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Dear Ekta,

12 October 2012

PR13: TRACTION ELECTRICITY & ELECTRIFICATION ASSET USAGE CHARGES IN CP5

This letter contains the response of DB Schenker Rail (UK) Limited ("DB Schenker") to Network Rail's consultation document entitled "Periodic Review 2013: Consultation on Traction Electricity & Electrification Asset Usage Charges in CP5" published in September 2012.

General Comments

1.1. In principle, DB Schenker supports the movement towards the fitment of meters to electric traction to measure and charge more accurately for the use of electricity as this should help incentivise operators to make their electricity for traction ('EC4T') consumption more efficient. However, for operators such as DB Schenker with relatively small fleets of electric trains that traverse many different routes with both ac and dc supply, the benefits of opting for metered EC4T consumption may be less clear cut when considered against the costs of fitment, the ongoing costs of maintenance of the equipment and the complexity and cost of managing and transmitting the data generated.

1.2. DB Schenker, therefore, considers that operators who can demonstrate that the costs of moving to metered electricity far outweigh the likely perceived benefits gained through more efficient EC4T consumption should not be penalised for remaining on modelled usage (e.g. through the artificial uplifts of modelled EC4T consumption rates). There may also be sound technical reasons why the necessary metering equipment cannot be fitted to certain types of traction without significant redesign and fitment costs (this is an issue that has been challenging DB Schenker with its Class 92 locomotive fleet). Consequently, DB Schenker believes that operators of such traction should also not be penalised for having to remain on modelled electricity usage.

1.3. In the scenarios outlined in paragraph 1.2 above, mechanisms designed to incentivise operators to move to metered electricity in effect become penalties. Furthermore, in the case of operators who have a choice of traction types, such 'incentives' may have unintended consequences including incentivising increased use of 'less environmentally friendly' diesel traction. DB Schenker strongly believes that if the

economic benefits of moving to metered EC4T consumption are overwhelming, then operators would already be sufficiently incentivised to fit electricity meters to their trains. Those that do not would have clear and justifiable reasons why an 'opt-in' to metered electricity is not viable.

1.4. DB Schenker also understands that there are many other significant consumers of Network Rail's traction electricity supply both for traction and non-traction uses that are not currently subject to the same rules that are applied to operators with track access agreements (i.e. freight and passenger operators). These consumers include Network Rail itself, London Underground and operators of Traction Maintenance Depots leased from Network Rail. DB Schenker considers that any rules, incentives and penalties applied to passenger and freight operators should also be applied to these other consumers to avoid possible discrimination and cross-subsidy.

Responses to the Specific Questions

Q1. Do you agree with our proposal to leave all modelled passenger and freight EC4T consumption rates unchanged for CP5?

2.1. There is no doubt that the annual volume 'washup' process causes significant uncertainties for freight operators as the magnitude of any payment to or from Network Rail remains unknown for up to three months after Network Rail's Financial Year End. This can have significant effects on cash flow, particularly if the annual volume 'washup' process results in a large payment from the freight operator to Network Rail.

2.2. It appears however, from the consultation document, that the modelled EC4T consumption rates are in most cases considered to be set too high which normally results in most operators being refunded by Network Rail through the annual volume 'washup' process. Whilst it would be beneficial to ensure that the modelled EC4T consumption rates are adjusted so that they are more closely aligned with actual EC4T consumption, thereby reducing the uncertainty presented by the annual volume 'washup' process, it is clear from the analysis presented by Network Rail in the consultation document that achieving closer alignment is by no means easy given the number of variables involved. With many operators now moving to metered EC4T consumption in any case, DB Schenker supports Network Rail's proposal to leave all modelled passenger and freight EC4T consumption rates unchanged for CP5.

Q2. Do you have any other suggestions to make about modelled consumption rates in CP5?

2.3. DB Schenker has no further suggestions to make about modelled EC4T consumption rates in CP5 at this time.

Q3. Do you agree that it is appropriate to continue using the current uplift factors for electric multiple units?

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2.4. Unless there is any evidence readily available suggesting that the current uplift factors could be made more accurate, DB Schenker would concur with Network Rail's view that it is appropriate to continue to use the current uplift factors for electric multiple units.

