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Dear Ekta

Periodic Review 2013: Network Rail consultation on traction electricity & electrification asset usage charges in CP5

Without prejudice this is the view of Freightliner Group Ltd. (FL) encompassing its subsidiaries Freightliner Ltd. and Freightliner Heavy Haul Ltd. Comments or tables in italics should be treated as confidential and are not to be published.

Executive Summary

In response to the consultation on traction electricity and electrification asset usage charges Freightliner (FL) broadly supports the proposals made by Network Rail (NR). However, FL would take the opportunity to highlight certain key messages with respect to the proposals as described by NR:

- a) Changes in structure and charges have a real cost impact to freight operators (FOCs) which in turn can affect the competitiveness of rail freight and key to any changes is certainty of charges over the term of the control period (CP);
- b) FL supports a status quo on the current arrangements for modelled consumption rates although is concerned at the level of, and evidence for the incentive and whether it is perceived as adequate to convert non-metered operators to metering;
- c) FL recognises the difficulty surrounding the calculation of accurate transmission losses but equally has concerns over the lack of weighting within the calculations and the implementation of changes considering known enhancements to the infrastructure;
- d) FL would stress that for a number of reasons it is unable to independently fix its actual prices on an expected consumption and so would in effect be a price taker which seemingly is in conflict to being able to effectively manage cost; and,
- e) FL has significant concerns over the doubling of the asset usage charge and requires additional information to understand the driver of the change from CP4 to CP5, specifically whether there has been an infrastructure holiday in CP4 or a fundamental redefining of what are considered fixed and variable costs.

1. Introduction

1.1. We welcome the opportunity to make our views on the proposed options for traction electricity (EC4T) and asset usage charges known. We note the deliberately limited scope of the proposals, which considers only the incentivisation of operators to a metered world through changes to the charging structure of electricity consumed.

1.2. We would stress that EC4T and asset usage charges are real costs to rail freight operators (FOCs) and significant movements not only impact the competitiveness of rail, versus road, but also the choice of traction used to haul trains. The choice of traction is a long term decision and dependent on existing and expected infrastructure, availability of diversionary routes and connectivity to terminals. In addition, the on-going costs and certainty of costs of traction electricity will also influence the decision between electric and diesel power traction.

1.3. During the Periodic Review 2008 (PR08) there was a revision of the modelled consumption rates (Railsys) and tariffs faced by FOCs that were not implemented. However, provisions for changing to metered billing and inclusion of the FOCs in the volume wash-up were. The proposals for PR13 would appear to be continuing this trend towards metering and the principles ascribed have our support.

1.4. The specifics of the proposals are discussed in greater detail later in this response. We do note that this is still work in progress but urge a degree of urgency to resolve the outstanding issues as soon as feasible to enable FOCs to have certainty of costs going forward. Material changes to either the scale or scope of the charging regime the FOCs face requires time for negotiation with customers as there is a direct impact on rates offered. Whilst it is accepted that electric traction is unique to rail freight versus its primary competitor, road, it is a material element in our cost base and has an impact on rail freight's ability to compete not only at a price level but also in the perception of rail freight as a sustainable alternative to road.

2. Modelled consumption rates

2.1. In principle, we recognise and support NR's desire to retain the current modelled consumption rates by vehicle type and service group across all ESTAs, thereby sustaining the existing relative balance between operators. We concur that the recent variability in wash-up and NR's suggested nominal 10% adjustment would not necessarily add any further certainty to the charge, or the credit / debit, a non-metered operator might face at the year-end.

2.2. With respect to new vehicles, and as a supporter of the Railsys method in PR08, we support the proposed method for new vehicles and proposed penalty¹ to incentivise meters being fitted. However, we would query the absence of evidence to support the level of the penalty as a meaningful lever to promote conversion to meters.

2.3. We remain unclear as to whether the TRATIM modelling did or didn't include distribution losses in the model rates applied. However, our strong suspicion is that TRATIM did include an adjustment for distribution consumption on the modelled freight vehicle consumption rates. This is only relevant for the proposed actual price levied on freight where a FOC remains a non-metered user.

¹ Plus 5 KWh per mile

2.4. We are intrigued by the proposed additional 10% uplift on modelled consumption rates for non-metered operators. The nub of our query resides with the robustness of the 10% premium nominally quoted as the inefficiency cost of modelled over metered management of consumption. This implies a material gain in consumption efficiency from meters that we see no evidence for. However, we accept the drive is to incentivise conversion to meters; has NR calculated whether a 10% uplift would be sufficient to generate a business case²?

