Freight Caps Consultation on Variable Usage Charge (VUC) and Freight Only Line Charge

Response from Rail Freight Group

January 2012

1. Rail Freight Group (RFG) is pleased to respond to the Network Rail consultation on Variable Usage Charge and Freight Only Line Charge. The level of these charges have a significant impact on freight operators and their customers and we are therefore pleased that this work has been undertaken at an early stage in the PR13 process.

2. We have a number of comments on the consultation. We note that the Network Rail consultation relates particularly to the calculation and modelling of charges; nonetheless we have also made some comments on the surrounding policy framework.

General Comments

Freight Caps – Principles

3. RFG supports the principle of applying a cap on freight charges at an early stage in the PR13 process. A cap is an important way of building confidence for freight operators, and in particular for freight customers and potential customers. With many businesses, particularly in the retail sector looking to expand their use of rail, it is particularly important that cost uncertainty can be minimised as soon as possible. We strongly support applying a cap to charges during the first half of 2012, as a way of supporting business confidence.

4. However, a cap is only likely to be useful if it gives a sufficiently small limit on the potential increase, and also if it captures a sufficiently large proportion of freight charges. Although the work in this consultation (subject to comments below) has made progress on VUC to the point that a cap might be possible, work on other elements of charge is clearly some way behind. ORR may wish to consider when they may be able to give guidance on the likely level of other charges, and the relativity to any VUC cap.

5. ORR and DfT have been clear that any cap should be linked to commitments by the freight industry to reduce whole industry costs. A number of such initiatives have now been suggested by the freight operators and others; however there is no real sense of progress. If a freight cap is to be agreed in 2012, we therefore consider that there needs to be urgent progress involving all parties on the so called 'freight deal' with much greater clarity on expectations from all sides, and a programme of work established to deliver the necessary outputs in the available timescales.

Affordability

6. We note that the affordability test for freight only lines is not a matter for Network Rail, but for ORR. We understand that, in addition to the work to assess the affordability of freight only line charges, ORR are also to assess the affordability implications of some commodities contributing to the fixed costs of the mixed network. This is clearly a major piece of work, and the scope and detail of such analysis must therefore be made clear at an early stage.

7. Based on some of the concerns set out below, ORR must also be clear how they expect NR to assess the level of any fixed cost elements for freight traffic. We would expect this to be a rigorous approach, given that, unlike in the passenger sector, this represents a real cost to business, and is not passed back to Government through the franchise regime. The analysis on freight only lines (see below) would suggest that the quality of data on costs associated with freight traffic may not be as good as expected.

Modelling Approach

8. Overall, and subject to comments below, we do not have significant issues of principle with the modelling approaches used to calculate the track costs. We would however expect that ORR will wish to assure themselves of the rigour of the specific models used (VTISM and SRSMM) and to the extent possible validate that the modelled results are reflecting experience.

9. For non-track costs, the assessment of variable costs relies heavily on engineering judgement. These judgements are particularly critical as they alone lead to the proposed increase in VUC. We would therefore expect ORR to consider how best to peer review these engineering judgements to ensure that they have been rigorously considered and fairly applied.

10. There are a number of areas of concern in the analysis, many of which were discussed at the workshop on 6 Jan. We have detailed our concerns in the following sections.

Specific Questions

Variable usage charges

1. What are your views on the range of traffic scenarios (+5%, +10% and +20%) that we used to model costs?

Based on IIP and industry forecasts we support the range of scenarios selected.

However, we are concerned that the models used are unable to cope with modelled scenarios implying a reduction in traffic levels. This raises concerns over the validity of the model, if it can only assess traffic increases. There is no guarantee that, particularly if there is a move to route by route charging, certain routes would not see reductions in traffic at some future point, even in the context of overall growth.

Freight growth forecasts are not evenly spread between traffic commodities. Heavy bulk sectors such as coal are forecast to be essentially flat, whilst lighter intermodal and retail sectors are expected to grow. These different sectors would be expected to have different impacts on track costs, which should be taken into account. The current modelling approach, applying the same growth figures for all sectors, is likely to overstate charges.

We recognise that the modelling approach taken does not produce results for freight route by route but as averages. However we would still expect that the underlying models would be able to assess the impacts by sector, or at least use a weighted average approach. If ORR/NR are to move to route based charging this is even more important, as growth is not likely to be evenly spread across all NR routes.

2. What are your views on our proposal to use the +20% traffic scenario to estimate an average track vehicle cost per kgtkm?

20% is broadly in line with the forecast levels over the period, and is therefore likely to be an appropriate top end on which to model.

However, whilst this is based on the agreed forecasts there are a number of conditions that will need to be met for this level of growth to be achieved, for example relating to the development of interchanges. Assessing costs at the top end of the range therefore means that NR are insulated against a failure to achieve the expected growth.

3. What are your views on our proposed 'top down' variability assumptions that we have applied in order to estimate non-track variable usage costs?

As outlined above, we note the criticality of the non-track costs as the main contributor to the increase in VUC. This means that there must be a real focus on ensuring that the engineering judgement behind the calculations are rigorous and valid.

With reference to the assumptions on signalling, we are unclear why an 18% variability is assumed for points generally, but 44% for minor works points. This difference should be explained in more detail. At the workshop there was discussion over which elements of signalling costs, particularly at level crossings should be assumed as variable, and which as fixed and this should be resolved. We would consider that road user misuse should be included as part of the fixed cost.