Q4. Do you agree that it is suitable to continue using the agreed methodology for calculating new modelled EC4T consumption rates, during CP5?

2.5. DB Schenker concurs with Network Rail's expectation that new electric traction introduced during CP5 and beyond would already be fitted with electricity metering equipment as standard. Therefore, it would seem pointless to spend a great deal of time and effort in changing the current methodology that was introduced for CP4 if such methodology is likely to be rarely required.

Q5. Do you have any views on our suggestion to uplift modelled consumption rates by 10%, consistent with the surcharge applied for missing metered data?

2.6. DB Schenker rejects the proposals to impose financial penalties as a means of incentivising or, as some might say, forcing operators to move to metered electricity. If the benefits of metered electricity are as overwhelming as is suggested by the number of operators who have already 'opted in' to metered EC4T consumption, then the only reasons for not 'opting in' would surely be valid and justifiable ones. These would include situations where: (1) the benefits of metered EC4T consumption are outweighed by the ongoing management and operational costs (for example, where operators have small or diverse fleets); or (2) that it is extremely difficult to retrofit metering equipment to existing vehicles for technical reasons unless substantial sums are expended in redesign, modification and fitment works (for example, in the case of DB Schenker's Class 92 locomotives).

2.7. In such cases the financial incentives to move to metered EC4T consumption instead become penalties for not adopting metered electricity or, in other terms, constitute 'mark ups' which, for freight operators, are not permitted unless it is deemed the market sectors can afford to pay them. The introduction of such penalties could also result in perverse outcomes, such as incentivising operators who have a choice of traction types to increase their use of 'less environmentally friendly' diesel traction.

2.8. DB Schenker also echoes Network Rail's view expressed in the consultation document that operators on modelled EC4T charges already experience a degree of financial uncertainty through the annual volume 'washup' process, which results in adverse 'cash flow' issues for those operators. It could, therefore, be argued that there is already an incentive for modelled operators to move to metered billing, because of the increase in certainty and improved cash flow.

2.9. In keeping with DB Schenker's position outlined above, it also rejects Network Rail's proposal to artificially uplift modelled EC4T consumption rates by 10%. Whilst DB Schenker acknowledges that a 10% uplift would mirror the current uplift levied on metered operators in cases of missing data, penalising an operator in cases where it has failed

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to provide data it is obliged to provide is of a different magnitude to penalising an operator for not moving to the use of metered electricity for valid and justifiable reasons.

2.10. Finally, should modelled EC4T consumption rates being artificially increased despite DB Schenker's arguments, then such uplifts 'or 'mark-ups' should also apply to consumers other than freight and passenger operators who use EC4T for traction or non-traction purposes where no metered data is provided.

Q6. Do you have any views on the use of the proceeds from an uplift to modelled consumption rates?

2.11. The proposal that income received by Network Rail from any artificial uplift to modelled EC4T consumption rates should be shared with metered operators supports DB Schenker's position that these proposals constitute 'mark ups' and may arguably constitute cross subsidies because metered operators would receive 'windfalls' that they would otherwise not be entitled to. Excluding metered operators from the annual volume 'washup' process, modelled operators would pay for their electricity consumption in full irrespective of whether or not their consumption is deemed 'efficient'. In addition, making a conscious decision to levy charges for electricity above its procurement costs (thereby creating a profit), may bring Network Rail under the auspices of Ofgem, the electricity supply regulator.

Q7. Do you have any views on applying the uplift to modelled consumption rates to new vehicles only?

2.12. As an alternative to applying an artificial uplift to modelled EC4T consumption rates for new vehicles introduced during CP5, DB Schenker suggests that instead, there is a mandatory requirement for all new electric traction to be fitted with appropriate metering equipment as standard.

Q8. Do you have any views on whether regenerative braking discounts for modelled usage should remain in CP5 or CP6?

2.13. DB Schenker agrees with Network Rail's view that further consideration should be given to the eventual removal of the regenerative braking discounts from CP6, by which time most operators are likely to be on metered consumption.

Q9. Do you have any views regarding provisions to allow us to verify that regenerative braking is being used correctly?

