By Appointment to
Her Majesty The Queen
Royal Train Operator
English Welsh & Scottish Railway Ltd
Doncaster

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Dear David,

4 April 2014

2014 HIGH SPEED 1 PERIODIC REVIEW (PR14) – DRAFT ORR DETERMINATION

This letter constitutes the response of DB Schenker Rail (UK) Limited' ("DB Schenker") to the consultation document entitled "*2014 High Speed 1 Periodic Review (PR14) – Draft ORR Determination*" published by ORR in February 2014 ("the draft determination").

Introduction

1.1. Whilst it is recognised that the draft determination covers a multitude of different issues, DB Schenker's response mainly concentrates on its key concern which relates to the charging framework for freight traffic together with the principles that have been used to derive the proposed freight access charges from the relevant costs.

Background

2.1. DB Schenker has been successfully operating overnight freight services on High Speed 1 ("HS1") for around two and a half years now. It remains firmly of the view that the line presents a unique opportunity of a fast link from the Channel Tunnel to London thereby enabling the transit of international rail freight to/from the UK via the Channel Tunnel to be accelerated, consequently helping to attract further modal shift from road to rail. HS1 also presents the UK's only realistic opportunity to accommodate larger gauge traffic to/from Continental Europe which will also further promote the growth of international rail freight through the Channel Tunnel.

2.2. With these advantages in mind, since January 2014, DB Schenker has significantly increased the number of overnight freight services on HS1, augmenting its twice-weekly return service from London to Poland with a four days per week return service from London to Spain. This will increase the number of freight train movements on HS1 from 4 per week to 16 per week.

Access Charges for Freight on HS1

3.1. DB Schenker considers that the fundamental issue in ensuring that the regular operation of international rail freight services on HS1 continues to grow, relates to the price of access. DB Schenker was therefore, very concerned with the proposals set out in HS1 Limited's consultation on its 5-Year Asset Management Statement ("5YAMS") which reported that despite an overall reduction in freight costs over Control Period 2 ("CP2") by around 60%, there would nevertheless be a substantial increase in the price of access for freight services of around 450% (700% if the current discount is taken into account) to £31.05 per train km. DB Schenker pointed out in its consultation response to the 5YAMS, that given the fragility of the economics of international conventional rail freight, such a dramatic price rise would be wholly unaffordable and would effectively eliminate freight services from HS1. DB Schenker, therefore, disagreed with the proposed increase including the way in which it had been calculated.

3.2. The primary reason why access charges for freight on HS1 were set to rise substantially, transpired from the way in which HS1 Limited derives its access charges for freight by spreading the entirety of its freight costs (both variable and avoidable) across the forecast traffic. For Control Period 1, higher traffic forecasts coupled with the offer of a freight discount, generated access charges at a low enough level to enable freight services to commence operation on HS1 and subsequently grow. However for CP2, notwithstanding the subsequent decrease in overall freight costs, the original revised forecasts and the curtailment of the freight discount led to the prospect of freight access charges being set at an unaffordable level.

3.3. Since the draft 5YAMS was published in October 2013, DB Schenker acknowledges and welcomes the considerable efforts of HS1 Limited in working with relevant stakeholders (including DB Schenker) to address this issue. DB Schenker is, therefore, pleased to note that these efforts have now resulted in a much lower proposed price of access for freight services on HS1 of £5.36 per train km.

3.4. Despite this significant reduction, DB Schenker remains firmly of the view that the structure of freight charges on HS1 should mirror the principles that apply to the UK national railway network operated by Network Rail Infrastructure Limited ("the national network"). The key reason for DB Schenker's view in this respect is because the relevant legislation set out in the Railways Infrastructure (Access and Management) Regulations 2005 ("the Regulations") which transpose into UK law the provisions of EU Directive 2001/14 (now merged into EU Directive 2012/34) applies equally to both HS1 and the national network.

3.5. Schedule 3 of the Regulations provides the following stipulations:

- *Sub-paragraph 1(4) - The charges for the minimum access package and track access to service facilities referred to in paragraphs 1 and 2 of Schedule 2 shall be set at the cost that is directly incurred as a result of operating the train service.*

- *Sub-paragraph 2(1) - In order to obtain full recovery of the costs incurred the infrastructure manager, with the approval of the Office of Rail Regulation under the access charges review or, in the case of a rail link facility, the Secretary of State through the development agreement, may levy mark-ups on the basis of*

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efficient, transparent and non-discriminatory principles, whilst guaranteeing optimum competitiveness, in particular in respect of international rail freight.

- *Sub-paragraph 2(2) - The effect of sub-paragraph (1) must not be to exclude the use of infrastructure by market segments which can pay at least the cost that is directly incurred as a result of operating the railway service, plus a rate of return which the market can bear.*

3.6. On the national network, all freight services pay a variable usage charge which conforms to sub-paragraph 1(4) of Schedule 3 of the Regulations. In addition, those freight services which are deemed by ORR to be able to afford a ‘mark-up’ on top of the variable usage cost pay a contribution to the freight avoidable costs of the national network. This contribution (or ‘mark-up’), which is levied by way of a freight only line charge and a freight specific charge, conforms to sub-paragraphs 2(1) and 2(2) of Schedule 3 of the Regulations.

