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Dear Paul

Review of arrangements for establishing access charges for CP4

This is the response of Freightliner Group Limited (representing Freightliner Limited and Freightliner Heavy Haul Limited) to your letter dated 25th November 2009 entitled Review of arrangements for establishing access charges for CP4.

OVERVIEW

In overall terms Freightliner agrees with the summary in your letter; that the process for developing charging proposals for CP4 was generally satisfactorily managed by Network Rail. There were several areas where detailed charging proposals were made far too late in the process by Network Rail and some where the proposals made were not well thought through or where vital data was missing. We outline below some of our more detailed concerns.

Overall our foremost concern is to have as much certainty about any revision to charges at an early stage as possible before charges commence. Track access charges are real costs to freight operators and any changes directly affect our bottom line and/or the charges that we make to customers. The margins in the rail freight industry are very low so any increase in charges has a real impact on our business.

Customers, understandably are very unlikely to sign contracts that have access charge re-opener clauses that pass on the uncertainty about future access charges to them. Therefore if we are uncertain about future access charges this makes entering into new contracts with customers very difficult, this obviously becomes more acute as the date of any revised charges looms.

Uncertainty about future access charges also puts at risk future investment in new assets such as rolling stock and upgrading terminals, both of which would enable growth of the rail freight sector and modal shift of freight transport from road. The benefits of modal shift are well recorded including a 70% reduction in carbon (DfT figures), reduction in congestion on the UK's roads and a reduction in road accidents caused by lorries. In the current climate where it has become very difficult to secure capital funding it is even more important that there is early certainty of access charges to enable future investment.

In this context we urge the Office of Rail regulation (ORR) to consider setting access charges for 10 year periods instead of 5 year periods. Typical asset lives of rail freight investments such as rolling stock and cranes are 30 years so a 5 year period of charging creates a considerable uncertainty in making any investments. The ORR has acknowledged in this context the need for freight operators to hold access contracts for a period of 10 years, and it seems logical that the same policy is applied to track access charges.

DETAILED COMMENTS

Capacity Charges

In CP4 the capacity charges are set at a level that is apparently only understood by Network Rail, seemingly with only a couple of individuals understanding the black magic calculations behind the charges raised. No explanation or calculations of how capacity charges are set were forthcoming from Network Rail. There appears to be no transparency or real justification for the current level of charges. Freightliner challenged in the CP4 process the justification for the level of capacity charges set to be paid by freight operators but also queried the basis for the level of capacity charges (which is much higher) paid by passenger operators. Our challenges were not properly addressed.

Our basic understanding is that capacity charges are a payment for the personification effect on performance caused by additional trains on the network, i.e. if you add more trains to the rail network the amount of delay caused by an incident will increase. We do understand the principle of these additional costs. However in CP4 there was no transparency over what the baseline levels of traffic that had been assumed and funded, for example what was the assumed level growth of freight and passenger traffic in CP4, was this included in the baseline performance level forecasts which were part of the CP4 periodic settlement?

There was also no transparency over how the assumed additional payments were then calculated to be spread over all the traffic. We agree with the principle that any additional costs should be spread across all traffic flows not just new traffic (the latter would in many cases be impossible to identify anyway as trains regularly change destinations and there is much spot traffic which changes every week) but there was no transparency on how this calculation was made.

No consideration was made in the CP4 settlement about what happened if traffic actually reduced rather than increased. Unfortunately due to the recession freight traffic has reduced in real terms. There is no process in CP4 to calculate the benefits to Network Rail of reduced traffic on the Network and how this effects performance payments. We are currently in a situation where freight operators continue to pay a capacity charge for all traffic but the personification of delays caused by increased traffic has actually reversed so Network Rail are, in this context collecting both the money from freight operators and benefitting from reduced number of trains, causing less knock on performance effects, a double gain for Network Rail.

Freightliner would like to see an early review of capacity charges which properly lays out the assumed base level of traffic with an assumed level of performance and then how a marginal calculation is made on top of these assumed baselines.

Variable Charges

Network Rail did consult during the CP4 process with freight operators regarding the inputs to the model to calculate variable charges for individual wagon and locomotive types. The consultation that was undertaken was very late in the process and the consultation process was too short. There is no reason why the consultation on the inputs to the model could not be done at an earlier stage in the process. It is sometimes quite difficult for freight operators to verify all the input details to the model as many wagons are not owned by freight operators but directly by customers, so more time is needed.

In addition the consultation process in CP4 was confused by long lists of wagons that no longer exist and also wagons with inputs for spurious commodities for example oil tankers carrying coal, clearly this would never happen. As a consequence there were hundreds of lines in the model which are spurious, leading to confusion.

