URBAN TRANSPORT GROUP

Consultation Response

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

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1. Introduction

The Urban Transport Group brings together and promotes the interests of Britain's largest urban areas on transport. Our full members are Transport for West Midlands, Merseytravel (Merseyside), North East Combined Authority, South Yorkshire PTE (Sheffield City Region), Transport for Greater Manchester, Transport for London, West Yorkshire Combined Authority.

We also have associate members which are Bristol and the West of England Partnership, Nottingham City Council, Strathclyde Partnership for Transport and Tees Valley Combined Authority. However this evidence is on behalf of our full members.

Our members plan, procure, provide and promote public transport in some of Britain's largest city regions, with the aim of delivering integrated public transport networks accessible to all. Several of our members are also responsible for extensive light rail and suburban rail.

2. Response

Question 1. Do you consider any of the proposals set out in this consultation document are likely to impact the safety of the network?

We do not consider that they are likely to impact on the safety of the network.

Question 2. Do you agree with our proposals:

A) To use the new methodology developed by Brockley Consulting to allocate our fixed costs to operators in CP6?

We are very concerned to see the re-allocation of fixed costs in a way that further shifts costs in a disproportionate way to regional rail operations.

In our 2014 report, 'A Heavy Load to Bear, towards a fairer allocation of rail industry costs for regional rail[1]', we were already concerned that regional operators are overburdened with costs in comparison to other sectors such as freight and long-distance services. This is true despite their economic and social importance to the networks they serve.

Our work found that a different approach would halve regional rail's share of government backing for the rail industry. This difference is due to (a) an allocation of maintenance and renewals costs which better reflects track damage by different types of vehicle, (b) a recognition of the full financial costs of capital investment, and (c) an allocation of overheads in proportion to passenger revenues.

Indeed some may argue that fixed charges should be abolished given that other transport networks, such as the roads, do not expect users to directly cover the cost of providing and maintaining the infrastructure. It could be argued that central government should provide a network maintenance payment, in similar fashion to how roads are funded. This would mean that trains on a specific track would cover the cost of wear and tear through a variable charge, but would not be expected to cover major works to the track, say as a result of flooding or a landslip, or the opening of a new line, much in the same way that motorists do not cover these costs.

[1] http://www.urbantransportgroup.org/system/files/general-docs/A%20heavy%20load%20to%20bear_July%202014_FINAL.pdf

Current fixed cost methodologies have focused on train or vehicle kilometres. This is problematic when allocating the cost of maintenance, enhancements or general works on a section of track as it ignores the quality requirements and maintenance costs for the different operators. It is simply assumed that all vehicles are the same. Taking the example of the track from Leeds to Wakefield Westgate, the track is used by East Coast Mainline trains, Northern trains, and Cross Country Trains. Works on the track have to be completed to a standard that is acceptable for the 125 mph intercity trains travelling to the East Coast Mainline. This cost is reflected in the quality of the track, the signalling, the frequency that works are required and the quality of the works, in comparison with the requirements of, for example, a Northern DMU with a top speed of 75mph and a light axle-load. In this situation, it is not sensible to allocate costs based on the number of trains per hour or vehicle miles, as this does not accurately reflect where the cost of providing and maintaining the infrastructure, nor the revenue raising capacity, sits.

As the below table from 'A Heavy Load to Bear' demonstrates, using this methodology artificially inflates the cost of regional rail enhancements by almost 50%[2].

	IC	LSE	Regional
Share of enhancement spending in 2012/13	40%	39%	21%
Share of enhancement spending in 2011/12	28%	54%	18%
Share of financing costs (ORR allocation)	31%	37%	32%

We would also challenge the "vanilla costs" assumption which account for 32% of all costs in the avoidable costs methodology. Adopting this methodology would imply that designing and maintaining a network for use by 125 mph nine car intercity trains (or faster), 1000 tonne freight trains, or light weight 75 mph regional trains would have no impact on a large part of the costs. When you consider the quality of the infrastructure required, the cost of providing this infrastructure, and also the impact of the different vehicles on maintenance requirements, this assumption is at best questionable. This would seem to imply that 32% of the costs would be the same for HS2 and a slow speed urban rail network, assuming the vehicle kilometres matched. On this basis, the 32% may well in fact be an understatement, meaning that the proportion borne by regional rail is considerably inflated, creating an even less fair burden for the sector.

The table below from 'A heavy load to bear', highlights the share of renewals costs and the actual wear and tear that we estimate the different sectors to cause. Looking in more detail at the impact of different trains it is possible to arrive at a different set of cost assumptions that we wold argue more accurately reflect the cost of running the railway.

[2] Further details on any of the tables included in this report can be found in 'A Heavy Load to Bear', http://www.urbantransportgroup.org/system/files/general-docs/A%20heavy%20load%20to%20bear_July%202014_FINAL.pdf

	IC	LSE	Regional
Share of renewals (ORR)	33%	32%[14]	35%
Estimated share of track wear and tear	54%	31%	**15%**

Where Network Rail has defined the prime user this has been done using vehicle or train miles. We have previously argued that the prime user should be defined differently, with many other European countries focusing on revenue. However, it may be equally possible to develop a pro-rata approach with reference to the actual costs and revenue borne by the different sectors.

