Freightliner

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Dear Ben

Consultation on the phasing in of the freight-specific charge, applying the variable usage charge cap, updating our estimate of freight avoidable costs and updating/phasing in the freight-only line charge

Thank you for providing the opportunity to respond to this consultation. Without prejudice this is the formal response of Freightliner Group Ltd (Freightliner), incorporating Freightliner Limited and Freightliner Heavy Haul Limited.

We note that once again the freight operators have only had a very short period to respond to this consultation (in this case just 3 weeks). We have previously raised concerns regarding unreasonable expected consultation response times, caused by the late running of the Periodic Review process, and exacerbated by further delays to decision documents etc.

General Comments

Although this consultation follows the Office of Rail Regulator's (ORR) decision on 11th January 2013 on the Freight Specific Charge (FSC) and the Variable Usage Charge (VUC) caps we have some fundamental remaining concerns with regard to the calculations behind these costs and the link between these two charges. In our view many areas still require clarification and verification before they can reasonably be used for the basis of what are very substantial proposed increases in charges.

Variable Charges

Freightliner notes from the Network Rail consultation dated 29/11/11 on the Freight Cap on Variable Usage Charges that **total** variable track maintenance and renewal track costs for passenger and freight were calculated using VTISM at a value of £242.4 million per annum (11/12 price level end CP4 efficiency).

As an input to the LEK led work on calculating the Freight Avoidable Costs Network Rail ran the VTISM model and this indicated if all freight traffic was removed from the network a saving of £178 million per year would be made. This implies that only 26.5% of Network Rail's maintenance and renewal track costs would remain if there was no freight on the rail network.

The Arup report issued by the ORR, with their decision document on 11th January 2013 states that the £178 million actually only represents a 23% cost saving. This would indicate that total variable track maintenance and renewal track costs for passenger and freight are £773.9 million a year.

The Arup report goes on to suggest that the actual avoidable maintenance and renewal costs from freight could be somewhere in the region of £210 million, and indeed it is these assumptions that have been used by ORR to calculate the basis for the proposed Freight Specific Charge

There is a very considerable difference between Network Rail's total variable maintenance and renewal track costs, stated as £242.4 million and the implied total variable cost of the Arup report of £773.9 million. This appears quite fundamental and we suggest that this is reviewed so that the difference in the two numbers is clearly and transparently laid out as part of the proposed LEK review of freight avoidable costs.

One area of concern with regard to the difference in these figures is the treatment of capital and revenue costs and whether these have been properly accounted for in the difference between the figures. Any costs avoided that are treated as capital costs by Network Rail should be calculated in each year only as the depreciated amount, not the full capital value.

Another area where we would like further understanding is how sunk costs have been treated in the modelling of costs that could be avoided if in theory there was no freight, as many of the costs, such as renewals have already been undertaken and the opportunity to save these would only appear in time over a period of many years.

Updating Freight Avoidable Costs

We are concerned that the ORR's decision of the Freight Specific Charge cap is underpinned by an assessment of freight avoidable costs that we consider incomplete and inconclusive. Two pieces of work contracted by Network Rail/ORR (LEK and Arup) have come up with a considerable difference in their view of costs, with gross freight avoidable costs assessed as being somewhere between £152m and £400m. ORR proposes to use £278m to underpin the track access charge review.

We note that Network Rail have been asked by the ORR to revisit the LEK led work on estimating of freight avoidable costs, in particular following up the recommendations of the Arup report.

The Arup report was published as part of the ORR decision document and had not been previously seen in any format or discussed with the industry. We are very concerned about the broad-brush assumptions that have been used as a justification for increasing the % saving in maintenance and renewal costs from the 23% calculated by VTISM to 30%.

On the basis of 2 paragraphs on pages 7 and 8 of the Arup report the broad-brush assumptions regarding renewal policy for Criticality Bands 3 and 4 being changed to assume no renewals ever on these routes, changing policies to focus on the particular wear and tear of passenger traffic have increased freight avoidable costs by some £66 million a year.

