ways to significantly improve how the Network Rail allocation methodology allocates fixed costs to all operators, geographically disaggregates the cost base, allocates traffic characteristic and vanilla avoidable costs and allocates the RAB return based on asset costs. In addition, stakeholders did not raise any material concerns in response to Network Rail’s September 2017 consultation or our June 2018 consultation on these revisions to the current FTAC methodology. Therefore, relative to the counterfactual, the Network Rail allocation methodology would improve the information available to Network Rail on the drivers of fixed network costs.

Firstly, the geographical disaggregation of the cost base improves the information available on how the level of fixed costs varies across the network. This information is not currently available as the current FTAC methodology averages the costs across each Network Rail operating route and allocates an average to all train services. However, as previously mentioned, not all of Network Rail's cost base can be geographically disaggregated.

Secondly, the traffic characteristic avoidable costs allocated in the Network Rail allocation methodology provides information on the additional fixed costs caused by adding different types of traffic to the network. The specific traffic characteristics the Network Rail allocation methodology can provide information on are; speed; axle load; unsprung mass; curving class; electrification; and depot usage. Although this is not an exhaustive list of all the different characteristics of traffic on the network, following consultation with Network Rail engineers and industry stakeholders they are considered to have most material impact on costs and can be modelled without disproportionate effort.

These features of the new cost allocation methodology would provide Network Rail with more accurate and detailed information on the drivers of fixed costs, thereby providing it with more accurate incentives to lower fixed costs.

However, the allocation of Network Rail's non-avoidable fixed costs would not provide information to Network Rail that it could act on to lower its fixed costs. The report on the Network Rail allocation methodology by Brockley Consulting in September 2017 showed non-avoidable costs account for 50% of Network Rail's fixed cost base in CP5. This means the Network Rail allocation methodology would only improve the information on the drivers of a proportion of Network Rail's fixed costs.

Outcome: The network is efficient

Objective: Provide Network Rail with effective incentives to lower costs

As the Network Rail allocation methodology would improve Network Rail's knowledge of the drivers of fixed costs and how they vary across the network, it would be easier for Network Rail to respond to its main financial incentive to lower its fixed costs, i.e. retain any efficiency gains it makes during a control period. For example, allocating fixed costs at the constant traffic and route section level would help Network Rail to focus on areas where long-run cost savings can be made.

The improved information on the drivers of fixed costs and how they vary across the network would also be available to ORR and funders. ORR would have better evidence to challenge Network Rail on its fixed costs during the periodic review process. Funders, such as DfT and Transport Scotland, could use this information to inform decisions on enhancements and franchise specifications. Funders would also have an incentive to use the Network Rail allocation methodology to encourage Network Rail to lower its

fixed costs, given that a proportion of the fixed network costs is likely to be paid by funders through the network grant.

The allocation of non-avoidable costs in the Network Rail allocation methodology under this option would not provide information to Network Rail that it could respond to lower its fixed costs.

Although the allocation of non-avoidable costs would not improve the information available to Network Rail, ORR and funders on the drivers of a proportion of Network Rail's fixed costs, the Network Rail allocation methodology would still be an improvement on the information currently available. This would make it easier for Network Rail to lower its fixed costs and for funders and ORR to challenge Network Rail on its fixed costs, thus providing Network Rail with more effective incentives to lower its fixed costs.

Outcome: The network is efficient

Objective: Ensure Network Rail can recover its total costs

The Network Rail allocation methodology would only change how Network Rail's fixed costs are allocated between operators; on its own it would not affect how Network Rail's fixed costs are recovered. As a result, this option has no impact on Network Rail's ability to recover its total fixed costs.

The design of ICCs for different services is being considered separately to the methodology used to calculate the maximum level of ICCs for each service.

Outcome: The network is better used

Objective: Provide accurate incentives for Network Rail to add traffic to the network

The refinements the Network Rail allocation methodology makes to the current FTAC methodology improves the information available to Network Rail about both the costs and income of adding new traffic to the network.