As part of the consultation Network Rail should be clear which wagons are charged at a loaded rate for both the empty and loaded movements, for example oil and waste wagons. The lack of clarity has led to incorrect assumptions being made about the wagon weights input into the model, which in turn has led to charging disputes.

Freightliner would as part of the CP4 process like to have more clarity about the rail surface damage calculation included in the model and how this is linked to different bogie types.

Suspension Band Discounts

The consultation undertaken by Network Rail on suspension band discounts for CP4 was both far too late and badly thought through. The net result was that there was no option in the timescales but to keep the same discount system used in CP3. The ORR's CP4 conclusions stated that this issue should be reviewed by Network Rail very early in CP4 but Network Rail have to our knowledge undertaken any further work on this topic.

Any changes to banding for CP5 should be published as soon as possible as this does have a material effect on decisions made by parties purchasing wagons. Freightliner has made decisions to buy track friendly bogies purely on the basis of the incentives set by differential charging.

Any changes to the banding system must take into account that wagons are 30 year life-span equipment so it is unhelpful to keep changing the incentives as this will undermine future purchasing decisions. It is also vital that any banding system aligns with Network Rail engineering policy and the direction Network Rail is giving to wagon and loco manufacturers. During preparation for CP4 Network briefed wagons suppliers about what they wanted them to build and then suggested a banding system that did not match these briefings. The two clearly need to be aligned.

Traction Electricity

There was considerable confusion during the last year before CP4 whether train or freight operators would be able to buy slugs of electricity through Network Rail's contract or not. Freightliner did ask Network Rail what our options were in this regard in line with our track access agreement but Network Rail are not able enable this mechanism for Freightliner, mainly we understand due to their arrangement with British Energy, which was already in place and the limited size of our electricity requirement.

Network Rail did quite late in the process consult regarding revision to assumed consumption rates but these were not agreed by the passenger train operators so were rejected.

There is no reason why many of the issues regarding traction electricity could not be resolved quickly rather than leaving them yet again until a year before the next control period starts. There is currently considerable uncertainty about what correct electricity charges are, this makes any decision about future traction options between electric or diesel haulage virtually impossible to call. This is an unsatisfactory position for us to be in as for a freight operator these are solely our choices, not just a questions of DfT controlled fleet cascade as in the case of passenger operators.

The fitting of meters may help the solution but the issue of who pays to fit meters has not been addressed and for Freightliner with an aging fleet of electric locomotives we are unable to make a business case to fit electricity meters. We are concerned that other operators who have newer fleets will fit meters and those smaller operators like ourselves will be left with the uncertainty of losses calculations. We are very concerned about this risk. There seems considerable uncertainty about when any charges based on metering will commence, this is not helping the uncertainty.

The current price variation mechanism of using the MLUI index not only means that prices paid by the freight operator lag actual prices by about 18 months, which is unsatisfactory for both the freight operator and for Network Rail. We also have no idea whether the price paid reflects what Network Rail are paying for the electricity we are using. MLUI is also notoriously difficult to predict and prices have as a consequence swung up or down very quickly, this makes managing our cost budget very difficult. Freightliner would prefer a system that allowed for more certainty in the price we were to pay for electricity. We have suggested that ATOC are used as a clearing house to enable smaller operators to collectively bid for tranches of electricity at certain prices, otherwise we are concerned that smaller operators will not have the same opportunities as larger ones; this does not seem an equitable system.

Coal spillage charge rebate

Freightliner were concerned that Network Rail's original proposal to increase the coal spillage charge was based on no evidence whatsoever. For CP5 we would expect to see more evidence from Network

Rail on the cost of the damage caused on the Network by coal spillage and also Network Rails' plans for undertaking mitigation work to prevent any damage to points etc caused by coal spillage.

We do not believe that there are any of the old type open coal wagons still running on the network, and we believe that it was these wagons that historically led to a build up of coal spillage on some parts of the network. Whilst we accept that some coal spillage does still occur the levels are much lower than historically, and we would like to understand better where any new coal spillage is occurring.

We also note that so far there has been a lack of take up of the investment pot created to enable terminals to invest in equipment to prevent coal spillage. This was an idea put forward by the coal industry so we would like to understand why there has been little interest.

Connection Charges

We are concerned that connection charges were not addressed at all in the CP4 periodic review process. We are concerned about the overall level of charges, value for money, whether marginal cost principles are being applied, whether some costs are double counted, how Network Rail apply charges equally to all and how this income source is dealt with as part of single till. We will be writing to the ORR separately with more detail as this is a complex subject.

Please contact me if you would like to discuss any of the issues raised in this letter further.

Yours sincerely

Lindsay Durham
Head of Rail Strategy
Freightliner Group Limited