Allocating costs in line with train or vehicle kilometres is debateable, and at the very least provides a misleading idea of the true cost of providing different rail services, because it does not have regard to the actual costs that different types of train impose. This point is important in determining which parts of the network pay for Network Rail's overheads and wider costs, with the cost of simply operating the railway estimated at 50% of total costs in the avoidable costs methodology.

If we take signalling as an example, although train kilometres provide a good starting point for allocation, it ignores the role played by traffic density and operating speed on the need to provide ever more sophisticated systems and a greater number of specialised staff. The highest cost signals are used on the fastest and densest sections of track, with train kilometres not making up for the additional cost when compared to a much cheaper regional rail network.

In the case of back-office functions and operations management, it is even more difficult to use train or vehicle kilometres, and this may result in a somewhat arbitrary allocation system. Many present day European railways have employed the prime user principle, as British Rail did before privatisation, whereby shared costs are allocated to the most profitable operations (or put differently, those most able to bear the costs). The reasoning behind this approach is that if unprofitable services were removed from the network, prime user services would need to bear the full costs. Part of the point here is that any system is a political decision on how costs should be allocated, with the costs varying for different parts of the network depending on the decisions that are taken. Arguments may also be made around the revenue raising capacity of different services, and how this impacts on what they should pay. The table below shows how such an approach could change the cost base of the network[3]:

[3] Further details on any of the tables included in this report can be found in 'A Heavy Load to Bear', http://www.urbantransportgroup.org/system/files/general-docs/A%20heavy%20load%20to%20bear_July%202014_FINAL.pdf

	IC	LSE	Regional
Share of operations costs (ORR allocation)	28%	40%	32%
Share of traction user charges	*24%*	*62%*	*14%*
Share of other operations costs	*29%*	*35%*	*35%*
Share of operations costs (*pteg* allocation)	35%	48%	**17%**
Share of operations costs (IC and LSE treated as prime users)	39%	53%	**8%**

Our previous work, shown in the table below, demonstrates the large difference in cost allocation that the use of a different, and we would argue fairer, approach could make[4].

		IC	LSE	Regional
	TOC operating subsidy (pence / pax-km)	2p	2p	-10p
ORR estimates	Infrastructure subsidy (pence / pax-km)	-6p	-6p	-12p
	Total govt. support (p / pax-km)	-4p	-4p	-22p
	Total (£billion)	£0.9 billion	£0.8 billion	£2.3 billion
***pteg* estimates**	Infrastructure subsidy / pax-km	-14p	-10p	-7p
	Total govt. support, including Network Rail borrowing (p / pax-km)	**-12p**	**-8p**	**-17p**
	Total gov. support, including Network Rail borrowing (£billion)	**£2.8 billion**	**£1.8 billion**	**£1.8 billion**

[4] The ***pteg*** estimates provided include Network Rail borrowing that can be attributed to the different sectors to provide a more holistic understanding of the subsidy received by each sector. This inflates the figure when compared to the ORR estimates. Further details on any of the tables included in this report can be found in 'A Heavy Load to Bear', http://www.urbantransportgroup.org/system/files/general-docs/A%20heavy%20load%20to%20bear_July%202014_FINAL.pdf

The way that fixed costs are determined is a construct based on a series of assumptions, in this case assumptions which we dispute and do not feel are justified.

B) That these revised cost allocations should form the maximum level of operators' fixed cost charges?

We agree with setting out a maximum level of fixed cost charges which should align with the cost of running the railway.

Question 3. Do you agree with the revised methodology developed by Brockley Consulting for allocating income to train operators when calculating their fixed cost allocations?

The allocation of income by train operator should be reflected in the charges paid by operators. It is not clear in the report whether charges are fully aligned, so we cannot comment on this question.

Question 4. Do you have any comments on the overall change in cost allocations shown in Table 12, above?

There is a clear trend in this document of transferring costs from long-distance inter-city operators to regional operators.

Our previous research has shown that regional trains cause up to twenty times less damage to the network than inter-city trains and have considerably cheaper infrastructure requirements. Because of this we would argue that the current methodology already overstates the cost of regional railways.

We therefore strongly oppose the direction of this policy which, in our view, artificially inflates the costs of providing regional rail services on the basis of assumptions that we do not believe can be justified. This in turn will artificially improve the profitability of intercity services in a way that could lead to windfall profits leaving the industry, whilst loading costs on to regional rail services in a way that could be used to justify future reductions in the extent and scale of regional rail services.

The way that fixed costs are determined is a construct based on a series of assumptions, in this case assumptions which we dispute and do not feel are justified.

Question 5. Do you agree that we should be transparent about which train operators are responsible for our fixed costs?

We agree that it is important to be transparent about fixed costs. However, it is also important to qualify these statistics on the basis that they are a construct based on a series of assumptions, in this case assumptions which we dispute and do not believe are justified.

Question 6. Do you agree with our proposal to retain a simple approach to adjusting FTACs for franchise re-mappings but based on train miles, rather than vehicle miles?

We believe that vehicle miles would provide a more accurate picture than train miles as it helps to account for the length and weight of trains in assessing their costs. However, there is still more that could be done, such as looking at speed to ensure that the FTAC accurately

reflects the cost of the train. Train miles ignore the length, weight and speed of the service, all factors which should impact on the FTAC that operators pay.

Whilst in principle there are benefits to a simple system, attempting to simplify the outcomes of a series of contestable assumptions can result in heavily skewed and distorted results, in this case grossly overcharging regional rail services in a way which could have fundamental future implications for perceptions of their viability.