2.5. We support the exclusion of the proposed uplift from the volume wash-up and the annual re-distribution of the charge collected by NR back to operators. However, we see a number of issues with this proposal in its current guise:

- a) A 10% uplift with a subsequent rebate³ assumes an elasticity for behavioural change that isn't evidenced or explained beyond the anecdotal experience of incentivising metered operators to build resilience (cost) against providing incomplete metering data;
- b) The additional charge will be retained by NR until the year-end which ultimately is a cash-flow impact, i.e. the incentive lies in value of cash to the non-metered operator, which exists today under the volume wash-up but would struggle to be attributed as the reason for operators moving to metered billing; and,
- c) Given the aim is to incentivise meters to be fitted, the additional revenue should be:
 - i. Rebated solely amongst those with meters fitted; or,
 - ii. Allocated against the additional overhead⁴ faced by operators in delivering meter readings to NR.

2.6. We concur with the highlighted issue that the Department for Transport (DfT) needs to consider relaxing the provision of “*no net loss or net gain*” in order to ensure that TOCs are incentivised to move to metered billing.

3. Regenerative braking discounts

3.1. Regeneration is a subject upon which we can add limited value given our experience is one of a fleet of traction where the capital investment required is too high even at the generous discounts NR has proposed. NR's described apparent hit or miss nature that the energy regenerated can be used effectively without on-board storage suggests that regeneration is not a viable business case for operators and NR's proposed discounts are artificially high to promote a perceived good. The impact on the volume wash-up for non-metered operators is affected by discounts applied for regeneration. As such, we would support the removal of the discount until there is better evidence or the discount is only available to metered users to further incentivise the move to metered billing.

4. Electrical losses mark-up

4.1. We recognise the work performed by NR to ascertain the extent of transmission and infrastructure losses on the existing AC network. We understand this is a difficult area to form any firm

² Cost avoidance rather than net benefit

³ Admittedly not the full 10% as proposed the rebate would be shared with metered operators

⁴ External bureau services

conclusions given the number of influencing factors on transmission losses. However, we do note the absence of the DC losses within the consultation and ask whether this has been performed, despite being of little direct interest to ourselves as users of the AC network.

4.2. We readily admit this is an area outside of FL area of expertise and broadly we see NR approach as reasonable. We would agree there is no material gain from geographically disaggregating the losses despite the evidence being available. However, we do have the following comments / points of clarification on the NR report “*Estimate of AC Losses - Electricity Supply Tariff Area Analysis, 2012*”:

- i. *Para 2.1: We assume the review referred to should read NR-EP-EC4T-2011-001. We haven't a copy of the report but would be interested to learn what “Commercial” losses are in this context;*
- ii. *Section 3, Point 1: We assume the justification for the 10% uplift from modelled data to actual data is to be consistent with the consultation's premise, although reiterate the absence of robust and consistent evidence to support this value;*
- iii. *Section 3, Point 3 & 4: Please explain how the metering accuracy has an effect on losses?*
- iv. *Para 4.3, Table 1: We are struggling to see the mathematical link between the figures in the columns, specifically the final two;*
- v. *In addition, it appears the national average is a straight mean of the loss mark-ups for each ranking. We suggest this should be weighted for the size or number of the Electricity Supply Tariff Areas (ESTAs) in each ranking and the MWH per STK. Our concern is that NR's proposed method would mean that a small under-utilised ESTA (having a high fixed % loss) would have as much effect on the national average figure as a whole group of heavily used ESTAs each with a much lower % loss;*
- vi. *We assume “section 5.3” referred to in the final paragraph of Section 6 Conclusions should read 4.3;*
- vii. *We are uncomfortable with the conclusion drawn in Section 6 Point 3 because although increasing demand and future electrification will increase the overall losses, it will not necessarily increase the loss as a % of the traction energy used. We would suggest Para 4.3 Table 1 supports this by way of the % losses decreasing with increased utilisation;*
- viii. *We are disappointed to note there is no mention in the report of the work we understand is already planned to lower the impedance of parts of the network and therefore reduce the load losses. The excerpt below is from appendix A of NC/G1/2011/LNW495:*

Network Rail have produced a report TPD-NST-010-ACER-REP-0001: Two Track A.C. Electrification Analysis Report dated July 2010 which identifies a 3.14% improvement in electricity usage for a 12 kA over a 6 kA system for the same traction loads.

A trial was carried out in the first six months of 2010 using the sections of the WCML between Patford Bridge and Hillmorton (ELR HNR) and between Long Buckby Wharf and Hillmorton (ELR LEC1), following tests which were carried out at Christmas 2009. The objective of the trial was to provide operational experience of 12 kA. This trial was successful and operation of this section of route in 12 kA is now permanent. (Network Change consultation notice NC/G1/2009/LNW449 refers). Operational data from this trial indicate that savings may be greater than the 3.14% mentioned above.

ix. *Although the report refers to a limited section of the WCML it is known that work is in progress to uprate a large part of the network which should lead to a considerable reduction in losses.*

4.3. We would expect the implementation of a revised losses mark-up is given sufficient lead time for the affected parties to reasonably accommodate the change.