3.7. Given that the freight services operating on HS1 belong to a market segment that ORR has deemed cannot afford to pay a ‘mark-up’, DB Schenker submits that such services should only be levied the variable element of HS1 Limited’s freight access charge (i.e. £2.77 per train kilometre in CP2) and not a charge composed of variable (“OMRCA1”) costs and avoidable (“OMRCA2”) costs as this is contrary to sub-paragraph 2 of Schedule 3 to the Regulations.

3.8. DB Schenker notes that whilst the proposed price of access for freight on HS1 has reduced dramatically, this has not been achieved through HS1 Limited adopting the freight charging principles that apply to the national network as outlined above. Instead, the reduction has been achieved through the adoption of higher freight traffic forecasts together with further reductions in freight costs and the reallocation of some costs into ‘non-freight’ categories.

3.9. DB Schenker is disappointed that although ORR accepts that the principles applied to freight charging on HS1 are different to those applied to the national network, primarily given the lack of definition of “costs directly incurred” it has concluded that the approach is, nevertheless, consistent with the Regulations.

3.10. Whilst DB Schenker acknowledges that there is no definition of “costs directly incurred” in the Regulations, it finds it inconceivable that different principles can be considered and applied by different infrastructure managers in the same Member State, particularly when the long standing principles applied to freight access charges on the national network have been determined consistently by ORR over many successive Control Periods.

3.11. DB Schenker will continue to consider its position on this matter and notes that the provisions of Article 31(3) of EU Directive 2012/34 (First Package Recast) should hopefully provide consistency on this issue. This is because the Commission is required

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(before 16 June 2015) to adopt measures which provide clarity to the calculation of the cost that is directly incurred as a result of operating the train.

3.12. DB Schenker is hopeful that such measures, once adopted, will support its view that the wording of sub-paragraph 1(4) of Schedule 3 to the Regulations which states "……*shall be set at the cost that is directly incurred as a result of operating the train service.*" (emphasis added) implies that it is the costs that are directly incurred as a result of operating the train that are taken account of, not the costs of providing capacity and capability for an entire market sector such as rail freight as a whole.

Re-openers

3.13. DB Schenker notes the proposed approach to be taken in respect of the volume reopener. However, it considers that the threshold of 12.5% to be far too low. With the current forecast of freight services for CP2 being set at 800 per annum, the proposed threshold would trigger a review with any change in the current level of freight traffic (i.e. one return service per week added or removed).

3.14. Although DB Schenker recognises the reasons for including a volume reopener, such provisions can result in increased uncertainty for a freight operator and its customers given that its access charges could conceivably be modified significantly through actions outside of its control (e.g. through a competitor's service(s) ceasing to operate). Therefore, reopeners should only be triggered in exceptional circumstances and not, as is proposed here, for any incremental change in the level of freight services. Consequently, DB Schenker proposes that the threshold be increased to at least 37.5% which would be equivalent to a change of at least 3 return trips per week.

3.15. In addition, DB Schenker considers that any volume reopener should take into account any reductions in volume that are caused by the infrastructure manager (e.g. trains being cancelled through engineering possessions) or by unplanned constraints on access to HS1 (e.g. a force majeure event). DB Schenker is pleased that HS1 Limited has agreed to reflect this concern in its Freight Access Terms.

Ripple Lane

3.16. The costs of Ripple Lane Exchange Sidings represent the largest single cost item in freight OMRCB. DB Schenker is therefore pleased that many of its comments raised in its 5YAMS consultation response concerning Ripple Lane Exchange Sidings have been taken account of, thereby helping to achieve the significant reduction in the proposed price of access for freight on HS1.

3.17. DB Schenker remains firmly of the view, however, that Ripple Lane Exchange Sidings should be transferred to Network Rail as soon as is possible and become part of the national network. The infrastructure is not 'high-speed', is used by 4-times as many domestic freight services than it is by those operating on HS1 and is already operated and maintained by Network Rail. The transfer of ownership of the facility would ensure that

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such maintenance and operation would be subject to the same efficiency targets that Network Rail is expected to achieve for other freight-only infrastructure on the national network.

3.18. Consequently, DB Schenker welcomes and supports the recent commitment by HS1 Limited to begin discussions with the Department for Transport and other relevant stakeholders with a view to seeing whether such a transfer can be accomplished. DB Schenker is willing to participate in such discussions if this would be helpful.

3.19. Should a transfer of Ripple Lane Exchange Sidings to Network Rail be achieved, DB Schenker considers that provisions should be in place in the Freight Access Terms to enable the consequent change in HS1 Limited's freight avoidable cost base to flow through into a reduction in the access charge for freight on HS1.

3.20. DB Schenker notes from the consultation document that HS1 Limited intends to recover a significant proportion of the costs of Ripple Lane Exchange Sidings from freight services accessing the facility to and from the national network. However, DB Schenker understands that when the Network Change was proposed to transfer the facility in its previous guise from Network Rail's predecessor to HS1 Limited's predecessor, the change was agreed only on the basis that this would not lead to an increase in the costs of access as a result of the change of ownership. This further strengthens the arguments for the facility to be transferred back to Network Rail.

Yours sincerely,

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cc. Geoff Jones HS1