2.14. If an operator is claiming a discount for regenerative braking, DB Schenker considers that it is only fair and equitable that Network Rail has a right to audit that operator to verify that regenerative braking is being used correctly. This is provided of course that the rules and procedures surrounding such audits are agreed and made transparent.

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Q10. Do you agree with our proposal to apply a regenerative braking losses factor of 0.9899 (based on losses estimate of 1%) to metered AC regenerated energy?

2.15. DB Schenker has no evidence to suggest that Network Rail's proposal to apply a regenerative braking losses factor of 0.9899 is unreasonable.

Q11. Do you have any views on reopening the regenerative braking losses factor for AC after two years during CP5 to reflect emerging information, capped at no less than 0.9744 (losses estimate of 2.5%)?

2.16. DB Schenker has no objections to Network Rail's proposal to review the 0.9899 regenerative braking losses factor after 2 years and, if necessary, revise it subject to a cap of no less than 0.9744.

Q12. Do you have any views on the other options for charging for metered regenerated energy?

2.17. DB Schenker has no views on the other options for charging for metered regenerated energy at this time.

Q13. Do you support the work that we have carried out to quantify AC system losses?

2.18. DB Schenker supports the work undertaken by Network Rail to quantify AC system losses.

Q14. Do you support further validation of the 4.82% likely to be proposed for CP5?

2.19. DB Schenker does not support further validation work of the 4.82% likely to be proposed for CP5 (please see paragraph 2.20 below).

Q15. Do you have any views on reopening the losses mark-up after two years during CP5 to reflect emerging information?

2.20. If Network Rail considers that the proposed value of AC system losses of 4.82% for CP5 is likely to require further validation as it is expected to rise due to increased electrification and energy use, DB Schenker suggests that the value should be set at the current CP4 level of 5% for the whole of CP5. This should then avoid further work becoming necessary for CP5 so that Network Rail could concentrate its efforts on carrying out analysis to support a full review for implementation from the start of CP6.

Q16. Do you have any views on not geographically disaggregating the AC losses mark-up?

2.21. DB Schenker supports Network Rail's proposal not to adopt a geographically disaggregated AC losses mark-up.

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Q17. Do you have any comments on the AC losses report published alongside this consultation?

2.22. DB Schenker has no comments to make at this time on the AC losses report that accompanied the consultation document.

Q18. Do you support our proposal to adjust the way the EC4T delivery charge is levied?

2.23. Network Rail's proposal to adjust the way the EC4T delivery charge is levied appears reasonable.

Q19. Do you support our proposal for all freight traction electricity charges to be based on actual electricity costs faced by Network Rail from the start of CP5?

2.24. As noted in the consultation document, DB Schenker has previously supported the proposal that should freight operators wish to 'opt-in' for on-train metering; their prices for metered usage will be based on Network Rail's actual costs, to be consistent with passenger pricing arrangements. However, DB Schenker has not previously supported this approach in respect of modelled freight EC4T consumption.

2.25. Freight operators currently pay for their EC4T consumption based on three national commodity dependent rates. Apart from the annual price variation mechanism (which is based on the MLUI index) and the annual volume 'washup' process, this charging mechanism provides a reasonable degree of certainty which is simple to administer and reduces bureaucracy and transaction costs. Under Network Rail's proposal, these factors which are crucial for freight operators, would be significantly diminished as the national based charging mechanism would be replaced by a system based on many different rates by season, time of day and geographical area. The proposal would also require freight operators to be included in the annual cost 'washup' process, thereby introducing further cash flow uncertainty.

2.26. Whilst such a complex regime can be easily applied to the relatively fixed timetables of passenger operators, DB Schenker is concerned that applying it to the ever-changing pattern and number of freight services would be an altogether different proposition and lead to a far more complicated and bureaucratic process which would increase transaction costs and make it more difficult for freight operators to respond quickly to their customers pricing enquiries.

2.27. There is scant information in the brief section of the consultation document concerning this issue as to how Network Rail's proposal is intended to operate in practice and what would the likely impact be on freight operators in terms of overall charges, cash flow, complexity, transaction costs and certainty. Without such information, DB Schenker cannot even begin to evaluate Network Rail's proposal in any detail.