5. Pricing (inc. delivery)

5.1. FOCs should face the actual price but currently remain unable to individually set / fix a price for their consumption as even the larger FOCs don't have sufficient volume to hit the 5% minimum tranche of all railway consumption demand by the scheme. It has been expressed in the past that buying consortiums exist with open memberships or can be formed. However given the relative weak power of FOCs to determine the fixing point within a consortium, the conflicting economic pressures between TOCs and FOCs or indeed the lost opportunity for a competitive advantage over other FOCs make self-determined prices a fantasy.

5.2. We accept there is an overall industry incentive to fix at the lowest possible price albeit the risk profile between operators can be materially different. As such, FOCs require an ability to fix price independently otherwise the application of real charges becomes an imposed and uncontrolled price. It is only fair that once real charges are applied FOCs should have an ability to fix prices⁵ independently and so enter the cost wash-up on an equal footing.

5.3. It is of some concern that the ESTA boundaries may possibly change during CP5 as the power sourcing points change. The impact will be changes in delivery charges liable between power station and NR ESTA boundary. We understand there is probably a practical reason behind moving ESTA boundaries but for certainty and stability of charges, especially distribution charges, we hope these changes are implemented at a change in Control Period or an equally infrequent point in time. FOCs are go-anywhere, national operators but the constraints of the existing AC network mean electrically hauled trains are generally confined to the Great Eastern (GE) and West Coast Main Line (WCML) that contain at around a third⁶ of the current ESTAs.

5.4. For clarity, our experience of buying non-traction electricity has indicated that the distribution charge is applied to the peak charge for consumption only. Will this be the case under the traction contract? Furthermore, NR appears to be proposing a blended average for the year to avoid the traditional November "leap" in distribution charges. If so, we would be supportive of such a position.

5.5. For metered users the differing time of day charges present no problem for billing. Is it NR proposal that the non-metered users move from a modelled rate to an actual charge and will this actual charge be a weighted average based on the planned timings of services?⁷

6. Contractual framework

6.1. We agree that the Schedule 7 content should be replaced with the Metering Rules given the

⁵ Recognising the different consumption profile between FOCs and TOCs

⁶ Eight out of twenty-six, 8/26

⁷ We run 60% of our trains during the night so would expect an "actual" rate closer to the night rate rather than say the peak assuming we remain a non-metered user.

shift in how traction electricity will be levied and the provisions for a mixed user (metered and non-metered) world. We would stress that FOCs do operate over a number of ESTAs, which is significantly greater than individual TOC operators, for a single journey and as such the wash-ups will be challenging from a process perspective.

6.2. We agree volume and cost wash-ups should be performed at the ESTA level with actual prices against consumption for metered operators (cost wash-up only) and an appropriately weighted version for non-metered operators (both volume and cost wash-up). However, as mentioned we remain nervous regarding the provision NR has for adjusting ESTA boundaries and the frequency or timing of such changes outside of the Periodic Review process.

7. Asset usage charge

7.1. We support the application of the charge on a distance metric rather than consumption.

7.2. However, we are confounded at the proposed more than doubling of the Asset Usage charge. The order of magnitude suggests the CP4 assessment was for a period of near comatosis for renewal activity against the latest 35 year average. Therefore, is the change due to a recovery or expectation of additional infrastructure renewal over the coming 35 years (old and planned new infrastructure⁸), or purely down to a significant reallocation (definition) of cost from fixed to variable? The consultation provides no direct evidence (presumably VTISM generated) to the change proposed. As it stands this is not something we can accept.

7.3. Recent history would suggest that this order of magnitude change is a significant departure from what could have been reasonably expected during this Periodic Review for CP5 and one that gives cause for concern over NR's control and identification of work required in this area.

8. Issues outside of the consultation

8.1. We fully support some sort of losses trajectory towards improved efficiency accepting a degree of losses is unavoidable. We would suggest this is critical to providing an incentivised move towards a more efficient network and potentially greater use of electric traction.

8.2. We would support the continued inclusion of, and an increase in, NR's share of volume wash up to incentivise better behaviour and investment by putting more of NR's "skin in the game".

We are willing to discuss this response in more detail if it would prove helpful to the process and we commend NR on its engagement to date with the industry on this topic.

Yours sincerely

⁸ Midlands spine, Great Western and Southern networks

A handwritten signature in black ink, appearing to read 'Angus Johnston', with a stylized, cursive script.

Angus Johnston
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