Draft Determination consistent FTAC price list: key assumptions and forecast income

Published 24 August 2018

Purpose

The purpose of this note is to set out the key assumptions which underpin the draft Fixed Track Access Charges (FTACs) price list for Control Period 6 (CP6), which we published on 24 August 2018, consistent with ORR's Draft Determination.

We also set out in this document our forecast income in CP6 from FTACs.

We encourage stakeholders to review this draft price lists in detail and if they identify any issues please send them to Regulatory.Economics@networkrail.co.uk by COP 28 September 2018. Where appropriate, we will then address these issues prior to publishing final price lists on 20 December 2018. Once we publish final prices in December 2018 it will not be possible to re-open these prices until CP7 (i.e. 1 April 2024). Therefore, we strongly encourage operators to take this opportunity to work with us and resolve any potential issues now.

This note does not cover variable and station charges that will be payable by train operators in CP6. We published these draft price lists on 31 July 2018 with a supporting note setting out our key assumptions and forecast income. These price lists and accompanying note are available on our website here.

The models used to produce the draft CP6 FTAC price list have been assured by Steer Davies Gleave (SDG). The report produced by SDG is available on our website here.

This note does not include an assessment of the overall impact of the changes to charges (including FTACs) on franchised passenger operators following ORR's Draft Determination. ORR is responsible for assessing the impact on train operators of changes, rather than Network Rail. It has already published impact assessments, consistent with its Draft Determination here, and will be updating these following its Final Determination.

If you would like to discuss any aspects of this note or the draft price lists please contact Ben Worley (Ben.Worley@networkrail.co.uk / 07801 900 424).

Background

When trains run on our network they cause wear and tear that needs to be repaired. For example, our track is worn away by the action of train wheels running on our rails. We charge train operators for the wear and tear that they cause through variable track access charges – the main one being the Variable Usage Charge (VUC).

However, like most network businesses, most of our costs are fixed. This means that our costs do not vary that much in the short term when more (or fewer) trains run on it. In fact, we will incur about 80% of our costs irrespective of how many trains run on the network.

Many of our fixed costs will not vary, even in the long run, if fewer trains operate on the network – this is because even a very small number of trains running on the network means that we need to keep open the track and stations throughout the country.

However, some of our fixed costs can be linked with the operation of trains - this is because the shape of our network would, over time, be different if fewer trains ran. For example, we may reduce double track sections to single track if fewer trains ran. These sorts of fixed costs are called 'traffic related fixed costs'. It is these types of fixed costs that we charge to train operators through Fixed Track Access Charges (FTACs). However, ORR only allows us to charge these fixed costs to train operators who can afford them, otherwise certain types of traffic could be priced off the network. ORR is particularly careful to make sure that freight operators are only charged fixed charges that they can afford to pay.

Industry engagement

The draft price list published alongside this note is the result of lengthy engagement with stakeholders.

In December 2016, ORR published a consultation on the policy to be used to calculate charges and incentives in CP6 (available here). This was followed by ORR's conclusions, which were published in June 2017 (available here).

Following the publication of ORR's conclusions, we published a consultation in September 2017 on the detailed methodology for allocating our fixed costs to train operators in CP6 (available here). We concluded on this consultation in May 2018 (available here). Our consultation focussed on implementing a new methodology for allocating our fixed costs to train operators, developed by Brockley Consulting (available here).

Key assumptions

We set out, below, the key assumptions which underpin our draft CP6 FTAC price list and income forecast, consistent with ORR's Draft Determination. For a full explanation of the methodology used to calculate the draft CP6 FTAC price list, please see Annex 1

- FTAC rates reflect the cost allocation methodology set out in our May 2018 charging conclusions document available here. This methodology was developed by Brockley Consulting and discussed with industry over the course of PR18.

- Costs have been allocated to train operators based on their share of avoidable 'traffic related' fixed costs. 'Traffic related' fixed costs consist of:

    - Fixed costs that could be avoided in the absence of certain subsets of traffic. For example, the fixed costs of electrification assets could be avoided in the absence of electrified traffic; and

    - The fixed costs that could be avoided in the long-run with reductions in traffic levels, assuming the railway continues to serve the same parts of GB with a 'basic' network.

- The costs allocated to train operators continue to be based on cost data from our Strategic Business Plan. ORR's Draft Determination makes proposals at a very high-level and it is not clear how we could reflect these decisions in specific cost categories. We will update this assumption and if possible share an updated price list with operators, following ORR's Final Determination, before publishing the final FTAC price list on 20 December 2018.

- The total FTAC value that we propose recovering in CP6 is consistent with the overall level of expenditure as set out in our Strategic Business Plan (SBP). This reflects the fact that ORR's Draft Determination assumes the same level of overall expenditure in CP6 as our SBP. However, ORR has expressed a different high-level view in relation to the allocation of expenditure between certain cost categories (e.g. a lower level of R&D expenditure and an increased level of funding to improve asset sustainability).