Geographically disaggregating the cost base provides Network Rail with more information on the long-run costs of adding new services to different parts of the network than it is currently available. For example, the Brockley Consulting report showed fixed cost allocations will increase in areas of the network that are inherently costly per mile, such as urban areas that tend to have relatively high level of junctions and bridges close together.

The avoidable cost approach used in the Network Rail allocation methodology would also provide Network Rail with better information on the costs of adding new traffic to the network. The traffic characteristic avoidable costs would provide information on the long-run costs of adding particular types of traffic to the network.

The revisions included in the new Network Rail allocation methodology around the allocation of variable and third party income to services provides Network Rail with

better information on the income it would receive by adding new services to the network. Firstly, the allocation of variable and third party income to all services on a consistent basis provides Network Rail with information on what the level of income it can expect to receive from any type of service joining the network. Secondly, the changes the Network Rail allocation methodology makes to how variable and third party income is allocated to services more accurately reflects the amount each service is expected to pay.

However, allocating non-avoidable fixed costs to services could lead to misperceptions about the actual long-run costs caused by adding services to the network. If Network Rail considers the total allocation when considering whether to add a new service to the network, it could overestimate the costs of adding a new service to the network, since the non-avoidable costs would be incurred even if the service did not join the network.

Overall, despite the allocation of non-avoidable costs, the Network Rail allocation methodology would provide Network Rail with more detailed and accurate information on the long-run fixed costs of adding new traffic to the network, improving the accuracy of Network Rail's incentives to add new traffic to the network.

Outcome: The network is better used

Objective: Ensure operators take costs of service into account when using the network

The Network Rail allocation methodology provides operators with more detailed information on the fixed costs they are allocated. For instance, the allocation of traffic characteristic avoidable costs highlights to operators the characteristics of their services that are driving fixed costs.

The extent to which operators would consider the improved information on the fixed costs they cause when using the network depends on how closely their ICCs reflect their allocation. If the MCB test shows an operator cannot afford any level of ICCs, they would have minimal additional incentives to consider the fixed costs they are causing on the network.

The allocation of non-avoidable costs under this option would not provide operators with any additional information on the fixed costs they are driving on the network, since these costs would exist even if they stopped running. Including non-avoidable costs in operators' total allocations could also make the information on how fixed costs vary in different areas they run in and the costs of different characteristics of their services less transparent.

Outcome: The network is better used

Objective: Ensure capacity is allocated on the basis of the cost of provision and value of use

In the 'do nothing' option, the approach to allocating fixed costs to operators varies between passenger and freight services, making it difficult for the bodies responsible for allocating capacity to ensure capacity is consistently allocated on the basis of the long-run cost of provision. This issue is addressed under this option as the Network Rail allocation methodology allocates Network Rail's net revenue requirement to all operators on a consistent basis.

Since the 'do nothing' option also provides limited information on how fixed costs vary across the network and between different types of traffic, the Network Rail allocation methodology would improve information available in these areas through the geographical disaggregation of the cost base and the avoidable cost approach.

However, in response to our [December 2016 charges and incentives consultation](#), Network Rail highlighted that the allocation of capacity is largely driven by administrative mechanisms, potentially limiting the extent to which the Network Rail allocation methodology would be used when allocating capacity. Network Rail's response is available [here](#).

If this option were implemented and the bodies responsible for allocating capacity did use the Network Rail cost allocation methodology, decisions could be influenced by the allocation of non-avoidable costs.

On balance, the Network Rail allocation methodology would improve the information available to the bodies responsible for allocating capacity on the network on the long-run costs of adding any new service to the network. This, in turn, would help them allocate capacity consistently based on the cost of provision.

General objectives

Impact on operators

This option would change the level of fixed costs allocated to different types of services. For instance, operators that run relatively faster trains could expect to have a higher fixed cost allocation, as a result of the allocation of traffic characteristic avoidable costs. The extent to which this affects operators largely depends on how their allocation is reflected in their ICCs, which is not in scope of this impact assessment.

