Freightliner Group Limited - Information providing justification for a contract over five years

This paper provides detailed justification for a Track Access Agreement (TAA) over 5 years for Freightliner Limited (FLL) and Freightliner Heavy Haul Limited (FHH). As many of the investment decisions and risks are taken at a Freightliner Group (FLG) level this paper is produced covering both FLL and FHH, with differentiation provided where appropriate.

1.0 Summary

Rail freight is a highly capital-intensive industry. Unlike with the passenger train sector, freight operators including FLG, make substantial investments in long-term assets to move goods by rail. This includes investments in locomotives, rolling stock and terminals, yards and other facilities to handle the freight – all of which usually have a life-span of more than 30-years. Freight customers and other parts of the supply chain make their own investments in equipment and facilities to support the efficient movement of freight by rail.

Against the backdrop of the current 10-year TAA, and on what has largely been stable track access charges, FLG has itself made substantial specialist investments over recent years, many of which are in assets which typically have a 30-year life. As a private company operating without the protection of a franchise agreement or other contract with Government, FLG bears the risk of making these investments. In order to minimise this risk and maximise the return on these investments it is essential that long-term access to the network is secured. Having certainty over future access is also absolutely fundamental in creating an environment that facilitates future investments.

As well as being important for freight operators, a long-term access framework is also a pre-requisite for many customers and provides the certainty needed to switch to rail, and to make the investments necessary to move their logistics chains accordingly. New customers require the certainty of being able to access the rail network and the assurance that they can move their goods within an appropriate window of time to the required locations, in order to have the confidence to enter into contracts with freight operators. Existing customers still require contractual certainty that a freight operating company can continue to deliver what is required in order to allow them to make the on-going investments needed.

Having this certainty is especially important in the intermodal and bulk sectors in which FLG operates. Both sectors compete intensely with road, and on the intermodal side road hauliers transport the vast majority of all deep-sea boxes entering the country. As the dominant mode it sets both price and service standards that Freightliner must be able to match to attract and retain customers. As road hauliers are not time bound in their ability to offer access to the road network, a long-term TAA is essential for FLG to compete.

Having a long-term access framework is one of the key elements to deliver an environment that provides confidence to customers and enables investment, but it is not the only element. Certainty in the long-term charging regime and over future track access charges is another central plank in creating an environment which supports the investment required to drive growth and generate significant economic benefits to the UK economy.

The current regulations are clear – a track access contract of longer than five years must be justified by the existence of commercial contracts, specialised investments or risks. The following sections outline how FLG meet this threshold.

Section 2.0 outlines a number of these specialist investments that have already been completed, others that are currently on-going and details potential future investments which are in contemplation, and which would be supported with a longer-term contract.

Section 3.0 discusses some of the specific risks which a long-term contract would help overcome.

Section 4.0 makes reference to customer contracts.

2.0 Specialised investments

Rail volumes remain higher than at rail privatisation. This is despite the effective loss of coal for electricity generation, once the largest commodity transported by rail. Intermodal and construction traffic now represents the majority of freight transported by rail, and the growth of these commodities since the decline of coal, has been a real success story.

Substantial investments made by FLG to enhance capacity and improve performance, have played a key role in attaining this growth. Predicated by a ten year TAA, FLG has been able to secure the funding necessary to make large-scale investments, many in assets which have a 30-year life. The certainty of having long-term access to the network has helped create a stable environment which has facilitated these investments.

Many of the benefits of the investments and the growth that they have supported fall outside of the railway balance-sheet. Last year Deloitte calculated that rail freight generated circa £2.45bn in economic and environmental benefits in 2019. This included £1.65bn in productivity gains for business, and £800m in social and environmental benefits.

Section 2.1 outlines some of the recent investments made by FLG and other investments which are on-going. These investments were made against the backdrop of the current ten year TAA and have a payback beyond the proposed 2030 TAA expiry.

2.1 Recent and on-going investments

- **Ipswich Vehicle Maintenance Facility**

In Autumn 2021 Freightliner opened its new wagon maintenance depot and locomotive fuel and servicing point in Ipswich. This represented over [redacted] investment in a new facility to maintain Freightliner's growing fleet of intermodal wagons. The facility, which includes a wheel set re-profiling shed, created [redacted] new full-time skilled positions in Ipswich.

