ORR Consultation - Network Charges

Response from Rail Freight Group

February 2016

1. Rail Freight Group (RFG) is pleased to respond to the ORR's consultation on Network Charges. No part of this response is confidential.

2. RFG is the representative body for rail freight in the UK. We represent around 120 member companies who are active across the rail freight sector including train operators, customers, ports, terminal operators and developers, supply chain and support services. Our aim is to grow the volume of goods moved by rail in the UK.

General Comments - Context

3. The regulatory framework is important to the rail freight sector. Independent regulation of charges is a key tenet of competitive rail freight, as is the process for ensuring that charges are fair, equitable and transparent.

4. Yet the level and structure of charges also has a major bearing on the success or otherwise of rail freight. The balance of rail charges, and equivalent costs in competing modes, is a critical factor in retaining and growing rail freight, and determines what the rail market can afford to pay. This also has a direct influence in the level of benefits which rail delivers for the UK, including environmental and productivity benefits which are 'off balance sheet' for the railways.

5. Given the importance of charges we welcome ORR's early start on the review of charges for 2019. It is clear from the consultation that there has already been some initial scoping of options, which is welcome, and that the wider context for the review is understood.

6. That said, this consultation takes place at a time of uncertainty and change for the railways. The Shaw review of Network Rail, DfT's review of ORR and the recommendations of the Bowe and Hendy reports are set to change the way the railways are structured, and influence the relationships between different parties. Some potential outcomes from the Shaw review could also impact on the funding of the railways, and consequently on the way it is regulated.

7. Whilst it remains right that ORR should start work on PR18 at this stage, it will be necessary to constantly review whether the package of work remains appropriate and necessary in the light of other changes.

8. ORR should also be mindful of the ability of the industry to resource multiple reviews and workstreams in parallel.

9. We note the extensive work undertaken by RDG, and support its conclusions. We have participated in the RDG group leading this work. This does not however mean that the areas highlighted by their work are necessarily good outcomes for freight. However the framework for prioritisation and assessment of options against states of the world is robust and we would expect ORR to give this significant weight in their considerations.

General Comments - Freight

10. During PR13, the ability of rail freight to pay an increased level of charge was tested extensively, and the final conclusions of the review set a framework of charges which was judged to be affordable overall.

11. We would expect that as part of this review, ORR will wish to update this work to inform their considerations. At this stage however, it seems highly unlikely that the rail freight market will be judged as able to pay any more than at the previous review. This is particularly due to exogenous factors which have affected the freight market, in particular;

    - The rapid decline of the coal use in generation in the last two years means that the volumes of rail borne coal moved are significantly lower than at the last review. As coal is the only major sector to pay a freight specific charge, we can expect the income from that charge to also be significantly reduced. However, we should also expect Network Rail to be making considerable cost savings as coal volumes reduce, and ORR may wish to assure themselves that these savings are also being properly attributed to the freight sector.

    - The continued freeze on road fuel duty, coupled with a low oil price, continues to make road freight highly cost efficient, and is hampering our ability to attract new business particularly for the retail sectors. The ability of the intermodal market to pay an increased charge is therefore likely to be even less than previously assessed. The budget for the MSRS grant scheme has also been reduced.

    - Rail freight has sought continued efficiencies, for example in running longer trains. However, difficulties with Network Rail's enhancement programme have delayed some of the SFN funded work to facilitate this, for example, work to run longer trains from the Port of Southampton which is still incomplete.

12. ORR may also wish to review the work to assess the freight avoidable cost. If so we would note that some elements of the assessment will have changed over time, for example, the Hendy review will have caused the assumed enhancement costs to be different as major elements, such as F2N have not been progressed as quickly as planned.

13. Given these factors, we would therefore suggest that ORR quickly conclude on the 'envelope of affordability' for freight charges, such that the impact on the

sector of other proposed changes can be readily understood. Given the market changes above, we would suggest that a 'light touch' update would be sufficient.