The allocation of non-avoidable costs to services could lead to misperceptions about the level of fixed costs driven by different types of operators. Operators raised this concern in response to Network Rail's September 2017 consultation on its fixed cost allocation methodology. Freight operators explained that this methodology could affect decisions on investment in rail freight and passenger operators raised the concern that it could weaken the financial case for services that are already heavily subsidised, such as rural services.

Impact on the funds of Secretary of State and other funders

As the Network Rail allocation methodology would change the allocation of fixed costs to services with respect to the status-quo, it would also change the allocation of fixed costs between funders.

We have discussed the impact of the change in allocation with DfT and other non-central governments. Based on these discussions, our understanding is that most non-DfT funders would be held harmless to any changes in the fixed costs allocated to the services they sponsor. For non-DfT funders that are not held harmless to changes in the fixed costs allocated to the services they sponsor we have taken the impact into consideration as part of our PR18 decision-making process.

Information requirements

The data in the model comes from internal Network Rail databases, mainly the “Asset Lifecycle Profiles” database. Network Rail has already collected the necessary information to use the Network Rail allocation methodology for CP6.

Implementation difficulties for Network Rail

Although the Network Rail allocation methodology is a large and complex model, the study has now been completed and applied to the whole network. In addition, the data in the model has been updated to reflect Network Rail’s fixed costs for CP6, meaning Network Rail cost allocation methodology is ready to use for CP6.

Option 2: The Network Rail allocation methodology, excluding the allocation of non-avoidable costs

As with option 1, this option involves using the Network Rail allocation methodology to allocate Network Rail's total net revenue requirement for CP6 to different types of services. However, unlike option 1, this option would not involve allocating non-avoidable costs to any services.

Under this approach only traffic characteristic and vanilla traffic avoidable costs would be allocated to services. Non-avoidable costs would be identified, but not allocated to any particular services.

Assessment of Option 2: The Network Rail allocation methodology, excluding the allocation of non-avoidable costs

Outcome: The network is efficient

Objective: Provide Network Rail with accurate incentives to lower costs

This option involves geographically disaggregating Network Rail's cost base and calculating the avoidable fixed costs driven by different types of services in the same way as option 1. As a result, relative to the status quo, this option would also improve the information available to Network Rail on the drivers of fixed costs.

As a significant proportion of Network Rail's fixed costs are non-avoidable, this option would still only improve the transparency on the drivers of a proportion of Network Rail's fixed costs.

Overall, relative to the 'do nothing', option 2 would provide Network Rail with more accurate and detailed information on the drivers of fixed costs, improving the accuracy of its incentives to lower fixed costs.

Outcome: The network is efficient

Objective: Provide Network Rail with effective incentives to lower costs

The Network Rail allocation methodology would improve the information available to Network Rail, ORR and funders on the drivers of fixed costs and how they vary across the network. As explained in the assessment of option 1, increasing the transparency of the drivers of fixed costs would make it easier for Network Rail to identify ways to lower its fixed costs and for ORR and funders to provide challenges to Network Rail on its fixed cost forecasts.

Although this option would not involve allocating non-avoidable costs to services, due to around 50% of Network Rail's costs being non-avoidable, this option would still only improve the information on the drivers of a proportion of Network Rail's fixed costs.

Outcome: The network is efficient

Objective: Ensure Network Rail can recover its total costs

As with option 1, this option would only change how Network Rail's fixed costs are allocated between operators. On its own it would not affect how Network Rail's fixed cost charges are recovered.

Although non-avoidable costs would not be allocated to services under this option, it would not affect Network Rail's ability to recover these costs. In its [conclusion](#) to its September 2017 consultation on the Network Rail allocation methodology and in response to our June 2018 consultation, Network Rail suggested that non-avoidable costs should be recovered through the network grant. Network Rail's rationale for this suggestion is that the connectivity of the network is largely determined by funders through the franchising process.