Explanation of redacted section: This section references cost of investment and number of employees at site.

The new maintenance facility in Ipswich supports the introduction of new intermodal wagons, which are being introduced into the fleet to deliver further growth in intermodal volumes. The facility will also improve network performance as it incorporates a new fuel point, which will eradicate the need for locomotives to cross the mainline to be fuelled, thus reducing the impact to the mainline and passenger services.

The new maintenance facility represents a significant long-term investment for FLL. It is expected to have a life-span that exceeds 30-years and so can only be justified over a long-term planning horizon.

- **Intermodal wagons**

In September 2021 the first 40 of 230 new Freightliner FFA-G wagons arrived in the UK from Poland, representing the next generation of lighter, energy efficient, 40ft intermodal wagons. The remaining 190 wagons were delivered in the Winter of 2021/22.

The FFA-G wagons are more than two tonnes lighter than other comparable intermodal wagons decreasing the weight per train, thereby lowering carbon emissions, whilst maintaining industry safety standards. The modern low track force bogies ensure significantly reduced noise levels and minimise track damage.

At a cost of over [redacted], the purchase of 230 new 40ft container wagons will help grow intermodal volumes and improve further the sustainability of rail freight.

With an expected life-span greater than 30-years, these wagons have a payback beyond the proposed 2030 TAA expiry.

Explanation of redacted section: This section references cost of investment.

- **Class 90 electric locomotives**

During 2019, Freightliner purchased 13 Class 90 locomotives formerly operated by Greater Anglia, which were transferred into the fleet in 2020. The locos underwent a modification programme to match the freight Class 90 specification before being introduced into traffic.

This was a [redacted] investment in electric traction to both increase capacity and grow volumes in addition to further improving the environmental sustainability of rail freight. These locomotives are expected to be in the fleet for the decades ahead and will play a pivotal role in supporting Freightliner's journey to further reduce carbon emissions.

Explanation of redacted section: This section references cost of investment.

- **Crewe AC maintenance facility**

Freightliner opened its new Vehicle Maintenance Facility in Crewe in 2016. The facility operates 24/7 providing maintenance services for both electric and diesel locomotives. Home to Freightliner's electric fleet, this [redacted] facility carries out all planned maintenance activities on these locos including wheelset changes, bogie overhauls and transformer changes.

The introduction of this facility has driven further improvements to the performance and reliability of the FLG locomotive fleet. Its payback is beyond the proposed extension to the TAA.

Explanation of redacted section: This section references cost of investment.

- **Guide Bridge wagon maintenance facility**

Freightliner Maintenance Limited opened a new wagon maintenance facility at Guide Bridge, outside Manchester, in 2017. This [redacted] repair facility is used for general repairs and overhauls of FLG wagons.

The facility supports growing the fleet of wagons to increase capacity and drive further improvements in performance and reliability. Payback is beyond the proposed extension to the TAA.

Explanation of redacted section:

This section references cost of investment.

- **Land and Sidings leases**

FLL and FHH hold a number of long-term leases on land and sidings around the railway network. Market rent is paid for long-term leases at sites including Guide Bridge (current lease contract expires [redacted]), Crewe (expires [redacted]), Crewe Gresty Green ([redacted]), Stoke Gifford (expires [redacted]), Leeds Midland Road (expires [redacted]) Hunslet (expires [redacted]) and sidings in Leeds Hunslet (expires [redacted]).

Explanation of redacted section:

This section references lease expiry dates.

The viability of these leases can only be assured with long-term access to the network.

Summary

Highlighted above is a selection of the recent and on-going, investments being made by FLG. Many of these investments are in assets with a projected life of 30+ years and all have been predicated on the long-term TAA that FLG has previously been granted. New long-term access rights will instil further confidence and enable similar future investments to be made.

Section 2.2 outlines some potential future specialised investments that are in various stages of development. All of these investments would represent a substantial capital outlay and in all cases securing a longer TAA would help unlock and support the investment being made.