We are disturbed that these subjective assumptions have been accepted by ORR in this way as a justification for increase in the low case scenario for freight avoidable costs. We understand that these assumptions have been made by Arup and not Network Rail but we assume that you have been requested to investigate these areas and provide evidence of any future savings, if indeed there are any, in these areas.

In particular it does not seem credible to us, for example that all Criticality Bands 3 and 4 track policy would be changed to renewals only when expectation on performance reliability and ride quality from government and passengers will continue to increase. We also suggest that the specification of track quality is likely to be higher (speed and ride quality) than that required by a freight train rather than lower.

We are also expecting that the VTISM model is rerun with the engineering trains re-instated, as the assumption made here by ARUP is very basic.

We note from the consultation that ORR has advised Network Rail that it will only adjust the Freight Specific Charge to below the cap level if the “central” estimate is lower than the capped amount rather than the “low” estimate that was used to set the cap. This apparent change of policy has not been discussed with the wider industry and is surprising given that in its conclusions document of January 2013 the ORR stated that it was “taking a conservative approach to the level of the FACs we seek to recover from the charge by setting the cap on the charge at the lower end of the range of our estimates for FACs”.

The LEK report should also be updated to use the forecast freight volumes for CP5 (and beyond) put into the Strategic Business Plan which have updated the forecasts used in the original report which were the Initial Industry Plan forecasts.

Relationship between the Freight Specific Charge and the Variable Charge

In Table 3.2, (Page 46) of the ORR’s conclusion on the average variable usage charge and freight specific charge low case Variable usage costs (£171 million) are some 74.6% of the total (£229 million).

It is not clear from the Network Rail consultation but we assume that any increase in the Variable Usage Charges that are determined by the ORR will be netted off the Freight Specific Charge, as the Freight Specific Charge is calculated net of the Variable Usage Charge (Table 3.3 page 47 of ORR conclusions). It would be helpful if Network Rail could lay out how it would calculate this adjustment to the charges.

Cap on average Variable usage charge rates

Freightliner agrees with the proposed methodology laid out by Network Rail on page 5 first paragraph of its letter with regard to the scenario of a cap being applied.

Freightliner has already laid outs its concerns in detail with regard to the Serco report on vertical costs and the Network Rail on lateral forces, so we do not repeat these arguments here.

Consultation Questions

Q1. What is your view on the illustrative profile of the FSC shown in Table 2, above (i.e. 0% in years one and two, 20% in year three, 60% in year four and a 100% of the charge in year five of CP5)?

Freightliner does not agree with the decisions reached by the ORR in its conclusions document published in January 2013 with regard to the assessment of whether certain markets can bear additional charges. In particular we do not agree with:

- ORR’s interpretation of the Access and Management Regulations with regard to “exclusion”, not meaning a reduction in demand.

- ORR’s interpretation of the impact of the proposed Freight Specific Charge on the Scottish mining industry, and

- ORR’s reliance on modelling of impacts over evidence supplied by the industry, in particular the reliance on MDS modelling on coal source impacts; an area where they are not experts.

In our view the market analysis undertaken for ORR is flawed and distortions in the supply of ESI Coal will result. The phasing of Freight Specific Charge merely defers the pain for FOCs (who carry a considerable risk of passing on these charges) and our customers.

Assuming the ORR decision on the Freight Specific Charge cap, set at £4-04 per kgtm we agree with the illustrative profile shown in Table 2 (Page 3).

We note that the actual total level of income to Network Rail in each year will depend on the actual kgtm moved in each year, and that there is considerable uncertainty in the ESI coal market, not least because the introduction of such a high Freight Specific Charge will itself cause displacement in the market. However we assume that this will be self-adjusting as Network Rail will also be reducing its costs. We seek confirmation that the charge will not be adjusted mid- control period if there are fluctuations in market volumes.

We note that the forecast kgtm figure used here is different to the one used in Table 4. (Page 8), we do not know why this is, or what the source of these figures are; these figures should be consistent.