Outcome: The network is better used

Objective: Provide accurate incentives for Network Rail to add traffic to the network

In the assessment of option 1, we explained that geographically disaggregating the cost base, allocating avoidable costs and improving the allocation of variable and third party income would provide Network Rail with more detailed and accurate information on the costs and revenues of adding new traffic to the network. Option 2 would also make these refinements to the current FTAC methodology, thus also providing Network Rail with more accurate incentives to add traffic to the network.

A risk under option 1 was that the allocation of non-avoidable costs could lead to misperceptions about the actual long-run costs caused by adding services to the network. Since this option would not allocate any non-avoidable costs to services, Network Rail would not consider non-avoidable costs when assessing the long-run costs of adding a new traffic to the network.

Outcome: The network is better used

Objective: Ensure operators take costs of service into account when using the network

As with option 1, the extent to which operators would take into account the improved information about the fixed costs they cause on the network provided by the Network Rail allocation methodology depends on how closely their ICCs reflect their fixed cost allocations.

As this option would not include non-avoidable costs in operators' total fixed cost allocations, there would not be the risk of operators influencing fixed costs in an unclear manner as occurring under option 1.

Outcome: The network is better used

Objective: Ensure capacity is allocated on the basis of the cost of provision and value of use

This option would have the same benefits as option 1, as it would improve the information available to the parties responsible for allocating capacity on the long-run costs of adding any new service to the network.

However, because the Network Rail allocation methodology under this option would not allocate non-avoidable costs to services, there would not be the risk of considering fixed costs that operators are unable to influence when capacity is allocated.

Network Rail's point that the allocation of capacity is largely driven by administrative mechanisms means that the extent to which the Network Rail allocation methodology is used when allocating capacity may also be limited under this option.

General objectives

Impact on operators

Whether the change in the fixed cost allocation due to the Network Rail allocation methodology becomes an issue for operators depends on the ICCs they are charged, as opposed to just the level they are allocated.

Although this option would increase the fixed cost allocation for certain operators (as well as decrease the allocation for others), each operator's allocation would only reflect the fixed costs they are causing. As a result, there would not be misperceptions about the level of fixed costs driven by different types of operators.

Impact on the funds of Secretary of State and other funders

The discussions we have had with DfT and non-central government funders indicate that most non-DfT funders would be held harmless to any changes this option would have on the fixed costs allocated to services they sponsor. For non-DfT funders that are not held harmless to changes in the fixed costs allocated to the services they sponsor we have taken the impact into consideration as part of our PR18 decision-making process.

Information requirements

As explained under the assessment of option 1, the data in the model comes from internal Network Rail databases and Network Rail has already collected the data necessary to use the Network Rail allocation methodology for CP6.

Implementation difficulties for Network Rail

The Network Rail allocation methodology study has now been completed and applied to the whole network. The data in the model has been updated too and it is now ready to use for CP6.

Decision

- **Our decision is option 2, the Network Rail allocation methodology, excluding the allocation of non-avoidable costs.**
- In response to our June 2018 consultation, stakeholders were generally supportive of this option and agreed with our assessment that it would improve the information available about the drivers of fixed costs in the rail industry.
- Based on our review of the Network Rail allocation methodology, we consider the approaches used to allocate fixed costs to smaller parts of the network and link these costs to the services that cause them to be robust. In response to our June 2018 and Network Rail's September 2017 consultation, with the exception of the allocation of the non-avoidable costs, stakeholders did not raise any significant concerns with the revisions the Network Rail allocation methodology makes to the current FTAC allocation methodology.
- On the allocation of non-avoidable costs, we agree with the concerns stakeholders raised in response to the Network Rail consultation. Since operators are not able to influence non-avoidable costs, allocating them to services would not provide any benefits in terms of increasing transparency or knowledge around the drivers of fixed costs, and could create the impression that a high proportion of costs could be avoided by removing those services from the network.



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