2.2 Potential future investments

FLG has identified a series of future investments that would further enhance capacity and improve performance, reliability and efficiency. These would represent significant investments and as such would require a business case that could only be justified over a long-term planning horizon.

[redacted]

Explanation of redacted section:

This section outlines investments in facilities that would be supported by the longer TAA.

[redacted]

New locomotive traction

Explanation of redacted section: This section outlines investments in locomotives and rolling stock that would be supported by the longer TAA.

[redacted]

Investments in terminal equipment

Explanation of redacted section: This section outlines investments in terminal equipment that would be supported by the longer TAA.

[redacted]

Storage capacity

Explanation of redacted section: This section outlines investments in storage capacity that would be supported by the longer TAA.

[redacted]

[redacted]

Explanation of redacted section: This section outlines investments in IT systems that would be supported by the longer TAA.

[redacted]

Summary

FLG hopes to continue to build on the significant investments that have been made to improve performance and reliability and enhance capacity in recent years. Industry forecasts suggest that rail freight volumes could triple and with that deliver even greater benefits to the UK economy. However, to achieve this growth and realise the economic benefits, continued investment by all stakeholders – freight operators, government and end users – is required. [redacted] [Redacted section explains the environment to support funding]. [redacted] [Redacted section discusses Freightliner's corporate structure and governance].

3.0 Risks

3.1 Pandemic

Rail freight has demonstrated strong resilience during the pandemic, continuing to move essential supplies and vital goods up and down the country. While volumes have now recovered and are higher than before the pandemic, COVID-19 has presented significant financial challenges for rail freight operators, including Freightliner. The sharp decline in volumes immediately after the first lockdown, caused by the closure of construction sites and reduced consumer demand led to a >50% reduction in volumes. [redacted] [Redacted section discusses financial impact of the pandemic].

It is in this context that the DfT wrote a letter of support to Network Rail, supporting the request for a track access contract extension by the Freight Operators, specifically noting the "*financial challenges and commercial risks*" caused by the COVID-19 crisis.

As the DfT stated, the long-term access framework helps support investment decisions and helps to manage commercial risk. [redacted] [Redacted section discusses response to address challenges posed by the pandemic].

3.2 Rail Reform

The reform of the railways represents the greatest structural change to the railway system since privatisation in the mid-1990s. With likely changes to the contractual, legislative and regulatory foundations of the industry, reform is creating significant uncertainty for the rail freight sector, including to FLG. It remains unclear against what legislative and regulatory framework, owners and shareholders of freight operators are being asked to make investments.

Although the proposed extension of the TAA has a break clause provision to accommodate elements of reform, crucially the access rights contained in Schedule 5, will move across into any new contract. This is important as it helps manage some of the risks of reform, by providing confidence that the access framework will largely be replicated in a post-Reform railway. The extension to the TAA therefore represents an important measure to reduce some of the risks associated with Rail Reform.

4.0 Customer contracts

4.1 FLL

[redacted] [Redacted section discusses contract lengths].

By contrast, road as the dominant mode, does not need to make the same substantial investment in specialist long-term assets. Yet despite these different investment requirements, rail has to offer similar terms to road in order to compete.

[redacted] [Redacted section references typical contract length], FLL's customers expect to be able to be able to plan their logistics chain with a reasonable degree of long-term assurance. The world's largest shipping lines, are constantly striving to invest in new larger container ships, and as a result are continually assessing the capabilities of ports in order to understand the implications these changes will have for the surface leg of the journey. Ports themselves are making investments in order to accommodate these larger ships and handle the increased freight volumes and improving the through-put of containers through the terminal is a key element of this. In order to include rail in their strategic plans there needs to be certainty over long-term access to the network.

Customers tell us that future certainty is important and that they need to be able to plan their business with predictability. As road hauliers can reasonably offer access to the road network for the foreseeable future, they are in a position to offer this certainty to shipping lines. For rail freight to be able to grow in line with forecasts and compete with road, it is important that it can do likewise. Securing long-term access is an important component in achieving this.

4.2 FHH

FHH hold haulage contracts with customers that [redacted].
As examples:

[redacted]

Explanation of redacted section: This section references contract durations.