Mines are long term businesses where investments are made on the basis of long term returns. The announced increase in track access charges is already putting investments on holds. Given that investments have already been made on the basis of the current charging regime it would be more appropriate to phase charges in over a longer term period than currently proposed. We suggest at least a 10 year period would be more appropriate.

Q2. What is your view on the illustrative profile of the spent nuclear fuel freight-only line charge rate shown in Table 3, above (i.e. retain the current rate for years one and two, 20% in year three, 60% in year four and a 100% of the charge in year 5 of CP5)?

It is concerning that such a manifest error has only just come to light. The prices quoted in Table 3 are at end CP5 efficiency levels whilst those in Table 2 are quoted at end CP4 efficiency levels.

We ask for all prices to be quoted at consistent levels, as it is hard enough to follow all the changes in the numerous charges in any event.

Q3. What is your view on how we have calculated initial freight-only line charge rates for ESI coal and spent nuclear fuel?

We note that the forecast kgtm figure used here is different to the one used in Table 2. (Page 3), we do not know why this is, these figures should be consistent. It is not clear where these figures have come from. We also note that values are quoted here at end CP5 efficiency, we plea for consistency in how all prices are presented; Table 2 is at end CP4 efficiency levels.

Freightliner does not understand why the Freight Only Line charge is raised per tonne mile and we strongly contend that this charge should be raised per tonne. The ORR stated in its conclusions, with regard to the Freight Specific Charge that “a charge that is more cost reflective should incentivise efficiencies more effectively”. If this logic is carried through to the Freight Only Line Charge (and also the Coal Spillage Charge) then this charge should be raised per tonne.

There is just as much likelihood that a train travelling in total 30 miles will use the same amount of Freight Only Line as one travelling 200 miles, as the Freight Only Lines are exclusively at one end or both ends of a journey but in no cases in the middle of the journey.

To continue raising the Freight Only Line charge on the basis of tonne miles would be in direct conflict to the ORR’s cost reflectivity mantra and the reasons given in paragraph 4.34 of chapter 4 of its conclusions and would discriminate against longer distance flows as it would not be cost reflective.

As it has already been decided to raise the Freight Only Line charge as a separate charge we do not think that the raising the charge on the basis of a different unit would add any administrative costs.

Q4. What is your view on the illustrative profile shown in Table 5, above, for iron ore and potentially biomass freight-only line charges in CP5 (i.e. 0% in years one and two, 20% in year three, 60% in year four and a 100% of the charge in year five of CP5)?

We do in principle support the phasing in of any new charges. However we do not know what these charges are and how they are calculated, so it is rather difficult to sensibly comment. Freightliner does not support a Freight Specific Charge being applied to the biomass sector.
As the investments required to enable power station to convert to biomass will require a 10-15 year payback, and may in themselves take several years to implement simply delaying the introduction of this charge to start ramping up from 2016 is likely to have marginal benefit, as if the charge is implemented we expect at least some of the investments in biomass capability will not go ahead.

We do not understand how Network Rail will be able to calculate any biomass freight only line charge as there is currently only a small volume of business running and future volumes are difficult to predict until the Department of Environment and Energy makes decisions with regards to the subsidy levels for the use of biomass to generate electricity, these decisions are expected in autumn 2013. Care will be needed not to double count the same costs through the coal freight only line charge.

We will be replying separately to the consultation led by the ORR regarding biomass but in brief we do not support this charge for the following reasons;

- The assessment and consultation on the proposed charges for biomass is in its infancy. As power generation from biomass is intrinsically linked into UK Government transport policy and DECC's regulatory support for renewable energy, any proposals on track access charging of biomass needs to be checked for alignment with Government policy.

- The extremely high costs of conversion from coal to biomass generation mean that these are long term projects. Any track access charging regime needs to also have long term clarity, if taxpayer subsidy of renewable generation is to meet Government targets.

We are content for the contents of this response to be published in full on your website and are happy to meet with you to discuss any of the points raised in this document.

Yours sincerely

Chris Wilson

P.P.

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