14. A number of other factors remain important in considering the structure, level and framework for charges in the freight sector. This includes;

    a. Maintaining fair and level competition in the freight sector, including for new entrants and smaller operators. This means that charges must be the same for all operators, and that there is no barrier to entry created by the charging structure.

    b. Ensuring that freight operators can respond quickly and efficiently to customer requirements with forward certainty of charges. Processes such as MSRS, which is bid on a quarterly basis, tend to work against this, and whilst the market has accepted this for the small grant regime, it would be unacceptable for as a core part of the charges structure, as might be the case in some direct grant options.

    c. Recognising the modal comparison with charges on the road network (VED and fuel duty), and the relative costs of rail freight and HGV traffic on their respective infrastructure.

    d. Maintaining a national structure of charges recognising that rail freight operator, and their customers, work on a national basis. A regional framework of charges would be perverse, and could also be anti-competitive, for example, if one port were charged more than another for the same access.

Specific Questions – Introduction

15. As a general comment, we believe the review of charges would be better served by some more accurate definition of terms such as 'better value' and 'better outcomes'. Specifically, we would like to see a greater definition of how value is defined in both social and monetary senses, and how ORR plans to consider both.

16. The level of Network Rail's charges for freight operators and customers is critically important to their ability to operate and grow their business. There are elements of the structure which are also important in driving behaviour, for example the wagon based charges which have encouraged a greater take up of low track force bogies. However overall, the *total level of* charge is likely to be the determining factor for freight customers in making modal choice rather than any specific element of its structure.

17. The ability of the freight sector (or indeed the passenger sector) to influence Network Rail's costs is also more limited than perhaps ORR perceive. It is of note that, despite the overall efficiency targets of up to 20% set by ORR each control period, Network Rail has not to date sought the granularity of cost information to fully understand cost causation and drivers. It seems unlikely that the action of an individual FOC is more likely to achieve this than an overarching

regulatory target.

18. There are of course examples where the freight sector has challenged costs. Certain SFN schemes are now being effectively value managed through collaborative efforts. Freight operators have at previous periodic reviews challenged Network Rail's data and caused reduced costs to be used and attributed. The proposed freight reform programme was also set to review freight land holdings, although this has now been overtaken by the Hendy review.

19. However, for core access charges, the drivers of costs are likely to be around asset policies, choices on infrastructure design, and maintenance and renewal approaches. Train or freight operators may not have the expertise to challenge such areas, and on a mixed use network, solutions which reduce costs for one sector may raise them for others. For example, freight costs on main lines would be lower if passenger running speeds were reduced, but this is unlikely to be a productive area of challenge.

20. The structure of charges is also only one part of how Network Rail's actions influence freight costs. For example, the paths that many freight trains have on the network are inefficient, and extended journey times require additional fuel and driver costs. Biomass trains between Hull Docks and Drax for example can take over 4 hours to travel 35 miles. For freight operators, challenging these areas is likely to be much more productive in reducing costs than seeking to influence track maintenance asset policies, particularly given a five year lag for charges to be adjusted.

21. Whilst we recognise the case for a greater understanding of what drives Network Rail's costs, we do not believe that there is a convincing case for the translation of this into charges. For freight, noting the legal framework, the outcomes of such a move will either be;

    a. An increase in charges which will cause traffic to be lost to road or,
    b. The need for a potentially complex system of protection for freight, which amongst other factors is likely to numb any incentive on freight operators to challenge costs.

Specific Questions – Background and Approach

22. We have no specific comments on the objectives, gaps and assessment criteria. The link between the assessment criteria and ORR's overall duties, along with any Guidance from the Secretaries of State should be explicitly noted.

23. We support a state of the world approach as a key part of identifying the factors alongside the structure and level of charges that would be necessary for success. An honest assessment of these areas is important in seeking wider support for any proposed changes.

24. However, the states of the world, as defined by RDG, are not themselves assessed against wider outcomes. So, for example, direct freight protection is a

legitimate consideration in determining how changes might deliver outcomes. Yet depending on the model used, it could also come with a number of other potential downsides, for example a reduction in competition between operators.

Specific Questions – High Level Options and Proposals

25. We note the package of options which ORR proposes to consider. We agree that the list is reasonable and that some options, such as full scarcity based charging, should not be progressed.

26. As previously, we do not see a compelling case for linking a greater understanding of costs with those costs being passed into charges. As such, work to understand costs could proceed in parallel with the option of making small improvements in the current structure.