The analysis on masonry under-bridges has raised a number of concerns and requires further detailed analysis to justify the costs identified for freight and passenger vehicles.

4. What are your views on our proposal to apportion costs between freight and passenger traffic based on the CP4 allocation methodology?

We are content with the approach to apportioning costs between passenger and freight traffic, updated from the CP4 approach.

5. What are your views on our proposal that the most appropriate way of placing a cap on charges is likely to be to determine a maximum average £ per kgtkm rate for freight traffic (as opposed to a maximum £m absolute value)?

We support capping as a maximum average £ per kgtkm as this is most likely to be meaningful to operators and customers.

6. What are your views on our proposed confidence interval of +/- 20%?

Given that the majority of the costs are generated from accepted models such as VTISM we consider that a 20% margin is too high. We would expect that, given the detailed development of the modelling approach a lower limit, perhaps of 10% would be appropriate.

7. What are your views on our proposal that it would be prudent to cap charges at the upper limit of our +/- 20% confidence interval i.e. £1.81 per kgtkm?

We understand that there needs to be some measure of flexibility in the cap. However the modelling already takes the high end of the forecasts in calculating track costs, and applies a significant uncertainly to the modelled results from VTISM. Overall therefore the confidence limit may be unduly generous.

The estimated cost for freight VUC is already some 11% higher than CP4 which means that a +20% cap represents a 30% increase on CP4 charges. This is before other elements of charge, such as scarcity charge, which could be applied on top of VUC. The potential of a 30% + increase is unlikely to achieve the business confidence which the cap is intended for.

8. Do you have any other comments?
No further comments.

Freight only line charges
9. *What are your views on the freight only line definition established in PR08?*

We continue to support the definition of freight only line as established in PR08.

Any work to look more generally at whether certain commodities can afford to pay a greater part of the fixed charge will undoubtedly need to consider the definition of freight infrastructure and costs on the main network. However, we would not expect that the definition of freight only lines will need to change.

10. What are your views on the initial list of freight only lines set out in Annex B?
We have no view on the specific route sections in the list which are a matter for the operators to comment on.

11. What are your views on the track kilometres contained in the freight only line list in Annex B?

The updated list contains a significant increase in track km, which it appears results from omissions in the CP4 list. Whilst this corrects a previous error, we remain concerned that NR have had such an inaccurate understanding of the network. There must be an assurance now that the list is accurate and that other route sections have not been omitted.

Similarly we are concerned to see that there is no robust traffic data for some route sections. We are unclear how this can occur, and it must be remedied. Overall therefore it appears that NR still do not have accurate data on which to model freight only line costs. ORR may wish to consider whether this is limited to freight only lines, or whether it represents a more general issue of data quality. If there is a move towards route based charging it will be vital that accurate data for all lines can be generated.

The impact of these errors will be particularly felt in the spent nuclear fuel sector with an 83% increase in costs and, irrespective of the outcome of the affordability modelling, we would consider that urgent discussions with DRS and their customers over this increase would be appropriate. The increase for ESI Coal is also concerning, and should be discussed in the overall context of coal charges with the relevant operators and customers.

12. What are your views on the commodity traffic splits contained in the freight only line list in Annex B?

We have no view on the specific commodity splits in the list which are a matter for the operators to comment on.

13. What are your views on our proposed methodology to adjust for the fact that some lines carry multiple commodities? Where freight only lines carry multiple commodities our proposal would (consistent with the approach in CP4) be to charge those commodities deemed capable of paying toward fixed costs based on their share of total tonnage (kgtkm) conveyed on these lines?

Aside from the data quality issues already referred to we have no comment on the approach.

14. What are your views on our proposed confidence interval of +/- 20%?

As with the proposed VUC cap, the 20% confidence interval is on top of an already significant increase in charges. For spent nuclear fuel for example, the cap would represent an actual increase of over 100%. A lower confidence interval may be appropriate.

15. What are your views on our proposal that it would be prudent to cap charges at the upper limit of our +/- 20% confidence interval i.e. £8.15m and £1.85m for coal ESI and spent nuclear fuel respectively?

As above.

16. Do you have any other comments?

The analysis has not attempted to remodel freight only line costs, rather a mark up has been applied to CP4 levels, of 24% for ESI Coal and 14% for spent nuclear fuel. It is wholly unclear what the mark up represents and this must be clarified.

During the analysis for CP4, there were a number of concerns relating to the assessment of costs. We would have expected therefore that a more refined modelling approach would have been developed over the period allowing for a more accurate assessment for CP5.

Lower unit renewal costs of 80% of average have been used, reflecting a lower cost of doing a particular kind of work on freight only lines. It is unclear why a figure of 80% has been chosen – and not a lower value, say 50% - since the timing of the work on such lines is very much more flexible. Either way, we need to see some evidence to support NR's proposal.

At the seminar, we also discussed if lower renewal rates have also been included recognising the fact that work is undertaken less frequently on such routes because, effectively, they are, or could be, maintained to a lower standard than mixed traffic lines. NR could provide no information. Again, this was a point discussed at PR08 and we would have expected subsequent analysis. Further evidence should be provided.