2.28. In summary, therefore, DB Schenker opposes Network Rail's proposal and given that freight operators account for a very small percentage of the total EC4T income of

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Network Rail in any case, DB Schenker considers that the current freight charging mechanism should remain unchanged until such time as freight operators 'opt-in' to on-train metering.

Q20. Do you support the reform of the EC4T Metering Rules to be widened and renamed the traction electricity rules?

2.29. In principle, having a single document setting out all of the rules, principles, mechanisms and processes surrounding the supply and levying of charges of traction electricity would seem a sensible approach. However, before DB Schenker could give further consideration or support to this proposal, it would need to be provided with much more detail as to how the new 'multilateral' Traction Electricity Rules would operate in practice, particularly in terms of governance and change processes. It is relatively simple to propose bespoke changes to bilateral track access agreements, it is an altogether different proposition for a single party to effect changes to multilateral documents.

2.30. DB Schenker would also want to understand where in the industry contractual framework any new Traction Electricity Rules would sit. For example, would the Traction Electricity Rules form a new section of the Network Code or would it become a stand alone document referred to in any relevant bilateral agreement (e.g. track access contract)?

Q21. Are there any other areas which you consider should be included in the new traction electricity rules document?

2.31. If the new Traction Electricity Rules were introduced, DB Schenker believes it essential that the document applies to all users of traction electricity (for traction and non-traction purposes). A set of rules applying to some consumers and not others would not, in DB Schenker's view, be either fair or equitable.

Q22. Do you support the modification of the cost wash-up drafting to allow it to be more accurate and reflect direct price-setting arrangements?

2.32. Whilst Network Rail's proposals to modify the annual cost 'washup' would appear to increase the fairness and accuracy of the process, given that Network Rail has also proposed to include freight operators in this process, DB Schenker would need to understand more about the direct price setting arrangements enjoyed by passenger operators and how these may apply to and affect freight operators, particularly if the proposals result in further uncertainty, increased complexity and transaction costs.

Q23. Do you have any views on the cost activities we have included in our EAU cost estimates?

2.33. The cost activities included in Network Rail's EAU cost estimates appear comprehensive.

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Q24. Do you have any views on the variability assumption we have used in our EAU cost estimates?

2.34. DB Schenker currently has no specific evidence to challenge the variability assumptions used by Network Rail in its EAU cost estimates. However, it would not expect any overhead line equipment ('OHLE') that is not directly associated with the contact wire (e.g. the head span structures) to have any variability with traffic.

Q25. Do you have any views on our proposal to use long-run cost estimates over 35 years instead of 5 years?

2.35. DB Schenker is concerned that Network Rail's decision to use 35-year long-run rather than 5-year short run cost estimates will result in a doubling of the costs of ac OHLE and a trebling of the costs of dc equipment. Whilst Network Rail makes the point that its proposal to adopt a long-run average approach to estimating costs has the advantage of smoothing out 'lumpy' renewal costs that would otherwise occur due to the age/condition profile of the OHLE assets, moving from a 5-year to 35-year approach will have the same effect from the start of CP5.

2.36. Whilst DB Schenker considers that adopting a long-run average cost approach is reasonable, it considers that the financial effects of this on operators should be phased in across CP5 rather than implemented in full from its commencement.

Q26. Do you have any views or suggestions about our approach to stakeholder engagement?

2.37. Although Network Rail has recognised the need to continue its engagement with stakeholders to help ensure that the industry is fully informed on the progress being made in this area, the development milestones set out in the consultation document merely state that Network Rail's conclusions will be published in December 2012 with draft rates issued in March 2013. It is clear from the issues and proposals contained in the consultation document that much more work is needed to develop and provide further detail on the proposals so that they may receive wide industry support, particularly in relation to those affecting freight operators. DB Schenker suggests that such issues should be taken forward under the auspices of the industry Traction Electricity Steering Group with perhaps separate meetings with freight operators to discuss issues directly relevant to them.

DB Schenker hopes that these comments are helpful. If you require any further clarification on any of the matters raised, please let me know.

Yours sincerely,

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