27. It is difficult to make a judgement on the likely success of the infrastructure costs package and the value based capacity package for freight, as both are likely to have implications. A value based capacity package with value defined as social benefits may have some upside for freight, whereas one which prioritises cash returns will not. However, given the complexity likely to be associated with value based charging, we agree that it should not be a priority area.

Specific Questions – Infrastructure Costs Package

28. As outlined above, we recognise that Network Rail will be most able to identify cost reductions if the granularity of cost causation is better. We would expect that, as the data appears to exist, Network Rail should be incentivised to do this through the overall efficiency target that ORR sets.

29. We also note that information on costs could be helpful to Government in making investment decision and in determining the level and shape of franchised services. However, given other pressures to deliver effective franchise services, we note that this will be only one factor in their decision making.

30. Given that these benefits can be delivered through an understanding of cost drivers, we see little additional advantage in using this information to set charges. As noted in the Impact Assessment, the proposals would be likely to see a significant increase in charges for freight and open access operators if it can be charged legally.

31. The Impact Assessment also makes specific reference to ‘compensating’ freight via a Government grant. If this is to be considered, then ORR must urgently clarify how such a grant could be paid in a way which did not create additional uncertainty for freight. For example, the MSRS grant which is presently paid for some flows at the margin has to receive State Aid clearance every 3-5 years, and must compete for budget at every Comprehensive Spending Review. Both activities create great uncertainty for operators and customers, require significant ongoing resources to manage in Government and industry and are unpredictable over the medium and long term.

32. The capped budget for MSRS can also act as a barrier to growth in the market, and again we would be concerned if this were to be replicated.

33. We would be deeply concerned if freight were subject to such constraints for all its business and a greater part of its costs. It is of note that road freight, who's track damage costs are generally calculated to be in excess of rail's, faces no such complication.

Value Based Capacity Package

34. It is difficult to assess the impacts of the value based capacity benefits without a greater understanding of how value will be assessed. Assuming that financial return is likely to be a key determinant, then the impact on freight is likely to be detrimental.

35. Unlike the road network, rail freight cannot easily divert onto alternative routes, and so its ability to avoid the more expensive routes is restricted. Overnight access is also restricted by engineering schedules. As such, freight services would have little ability to respond to a changed charging structure and as the charges are likely to exceed the market's ability to pay, would most likely lead to traffic loss to rail.

36. As such we support the conclusion that this package should not be progressed.

Specific Comments – Improvements to Current Short Run Variable Charges

37. We accept that there is space for some improvements to the current system, and note the RDG work in this regard.

38. As outlined previously, we think that geographically disaggregated charges for freight risks anti-competitive effects for example between different ports. Given that freight routing is limited by network constraints, the ability of operators to respond to geographic charges is negligible.

39. The coal spillage charge as referenced in paragraph 138 will be declining as coal volumes reduce, and we would suggest that no further work is done on this charge. We note that some resolution of the CP5 charging settlement for freight will be necessary.

Specific Comments – Supporting Packages

40. We have no specific comments on the framework for passenger open access. However any decisions for this sector must not become a precedent for freight open access. The legal framework must also be respected.

41. We note in paragraph 165 the reference to transitional arrangements, which are also an important factor for any changes to the charging framework for freight. However, if the increase in charge is sufficient that traffic will be lost to rail transitional arrangements are unlikely to be sufficient to compensate.

42. We support measures to limit the complexity of charges. Whilst a 'charges calculator' would be beneficial in some respects, any incentive effect will be masked by such an approach. In essence, if the regime requires a calculator, it is probably failing on complexity.

Specific Comments – Implementation and next steps

43. In concept we support the measures in paragraph 180, and note that the approach to developing these will depend to some degree on the options chosen.

44. As outlined above, mechanisms to protect freight from higher charges do also risk other adverse outcomes, and should not at this stage be necessarily presumed as a preferred option.

45. We are concerned with 180 (g) which suggests that freight should face similar charges to franchised operators. As a minimum we note the legal framework which applies in respect of any mark up to the variable charge. This paragraph should be urgently clarified.