- The total FTAC value set out in the CP6 draft price list c. £5.2bn reflects ORR's Draft Determination in relation to the level of variable and station charges, and ORR's view that we should be able to generate an additional £67m of property income over CP6.

- Although, consistent with ORR's Draft Determination, we have assumed that we will generate an additional £67m of property income over CP6, this should not be interpreted as us supporting ORR's view in this area.

- Our SBP forecast of Managed Station Qualifying Expenditure (QX) did not include income that we expect to receive in CP6 for Clapham Junction and Guildford stations. This is because, at the time of preparing our SBP, it was not sufficiently certain that these stations would be transferred to the managed station estate. Similarly, the forecast of opex costs did not include the costs of providing QX services at these stations.

- The draft CP6 FTAC price list published alongside this note reflects the fact that Clapham Junction and Guildford have now been successfully transferred to the managed station estate.

- The amount of income that we will recover in CP6 through the FTAC is determined in part by the level of the network grant. The level of income that we will receive in CP6 through the network grant was determined as part of the Statement of Funds Available. ORR has instructed us to profile the network grant income that we will receive directly from funders as follows:

    1. Calculate our net revenue requirement for each year of CP6 (reflecting total funding availability).
    2. Forecast and deduct variable usage charge revenue for each year.
    3. Deducted total available network grant from residual total net revenue requirement.
    4. Divide the balance of the net revenue requirement by five to get the same FTAC level for each year.

5. The network grant amount (from step 3) is then profiled to meet the net revenue requirement each year.

- The price list incorporates a funding adjustment which maintains 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. The impact of this adjustment is that we continue 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.

- The income forecast set out, below, reflects the forecast level of passenger traffic set out in our February 2018 SBP. However, the passenger traffic forecast has been updated slightly to correct issues subsequently identified by Network Rail and ORR. These generally relate to train services being assigned to the incorrect operators, rather than the overall level of forecast traffic in CP6.

- The freight traffic forecast is the same as that which underpinned our February 2018 SBP income forecast. However, it corrects the detailed freight traffic forecast provided to ORR on the SBP SharePoint site, which included a transposition error.

- All FTAC rates have been published in 2017/18 prices and, therefore, will need to be uplifted 2019/20 prices prior to the start of CP6 to reflect the impact of inflation. The FTAC income forecast, above, is also shown in 2017/18 prices.

- We have deflated CP6 FTACs from cash prices to 2017/18 prices using forecast CPI, rather than forecast RPI, reflecting ORR's CP6 indexation policy. This approach should mean that, assuming forecast levels of traffic, we receive the same amount of funding overall in CP6 (in cash terms) as we would have if all charges continued to be indexed by RPI.

Forecast CP6 income

The table, below, sets out our forecast income from franchised passenger operators through FTACs in CP6.

Operator type (£m, 2017/18 prices)	2018/19	2019/20	2020/21	2021/22	2022/23	2023/24
Franchised passenger	949	1,043	1,043	1,043	1,043	1,043

Annex 1: Detailed description of FTAC methodology

The purpose of this annex is to provide a detailed description of the methodology used to calculate draft CP6 FTACs.

1. The total amount of FTAC to be recovered in each year of CP6 for England and Wales and Scotland, respectively, is an output of Network Rail's financial model. The FTAC for England and Wales and Scotland for each year of CP6 is an input into the calculation of draft FTACs for CP6.
2. As part of the work that we commissioned Brockley Consulting to undertake, Brockley Consulting allocated the fixed costs of each operating route to operators for each year of CP6. We take the outputs of the Brockley Consulting work and make two adjustments:
    a. We made a 'Funding Adjustment'. The purpose of this adjustment is 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. The impact of this adjustment is that we continue 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.
        i. For routes in England and Wales, the avoidable fixed costs of TS specified franchised operators are allocated to each DfT-specified franchised operator in proportion to their share of the total avoidable fixed costs for DfT-specified franchised operators.
        ii. For the Scotland route, the avoidable fixed costs of DfT-specified franchised operators are allocated to each TS-specified franchised operator in proportion to their share of the total avoidable fixed costs for TS-specified franchised operators.
    b. We allocate the costs of De Minimis passenger services to other passenger services in proportion to their share of the remaining passenger avoidable fixed costs.
3. The England and Wales FTAC for each year is allocated to individual routes in England and Wales based on each route's share of England and Wales' franchised passenger avoidable fixed costs in the relevant year (after the adjustments described in (2)). The Scotland FTAC is allocated to the Scotland route.
4. The route-level FTAC value for each year is allocated to individual franchised passenger operators according to their share of avoidable fixed costs (after the adjustments described in (2)).
5. To calculate each operator's annual FTAC in each year, their FTAC for each individual route is summed.