

Pedro Abrantes

Head of Analysis and Rail Economics

30 October 2018

Dear Schedule 4 and 8 Working Group

Final Decision: Methodology for estimating a representative fuel cost figure in the Schedule 4 compensation regime

1. In your submission to us on 20 September 2018, you asked us to determine on a methodology for estimating a representative fuel cost figure as part of the Rail Delivery Group's (RDG) PR18 recalibration of train mileage payment rates.
2. We have reviewed this submission and decided that the representative fuel cost for use in recalibrating train mileage payment rates should be based on fuel cost data in UK rail industry financial information releases, published by ORR.
3. The rest of this letter sets out the rationale and the process we have followed to arrive at this decision.

Background

4. Train mileage payment rates (TMPR) are part of the Schedule 4 cost compensation regime. TMPR reflect train operating cost savings where train operating companies (TOCs) are not able to run trains because of possessions, or, conversely, the additional costs incurred by running trains over longer distances, e.g. where services run over diversionary routes due to possessions. TMPR are intended to reflect changes in track access variable usage charge payments and electricity or diesel fuel costs incurred.
5. As part of the Schedule 4 recalibration, RDG reviewed TMPR to ensure they reflect current operating costs. To assess the diesel fuel cost component of TMPR involves estimating the diesel fuel consumption rate per vehicle. RDG considered three ways to derive a fuel cost rate:
 - a. using a pre-existing value held by the industry or by DfT, if such a value existed;
 - b. applying individual operator-provided costs to their own TMPR calculations;
 - c. calculating the average value of all operator-provided costs and applying this average value to all operators' TMPR calculations.

6. For the reasons set out in its submission, RDG chose option (c).

Summary of disputed areas

7. RDG originally estimated an average fuel consumption rate based on data supplied by eight TOCs, for the year 2016/17. This resulted in a fuel cost rate of £0.33 per vehicle-mile (2017/18 prices).
8. Most train operators that expressed a view considered this figure to be sufficiently representative for these purposes. However, Network Rail raised some concerns around this approach, in particular that the fuel cost figure was based on one year's worth of data and that it was not possible to check that all TOCs had produced the fuel cost data on a consistent basis.
9. As a result, RDG submitted an alternative methodology to ORR on 20th September 2018, which uses publicly available data on franchised operators' fuel costs published by ORR as part of its regular UK rail industry financial information releases.¹ This used fuel cost data from 2011-12 to 2016-17, inclusive, to generate a total annual diesel fuel cost for all operators, which was then divided by the total franchised operators' diesel vehicle miles in the 2016-17 dataset to produce a fuel cost rate per vehicle-mile. The resulting figure was £0.54 per vehicle-mile (2017/18 prices).
10. Network Rail supported the revised methodology but a number of TOCs objected to the alternative approach citing the following reasons:
 - a. "Insufficient time to consider the proposal and evaluate its potential impact relative to the original proposal";
 - b. "That any dataset used for the calculation should be limited to years within CP5 only";
 - c. "That it may not be valid to divide the annual average fuel cost figure (derived from several years' worth of data) by the number diesel [sic] vehicle miles in 2016/17. This is because electrification, changes to services and rolling stock,

¹ <http://orr.gov.uk/rail/publications/reports/uk-rail-industry-financial-information>.

infrastructure changes and the trend of increasing delay may have changed the relationship between fuel used and diesel vehicle miles over time”.

- d. “The fuel costs in the ORR publication may not have been be [sic] prepared on a consistent basis.”

ORR decision

11. Having considered all the arguments presented we have decided that a modified version of the RDG’s latest proposal is likely to provide the most appropriate fuel cost rate for CP6. The modification that we propose is to use fuel cost data from Control Period 5 only. This has the effect of reducing the estimated fuel consumption rate to £0.52 per vehicle-mile (in 2017/18 prices). As this is different to the fuel cost figure in RDG’s submission, RDG will need to revise and resubmit its TMPR recalibration using a fuel cost figure of £0.52 per vehicle mile. We will review RDG’s TMPR recalibration when we receive its revised submission.
12. In response to the points made by TOCs, listed in paragraph 10, we have the following observations to make:
 - a. We consider management of the TMPR recalibration a matter for RDG. However we note the fuel cost data is taken from TOCs’ own management accounts.
 - b. We agree with the argument that recalibration data should be based on CP5 data only. This is consistent with how other Schedule 4 parameters are recalibrated whilst providing some smoothing out of annual fluctuations in fuel prices. Moreover, the earliest years are likely to be the least relevant in determining future fuel prices.
 - c. We recognize it may be preferable to use more than one year’s mileage data. However, this information is not readily available. We made the judgement that fuel prices are likely to be subject to much larger fluctuations than fleet composition, and it is therefore worth using several years’ worth of fuel cost data to smooth out these fluctuations, even if this involves some error due to the absence of corresponding fleet composition data. .
 - d. We do not agree with this objection as the fuel cost data is drawn from TOCs’ own management accounts and compiled by ORR on a consistent basis as far as is practically possible.

Next steps

13. This letter states our final decisions on the method for calculating a representative fuel cost for use in train mileage payment rates calculation which you asked us to determine.
14. Our decision is restricted only to the issue on which we have been asked to determine. You should note that we still need to review and approve the detail of how the TMPR have been calculated.

Yours faithfully,

A handwritten signature in black ink, appearing to be 'Pedro Abrantes', written over a light blue horizontal line.

Pedro Abrantes